MALTA COMPETITION AND CONSUMER AFFAIRS AUTHORITY

Sector inquiry on interest rates charged on loans to small and medium-sized enterprises in Malta

28th July 2015

Office for Competition

The Office for Competition has excluded from this report information which it considers confidential. The omissions are indicated by [✂] while figures have been replaced by ranges of figures.

Executive Summary

During recent years, a number of leading domestic and international institutions, including the Ministry for Finance, the Central Bank of Malta (CBM) and the European Commission expressed concern over the alleged high interest rates at which Small and Medium-sized Enterprises (SMEs) were charged when borrowing from domestic commercial banks, noting that high interest rates increase businesses' costs and erode the country's competitiveness. In view of this, the Director General of the Office opened a sector inquiry in terms of Article 11A(1) of the Competition Act to examine the prevailing competition conditions in the market during the period between 2008 and 2013, with particular focus on interest rates charged on loans to SMEs. When sufficient information was available, the year 2014 was also included.

During the course of the inquiry, the Office consulted with relevant and interested parties, including Malta's core domestic banks, a number of non-core domestic banks, the Malta Chamber of SMEs (GRTU), the Malta Chamber of Commerce, Enterprise and Industry, supervisory and regulatory institutions (including CBM and the Malta Financial Services Authority (MFSA)); and entities which, in one way or another, are related to developments in the market for bank loans to SMEs. In addition, the Office issued a public consultation document inviting all interested parties to submit their views, feedback and evidence related to the inquiry.

The inquiry involved a detailed exercise which analysed the extent to which the sector exhibits the characteristics of a well-functioning market, that would primarily include: (i) relatively low barriers for new players to enter the market or for existing players to expand their market share; (ii) competition between lenders to SMEs such that the market operates efficiently; and (iii) SMEs that are able to make informed decisions. The report makes a number of observations about the characteristics of the market and the behaviour of all market players on which a number of conclusions and recommendations are drawn.

Data shows that more than 99% of Maltese enterprises are SMEs and the majority of these are micro enterprises that employ less than 10 workers. Since these businesses do not typically have access to capital markets, they rely heavily on bank loans to finance their investments. These are generally provided by Malta's core domestic banks, namely, APS Bank Limited, Banif Bank (Malta) plc, Bank of Valletta plc, HSBC Bank Malta plc and Lombard Bank Malta plc. Thus, for the purposes of this inquiry, the Office considered that these five banks constitute the supply side of the market.

Market concentration analysis, based on concentration ratios and the Herfindahl-Hirschman Index (HHI), showed that the market for bank loans to

Maltese SMEs is highly concentrated both when compared to other industries and other EU banking sectors. This may have significant implications particularly when considered together with high barriers to entry and expansion. Amongst the more significant barriers are regulatory requirements, reputation and the need for adequate infrastructure. Other barriers to entry identified by competitor banks include the difficulty in obtaining relevant data on SMEs due to the lack of publicly available information on their financial performance, the inherent risk profile of SMEs as is evident from their higher failure rates and because they usually have fewer assets to collateralise, and difficulties in competing with banks that benefited from EU-backed loan guarantees for SMEs. Together with the high level of concentration, this points to market characteristics that are typically associated with low levels of competition.

In fact, in spite of the noted decline in market concentration during the period between 2007 and 2013, estimates suggest that new entrants and smaller banks have either found it difficult, or have been unwilling (for strategic purposes), to penetrate the market and expand their market shares. Indeed, at the end of 2013, the two largest banks still accounted for a large share of the market for bank loans to SMEs.

These observations are of particular concern when considering that the weighted average interest rate that banks charge on loans to Non-Financial Corporations (NFCs) are amongst the highest in the European Union (EU). In part, this reflects a relatively low pass-through of the ECB policy rate, which was one of the lowest in the euro area. Although there are several factors that may explain this divergence, such as the higher cost of funding (due to Maltese banks' heavy reliance on deposit funding) and credit risk (due to the relatively large share of SMEs in the banks' loan portfolio), it may also reflect differences in the profit margin.

In fact, profitability indicators, such as the return on assets and equity, of Malta's core domestic banks are and have persistently been significantly higher than those of the EU average. Thus, in spite of the 2 percentage point reduction in the banks' lending rates recorded between 2008 and 2013, the Office believes that there may have been room for further reduction. In particular, it is noted that the spread between the lending rates to SMEs and the average deposit rate only started to decline following pressure by domestic and international institutions for reductions in lending rates, suggesting that banks could have lowered them earlier than they actually did.

Literature as well as a survey carried out by GRTU shows that, in addition to market structure, there are a number of behavioural characteristics which may have weakened competition. Primarily, among these is the lack of price transparency. Indeed, the analysis carried out by the Office shows that Maltese banks provide little information to help SMEs take informed decisions when compared to that made available by international banks. This lack of information and price transparency are detrimental to the consumer.

Although price transparency also risks leading to price signalling between suppliers (which would in itself be considered anti-competitive), improved price transparency is desirable in a situation where suppliers are more knowledgeable than consumers. The Office believes that the banks' tools and resources make them more knowledgeable than SMEs and may therefore be able to understand what their competitors are charging even with "low" levels of price transparency. On the other hand, often, the less informed SMEs may not be able to compare the prices charged by different banks. In such cases, more price transparency may be desirable because it mainly benefits consumers.

At the same time, the Office notes that price signalling, that eliminates uncertainty about the future prices of banks' services, is considered anti-competitive. In this regard, the Office analysed price signalling from a competition law perspective in the context of the Maltese banking sector.

Competition in the SME loan market is also hindered by the reluctance of SMEs to "shop around" or switch banks. Supporting this claim are the preliminary results of a survey conducted by GRTU which showed that a number of SMEs do not seek out the best deal by shopping around when taking a loan because they believe, and experience has shown them, that there is "no choice in reality". Nonetheless, the survey also shows that a large number of respondents do not shop around because they prefer setting up a loan account with the bank with which they have existing accounts. Others, however, argued that they find it difficult to compare prices, conditions and services of the various banks.

Finally, the Office notes that there are lock-in effects and costs which could hinder consumer mobility. These include early repayment fees charged by some banks as well as the pressure exerted by some banks for SMEs to transfer their business current accounts to the same bank from which they want to take a loan. Moreover, it is important that customers have sufficient information on the characteristics of products and prices. If SMEs are restricted from making free and rational choices, competition and market efficiency will deteriorate.

On the basis of these observations, the Office proposes a set of recommendations that aim to enhance competition in the market for bank loans to SMEs. The Office considers it preferable to address the above identified concerns by proposing behavioural remedies since the traditional banking model adopted by Malta's core domestic banks has worked well in terms of ensuring stability in the domestic financial sector. It considers that these recommendations can be put into practice without any adverse effects on financial stability.

The Office's recommendations seek to address issues primarily related to price transparency, barriers to expansion and consumer mobility such that the market for SME bank loans is conducive to competition, leading to more competitive prices and consumer benefits:

i. Banks should provide SMEs with free-of-charge quotations on potential loan inquiries, detailing interest rates and all applicable fees. The variation between the quoted price and the actual price (issued later in the sanction letter in the eventuality that the consumer chooses that particular bank) should be limited to a narrow degree, so as to provide the SME with the opportunity to make an informed choice without incurring any cost.

ii. Banks should make available more information on business loans for SMEs. Examples include making available a Frequently Asked Questions (FAQs) section on business loans, providing an example of a typical SME loan and the costs involved, and make available an SME loan calculator for loans which do not exceed a certain threshold. See examples in Appendices 2C and 2D.

iii. Banks should also provide information regarding business loans in the Maltese language.

iv. Banks should make available a list of all charges related to SME loans on *their* websites. This should be easily accessible and regularly updated.

v. Banks should not communicate more information than is strictly necessary, particularly regarding *future* pricing or commercial strategic plans.

vi. EU funded support to facilitate SME financing should be applicable to facilities provided by more than one bank, if possible.

vii. Subsequent to the provision of more information and increased price transparency, SMEs should take the initiative (and be encouraged) to shop around.

viii. Government ought to ensure the setting up of a credit register to facilitate access to credit information on SMEs. In this view, the Office supports the proposals made by CBM.

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Acronyms

Acronym	Full
ACM	The Netherlands Authority for Consumers and Markets
APS	Apostleship of Prayer Savings Bank
BOV	Bank of Valletta
CBM	Central Bank of Malta
CC	UK Competition Authority
CR	Concentration Ratio
CRD IV	Capital Requirements Directive IV
CRR	Capital Requirements Regulation
EC	Council of the European Union
ECB	European Central Bank
ESRB	European Systemic Risk Board
EU	European Union
FAQ	Frequently Asked Question
GDP	Gross Domestic Product
GRTU	Malta Chamber of SMEs
HHI	Herfindahl-Hirschman Index
HSBC	Hongkong and Shanghai Banking Corporation
IMF	International Monetary Fund
IT	Information Technology
JEREMIE	Joint European Resources for Micro to Medium Enterprises

LSE	Large Scale Enterprise
LTRO	Long Term Refinancing Operations
MBB	Malta Business Bureau
MFSA	Malta Financial Services Authority
NFC	Non Financial Corporation
NPL	Non-Performing Loan
OECD	Organisation for Economic and Co-Operational Development
Office	Office for Competition
PPCD	Planning & Priorities Coordination Department
RFI	Request for Information
ROA	Return on Assets
ROE	Return on Equity
SAFE	Survey on Access to Finance of Enterprises
SBA	Small Business Act
SME	Small and Medium Sized Enterprises
TFEU	Treaty on the Functioning of the European Union
UK	United Kingdom
WAIR	Weighted Average Interest Rate

1. Introduction

1.1 Background

1. Competition in the Maltese banking sector has been the subject of wide debate particularly over recent years. During the Budget Speech of 2014, the Minister of Finance expressed the Government's concern over the alleged high interest rates at which Small and Medium-sized Enterprises (SMEs) were borrowing from domestic commercial banks, noting that high interest rates and charges increase costs for businesses and erode the country's competitiveness.[1]

2. Similar concerns were raised by both international and local institutions.[2] The Governor of Central Bank of Malta (CBM) reported that banks' margins on loans are wider in Malta than in other EU Member States and that, in terms of SME interest rates, there is room for further alignment with our peers.[3] Furthermore, a recent European Commission report noted converging interest margins and has observed that higher interest rates on loans could reflect a lack of competitive pressure.[4] In particular, the European Commission argued that 'Low levels of competition among the core domestic banks could result in inefficiencies. Although not posing a direct risk for macrofinancial stability, anti-competitive behaviour in the banking system could result in higher costs for businesses and consumers and present a drag on growth".[5]

3. The high cost of borrowing was also emphasised by the Malta Chamber of SMEs (GRTU). Their concern is particularly evident in a number of newspaper articles where this was emphasised.[6] This is also attested by the preliminary results of the survey conducted by GRTU. The results demonstrate that interest rates charged to Maltese SMEs are a primary concern for businessmen and entrepreneurs.

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[1] Minister for Finance Hon. Edward Scicluna, Budget Speech (2014), page 36.

[2] The Governor of the Central Bank of Malta, the International Monetary Fund and leading researchers at the World Bank.

[3] Professor Josef Bonnici, Presentation on 'Access to Bank Funding For Businesses' (2014).

[4] European Commission, 'Macroeconomic Imbalances Malta' (2014), Occasional Paper 184 page 25.

[5] Ibid, page 36.

[6] For an example, refer to: http://www.timesofmalta.com/articles/view/20140424/business-comment/GRTU-in-defence-of-cheaper-financing-for-small-businesses.516240.

4. In view of this, the Director General of the Office for Competition (henceforth, 'the Office') has decided to examine the market and to open a sector inquiry in terms of Article 11A (1) of the Competition Act (henceforth, 'the Act') to examine the prevailing competition conditions on the market, in particular interest rates on loans to SMEs.

1.2 The role of the Office for Competition

5. The Office is vested by law with the responsibility to apply and enforce the Act and to apply Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU) in those cases where there is an effect on trade. The Office has the responsibility to make markets work well for consumers and businesses. It believes that well-functioning markets are in the interest of businesses as well as consumers and that effective competition benefits the overall economy. Through the application of competition rules, the Office has the responsibility to investigate and curtail anticompetitive practices and to study markets and recommend action so as to ensure that markets are increasingly competitive.

6. In terms of Article 11A (1) of the Act, where the trend of trade, the rigidity of prices or other circumstances suggest that competition may be restricted or distorted within the Maltese market, the Director General of the Office may conduct an inquiry into a particular sector of the economy or into particular type of agreements across various sectors. In the course of an inquiry, the Director General may request the undertakings or association of undertakings concerned to supply the necessary information for the application of Articles 5 and 9 of the Act and Articles 101 and 102 of the TFEU and may carry out any inspections necessary for that purpose.

1.3 Aim of the inquiry

7. The aim of the sector inquiry initiated by the Office is to:

    i. Assess the degree of competition in the market for bank loans to SMEs;

    ii. Identify competition concerns relating to interest rates charged by commercial banks on loans to SMEs; and

    iii. Propose recommendations to enhance competition in the market.

8. The focus of the inquiry is on *interest rates* charged by commercial domestic banks on *loans* to SMEs. The focus is on loans to SMEs because these are core lending products essential for investment and expansion by businesses, especially for SMEs, which may find it difficult to obtain capital in any other way. The study targets interest rates because the high cost of borrowing is a primary concern for Maltese businessmen and entrepreneurs.

1.4 Conduct of inquiry

9. The sector inquiry covers the period from 2007 to 2013. When sufficient information was available, the year 2014 was also included.

10. Since the early days of the inquiry, the Office consulted with relevant and interested parties, including Malta's core domestic banks, a number of non-core domestic and international banks, representatives of SMEs (the GRTU and the Malta Chamber of Commerce, Enterprise and Industry), supervisory and regulatory institutions (including CBM and the Malta Financial Services Authority [MFSA]) and entities which, in one way or another are related to developments in the market for bank loans to SMEs (such as the Planning and Priorities Coordination Division in connection with the JEREMIE scheme for SMEs). In addition, on 16th April 2014, the Office launched a public consultation document to invite all interested parties to submit their views, feedback and evidence related to

the inquiry. The consultation period closed on 16th May 2014. Feedback received from the public consultation exercise was limited.

11. The information and data used in the analysis has been largely obtained from publicly available sources (such as banks' annual reports and the statistical warehouse of the European Central Bank), meetings held with the abovementioned players, and requests for information sent to the same players (including MFSA and CBM). The Office concluded the final round of meetings with the various market players and relevant institutions in March 2015. The Office consulted various studies carried out by other entities such as GRTU, CBM and other national competition authorities.

1.5 Guiding principles

12. The assessment involves a detailed exercise which analyses the extent to which the sector exhibits the characteristics of a well-functioning market to the benefit of consumers – in this case SMEs. Among other characteristics, the Office considers a well-functioning market to demonstrate the following:

    i. Relatively low barriers for market players to expand their market share;

    ii. Competition between lenders to SMEs such that the market operates efficiently; and

    iii. SMEs that are able to make informed decisions.

13. Competition in the market is affected by many factors such as barriers to entry and exit, productivity growth and demand. Competition tends to be more effective the less concentrated the market and the lower the entry barriers. Competition thrives when businesses and consumers are well informed on market opportunities and are able to choose between different products and services on the market.

14. The analysis of this Report focuses on the degree of concentration within the market, the extent of competition on the market (including barriers to entry and expansion), interest rate developments, the possibility of SMEs to switch from one bank to another, transparency on the market and the

possibility for SMEs to take an informed decision when selecting their preferred bank. On the basis of conclusions arising from this analysis, the Office has drawn a number of recommendations (see Section 8).

15. Finally it should be noted that the proposed recommendations seek to strike an important balance between market competition and financial stability such that the resilience of the Maltese banking model is preserved. As highlighted in both theoretical and empirical literature (see, for example, a study conducted by Thorsten Beck, Ross Levine and Asli Demirgüç-Kunt in 2006)[7], the Office emphasises that competition and financial stability should not be thought of as incompatible goals, but can in fact complement each other.

16. As highlighted in the 2014 Dutch Report on Retail Banking, "Competition and stability are not necessarily mutually exclusive. From a theoretical as well as an empirical perspective, there is no consensus about the question of whether more competition results in a more stable industry or, in fact, in greater instability. Empirical studies, e.g. by Beck, et al. (2006), show that competition and stability can coexist, provided that there is adequate prudential regulation".[8]

[7] Thorsten Beck et al, 'Bank Concentration, Competition and Crises: First Results' (2006) 30 Journal of Banking & Finance 1581.

[8] The Netherlands Authority for Consumers and Markets, 'Barriers to Entry Into the Dutch Retail Banking Sector' (2014) page 13.

2. Market Players

17. This section focuses on the identification and definition of the relevant players in the market for bank loans to SMEs. These include commercial domestic banks as the suppliers of banking facilities, as well as Maltese SMEs.[9] In addition, this section briefly discusses: (i) the various types of SMEs in the light of their differing characteristics, (ii) the dependence of SMEs on commercial domestic bank loans to finance their investments, and (iii) the banks which constitute the subject of the inquiry.

2.1 SME segment

18. For the purpose of this inquiry, the definition of an SME is that adopted by the European Commission as per Recommendation 2003/361/EC of 6 May 2003 concerning the definitions of micro, small and medium-sized enterprises.[10] As suggested in the title of the Recommendation, SMEs represent a very heterogeneous segment, ranging from single unincorporated entrepreneurs to medium-sized companies.

19. In the Recommendation, an SME is defined as "any entity engaged in an economic activity, irrespective of its legal form. This includes, in particular, self-employed persons and family businesses engaged in craft or other activities, and partnerships or associations regularly engaged in an economic activity".[11] Any such entity that employs fewer than 250 individuals and which has an annual turnover not exceeding €50 million and/or an annual balance sheet that does not exceed €43 million in total is classified as an SME.

20. On the basis of this definition, in the Small Business Act (SBA) Fact Sheet (2014), the European Commission reports that 99.8% of all enterprises in Malta are SMEs.[12] Although this is similar to the EU average, Table 1

[9] In view of the fact that core domestic banks are focused on servicing the domestic economy while offering loans to the whole of the Maltese Islands, the Office considers that the relevant geographic market for the above mentioned product market is the national territory of Malta.
[10] This is also the definition adopted by the Small Business Act, Chapter 512 of the Laws of Malta.
[11] Commission Recommendation 2003/361/EC Concerning the Definition of Micro, Small and Medium Sized Enterprises [2003] OJ L124/36.
[12] European Commission, Enterprise and Industry - SBA Fact Sheet Malta (2014).

shows that in Malta, SMEs account for a larger share of total employment and value added than the average EU Member State. Indeed, SMEs in Malta account for around 73% of the country's total value added – compared to an average of 58% for all EU Member States – reflecting the important role that SMEs play in the Maltese economy.

21. SMEs may be further classified into three categories on the basis of three fundamental criteria, namely the staff headcount,[13] the annual turnover and the annual balance sheet.[14] The categories are the following:

- A micro enterprise employs fewer than 10 persons and has an annual turnover and/or an annual balance sheet total that does not exceed €2 million;[15]

- A small enterprise employs fewer than 50 persons and has an annual turnover and/or an annual balance sheet total does not exceed €10 million;[16]

- A medium enterprise refers to any SME which does not belong to the small or micro category.

22. This categorisation is important because it sheds light on the size distribution of Maltese SMEs. Table 1 shows that micro enterprises constitute circa 95% of total SMEs, small enterprises account for 4% and medium enterprises account for 1%. These statistics depict a clear predominance of micro-businesses which are typically family concerns.[17] While this may give rise to potential success, such as flexibility in decision making[18], there are usually additional stumbling blocks with

[13] According to Article 5 of the abovementioned Recommendation, the staff consists of: (a) employees; (b) persons working for the enterprise being subordinated to it and deemed to be employees under national law; (c) owner-managers; (d) partners engaging in a regular activity in the enterprise and benefitting from financial advantages from the enterprise. Apprentices or students engaged in vocational training with an apprenticeship or vocational training contract are not included as staff. The duration of maternity or parental leave taken by staff is not counted.

[14] http://ec.europa.eu/enterprise/policies/sme/files/sme_definition/sme_user_guide_en.pdf.

[15] Commission Recommendation 2003/361/EC, Article 2 (3).

[16] Ibid, Article 2 (2).

[17] Jeremy Boissevain, 'Small Entrepreneurs and their Cultural Context,' (1991) 3 Bank of Valletta Review, pages 1-16.

[18] Keith Psaila, 'Constraints and Opportunities for Micro-Enterprises in Malta', (2007) 35 Bank of Valletta Review, page 31.

regard to access to finance due to the high risk element they carry with them.[19]

	% of Enterprises		% of Employees		% of Value Added	
	Malta	EU	Malta	EU	Malta	EU
Micro	94.6	92.4	34.7	29.1	32.8	21.6
Small	4.2	6.4	20.7	20.6	21.0	18.2
Medium	1.0	1.0	22.6	17.2	19.3	18.3
SMEs	**99.8**	**99.8**	**78.0**	**66.9**	**73.2**	**58.1**
Large	0.2	0.2	22.0	33.1	26.8	41.9
Total	100.0	100.0	100.0	100.0	100.0	100.0

Table 1: SMEs in Malta and the EU: Basic Figures

Source: European Commission, SBA Fact Sheet Malta (2014) – 'SMEs in Malta - Basic Figures'[20]

2.2 Sources of finance available to SMEs

23. In Malta, the main sources of finance available to SMEs are traditional sources,[21] primarily bank loans (a form of long term assistance)[22] and bank overdrafts (a form of short term assistance),[23] apart from personal savings and financing obtained from family or friends.[24] While acknowledging the prevalence of 'short-term assistance' sources of finance, the inquiry focuses on longer-term financing, because despite the underlying similarities between loans and overdrafts, it is usually loans that enable high investment potential for companies. In fact, a European Commission

[19] Ibid, page 30.

[20] European Commission, SBA Fact Sheet Malta (2014). http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2014/malta_en.pdf.

[21] Other forms of traditional sources include credit line or credit card overdrafts, trade credit and factoring, leasing and hire purchasing and other non-prevalent sources including mezzanine finance, business angels and venture capital funds. Most entities also qualify for assistance through national and/or EU funds - Malta Business Bureau 'Market Gaps in Access to Finance and the Feasibility of New Financing Instruments in the EU Addressing the Credit Needs of Maltese Business,' (2013) page 13.

[22] The abovementioned MBB Study defines 'Bank Loan' as 'capital borrowed from the bank, whereby a loan is granted for a specific period, usually at a set rate of interest. This form of financing tends to be more expensive than an overdraft.

[23] The Study defines Bank Overdraft as a 'negative balance on a bank account with or without specific penalties. This source of financing is of a short term liability and is intended to assist the business temporarily. Very often, the overdraft is not for a specific amount of money since the business is given a maximum level of cash it may draw against the overdraft.'-

[24] Malta Business Bureau, 'Market Gaps in Access to Finance and the Feasibility of New Financing Instruments in the EU Addressing the Credit Needs of Maltese Business' (2013) page 13.

'Survey on Access to Finance of Enterprises' (SAFE, 2014) conveys that 69% of SMEs prefer bank loans to realise their growth ambitions.[25] To this end, a properly functioning market economy requires the support of lending institutions to create the financial impetus required by SMEs.

24. Amidst all the challenges that SMEs face, one of the greatest is that Large Scale Enterprises (LSEs) have direct access to capital markets and debt funding whereas SMEs generally do not[26]. It should be noted, however, that lending to SMEs is riskier than lending to LSEs because typically they are more sensitive to fluctuations in the business cycle, have higher failure rates and have fewer assets to collateralise the loan[27]. In this regard, banks may deem SMEs in their start-up stage and micro enterprises as 'uncreditworthy borrowers'[28] owing to the high risk involved,[29] in which case it is only possible to take loans from banks at high interest rate or against property collateral (generally, first residence).[30] In addition, assessing creditworthiness of SMEs can be difficult because often very little public information exists about the performance of most small businesses. Furthermore, due to the small size of the domestic market, the situation in Malta is exacerbated by a limited number of lenders which potentially constrains lending opportunities for SMEs.[31]

25. In addition, there are added hurdles to obtain this form of financing, particularly in the years following the global financial crisis. In fact, in its 2015 Report on SME debt financing, the Organisation for Economic and Co-Operational Development (OECD) commented that:

> "In the years since the crisis, the credit transmission channel in a number of jurisdictions has been impaired as regards quantity, price and distribution of credit. The effects of such malfunctioning are particularly felt by small and medium-sized enterprises

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[25] European Commission Analytical Report, 'Survey on the Access to Finance of Enterprises' (SAFE) [2014] Question 20.
[26] Ibid.
[27] Karen Gordon Mills and Brayden McCarthy, 'The State of Small Business Lending: Credit Access during the Recovery and how technology may change the game,' (2014) Harvard Business School Working Paper, 15-004.
[28] Ibid.
[29] According to Mills and McCarthy, 'small businesses are much more sensitive to swings in the economy, have higher failure rates, and have fewer assets to collateralise the loan'.
[30] Mills and McCarthy, Page 62.
[31] Ibid, Page 26.

especially in Europe. Being heavily reliant on traditional bank lending, SMEs are faced with important financing constraints..."[32]

2.3 Commercial banks

26. Primarily, CBM classifies financial institutions registered in Malta as domestic-oriented or foreign-oriented, based on the extent of their links with residents. With regard to domestic banks, the CBM further distinguishes between what are deemed as core and non-core banks. Thus, all banks licensed in Malta fall into three categories: (i) core domestic banks, (ii) non-core domestic banks, and (iii) international banks.[33]

27. As the main financial intermediaries that provide banking services to Maltese residents, the five core domestic banks – APS Bank Limited, Banif Bank (Malta) plc, Bank of Valletta plc, HSBC Bank Malta plc and Lombard Bank Malta plc[34] – possess a requisite link to the domestic economy.[35] In other words, core domestic banks are the main deposit takers and lenders to the Maltese private sector. These are generally characterised by a conservative business model with limited reliance on wholesale funding, a low loan-to-deposit ratio and an investment portfolio that consists largely of held-to-maturity securities, thus guarding their balance sheets from market volatility.[36] Furthermore, core domestic banks also play an integral role in financially aiding the government as they recently held over one third of the total government debt stocks.[37] Due to the substantial contribution of core banks in granting loans to residents, the Office focused predominantly on core domestic banks for the purpose of this inquiry.[38]

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[32] OECD Report, 'SME Debt Financing beyond Bank lending: The Role of Securitisation, Bonds and Private Placements' (2015).

[33] http://www.centralbankmalta.org/updates/Downloads/pdfs/FSR_2011.pdf.

[34] Central Bank of Malta, Financial Stability Report (2013), Page 8. According to the Central Bank of Malta, Med Bank will also be considered as a core domestic bank in the next Financial Stability Report Update 2015. However, since the period of the inquiry spans from 2007 until 2013, the Office will focus on the core banks as they were during that period.

[35] CBM Financial Stability Report (2011), Page 28.

[36] Ibid.

[37] European Commission, 'Macroeconomic Imbalances Malta' (2014) Occasional Paper 184, Page 21.

[38] One must shed light on the systematic relevance of core domestic banks. The relevance that is used to determine such relevance is based on five criteria: 1. credit to residents, 2. resident deposits, 3. domestic bonds holdings, 4. resident contingent liabilities, 5. market capitalisation – CBM Financial Stability Report (2011) Page 47.

28. On the other hand, the role of non-core domestic banks[39] in the Maltese economy is somewhat constrained particularly due to the limited banking services offered to residents.[40] In the case of international banks, their link to the domestic economy is almost non-existent[41] owing to prevailing transactions with non-residents. Without undermining the importance of non-core domestic banks and international banks, they are not considered to be relevant players for the purpose of this inquiry due to their low involvement in the market for bank loans to SMEs.

2.4 Concluding remarks

29. It is noted that more than 99% of Maltese enterprises can be classified as SMEs and that the majority of these are micro enterprises that employ less than 10 workers. Since these businesses do not typically have access to capital markets, they rely heavily on bank loans to finance their investments. Literature as well as interviews conducted with several domestic banks show that lending to SMEs in general – and to micro enterprises in particular – is usually riskier than lending to larger enterprises because of the lack of publicly available information on their financial performance, their higher failure rates and because they usually have fewer assets to collateralise.

30. From a supply-side perspective, the Office focused primarily on the five core domestic banks, namely APS Bank Limited, Banif Bank (Malta) plc, Bank of Valletta plc, HSBC Bank Malta plc and Lombard Bank Malta plc.

[39] The non-core domestic banks category consists of nine banks that do business mainly outside Malta. Additionally, the main source of income for these banks is the non-interest income; although these banks are considered to be healthy, high reliance on wholesale funding increases their exposure to any possible future liquidity shocks.
[40] CBM Financial Stability Report (2011), Page 47.
[41] Ibid.

3. Market Structure I: Concentration

31. Between 2007 and 2013, the number of banks in Malta has remained relatively constant. At the end of 2007, there was a total of four core domestic banks which increased to five in 2008 following the entry of Banif Bank (Malta) plc.[42]

32. Nonetheless, the number of market players is not necessarily a good indicator of the level of competition in the market. Indeed, an industry with five participants can be characterised by low or high levels of competition. Thus, this section of the report presents a market structure analysis based on market concentration indicators in an attempt to shed light on the degree of competition within the domestic banking sector and, in particular, the market for bank loans to SMEs.[43]

33. At this stage, a cautionary note is warranted. Although there is a tendency for highly concentrated markets to be less competitive, a high level of concentration need not imply a lack of competition, particularly when analysing markets in small island states. Thus, a complete assessment of competition in the market for bank loans to SMEs requires consideration of all available and relevant indicators, including the existence and significance of barriers to entry, pricing and profitability (which are the topics of subsequent sections in this report).

3.1 Concentration ratios

34. The Office employs two widely used measures of concentration. The first is the n-firm concentration ratio (CR_n) which is the sum of the market shares of the n largest banks in the market.[44] This is estimated for banks' total loans (i.e. including both home and business loans) and loans to SMEs. Whilst the CR_n ratio based on the latter variable is of direct relevance to this assessment, the ratios based on total loans are indicative

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[42] See CBM Financial Stability Report (2013).

[43] Concentration ratios are usually used to show the extent of market control of the largest firms in the industry and the extent to which the market is oligopolistic.

[44] The n-firm concentration ratio is measured as follows: $CR_n = \sum_{i=1}^{n} s_i$, where n refers to the n largest firms in the market and s_i is the market share of firm i. Thus, it puts equal emphasis on the largest banks and also neglects the small banks in the market.

of the level of concentration in the market for all bank loans. This ought to provide a useful benchmark in the competition assessment on bank loans to SMEs. The estimates are presented in Table 2.

35. The second measure is the Herfindahl-Hirschman Index (HHI). It is usually deemed preferable to the CR_n ratio as it captures all banks in the market but it also assigns a larger weight to the bigger banks.[45] It is calculated by summing up the squares of the market shares of all players in the market. The index can vary between 0 (representing perfect competition) and 1 (representing a monopoly). Like the CR_n ratio, the HHI indices are estimated using total loan values and loans to SMEs and are presented in Table 2.

	2007	2008	2009	2010	2011	2012	2013
CR2							
Total Loans	✂	✂	✂	✂	✂	✂	✂
SME Loans	✂	✂	✂	✂	✂	✂	✂
CR3							
Total Loans	✂	✂	✂	✂	✂	✂	✂
SME Loans	✂	✂	✂	✂	✂	✂	✂
HHI							
Total Loans	0.421	0.414	0.411	0.401	0.393	0.383	0.377
SME Loans	n/a	n/a	n/a	n/a	0.412	0.396	0.404

n/a: not available as information could not be provided by banks

Table 2: Market Concentration Measures
Source: Office calculations based on data acquired through RFIs to the core banks

36. The CR_2 ratio shows that in 2013 the two largest banks in the market accounted for [75 – 100%] of total loans. In spite of a decline of ✂ percentage points when compared to 2007 (which was largely the result of the entry of Banif into the market), the market share of the two largest banks remains significantly high. This suggests a duopolistic market structure with limited inroads made by the smaller banks into the total loans market.

[45] HHI is calculated as follows: $HHI = \sum_{i=1}^{N} s_i^2$, where N is the total number of market players and s_i is the market share of firm *i*.

37. The same ratio (CR_2) for the SME lending market in 2013 stood at [75 – 100%], around ✂ percentage points lower than that for total loans. This might suggest that the SME loans market is less concentrated than the market for total loans. However, the HHI index – which is often thought to be a better indicator of the level of concentration in the market for the abovementioned reasons – shows that the level of concentration in the SME lending market is actually higher than that in the total loans market. Indeed, at the end of 2013, the HHI index for bank loans to SMEs stood at around 0.404 whilst that for the total lending stood at 0.377. The seemingly contrasting results obtained from the estimation of the CR_n ratio and the HHI index can be explained by the significantly high market share of one particular bank in the SME loans market. Indeed, the data suggests that one bank – BOV – may be in a dominant position as throughout the period between 2011 and 2013 it accounted for around [40 – 65%] of the market for loans to SMEs.[46]

[46] Dominance relates to a situation where a firm enjoys a very high degree of market power, but the jurisprudence has made it clear that a firm with 40 per cent of the relevant market – far from being a monopolist – might well be a dominant one (Massimo Motta, *Competition Policy: Theory and Practice* (Cambridge University Press, 2004) Page 34). This gives rise to a presumption of dominance. See also Case C-62/86 *AKZO vs. Commission* [1991] ECR I-3359.

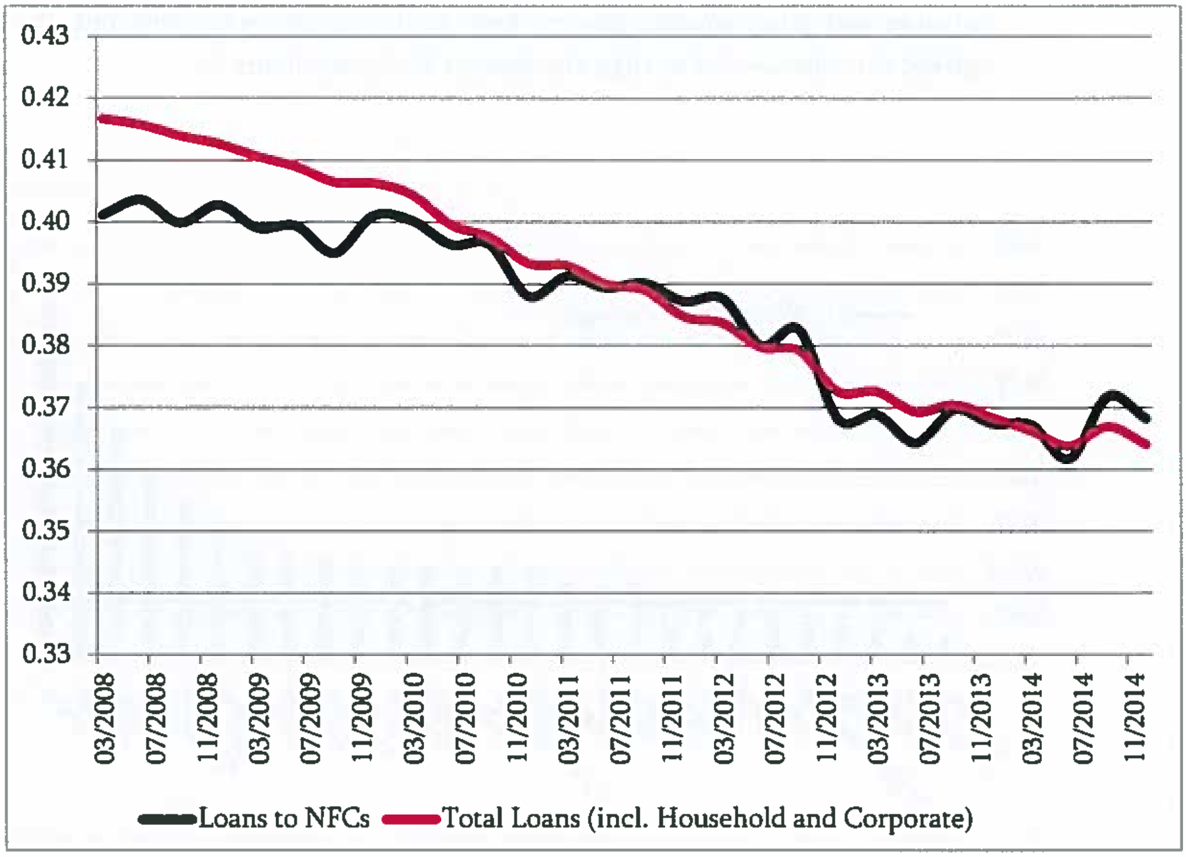

Figure 1: Herfindahl-Hirschman Indices *(0 = perfect competition; 1 = monopoly)*
Source: Office calculations based on CBM data

38. Since market shares data for the SME loan market is only available from 2011 onwards, the Office calculated market shares for all business loans (i.e. loans to both large corporations and SMEs) to get a time series perspective of developments in the market for bank loans to businesses (of which a substantial portion relates to SMEs). The HHI index based on these market shares and another one for total loans are presented in Figure 1. It shows that during the period between 2008 and 2014, an improvement has been recorded in the HHI index based on total bank loans, reflecting the entry of Banif into the market and marginal increases in the market shares of some of the smaller banks. A decrease in concentration has also been recorded in the market for bank loans to businesses. However, it is noted that the HHI index for the business loans market has recorded a smaller decline, suggesting that new market

entrants and other smaller players have found it harder to penetrate the market for business loans than the market for home loans.[47]

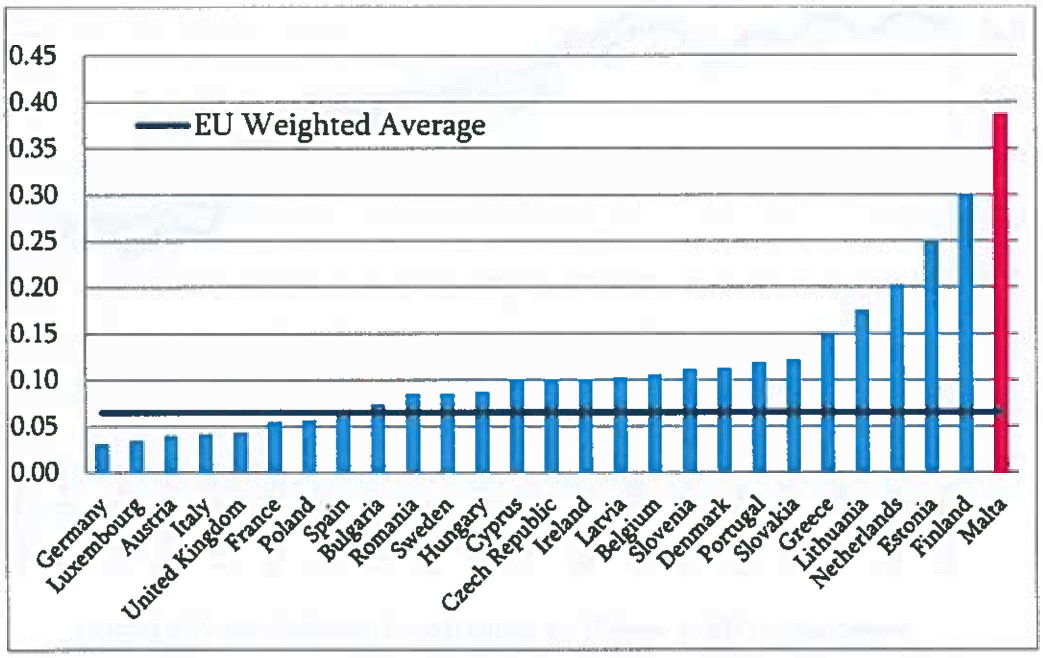

Figure 2: Herfindahl-Hirschman Indices Assets (2012)
Source: Calculation by the Office based on the core banks' annual reports and OECD - The State Of The Banking Sector In Europe January 2014)

39. The difficulty (or unwillingness) for new entrants to penetrate the market, and for existing small banks to expand their market share, may be problematic when one considers the high levels of concentration in the SME loans market. Indeed, in 2013, the HHI index based on SME loans stood at ✂, significantly higher than the minimum level of what is usually considered a to be a highly concentrated market.[48] Similar conclusions emerge from cross-country comparisons of the HHI indices

[47] The estimated HHI index for business loans (which include loans to SMEs) is lower than the HHI index for SME loans (alone). This suggests that the dominant bank in the SME loans market accounts for a lower market share of loans to larger corporations than that for SME loans.

[48] Competition authorities generally classify markets into three types: unconcentrated markets when the HHI is below 0.15; moderately concentrated markets when the HHI is between 0.15 and 0.25; and highly concentrated markets when the HHI is greater than 0.25.
See U.S. Department of Justice and the Federal Trade Commission, 'Horizontal Merger Guidelines' (2010) page 19. As a general rule, an HHI below 0.10 signals low concentration, while an index above 0.18 signals high concentration. For values between 0.10 and 0.18 an industry is considered to be moderately concentrated. Note that these indicators are calculated on a non-consolidated basis, meaning that banking subsidiaries and foreign branches are considered to be separate credit institutions.

presented in Figure 2.[49] Indeed, an HHI index based on banks' total assets – for ease of cross-country comparability – shows that Maltese banks are heavily concentrated relative to their European peers. Indeed, at 0.387, the HHI index based on assets for the Maltese banking sector is almost six times that of the EU average.

3.2 Concluding remarks

40. Overall, the results obtained from the market concentration analysis show that the market for bank loans to Maltese SMEs is highly concentrated both when compared to other industries and when compared to other EU banking sectors. In spite of the declines noted in the concentration ratios during the period between 2007 and 2014, the results suggest that new entrants and smaller banks have either been unwilling, or have found it difficult, to penetrate the market and expand their market shares. Indeed, at the end of 2013, the two largest banks still accounted for [75 – 100%] of the market for bank loans to SMEs.

41. Such high levels of concentration are typically associated with low levels of competition. However, as noted earlier in the report, concentration indicators should not be interpreted in isolation. Indeed, there is a tendency for concentrated markets to be less competitive when they are also characterised by significant barriers to entry and expansion.

[49] Although for Malta the Office only considers the core domestic banking segment, the data for other European countries is on a consolidated level. Therefore, assets data for countries other than Malta may relate to institutions that are not entirely geared towards their domestic economies. Thus, the HHI index based on banks' assets for Malta may not be directly comparable with that calculated for other EU countries.

4. Market Structures II: Barriers to Entry and Expansion

42. Barriers to entry have been defined as "factors which prevent or hinder companies from entering a specific market".[50] On the other hand, barriers to expansion are defined as "something which prevents or hinders an existing competitor from expanding output".[51] Both types of barriers should be assessed together and should not be seen in isolation. Such barriers are crucial when assessing the ability of an undertaking to act to an appreciable extent independently of competitors. The ability to enter and to leave a market, and the opportunity for existing and new undertakings to expand, are vital for competition; in a way, they limit the incumbents' ability to exercise market power.

4.1 Barriers to entry

43. There are barriers to entry in most markets, but the extent of these varies. Barriers to entry may be the result of established corporate strategies and development and can be identified as a strategic advantage for incumbents on both the supply and the demand side. Barriers to entry and expansion affect the undertakings' profitability when operating in a market, and when such barriers are high, smaller competitors will find it difficult to erode the incumbents' market position.

44. In an Irish case, Mr Justice O'Higgins stated that,

> 'The existence of high barriers to entry (being part of the market structure tending to show dominance), would be of very great importance in circumstances, if there were also high barriers to expansion for the existing competitors. The reason is that if there were both high barriers to entry and high barriers to expansion, it would be easier for an undertaking to act to an appreciable extent independently of competitors and consumers, as it would be

[50] Robert O'Donoghue and A Jorge Padilla, *The Law and Economics of Article 82 EC*, (2nd edn, Hart Publishing, 2006) page 117.

[51] Alison Jones and Brenda Sufrin, *EU Competition Law: Text, Cases, and Materials,* (3rd edn, Oxford University Press, 2009) page 86.

difficult for a rival enterprise, either to enter the market, or if already in it, to take advantage of anti competitive behaviour on the part of the other undertaking. Where either barriers to entry or barriers to expansion are low the likelihood of such anti-competitive behaviour being exercised with impunity is greatly diminished".[52]

4.1.1 Non-core domestic and international banks

45. When conducting the sector inquiry, the Office sent requests for information to Malta's non-core domestic banks and international banks registered in Malta, to find out their views on any barriers to entry and expansion they could potentially face in the SME loan market. In particular, the Office asked whether banks ever considered entering the market for the provision of business loans to SMEs and whether they consider that there are barriers to entry and expansion in the provision of business loans to SMEs in Malta. Part of this section examines the information which the Office has received from these parties.

46. The replies received from the banks demonstrate that they would not find any particular barriers to entry, were they to start providing loans to SMEs. Moreover, they do not completely exclude the possibility of entering the market for loans to SMEs. Although the non-core domestic banks concurred that tangible barriers to entry and expansion do not exist, they still pointed out that the market is small and that there is little growth potential. Therefore, it will also naturally create large concentrations of risk.

47. In fact, it has been shown that it is not impossible for smaller banks to enter the SME loan market. In 2003 Bawag Malta had opened a 100% owned subsidiary in Malta, concentrating primarily on commercial banking, offering loan and deposit services[53]. In 2008, another bank, Banif started operations in Malta.

[52] Communications Ltd and Cellular Three Ltd v Eircell Ltd [2002] 1 IR 17, per O'Higgins J., High Court.
[53] Refer to http://www.businesstoday.com.mt/2003/09/17/l1.html.

48. However, one bank stated that the market for loans to SMEs is highly competitive and relatively small and that the business is not deemed to be a viable proposition for the bank, due to the significant upfront investment in systems and infrastructure when compared to the potential volume of business available. Banks noted that the right platform has to be set up to handle SME loans which would entail significant investment and operational setup required for a credit organisation department, especially in the wake of the additional administrative and regulatory requirements caused by the Capital Requirements Regulation (henceforth 'CRR').[54]

4.1.2 Core domestic banks

49. Requests for Information were also sent to all five core domestic banks to seek their opinion on existing barriers to entry, barriers to exit and any existing competition constraint. An analysis of their views follows.

- **Regulatory requirements**

50. Regulatory requirements were identified by all banks as common entry barriers. Capital and regulatory requirements are regarded as obstacles and can hinder newly-established banks and small banks from accessing and expanding the market. One bank claimed that the cost of compliance may entail a significant fixed cost which the entrant cannot easily recover due to it not having yet acquired sufficient business. Another bank also recognised banking regulations as a real impediment to entry, but it also stated that new banks are still able to establish themselves on the said market. Yet another bank claimed that banking licence and capital requirements are existing barriers to entry.

[54] Council Regulation (EU) 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 (Capital Requirements Regulation) [2013] OJ L 176/1.

51. The Capital Requirements Directive (henceforth 'CRD IV'[55]) as well as the Capital Requirements Regulation[56] had to be amended to comply with the Basel III regulatory framework. Maltese core banks are mainly funded through retail deposits (unlike other European banks that are funded through wholesale deposits) and therefore these added requirements do not directly affect the banks' funding costs. Nonetheless, these added requirements made it more onerous for core banks to finance enterprises, since they had to increase available capital for lending purposes while maintaining high liquidity levels. All banks concurred that these capital requirements are very stringent. The requirements in relation to counterparty credit risk are such an example. Basel III requires "capital incentives for banks to use central counterparties for derivatives and higher capital for inter-financial sector exposures".[57] These requirements were enshrined in the amendments effected to the CRD IV and the CRR.

52. Indeed, as highlighted in the Dutch retail banking sector report,[58] the ACM "concludes that the overall package of laws and regulations constitutes a barrier to entry into the banking sector, due to its scope, complexity, and the frequent changes it undergoes. The compliance costs associated with the laws and regulations are often sunk costs. Higher sunk costs reduce the incentive for entry into the market".[59]

- **Reputation**

53. Marketing of established undertakings constitutes a significant barrier to entry. Importantly, reputation is another factor that could deter (new) banks from entering the market, since they would need to compete with other well-established banks. By establishing a brand, established undertakings are able to differentiate their products and benefit from higher customer loyalty. As a consequence, this could also deter potential entrants from accessing the market.

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[55] Directive 2013/36/EU, of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms [2013] OJ L176.
[56] Council Regulation (EU) No 575/2013.
[57] Summary Table available at: http://www.bis.org/bcbs/basel3/b3summarytable.pdf.
[58] ACM, 'Barriers to entry into the Dutch retail banking sector' (2014).
[59] Ibid, page 5.

54. In order to compete with established players, new players might need to develop a completely new product or process technology, which alters the conditions of competition. Established companies would often have built up a customer base, whereas new businesses have to exert substantial marketing efforts to acquire new customers. Marketing costs are partially irreversible costs, limiting the incentive for new players to enter the market.

- **Costs related to an IT system infrastructure, internal framework and economies of scale**

55. Established undertakings in a particular market can develop resources and capabilities that make it difficult for new undertakings to enter and compete in that same market. Undertakings that have been operating on a market for a particular time have, during that time, developed unique assets and resources that will enable them to produce goods and services of a given quality at lower costs than potential competitors. It may be because they have lower operating costs or access to a specific product or process technology. This may also be the result of experience, providing established undertakings with cost advantages independently of their size.

56. As was seen in the replies given by the non-core domestic and international banks, significant investment in infrastructure and operational setup is a must. Banks expressed the opinion that there is the need for substantial investment in an adequate IT infrastructure and an internal framework that allow the bank to identify, measure, manage and control credit risks. Moreover, SMEs are typically assigned a relationship manager to look after their accounts with their banks. The quality of this relationship and the knowledge that managers have will be important determinants of success. Collectively, all these investments allow the bank to perform essential services in relation to account management such as calculating interest, processing payments and identifying, measuring and managing risks.

57. The large core domestic banks also benefit from cost advantages incurred through economies of scale since fixed costs are spread out over more units of output. A study conducted by Ronald Anderson and Karin Joeveer concluded that : "... the most plausible explanation for our results is that large banks achieve a degree of operational efficiency which gives

them a competitive edge over smaller rivals, and this advantage allows them to retain some producers' surplus that creates value for their shareholders and for bankers themselves".[60] One of the banks claimed that since it is small, it does not benefit from the same economies of scale enjoyed by big banks.

- **EU financial incentive for SMEs**

58. The market for financing micro enterprises and that for financing start ups was in itself another entry barrier identified by banks. Importantly, the JEREMIE initiative[61] implemented by BOV counteracted this problem but it also put other banks in different positions in the market, since they did not form part of this initiative. In fact, other banks listed the exclusivity granted to BOV to manage JEREMIE funding package as a competition constraint.

59. According to the BOV 2014 Annual Report, the bank continued to strengthen its position in financing to SMEs. With the JEREMIE initiative, "the Bank managed to assist 650 SMEs, through 760 loans, for a total equivalent committed amount of €62 million. Particular emphasis has also been given to start-ups and micro SMEs. By tapping into EU centralised funds, the Bank was in a position to start offering a new risk-sharing instrument branded as the 'BOV Start-Plus Financing Package'. This micro-credit instrument is aimed at start-ups and micro-enterprises which usually find it hard to obtain external financing, but which constitute an important pillar for the country's economic development."[62] Therefore the goal of this initiative is to create an investment platform for small businesses. This initiative was awarded to BOV when a public tender was issued on the local market. It could however indirectly affect other financial intermediaries, which are not part of this initiative – since SMEs would benefit much more if they borrow from BOV; this in turn indirectly affects other core banks that are trying to attract customers. It follows that although the JEREMIE program is intended to improve access

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[60] Ronald Anderson and Karin Joeveer, 'Bankers and Bank Investors: Reconsidering the Economies of Scale in Banking' [2012] Financial Markets Group Discussion Paper 712, page 21.

[61] Joint European Resources for Micro to Medium Enterprises. It is an initiative taken up by both the European Commission and the European Investment Fund – "it promotes the use of financial engineering instruments to improve access to finance for SMEs via Structural Fund intervention." http://ec.europa.eu/regional_policy/thefunds/instruments/jeremie_en.cfm#1.

[62] https://www.bov.com/documents/bov-annual-report-2014.

to finance to SMEs, it indirectly discriminates and creates a competitive disadvantage against those banks that do not form part of it.

60. The GRTU survey indicated that out of those SMEs that did not try to compare deals between the banks, a percentage held that they would only consider the bank that offers a favourable scheme (e.g. JEREMIE).

- **Inherent risk profile and access to key information in relation to creditworthiness**

61. A bank identified the inherent risk profile of SMEs as a barrier to entry. It was stated that "financial intermediaries perceive SMEs as too risky to finance, especially start-ups. This risk may not be cushioned by alternative sources when the SMEs lack adequate collateral coverage to act as a fall-back scenario."

62. Financial institutions could find it discouraging to finance SMEs since the institution would acquire a burdensome task in doing so when it does not have any guarantee as to whether the start-up SME would be successful in the long term. Moreover, SMEs are very small in size and this would influence their capability of striking off any debts which they would have incurred. Consequently, this could be the reason that core banks are the only ones that finance SMEs, since they are ultimately the only ones who can afford to bear the burden.

63. Another barrier to entry is the limited information available on the nature of the market and the difficulties encountered by banks in obtaining reliable information on SMEs. The former Office for Fair Trading in the UK also identified lack of access to credit data as a major disincentive for competitor banks.[63] A non-core domestic bank stated that there is a difficulty to obtain the relevant data from SMEs since audited financial statements are not delivered and official deadlines are ignored. This makes determining credit worthiness of the SME difficult. For example, smaller SMEs often use personal banking services rather than dedicated business services, which means that there will not be a track record of information available on their business banking profile when

[63] https://www.gov.uk/government/consultations/competition-in-banking-improving-access-to-sme-credit-data/competition-in-banking-improving-access-to-sme-credit-data

they come to seek business banking services. Consequently, this makes it more difficult for banks to offer products to SMEs if the same banks cannot accurately assess their credit risk and price the debt accordingly.

- **Low interest deposit rates**

64. The Office believes that another barrier to entry faced by small core domestic banks is the low interest deposit rates, as major banks have the advantage of a legacy of low interest deposits. From the weighted average interest rate on total deposits between 2008 and 2013, in most periods BOV and HSBC had the lowest WAIR. From 2011 onwards, they kept interest rates constantly lower. For small core-domestic banks this is a barrier to entry since the fact that the leading banks can maintain a low interest deposit rates entails that they can offer better lending rates to SMEs.

- **A significant branch network**

65. One of the banks is of the opinion that despite the development of alternative delivery channels, the majority of SMEs still prefer access to a branch or centre. Thus another barrier to entry is the investment required in establishing a significant branch network. However, not all small banks competing in the SME loan market are of the same opinion. One of the banks considered that the fact that all its branches are spread out across the island, taking into account both the small size of the country and the close proximity with all commercial areas, it does not have any competitive disadvantage. Another small bank held that its Offices are deemed adequate enough for the firm to operate. Only one of the banks acknowledged that the bank's branches are not enough, claiming that the bank endeavours to compensate for the limited number of branches and the lack of presence in strategic locations by offering (as far as possible) personalised service to SMEs, including a better financial package (lower interest rates) that better suits their financial requirements.

4.2 Barriers to expansion

66. The Office analysed the market shares of the core domestic banks between 2008 and 2014 in relation to outstanding loans to NFCs. The following were the conclusions of such analysis.

67. Between 2008 and 2014 the market shares of APS, Lombard and Banif remained consistently small. Therefore it transpires that small core domestic banks have not made any significant inroads into the market share of the leading core domestic banks. One can say that, in essence, the market shares of the small core domestic banks have remained static. It is clear that the small core domestic banks have not been in a position to expand easily in the market.

4.3 Concluding remarks

68. It transpired that there are in fact barriers which stultify competition. Regulatory barriers, such as capital requirements were the most commonly identified. Among other barriers, reputation and the need for an adequate infrastructure were also acknowledged as key barriers to entry.

69. From an analysis of the market shares it was demonstrated that smaller core domestic banks have not made many inroads in the largest banks' market shares. High barriers to entry and expansion also cause the undesirable and probable effects of eliminating competitors from the market or alternatively limiting the potential growth of other banks. The Office considers that there are high barriers to entry and expansion and that competition in the SME loan market is effectively being hindered.

5. Price and Profitability

70. The reliance of Maltese SMEs on bank lending to finance their investments means that a high cost of borrowing would discourage economic growth and be detrimental to the country's competitiveness, particularly in situations where SMEs serve markets in which they have to compete with foreign firms. Against this background, there have been several calls for domestic banks to reduce the interest rates they charge to SMEs:

> "... according to the authorities, weak credit growth is partly attributable to the high cost of capital, particularly for SMEs, that could be addressed by a more diversified cost of funding and to some extent also by a stronger degree of competition in the banking market".[64]
>
> IMF (2015)

71. While the issue of diversification of the sources of funding is neither the scope of this inquiry nor part of the remit of the Office, it is the aim of the Office to ensure strong and sustainable competition in the market for bank loans to SMEs. This section therefore seeks to shed light on the extent to which the allegedly high interest rates charged by core domestic banks reflect limited competition in the market for bank loans to SMEs by analysing issues related to price and profitability.

5.1 International lending rate comparison

72. The interest rates charged by Malta's core domestic banks on loans to NFCs are amongst the highest in the EU, only lower than those of Greece and Cyprus, whose economic performance suffered significantly in the aftermath of the international financial crisis which started in the United States in 2007.[65] Indeed, Figure 3 shows that the weighted average interest rate (WAIR) on loans to NFCs for the period between 2008 and 2014 stood at around 0.86 percentage points above that of the euro area

[64] IMF Country Report n. 15/46, 2014 Article IV Consultation – Staff Report, Press Release; and Statement by the Executive Director for Malta (2015).

[65] See also CBM Annual Report (2014).

average. Currently averaging around 4.3% per annum, interest rates on loans to NFCs have declined significantly when compared to the pre-crisis levels of around 6%. Nonetheless, in the last quarter of 2014, there remained a gap of around 1.2 percentage points between the WAIR charged by Malta's core domestic banks and that of the euro area.

73. For the most part, this divergence between the interest rates charged by Maltese banks on loans to NFCs, and those charged by banks in other euro area countries, reflects a relatively low pass-through of the ECB policy rate by Malta's core domestic banks.[66] Indeed, research published in the CBM's Quarterly Review 2014 shows that since September 2008, in Malta, only around 60% of rate cuts by the ECB were transmitted to lending rates to NFCs.[67] Similarly, the IMF finds that the long-term pass-through for Maltese NFCs is one of the lowest in the euro area.[68]

[66] The ECB's monetary policy to lower interest rates to stimulate economic growth is usually expected to be reflected in retail lending and deposit rates which, in turn, would be expected to impact investment and saving decisions.

[67] Brian Micallef and Tiziana Gauci, 'Interest Rate Pass-Through in Malta', (2014) Central Bank of Malta Quarterly Review 2014:1.

[68] IMF Country Report n. 15/46, 2014 Article IV Consultation – Staff Report, Press Release; and Statement by the Executive Director for Malta (2015).

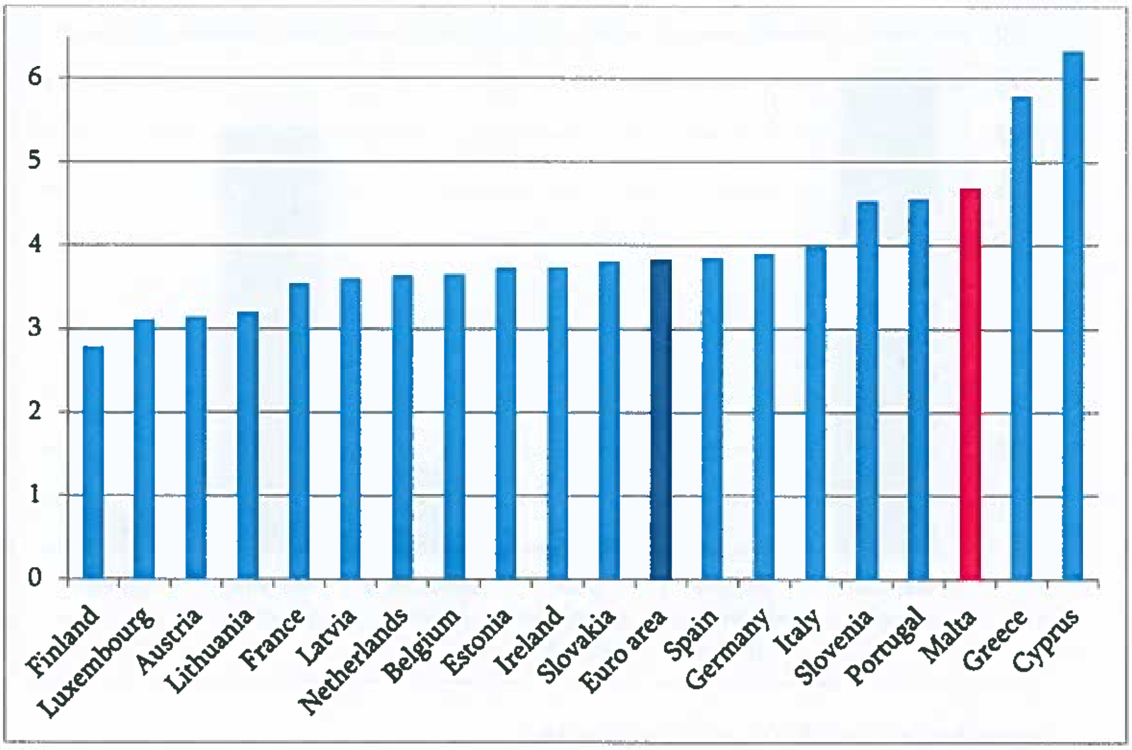

Figure 3: Interest Rates on Loans to NFCs (%, Average 2008 – 2014)
Source: Statistical Data Warehouse, ECB

74. There are several factors which may have contributed to the gap between the lending rates offered by Maltese banks and those offered by banks in other euro area countries. Replies to the RFIs sent to all core domestic banks show that the factors that are given the most weighting in determining the lending rate are the cost of funding and the risk factor.

75. The *cost of funding* refers to the cost that banks incur to finance their lending operations. These tend to vary significantly depending on the bank's funding model. The traditional approach is to rely on customer deposits. However, another increasingly popular and currently cheaper source is wholesale funding, such as borrowing from other banks with excess liquidity or from the ECB through long term refinancing operations (LTROs). Other financing options, although usually more expensive than both retail deposits and wholesale funding, include the issuance of subordinated loan stock and convertible bonds.

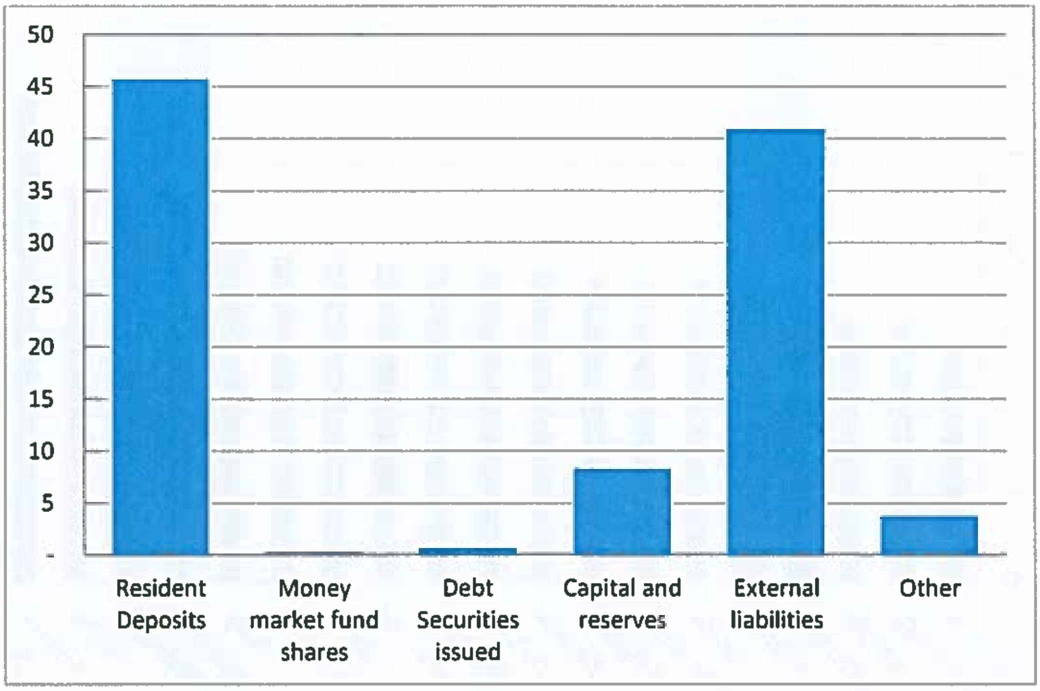

Figure 4: Banks' Liability Components 2014 (%)
Source: MFI Online Balance Sheets 2014 (ECB)

76. Malta's core domestic banks have generally adopted the traditional approach of relying on retail deposits. In fact, replies to the RFIs sent to the various banks revealed that only some had made use of alternative financing and that this amounted to a very small proportion of the banks' total liabilities (see Figure 4). This funding model is also reflected in a relatively low loan-to-deposit ratio which in December 2014 stood at 62% compared to 103% for the euro area.

77. In spite of paying interest rates on deposits which are roughly equivalent to those of the euro area average (see Figure 5); the heavy reliance of Maltese banks on this source of funding – rather than cheaper wholesale funding – makes it costlier for Maltese banks to finance their loans. ✂

✂

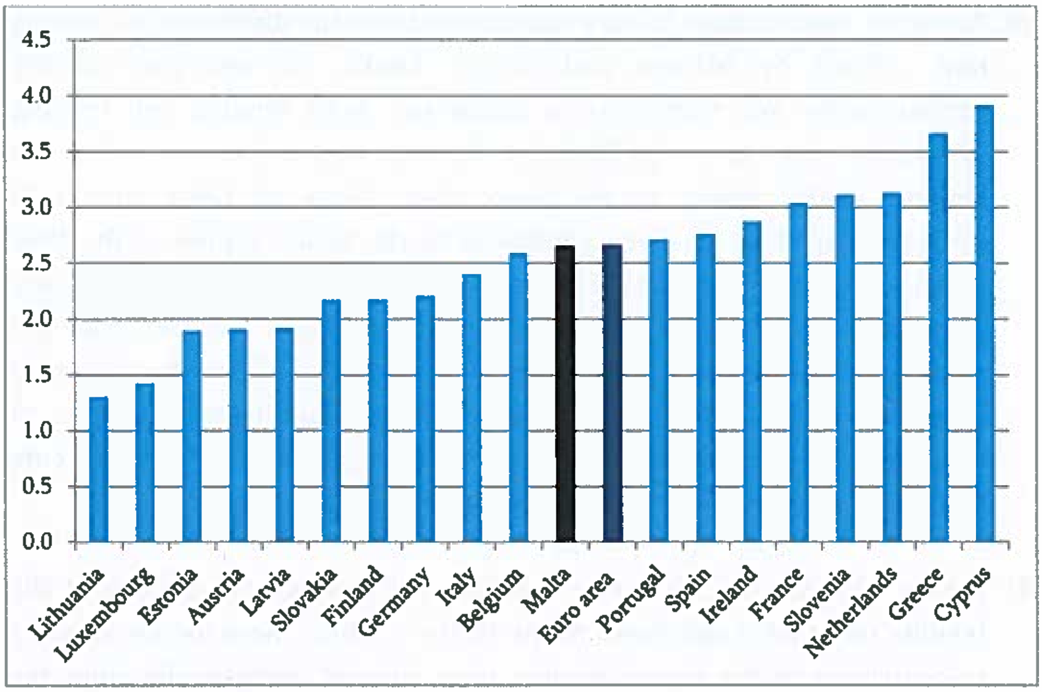

Figure 5: Interest Rate on Deposits with agreed maturity (%, Average 2008 – 2014)
Source: Statistical Data Warehouse, ECB

78. A second major factor that may explain the observed discrepancy are differences in credit risk. The replies to the RFIs sent to the core domestic banks show that this depends on a number of factors, such as the economic sector in which the prospective borrower operates, the life cycle stage of the SME and its product/services, the past financial performance of the SME, the provision of collateral and the capital structure of the business among others. Because most of these factors are specific to a particular borrower, it is difficult to make international comparisons about the contribution of credit risk to the lending rate.

79. Nonetheless, part of the gap between the lending rates offered to NFCs by core domestic banks and other euro area banks can be explained by the fact that in Malta SMEs account for a larger share of corporate loans than they do in other countries. Using bank loans with a value of €1 million or less (indicative of loans to SMEs), data shows that in Malta almost 35% of loans to NFCs are accounted for by SMEs compared to 27% in the euro area. Since lending to SMEs is usually considered riskier than lending to larger corporations, the larger share of SMEs in the banks' loan portfolio may be another reason for the observed higher WAIR on loans to NFCs charged by Maltese core domestic banks.

80. There are several other factors that may explain the difference in lending rates offered by Maltese and foreign banks. For example, relative administrative and staff costs to administer both funding and lending operations may vary significantly. Indeed, cost-to-income ratios for Maltese banks appear to be lower than those of their euro area counterparts.[69] This has been confirmed in the banks' replies to the RFIs whereby it was reported that "local banks have a higher cost efficiency ratio (measured as total costs divided by operating income) than the average European bank ... probably partly attributable to the relatively lower costs incurred by local banks." This would have the effect of reducing the gap between the lending rates charged by Malta's core domestic banks and those charged by other banks in the euro area.

81. Finally, the gap may also reflect differences between the portion of the lending rate that is attributed to the banks' profits. These too are thought to contribute to the higher lending rates charged domestically since the returns to assets (and equity) earned by Maltese core domestic banks are significantly higher than those earned by their euro area counterparts (see Section 5.4)

[69] Observation based on data from the annual reports of core domestic banks and data reported by ECB (2014).

5.2 Domestic lending rate developments

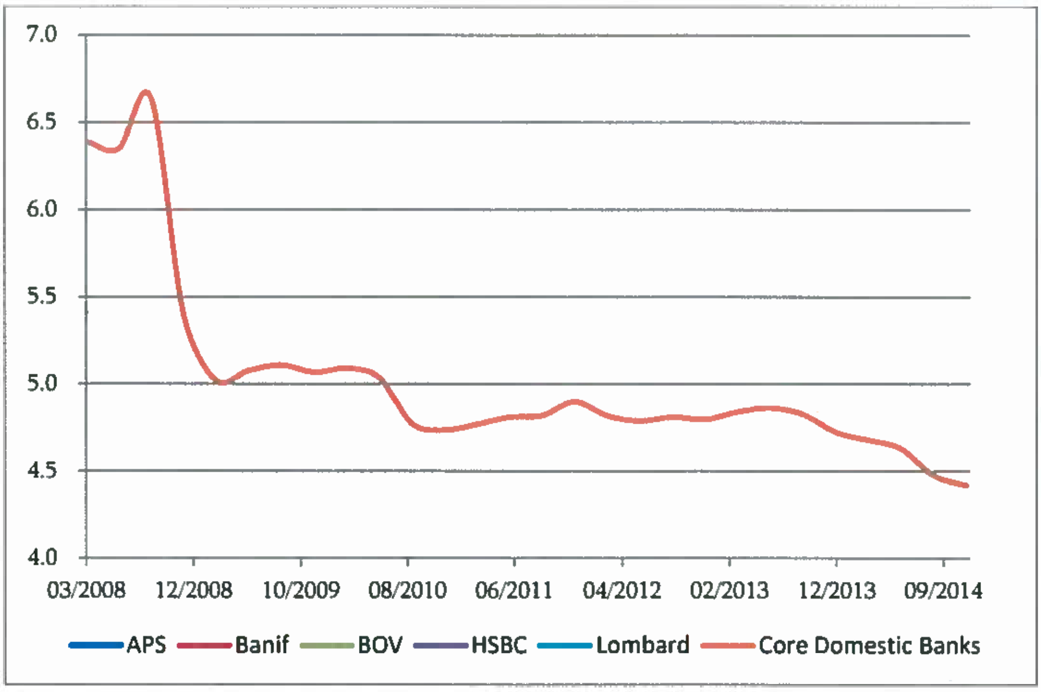

Figure 6: Interest Rate on Outstanding Loans to NFCs (%)
Source: Office calculations based on CBM data

82. Interest rates have varied significantly over the period under inquiry. Indeed, Figure 6 shows that interest rates charged by core domestic banks to NFCs decreased from a weighted average of 6.5% in the first three quarters of 2008 to around 4.5% in 2014. The most significant drop was recorded in the latter months of 2008 following significant cuts in the ECB policy rate, and remained relatively stable at around 4.9% throughout the subsequent four years. In the latter months of 2013 and 2014, the lending rates to NFCs decreased further following more cuts in the ECB policy rate and various calls by several domestic and international institutions for reductions in the lending rates charged to Maltese SMEs. These developments reflect changes in the various factors determining the lending rates outlined above, namely, the cost of funding, credit risk, administrative costs, and the profit margin.

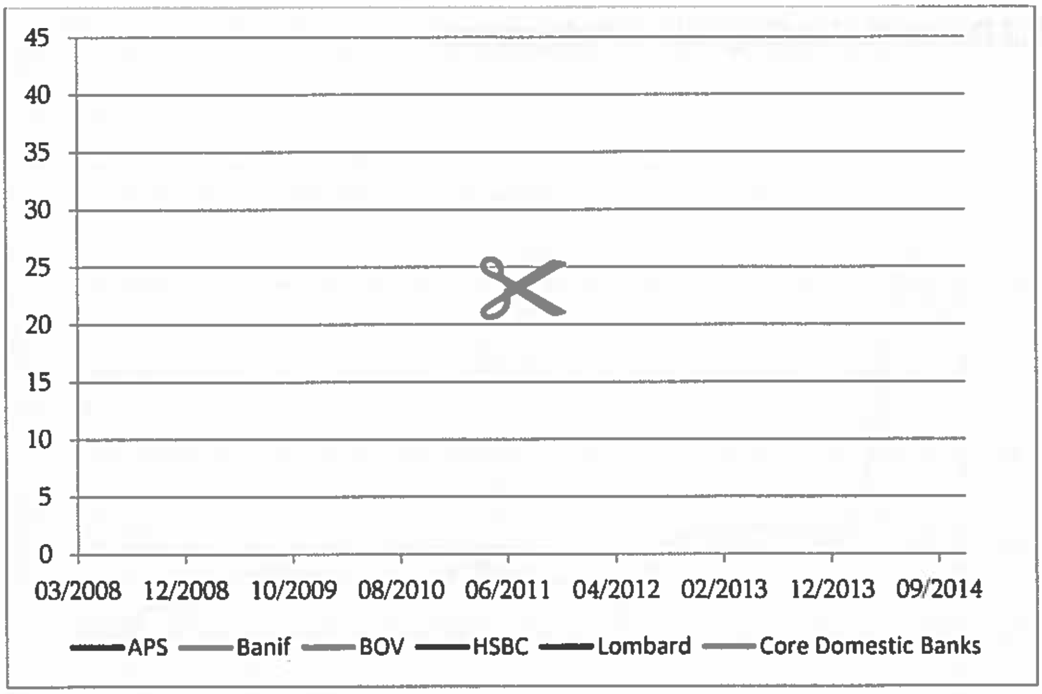

Figure 7: NFCs' Non-Performing Loans Ratio (%)
Source: Calculations based on CBM data

83. ✂

✂

84. ✂

✂

85. Throughout the period under inquiry, the interest rate spread – here defined as the difference between the interest rate on loans to NFCs and the interest rate on total deposits – increased marginally when compared to the pre-financial crisis period. ✂ ✂ In itself, this may suggest that there was room for reductions in the interest rates charged on loans to SMEs. However, it should be noted that several other factors may have led to the widening of the spread. In the response provided to one of the RFIs, one of the banks explained that the widening of the spread was primarily driven – although not solely – by the significant increase in non-performing loans (see Figure 7).

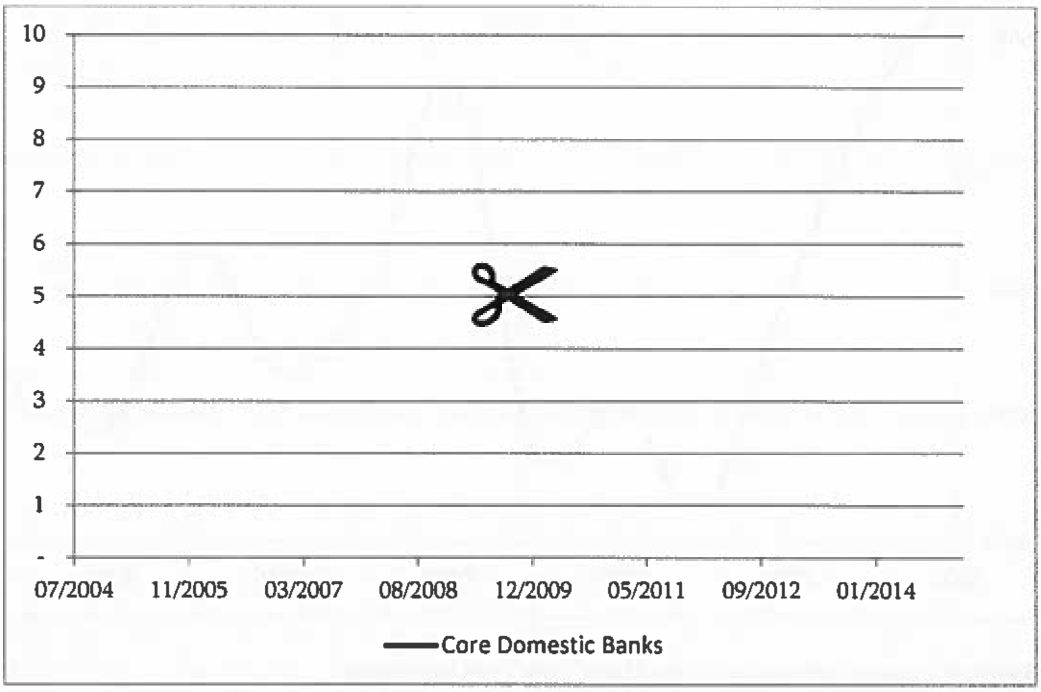

Figure 8: Interest Rate Spread (percentage points)[70]
Source: Calculations based on CBM data

86. Other factors which might have contributed to the widening of the spread are cost increases in the post-crisis period. In fact, data shows that total operating costs increased steadily for the banks during the period examined. These cost developments are reflected in the cost-to-income ratio which peaked in 2008, largely reflecting losses in income during the international financial crisis (see Figure 9). In subsequent years, however,

[70] The interest rate spread is the interest rate charged by banks on loans to SMEs minus the interest paid by banks on total deposits, including both demand and term deposits.

the cost-to-income ratio remained above the levels recorded in the pre-crisis period reflecting, in part, cost increases related to additional regulatory requirements. Indeed, in their replies to the RFIs the banks argued that although "the new regulations had no material effect on their funding costs, because they finance themselves almost exclusively through customer deposits ... the more onerous capital requirements of the Capital Requirements Directive IV means that banks must set aside higher amounts of capital against their lending business ... Hence, lending has become marginally more costly."

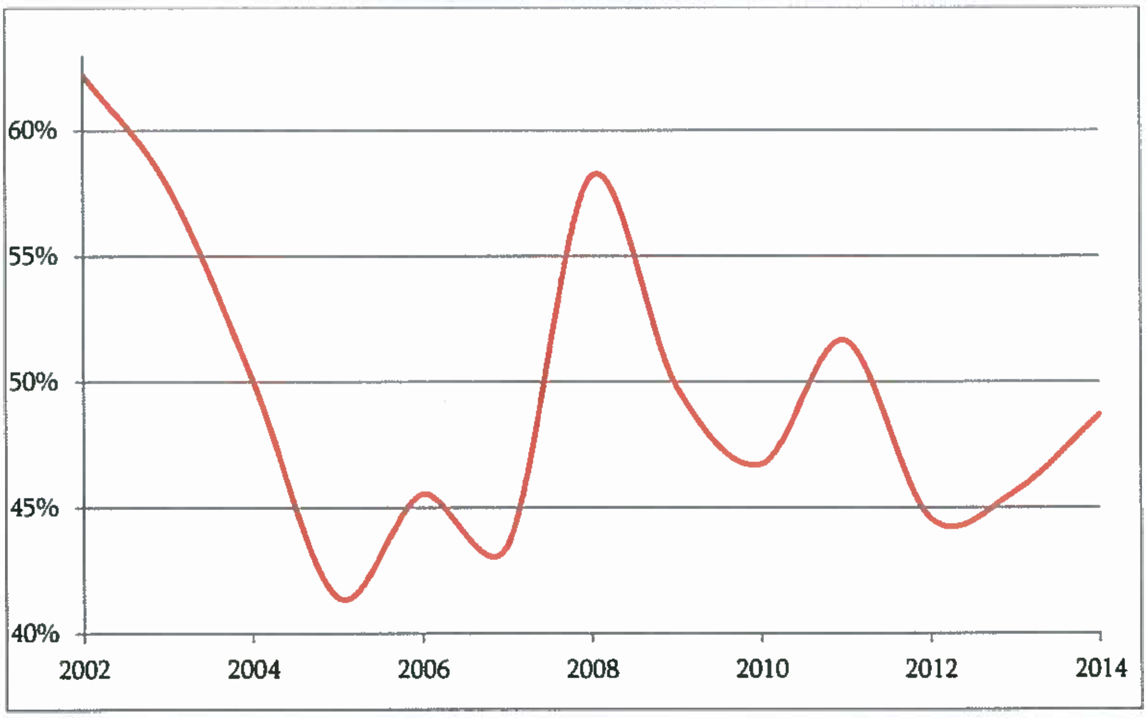

Figure 9: Costs to income ratio[71] for Malta' Core Domestic Banks
Source: Calculations based on Malta Core Banks' Audited Accounts (2002-2014)

87. Although it is difficult to determine the extent to which these factors might have played a role in the marginal widening of the spread, the observed reduction in the WAIR on loans to NFCs *following* pressure by several domestic and international institutions may suggest that there was room for reduction in banks' lending rates to SMEs. In particular, it is noted that the base rates (and consequently the lending rates) of the three

[71] The ratio measures the percentage costs per Euro of gross income for the bank. Viewing costs as a percentage of income provides an indication on costs for a given level of income. A lower ratio is indicative of increased efficiency. ✂

largest banks were reduced only after public statements by the Minister of Finance and the Governor of the CBM calling for lower lending rates to SMEs:

> "Government is concerned by the alleged high interest rates at which SMEs are borrowing ... Whilst Government understands and respects the free market in the financial sector, it also feels the need to appeal to all banks ... to be more cognisant to individuals and businesses' concerns".[72]
>
> Hon. Edward Scicluna, Minister of Finance (4th November 2013)

> "Margins between bank lending rates and deposit rates are high relative to those in stronger euro area countries, suggesting that bank lending rates could be lowered".[73]
>
> Prof. Josef Bonnici, Governor, CBM (29th November 2013)

88. According to a report in The Times of Malta dated 5th December 2013, such announcements did not come as a surprise since the Governor of the CBM had been discussing the issue with the banks at length.[74] In addition, the report noted that according to the Governor "one or two banks had already tweaked their rates". In fact, the aggregate WAIR charged by Malta's core domestic banks had already started to decline (although marginally) in September 2013. However, as noted by the Governor, this reflected the actions of only one or two domestic banks. Others reacted only after the Budget Speech for 2014. Actual reductions in the banks' base rates for loans to SMEs were announced (for the first time since 2009) in relatively quick succession and within a time period spanning 8 months:
    - Bank of Valletta plc reduced its base rate on 15th November 2013;
    - HSBC Malta plc reduced its base rate on 1st January 2014; and
    - APS Bank Limited reduced its base rate on 1st July 2014.

[72] Minister for Finance Hon. Edward Scicluna, Budget Speech 2014, page 40.
[73] Speech by Professor Josef Bonnici 'Achieving Malta's Potential Growth in Challenging Times', IFS Annual Dinner (2013).
[74] See Newspaper Article in the Times of Malta published on 5th December 2013.

89. When one considers the high level of market concentration as well as the significant barriers to entry and expansion, the above discussed developments may suggest that banks could have lowered their lending rates earlier than they actually did.

5.3 Price competition

90. Although banks do compete on factors other than price, it is useful to discuss the pricing behaviour of banks in an attempt to gauge the degree of competition in the market for loans to SMEs. Like competition authorities in other countries that sought to analyse the extent of price competition in the banking sector, the Office notes that it is very difficult to compare the lending rates charged by the various domestic banks because these are often subject to negotiation depending on the risk associated with the prospective borrower and its available collateral. Nonetheless, this exercise seeks to draw lessons from theoretical and empirical literature as well as from observations from a number of interviews conducted with all five core domestic banks.

91. As argued by the UK Competition Commission:[75]

> "In a concentrated market structure, it is to be expected that there will be recognition, however independently, on part of the companies concerned that price competition is likely to be damaging to them. A price cut that generates little or no increased sales would not be profitable. One that increases sales, at the competitors' expense, is likely on that account to trigger price cuts by competitors, such that all would end up less profitable than they previously were. In such circumstances there would be a strong disincentive to price cutting."

92. Figure 6 shows that the WAIR on loans to SMEs does vary between Malta's core domestic banks. In particular, it is noted that the WAIR charged by the smaller core domestic banks is significantly higher than that charged by the larger banks. However, this may reflect several fundamental characteristics of the banks' loan portfolio. First, it could reflect differences in the banks' client portfolio related to credit risk. Thus, any such comparison on the basis of the information presented in

[75] Competition Commission, 'The Supply of Banking Services by Clearing Banks to SMEs' (2002).

Figure 7 may be misleading. Second, differences in lending rates can reflect differences in the cost of funding. To account for this, Figure 8 shows the spread between the lending rates to NFCs and deposit rates. Again, it shows that there are significant differences between the various banks. It is noted that the smaller market players generally had higher interest rate spreads.

93. On the pricing issue, the European Commission reports converging interest margins in the Maltese market for loans (which includes both home and business loans).[76] It argued that "converging interest margins could reflect broadly similar loan books across institutions ... however, it could be indicative of collusive behaviour." Although the interest rate spread on loans to NFCs presented in Figure 8 shows some degree of convergence in the years to 2013, notable divergence is noted in 2014. Thus, if interpreted as such, recent developments ease this concern.

94. However, these differences could reflect strategic choices by banks. Indeed, the UK Competition Commission argued that "persistent price differentials between competitors could generally be regarded as indicative of lack of competition particularly given competition constraints".[77] The stability in the market shares noted in Section 3.1 of this report may be indicative of such behaviour; facilitated by the reluctance of SMEs to "shop around" or switch banks even if presented with the possibility of a reduction in the interest rate. Supporting this claim are the preliminary results of a survey conducted by GRTU which showed that a number of SMEs do not seek out the best deal by shopping around when taking a loan because they believe – and experience has shown them – that there is "no choice in reality". Nonetheless, the survey also shows that a large number of respondents do not shop around because they prefer setting up a loan account with the bank with which they have existing accounts. A smaller number argued that they find it difficult to compare prices, conditions and services of the various banks.

95. Overall, it is difficult to make clear cut conclusions from the pricing analysis. The insights gained from this section should be judged in the context of other competitive factors, primary among which is profitability. Indeed, any evidence of returns in excess of the cost of

[76] European Commission, 'Macroeconomic Imbalances Malta' (2014) Occasional Paper 184.
[77] Competition Commission, *op. cit.*, page 25.

capital could itself be regarded as indicative of the lack of competition in the market.

5.4 Profitability

96. During the inquiry period, four out of five core domestic banks registered profits in all years. Only one bank – Banif Bank Malta plc – registered losses until 2011 since it only started operating in Malta in 2008.[78] From 2012 onwards, all core banks in Malta were profitable.

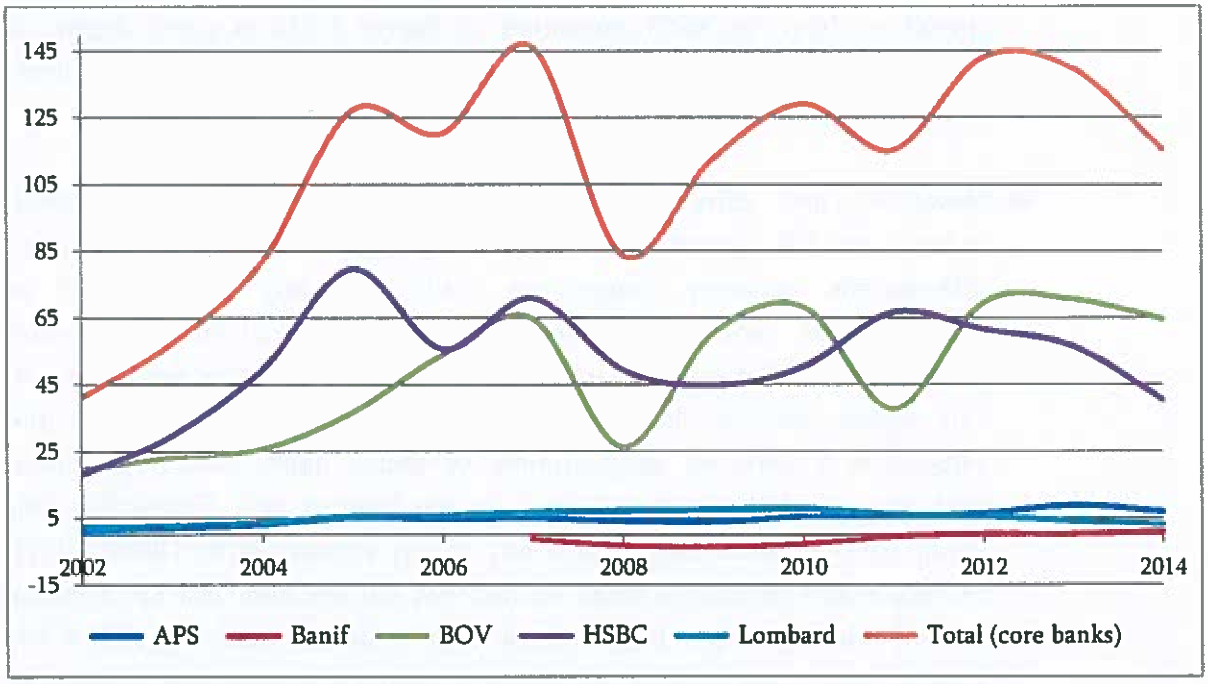

Figure 10: Profit (after tax) of Malta core banks (€ millions)
Source: Calculations based on Malta Core Banks' Audited Accounts (2002-2014)

97. On aggregate, the after-tax profits of Malta's core domestic banks have grown significantly over the years until the mid-2000s.[79] Subsequently, profits were generally pro-cyclical as evidenced by declines recorded in 2008 and 2011 when the growth rate of Maltese economy slowed down.[80] Another significant decline in profits was recorded in 2014, largely reflecting a heavy dip in profits of HSBC. A close inspection of HSBC's

[78] http://www.banif.com.mt/banif_bank_plc.
[79] There are no Banif figures for 2014 as there were no audited accounts for 2014 as at 26 May 2015.
[80] The Maltese economy contracted.

2014 audited accounts shows that this was largely the result of a much higher than usual net impairment loss (which was more than 5 times than that of the previous year). At the same time, the other core domestic banks experienced relatively lower declines in profits, resulting from a number of factors, including (i) higher costs related to additional regulatory and supervisory requirements; (ii) a decline in net interest income (partly reflecting lower lending rates on loans to SMEs); and (iii) net impairment losses.

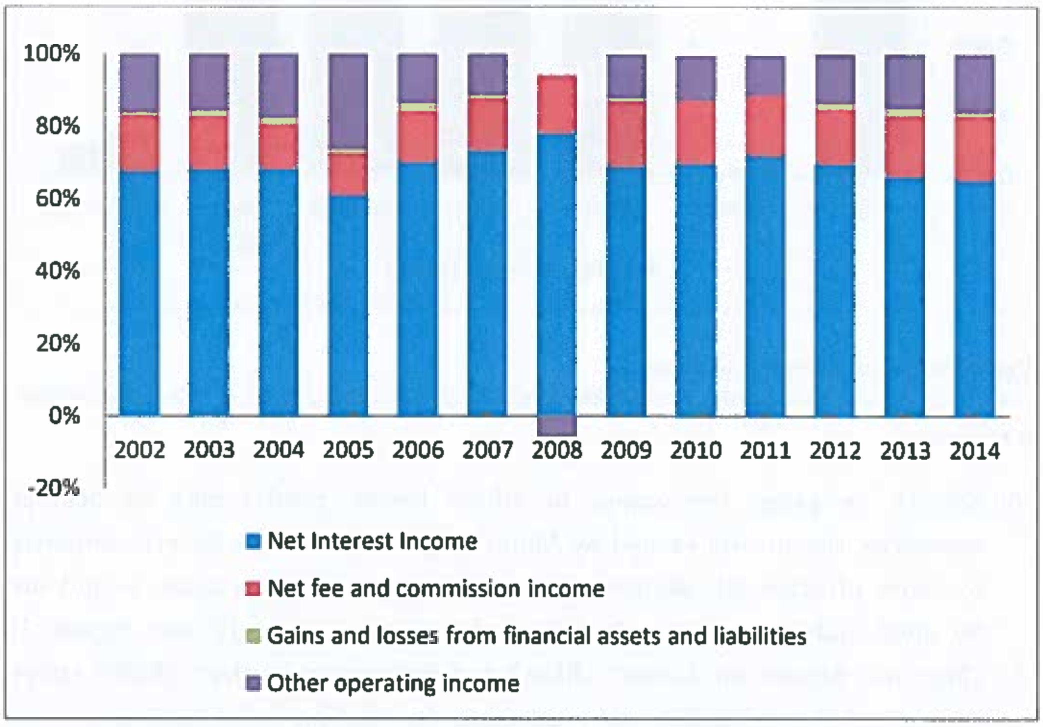

Figure 11: Income breakdown
Source: Calculations based on Malta Core Banks' Audited Accounts (2002-2014)

98. Although bank's profits are essentially a reflection of the banks' overall performance, for the purposes of this inquiry, the Office is primarily interested in the extent to which these profits reflect developments related to bank loans to NFCs. Figure 11 shows that in 2014 around 65% of banks' gross operating income is attributed to net interest income,[81] suggesting that core domestic banks rely heavily on income generated from interest received on loans. Almost one-half of this income is related

[81] Net Interest = Interest Receivable – Interest Payable.

to interest earned by banks on loans to NFCs, reflecting the reliance of core domestic banks on income from this market.

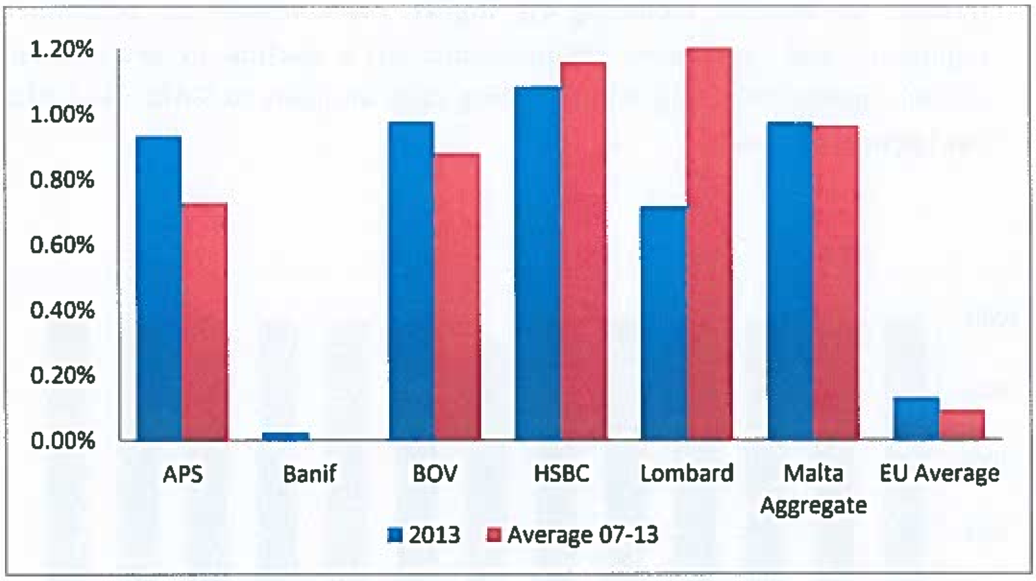

Figure 12: Return on Assets (after tax)
Source: Calculations based on Malta Core Banks' Audited Accounts (2007-2013) and ECB Statistical Data Warehouse

99. Finally, to gauge the extent to which banks' profits may be deemed excessive, the profits earned by Malta's core domestic banks are compared to those of other EU Member States. Since profit levels alone would not be good indicator of the banks' profitability, Figure 12 and Figure 13 show the Return on Assets[82] (ROA) and Return on Equity[83] (ROE) ratios; indicators of profitability for a company in relation to its total assets and equity respectively, such that they reflect the companies' returns in relation to their size.[84]

100. The figures show the average ROA and ROE for period between 2007 and 2013 as well as the two ratios for 2013. In 2013 the ROA for Malta's core domestic banks was essentially unchanged from the 2007-2013 average whilst the ROE was marginally lower. However, these remain significantly higher than those recorded by the average EU bank. Out of

[82] $\text{ROA} = \dfrac{\text{Net Income}}{\text{Average Total Assets}}$

[83] $\text{ROE} = \dfrac{\text{Net Income}}{\text{Shareholder Equity}}$

[84] ECB, 'Beyond ROE – How To Measure Bank Performance' (2010) page 8.

the five core domestic banks, four had a higher ROA and ROE than that of the EU average for all years in the period under analysis. The only bank that recorded lower ROA and ROE was Banif, which, as noted earlier, only started operating in Malta in 2008.

101. In interpreting these indicators, it is important to note that during recent years, banks across the EU have not been doing well, whereas the local core banks still managed to be profitable. It is an indication the Maltese banking sector is more stable than the EU.

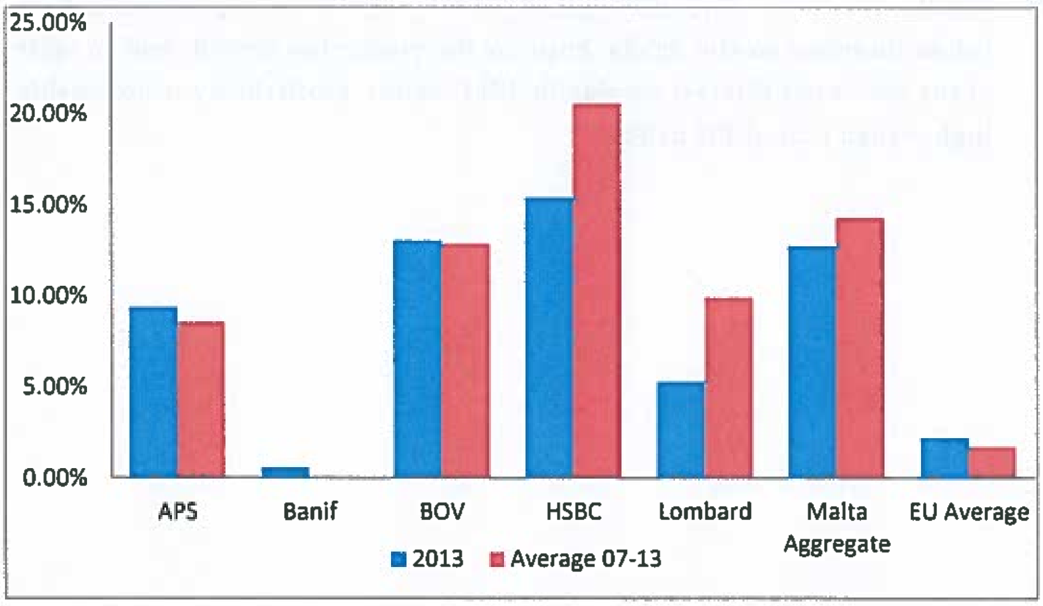

Figure 13: Return on Equity (after tax)
Source: Calculations based on Malta Core Banks' Audited Accounts (2007-2013) and ECB Statistical Data Warehouse

5.5 Concluding remarks

102. Overall, the analysis presented in this section shows that the interest rates charged by Malta's core domestic banks on loans to NFCs are amongst the highest in the EU. This reflects a relatively low pass-through of the ECB policy rate (which was one of the lowest in the euro area). A close look at the various factors that determine the banks' lending rates to SMEs shows that these differences emanate from differences in the cost of

funding and differences in credit risk, but may also reflect differences in the profit margin.

103. The interest rates charged by core domestic banks to NFCs decreased from an average of 6.5% in the first three quarters of 2008 to around 4.5% in 2014. Nonetheless, the interest rate spread increased marginally when compared to the pre-crisis period, suggesting that there may have been room for further reduction. In fact, in the latter months of 2013 and 2014, following pressure by several domestic and international institutions, the WAIR on loans to SMEs decreased.

104. Finally, it is noted that although additional regulatory requirements have led to increases in the banks' costs in the post-crisis period, and in spite of the lower net interest income in 2014, banks' profitability is noticeably higher than that of EU banks.

6. Price Transparency

105. Price transparency is a situation "where both the seller and the buyer know the price and no intermediary is involved."[85]

106. Price transparency is a constant plight. It is a known fact that price transparency has more than one facet. This is because price transparency features differently in different contexts, in some instances resulting in collateral damage, in other instances resulting in a beneficial change by facilitating the remedy for market failure.

107. Whereas price transparency could lead to a healthy competitive market, it could also result in anticompetitive behaviour if market conditions so permit. The binary effects of price transparency can be explained by considering both the demand and the supply sides of competition. From a demand side perspective, price transparency is desirable since it is through the knowledge of prices charged on the relevant market that consumers would be able to assess which service provider suits them best.

108. However, from a supply side perspective, price transparency could amount to anticompetitive price-signalling by undertakings. Therefore, it is to be borne in mind that there is both a negative and a positive form of price transparency. This dilemma raises numerous questions when analysing interest rates charged by Malta's core banks.

6.1 Negative price transparency and price signalling

109. The negative form of price transparency brings about collusion between firms, which can result in higher prices for the customer and a reduction of output. Consequently, in SME loan financing it may raise prices or restrict access to finance.

[85] http://www.businessdictionary.com/definition/price-transparency.html.

110. Anti-competitive price signalling refers to a corporation conveying to its rivals its future price intentions.[86] By so doing, the corporation eliminates uncertainty about the price of its goods or services, thereby reducing the risks of competition and impeding the functioning of a competitive market.[87] The Office discusses aspects of information exchange and price signalling between competitors and instances where information exchange with a competitor is considered to be anti-competitive.

111. According to the *Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements* (henceforth, 'Commission Guidelines'), information is exchanged in different contexts.

112. Firstly, data can be shared directly between competitors. Secondly, data can be shared indirectly through a common agency (for example, a trade association) or a third party such as a market research organisation or through the companies' suppliers or retailers.

113. Information exchange is a common feature of many competitive markets and may generate various types of efficiency gains. Furthermore, it may directly benefit consumers by reducing their search costs and improving choice, or by improving internal efficiency through benchmarking competitors' best practices. However, the exchange of market information may also lead to restrictions of competition, in particular where it is liable to enable undertakings to be aware of market strategies of their competitors.[88] Information exchange can only be addressed under Article 101 TFEU (and Article 5 of the Act) if it amounts to a concerted practice.[89]

114. According to the Commission Guidelines, "Information exchange can constitute a concerted practice if it reduces strategic uncertainty[90] in the market thereby facilitating collusion, that is to say, if the data exchanged is strategic. Consequently, sharing of strategic data between competitors

[86] Economics References Committee, 'Competition within the Australian Banking Sector *Chapter 8 Price Signalling*' (2011) page 145. (henceforth 'Economics References Committee Paper')
[87] Ibid.
[88] Commission Guidelines, paragraph 58.
See Case C-7/95 P *John Deere Ltd v Commission of the European Communities* [1998] ECR I - 03111.
[89] Commission Guidelines, paragraph 60.
[90] Strategic uncertainty in the market arises since there is a variety of possible collusive outcomes available and because companies cannot perfectly observe past and current actions of their competitors and entrants.

amounts to concertation, because it reduces the independence of competitors' conduct on the market and diminishes their incentives to compete".

115. A concerted practice can be defined as a form of coordination which falls short of an agreement.[91] The principles on the competitive assessment of information exchange are laid down in detail in the Commission Guidelines. According to this, in assessing whether an exchange of information can be anticompetitive, one must analyse whether the information exchange reduces strategic uncertainty around future commercial policy.

116. One must assess what type of information exchange would be considered anti-competitive under EU competition law, particularly in light of recent developments on price signalling, where undertakings have to be aware of the concerns regarding public announcements of future prices and output. Conveying future price intentions would be considered anticompetitive under EU law and jurisprudence. In recent years, price signalling has been addressed by competition authorities investigating public announcements as a form of information exchange. For instance, reference is made to an investigation by the ACM on the telecoms sector which has concluded that public statements on future market behaviour could carry antitrust risks leading to coordinated behaviour in the market. In a press release issued on the authority's website it was stated that,

> "...ACM did establish that public statements about future market behaviour could carry antitrust risks. These are statements made in public (for example, at conferences or in trade journals) by mobile providers about planned price increases or reductions in commercial conditions for consumers, which have not been based on a final decision. If competitors took note and followed such publicly-made statements, it could lead to collusive behaviour, which is harmful to consumers."[92]

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[91] As further corroborated by Dr Beaton-Wells and Mr Fisse when they state that *"... the concept of 'concerted practice' covers the situation where one party is active in disclosing information and another is passive in receiving or accepting it"* (Economics References Committee paper, page 161).

[92] https://www.acm.nl/en/publications/publication/12311/Investigation-into-mobile-operators-concluded/.

117. The UK Competition Commission[93] (henceforth CC) concurred with this reasoning. The CC found that certain large UK cement producers were using generic price announcement letters to their customers in order to facilitate coordinating their behaviour on the market. The CC claimed that"... these publications contributed to coordination in the UK cement market and assisted the cement producers to determine their own shares of sales of UK cement production. This allowed them to assess their position on the market.[94]

118. The boundary between implicit or tacit and explicit coordination is of course not always clear. The more transparent a market is, the better the conditions for monitoring the market outcome. This makes it easier for undertakings to coordinate their behaviour on the market. In Malta, market players in the market for bank loans to SMEs, are stable and few in number, and a large portion of the customer base tends to be of a more permanent nature because they remain customers of the same bank. This means that the SME loan market is a market where coordination between stakeholders could work well.

119. Indeed, it is more probable that price signalling occurs in a highly concentrated market, such as the banking sector in Malta. Therefore, market conditions influence the degree of price transparency. Since Malta has a highly concentrated banking market, an oligopolistic situation could arise whereby banks would follow each other's behaviour on the market. As remarked by Professor Frank Zumbo, "the underlying problem is the greater concentration of the market that we have seen, the increasing concentration we have seen. Where you have a highly concentrated market you do have a problem with price-signalling, but the price signalling is a reflection of the highly concentrated market"[95]. He continued that in an oligopoly, price signalling becomes harmful since a competitor tells another that if he behaves in a particular way on the said market, the former will also behave in that same manner. Conscious parallelism should be curbed when there is any proof of deliberate conduct, having as its purpose the coordination of competitors in decision-making.

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[93] The Competition Commission closed on 1st April 2014. Its functions have transferred to the Competition and Markets Authority (CMA).

[94]Scott Megregian *et al*, 'European Authorities Crack Down on Price Signalling,' (2014).

[95] Economics References Committee paper, page 151, quoting *Associate Professor Frank Zumbo, Committee Hansard, 14 December 2010, page 59.*

120. According to the Commission Guidelines "Where a company makes a unilateral announcement that is also genuinely public, for example through a newspaper, this generally does not constitute a concerted practice within the meaning of Article 101(1). However, depending on the facts underlying the case at hand, the possibility of finding a concerted practice cannot be excluded, for example in a situation where such an announcement was followed by public announcements by other competitors, not least because strategic responses of competitors to each other's public announcements (which, to take one instance, might involve readjustments of their own earlier announcements to announcements made by competitors) could prove to be a strategy for reaching a common understanding about the terms of coordination."[96]

121. Generally, genuine public announcements are not considered a concerted practice, but there are exceptions to this rule. The first exception is when these public announcements include an invitation to collude and the second exception occurs when public announcements by one firm are followed by subsequent public announcements by other competitors.[97]

122. The type of information that needs to be exchanged to amount to a concerted practice is that between competitors of individualised data on intended future prices or quantities that should therefore be considered a restriction of competition by object.[98] However undertakings that publicly announce prices and are committed to sell in the future at those same announced prices (not revising these prices) are in fact simply announcing prices and not price intentions. Hence those price announcements would not normally be found to restrict competition. The type of information that can trigger an allegation of concerted practice is most likely to relate to future price or output intentions.[99]

123. One particular instance where the Office deemed that a public statement could have raised competition concerns occurred in 2011.[100] In that case a bank's spokesman stated in a local newspaper that no imminent changes

[96] Commission Guidelines, paragraph 63.
[97] Ibid.
[98] Commission Guidelines, paragraph 74.
[99] See Article by Shearman and Sterling, 'Beware of Public Announcements! Recent European Competition Developments of Price Signalling' (2014) http://www.shearman.com/~/media/Files/NewsInsights/Publications/2014/03/Price-Signalling-Briefing-Antitrust-032414.pdf. See also Commission Guidelines, paragraph 99.
[100] The Office does not exclude the possibility that similar statements by banks could have been made in the past.

to rates were prospected except those relating to fixed rate loans where funding costs have risen. The Office considers that although one may think that this kind of information is unlikely to raise significant competition concerns, it might obviously facilitate other banks' actions. Therefore the Office considers that such statements should be avoided.

6.2 Positive transparency: its effects explained

124. Positive transparency of prices facilitates the process of choosing banks, where the bank with the most competitive interest rate will be preferred. Consequently, the increase in populace of informed customers increases switching between banks, and clears the market by channelling business to banks having the most competitive interest rates and to those having the best conditions of lending. It also increases the chances for the small banks to attract SMEs to take up a loan with them. This eventually leads to the desired result of increased competition without disrupting or radically changing the market structure.

125. In this section, the Office discusses the net effect of price transparency on the consumer side, assuming that the SME loan market is a differentiated duopoly. The Hotelling model and the Nash Static Equilibrium model are perfect in this regard. When analysing the two models concurrently, one easily concludes that, in a static equilibrium, increased transparency unambiguously increases competition (between banks), lowers prices (interest rates) and profits while consumers' surplus increases. Increasing transparency on the consumer side increases the incentive for banks to undercut each other. This therefore implies that increasing transparency makes collusion more difficult and is pro-competitive. Price transparency has to be equal on both the consumer and producer sides to effectively deter collusion. A general rise in transparency facilitates a reduction in price, if and only if, the level of transparency on the producer's side is such a level to be commensurate with the level on the consumer side, otherwise the settled price between the producers' firm (bank) will remain high.

126. The Office considers that greater price transparency is important to assist consumers (in this case SMEs) in making informed choices. As outlined in the previous chapter, the survey conducted by GRTU indicated that certain SMEs did not try to compare deals between banks since they

found it difficult to compare prices, conditions and services of the various banks. Informed customers are the ultimate goal of price transparency. Interestingly the less price transparency is possible, the less the switching. SMEs should be equipped with the necessary information to be able to switch to the best bank which meets their financial requirements. Ultimately, basic knowledge is the key which facilitates the process of making conscious investment decisions.

127. According to a research exercise conducted by Deutsche Bank titled 'Pricing in Retail Banking,[101]' "greater transparency is intended to promote consumer protection and boost market efficiency, as transparency is one of the prerequisites for functioning (price) competition"[102]. The research pinpointed three main reasons why price transparency could be beneficial; namely accessibility, comprehensibility and comparability of price information. Although the imposition of a flat fee by a bank is easy to decipher, in practice it is difficult to conceive of its transparency. SMEs would require further price information so that they would be able to suit one's personal requirements.[103] Deutsche Bank concludes this study by stating that "strengthening financial education is an important element here and helps to create effective and sustainable comparability. At the same time, it can also strengthen personal willingness to compare offers because existing skills reduce information costs."[104]

128. The OECD noted that "consumers may face particularly high transactions costs in certain markets. Transactions costs may be especially high as regards professional services where it is inherently difficult for consumers to determine what they need and to estimate the quality of proffered products. Various regulations have been enacted in most countries to improve the functioning of such markets."[105]

129. The OECD claims that some price transparency is essential for competition to exist - otherwise it would be futile to compete on price, unless consumers are able to compare prices. This notwithstanding, the Report also continues to state that with certain specific market

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[101] https://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000304766/Pricing+in+retail+banking%3A+Scope+for+boosting+cust.PDF

[102] Ibid, page 14.

[103] Ibid, page 15.

[104] Ibid.

[105] OECD Report 'Price Transparency' (2001).

conditions, conscious parallelism and anticompetitive coordination could result in increased price transparency. Specifically, "in a sufficiently concentrated market, the process could start by one seller simply raising its price and watching to see if others follow". Collusion would result since cooperating firms would sanction those deviating firms.[106]

130. In the first Scenario one has to explain in precise terms the tension which can exist between, on the one hand, price transparency as exercised by the firms, and on the other hand, that exercised by customers. It is clear that price transparency aids firms to determine the best price to be set to maximize their profit. On the other hand, the customers are concerned with having a price which is set at a reasonable level. Therefore the common concern of both firms and customers is precisely to establish the best price for sale and purchase. Pricing is a common concern for both the end users and the producers. However, the interests and motives behind the setting of the price are different, and, sometimes, conflicting. Moreover, firms are at a consistent advantage since they know all the data on which a price can be set and they know, through the knowledge of the market as a whole, the most probable price that their rivals are apt to set. The consumers, on the other hand, are imperfectly informed and they get to know more or less the average market price, after having negotiated with the prospective provider, the rates at which a loan can be issued after partially exposing their weaknesses, on which the provider is to calculate the element of risk. So, the market is typically a market based on a tension, related to information asymmetry.

131. In the second Scenario, one has to define the nature of the market. So far, we are considering a market which is an asymmetric duopoly, with the leader having certain advantages. It is a local bank, that pioneered the market for SME loan financing, and that benefitted from EU financing projects, substantial capital at reduced rates of lending interest, capital that was then put on loan to a robust SME client base, gaining a significant advantage over competitors. One may say, albeit with prudence, that strictly speaking, SME financing is a heterogeneous market, in that it is a tailor-made product which, in actual fact varies from one client to another. Simplistically, one can say that we are dealing with a market which is an asymmetrical duopoly offering a heterogeneous product.

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[106] Ibid, page 9.

132. The Office carried out a comparison between Maltese banks and International banks' websites to assess the degree of information which is available to an SME when it decides to take a loan with the bank. The Office considers that whereas Maltese Banks' websites (refer to Appendices 1A - 1E) provide little, if any, information which could help businesses to make an informed choice, international bank websites (refer to Appendices 2A – 2D) provide more information. In particular, in relation to business loans not exceeding a certain threshold, the information provided includes a business loan calculator, frequently asked questions, loan term, loan size and whether interest rate and repayments are fixed.

133. It can be argued that quotations, provided free of charge, increase price transparency as consumers (in this case SMEs) would be in a better position to shop around and acquire the best deal possible.

134. One of the Maltese banks stated that it provides verbal quotations of all terms and conditions, including interest rates and fees associated with prospective business facilities and no fee is charged for this service. Another bank stated that it does provide quotations on SME loans at the customers' request and at no added charge. However this bank emphasised that SME loans entail lengthier and more in-depth negotiations and discussions with SMEs, compared to personal customers requesting quotations for home loans and/or personal loans. The final interest rate offer is only arrived at after the Bank evaluates the SME proposal/business, such as its market share and business reputation.

135. The Office considers that the information provided on BOV 4 SME Financing Product was helpful to SMEs as it indicated that the fixed interest rate of 4% is applicable for the initial four years of the loan. BOV Start Plus[107] also contained certain information in relation to the security, maximum loan term, repayments and charges.[108] The above mentioned information helps SMEs make an informed choice.

[107] https://www.bov.com/content/bov-start-plus-financing-package

[108] https://www.bov.com/content/bov-start-plus-financing-package and https://www.bov.com/documents/bov-start-plus-info

6.3 Concluding remarks

136. Price transparency is desirable in a situation where competitors are much more sophisticated than consumers so as to allow the latter to acquire the necessary information useful for financial planning. Banks are much more sophisticated than SMEs and may therefore be able to understand what their competitors are charging even with "low" levels of price transparency. On the other hand, the often unsophisticated SMEs may not be able to compare the prices charged by different banks. In such cases, more price transparency may be desirable because it mainly benefits consumers.

137. Consumers would in this way, acquire a fair share of the information available and make an informed decision regarding which bank to choose when taking a loan. Even though banks could also abuse of this system of price transparency since they could signal to each other their future price intentions and act accordingly, price transparency is desirable when analysing the Maltese market for loans to SMEs.

7. Customer Mobility

138. Customer mobility may be limited by switching costs which can be either direct or indirect costs, incurred by the customer when switching supplier. No market can function well without active customers. It is therefore important that customers have sufficient information on the characteristics of products and prices and that they do not have to face large transition costs when switching suppliers. If consumers are limited or prevented from making free and rational choices, competition and market efficiency will deteriorate. Therefore, easy access to information and supplier switching would successfully improve competition.

139. The possibility for undertakings to expand in a market can be further restricted by various types of lock-in effects, such as early repayment charges on loans, processing fees relating to the sanction letter and the long term relationship with banks. It follows that SMEs will find it difficult to switch service or at least, they would be reluctant to do so. Lock-in effects and low customer mobility grant market power to the players in the market for loans to SMEs. It is a factor that leads to lower customer mobility and inertia in the market. The Office analysed whether there were any of the above-mentioned lock-in effects on those SMEs that tried to either switch from one loan provider to another or to take up a new loan.

140. When conducting the sector inquiry, the GRTU Survey was consulted to help the Office understand the extent to which SMEs decide to switch banks. The following are various lock-in effects and costs which could hinder customer mobility in the sector for loans to SMEs.

- **Long term personalised relationship between the bank and the customer**

141. Banks focus on building a long term relationship with their customers. This can be valuable to consumers as it provides opportunities for the development of efficient processes and services. However, it may be problematic from a competition point of view because relationship building can reduce customer mobility in the market. This was also

corroborated by a particular bank when it answered that "customers used to banking facilities with a particular bank might be reluctant to start a relationship afresh with another bank..." This would negatively impact a new bank which has just started out on the market or smaller banks.

142. Consumers in the banking market are usually very loyal and less likely to switch service than in many other markets. A particular bank pointed out that "some customers prefer not to switch out of bank loyalty, the strength of the relationship or because of other services offered by the relevant bank". Although another bank would offer new and innovative services, the client would not opt for such a bank due to bank loyalty and long term relationship. A bank held that there is a strong tendency not to change banks. One bank for instance emphasised that it is particularly difficult to switch banks in Gozo.

143. The complexity of the services provided by banks means that it is in both the bank's as well as the customer's interests to create and maintain long-term business relationships with each other. Through the long-standing business relationships, banks can build up knowledge about their customers, and this can make it easier for the consumer in question to obtain a loan. Long-term relationships between banks and consumers can lead to lock-in effects and reduce customer mobility. Indeed, this was evidenced from the survey that indicated that a percentage of SMEs do not try to compare deals between banks, either because they are satisfied with their bank or because they would prefer to set up a loan account with a bank with whom they have existing accounts.

- **Switching costs**

144. All core banks mentioned specific costs which customers must pay to switch from one bank to another. This could be another factor why SMEs may be reluctant to switch from one bank to another. The banks' replies indicated that switching costs are not regarded as entry barriers. Banks held that switching from an existing loan to another is generally easy and there are no restrictions for an SME to switch a loan from one bank to another bank, in spite of some minor costs.

145. On the contrary, the survey carried out by GRTU demonstrated that a number of SMEs believe that bank fees would make switching to another

bank difficult, and a number of SMEs would consider that other legal and account expenses as well as different guarantee requirements also make switching to another bank difficult.

- **Early repayment fee**

146. Most banks do not charge early repayment fees on loans with a variable interest rate. One bank may charge (at its sole discretion) an early repayment fee on business loans of 3% on the outstanding debit balance of an SME loan facility, if repaid ahead of schedule. The bank retains the discretion not to collect the fee if it deems it justified. Another bank retains the option to levy an early repayment fee, but such fee has never been levied in practice. Another bank held that generally no early repayment fees are levied with the exception of a particular business loan account whereby a fee is charged if loan is closed within 12 months from opening date.

- **Processing fees in relation to sanction letter**

147. Normally banks charge a processing fee when issuing a sanction letter. Such fees may consequently limit the SME's incentive to compare deals offered by various banks since the SME would incur additional expenses.

- **Other charges**

148. One bank claimed that switching costs associated with transferring or obtaining new business facilities from other banks primarily consist of legal fees, notary fees and hypothec-related fees.

149. One bank retained that where hypothecs exist and the customer is transferring his or her credit facilities to another institution, a charge is applicable for the cancellation of hypothecs and the waiver of hypothec charges in favour of third party. In addition, if the loan is secured via tangible property, the SME incurs costs such as processing or legal fees charged by the new provider, as part of the switching process. Another

bank referred to the receiving bank's fees. To this, one should add those fees that may be charged by advisors, such as accountants and lawyers.

150. In cases of switching, one bank declared that it requests payments for the balance of the outstanding loan and payment for the accrued (due) debit interest up to the cancellation date of the Bank's hypothecary charges. Additional minor costs may be incurred in certain circumstances, e.g. a one-time cancellation (legal) fee.

- **Transferring of accounts when switching bank**

151. Some banks require new or existing customers who hold any accounts with other banks to transfer these accounts with the new bank. Similarly, the bank which financed the SME would sometimes require the loanee to keep any existing accounts with that same bank.

- **Comparison of prices, conditions and services of the various banks**

152. The survey indicated that those SMEs which did not try to compare deals between banks found it difficult to compare prices, conditions and services of the various banks. Certain banks stated that all non-interest fees and charges relating to SME loans are not available on their websites but are available on the MFSA's website – "My Money Box".[109]

7.1 Concluding remarks

153. The prerequisites for effective competition are the consumer's willingness and ability to change service. The ability of consumers to opt out of a service and to have access to better options is the clearest manifestation of consumer power in competition law. A number of SMEs interviewed would consider going to multiple banks, when taking up a loan, to see the best deals offered. The GRTU Survey revealed that those SMEs which did consider other banks when taking up a loan, answered that in reality they felt that there was no choice available.

[109] http://mymoneybox.mfsa.com.mt/

8. Conclusions and Recommendations

154. The inquiry assesses competition in the market for bank loans to SMEs in the light of allegations of excessively high interest rates made by both domestic and international institutions. The report makes a number of observations about the characteristics of the market and the behaviour of all market players on the basis of which a number of conclusions are drawn:

i. More than 99% of Maltese enterprises are SMEs and the majority of these are micro enterprises that employ less than 10 workers. Since these businesses do not typically have access to capital markets, they rely heavily on bank loans to finance their investments.

ii. In spite of declines in concentration in the market for bank loans to SMEs, the market remains highly concentrated both when compared to other industries and when compared to other EU banking sectors. Indeed, at the end of 2013, the two largest banks still accounted for [75 – 100%] of the market for bank loans to SMEs.

iii. The concern about the high level of market concentration is even more important given the high barriers to entry and expansion. Amongst the more significant barriers are regulatory barriers (such as capital requirements), reputation and the need for adequate infrastructure. Other barriers to entry identified by banks include the difficulty in obtaining relevant data from SMEs and EU funded support to facilitate SME financing. When considered together with the high level of concentration, this points to market characteristics that are typically associated with low levels of competition.

iv. The analysis also suggests that new entrants and smaller banks have either found it difficult, or have been unwilling (for strategic purposes), to penetrate the market and expand their market shares. In fact, the three smallest core domestic banks each had a very small market share.

v. The above mentioned concerns are particularly important when considering that the profitability of Malta's core domestic banks, and the average interest rate on loans they charge to NFCs, are amongst the highest in the EU. Although there are several factors that may explain this divergence, and there has been a reduction in lending rates of around 2 percentage points between 2008 and 2013, the Office notes that there may have been room for further reduction. In particular, it is noted that the spread between the lending rates to SMEs and the deposit rates only started to decline following pressure by domestic and international institutions, suggesting that banks could have lowered their lending rates earlier than they actually did.

vi. Interest earned by Malta's core domestic banks accounts for a significant proportion of banks' gross operating income. In spite of the observed decline in the spread in 2014, the profitability of banks remains healthy and significantly higher than that of other EU banks.

vii. Maltese banks' websites provide little information to help SMEs make informed choices when compared to that made available by international banks. This lack of information and price transparency is detrimental to the consumer. At the same time, the Office noted that there may have been instances where banks have made public statements signalling future commercial strategic plans which may be anti-competitive.

viii. Although there are certain lock-in effects which are beneficial to the consumer, such as long-term personalised relationships between banks and SMEs, the same and other lock-in effects and costs could hinder consumer mobility. These lock-in effects include early repayment fees (charged by some banks) as well as the pressure exerted by some banks for SMEs to transfer their business current accounts with the same bank from which they want to take a loan.

155. On the basis of these conclusions, the Office makes a set of recommendations that aim to enhance competition in the market for bank loans to SMEs. Since the traditional banking model adopted by Malta's core domestic banks has worked well in terms of ensuring stability in the domestic financial sector, the Office considers it preferable to address the above identified concerns by proposing behavioural remedies. It considers that these recommendations can be put into practice without any adverse effects on financial stability.

156. The Office's recommendations seek to address issues primarily related to price transparency, barriers to expansion and consumer mobility such

that the market for SME bank loans is conducive to competitive interest rates.

Recommendation 1: Banks should provide free-of-charge quotations on loans to SMEs

157. It is desirable that SMEs consult multiple banks when considering a business loan, such that they obtain information about the amount of the loan, interest rates and all related charges, and the general terms and conditions of the loan.

158. It was observed that banks levy charges on the issue of sanction letters, which outlined the final fees and rates, as well as the actual terms of the loan. These charges are considerable, and could act as a deterrent for SMEs in obtaining multiple quotations.

159. The Office recommends that SMEs have access to this information prior to incurring costs when issuing a sanction letter. Banks would issue free-of-charge quotations which include the amount of the loan, interest rates and all applicable fees, including the general terms of service. When issuing such quotations, banks could indicate those parts of the document where the conditions could vary, such as changes to the financial status of the customer. However, in the absence of such changes, variation between the quoted price and the actual price should be limited to a narrow degree, so as to provide the SME with the opportunity to make a proper informed choice without incurring any cost.

Recommendation 2: Banks should provide further information on business loans for SMEs

- **Setting up an SME loan calculator for loans which do not exceed a certain threshold.**

160. Banks should provide an SME loan calculator on their websites for loans which do not exceed a certain threshold. For examples of an SME loan calculator, kindly refer to Appendices 2C and 2D. As indicated on international banks' websites, the calculator would be provided for

indicative purposes only and the results would not represent either a quote or a prequalification for a loan.

161. The loan calculator would not create any contractual obligation between the bank and the SME, either in terms of granting the loan or on the interest and repayment figures. The SME loan calculator would ideally calculate the monthly instalments, total interest payable and total payment required.

- **Example of a typical SME loan and costs involved**

162. With regard to loans which exceed a certain threshold, the banks' websites should provide numerical examples of the costs involved in a typical SME loan and all the applicable charges. This is already done by certain banks for home loans. The Office recommends that such examples would include information relating to interest rate, collateral, maximum loan term, repayments and all applicable charges in order to assist SMEs to compare costs related to such loans.

- **Frequently asked questions**

163. The Office believes that banks should make available the answers to a set of questions which are commonly asked by SMEs when interested in taking up a loan. The following are some examples:

- What do I need to apply for a business loan?
- How do I repay?
- Can I get an indicative quotation for a Business Loan?
- Is the loan secured?
- Can I repay my Business Loan early?
- Are there any early repayment fees?
- Is the interest rate fixed for the period of the Business Loan?
- What personal information do you need?
- Can my business apply for a loan if it has no assets?
- Does my business need a bank account?
- Do I need to give a reason why the business wants to borrow the money on the application?
- What if the business or I have bad credit?
- If the business is already in debt, can I still apply?

Recommendation 3: Banks should also provide information regarding business loans in the Maltese language

164. Information on the Banks' websites on business loans should also be made available in Maltese, so that SMEs would better understand the information provided therein.

Recommendation 4: Banks should list of all charges which the SME will incur

165. Information on charges should not only be available on the 'My Moneybox' website, but also on the banks' respective websites. A list of charges should be easily accessible and regularly updated. SMEs should be in a position to easily understand and quantify all the specific charges that they will incur.

Recommendation 5: Banks should avoid public announcements about future price intentions

166. When issuing public statements, banks should not disclose more information than is strictly necessary, especially with regard to future pricing or commercial strategic plans.

Recommendation 6: Financing Packages supported by government or the EU should if possible be awarded to more than one market player

167. Taking into account the importance of access to finance to SMEs, it is important that financing schemes supported by government or the EU be available to more than one bank. Competition on such schemes would increase the availability of choice to customers (SMEs) when obtaining a business loan.

Recommendation 7: SMEs should take the initiative to shop around

168. The Office considers that by reducing consumer inertia, competition and entry into the market for loans to SMEs would consequently increase. The difficulty encountered by SMEs when comparing prices, conditions and

services of the various banks would more likely cause consumer inertia. SMEs perception that banks would offer similar prices together with the various costs charged and lock-in effects increase consumer inertia. The Office believes that consumer inertia may be reduced by applying the recommendations proposed in the Report. As a consequence SMEs themselves should take the initiative and shop around more.

Recommendation 8: Government should facilitate access to credit information by setting up a Central Credit Register

169. As outlined in the inquiry, banks demonstrate a certain degree of reluctance when it comes to SME lending, due to the potentially high risk profile of SMEs and the limited information that hampers access to reliable data. As a result, the difficulty for banks to assess the creditworthiness of SMEs has been identified as a barrier to entry.

170. In the context of this inquiry, the creation of a Central Credit Register strikes the right balance between the key players: banks and SMEs alike. On one hand a credit register would allow banks to be able to reach an informed decision regarding actual and potential SME borrowers while enhancing the banks' loan portfolios, thereby leading to a lower cost of capital. On the other hand, it would also grant SMEs wider access to credit opportunities since banks would be in a better position to assess the borrowers' creditworthiness, irrespective as to whether the concerned SME is a client of the bank or not. In light of this, a Central Credit Register would facilitate split banking. To this end, the creation of a Central Credit Register would drive competition between banks, foster transparency, and aid access to SME loan financing where banks would be operating on a level playing field.

171. In view of this, the Office supports the initiative of the CBM concerning the creation of a Central Credit Register. This initiative will potentially diminish the lacuna that exists in the Maltese banking system with regard to access to credit data between borrowers and lenders. Primarily, a Central Credit Register administered under the auspices of an independent and impartial entity would record and aggregate the relevant data of the borrowers' indebtedness as reported by different credit

institutions. As suggested by the Governor of the CBM,[110] this will enable credit institutions to access information about their clients and to divulge data requested by other credit institutions with regard to client exposure, risk profiling and loan status, amongst others.

172. In this regard, it is appropriate to take into account the provisions of the EU Data Protection Directive and the Maltese Data Protection Act, having regard to the fact that, in the course of the exercise, financial personal data might be made available (for example in cases where an SME obtaining the business loan or guaranteeing the facilities is an individual).

[110] Speech by Professor Josef Bonnici, 'Enhancing Competitiveness,' IFS Annual Dinner (2014).

Appendix 1

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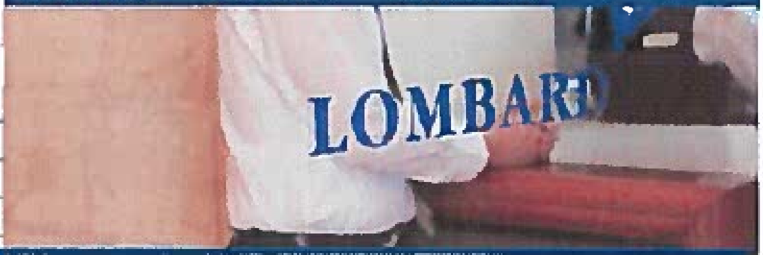

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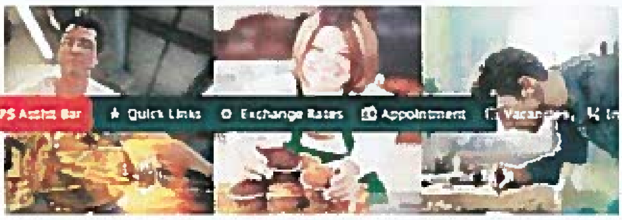

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Business Bridge Loan - Offers short term financing to help bridge any immediate financing gaps you may have.

Capital Expenditure Loan - Gives you the possibility to invest in those assets that will help your business run smoothly, such as purchase of vehicles, showroom or office equipment and IT systems.

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Organization-Based Scheme

As a successful business customer at APS, you and your employees are entitled to various benefits through our Organization Based Scheme. As an employer, you will be rewarded with lower payroll costs through an efficient, streamlined payroll system that makes use of our proven automated direct credit system.

Your employees will also benefit straightaway. For as long as they are in employment with your company, they are all entitled to a good number of banking benefits that they will enjoy. This is a great way of contributing to the well being of your employees by helping them save time and money.

Ecoplus Commercial

APS Bank supports businesses that save energy by using renewable resources. Whether you intend to purchase or sell photovoltaic or wind energy sources or ecologically responsible vehicles, our finances can provide the funds you need, whenever you need them.

Green loans for environmentally friendly products are intended for:

- Businesses wanting to make use of renewable energies
- Suppliers of renewable energy products and services

Investment Services

APS Bank also provides your business with additional tools by offering an extensive selection of investment services.

Foreign Exchange - At APS Bank, we offer you competitive foreign exchange rates for the most frequently traded currencies as well as the purchase and sale of banknotes.

Insurance

- Key Man Insurance - Offers cover against the eventuality that key persons within the business aren't present for a prolonged period of time and the resultant need to recruit and train suitable replacements.
- Group Life Policies - A great way of showing your employees that they matter. This policy offers cover to all your employees and can even be extended to their families.

Portfolio Management - Our team can create a uniquely structured portfolio that matches your company's risk profile and exigencies based on your specific business objectives.

Liquidity Portfolio Management - This discretionary portfolio makes sure that your funds are working for you until you need them, and when you actually do require them, they are readily available.

DOWNLOAD BROCHURE

REQUEST MORE INFO

Appendix 2

Business loans up to £25,000

Flexible business loans

If you need cash for working capital, refurbishment, property development, new machinery or equipment – between £1,000 and £25,000 – it's worth talking to us [2,3].

If you're looking for a larger loan, see Business loans over £25,000

Key features & benefits

- A quick, straightforward way to get extra business finance
- Match your loan requirements to your business plans
- No early repayment fee – so you can pay back your loan at any time without penalty
- 6 months repayment holiday available at the beginning of the loan (interest will continue to accrue and will be payable in future repayments)
- Fixed interest rates so you know exactly where you stand
- Select a monthly repayment term from 1 to 10 years, providing that the loan term doesn't exceed the life of the asset
- Choose the repayment option that matches your cash flow needs – from lower monthly repayments over a longer term to higher monthly repayments over a shorter term
- Business loans available for any amount from £1,000 to £25,000

Our lending process

Other business financing options

- If you have a short term cashflow problem, a Business overdraft can provide instant cash when you need it
- Business credit cards are the flexible way to control your expenditure

Existing Barclays customer?

To find out more, or to apply, call one of our lending specialists on 0333 202 7445 [4]

New to Barclays?

To discuss your options for business banking call us on 0800 015 462 [1]

Looking to move your business banking to Barclays?

Call us today and find out how to switch bank accounts

0800 015 462 [1]

If you're an existing Barclays customer call now to speak directly to our lending specialists

0333 202 7445 [4]

Important information

1. Lines are open Monday to Friday 8am–8pm and Saturday 9am–1pm. To maintain a quality service, we may monitor and record phone calls. Read our call charges and information

2. Business loans are subject to application and status.

3. The Lending Code. Barclays Bank PLC subscribes to the Lending Code which is monitored and enforced by the Lending Standards Board. The Lending Code sets minimum standards of good practice when dealing with certain customers in the UK in relation to loans, current account overdrafts, charge cards and credit cards. Further details can be found at: Lending Standards Board

4. Lines open Monday to Friday, 8am–7pm. To maintain a quality service, we may monitor and record phone calls. Call charges

Business lending

Existing Barclays customer?

To find out more, or if you want to apply for a loan, call us now to speak directly to our lending specialists 0333 202 7445 [4]

New to Barclays?

To discuss your options for business banking call us on 0800 015 462 [1]

Live web chat

Start a live web chat

I'm interested in

- Business overdrafts
- Business loans under £25,000
- Business loans over £25,000
- Commercial mortgages
- Credit cards for business
- Our lending process
- Business health check

I need to

- Finance my business
- Build my finance application
- Keep on top of my cashflow
- Release cash tied up in invoices

Tools

Business loan calculator

Find out how much it could cost to take out a small business loan

Helpful forms for business lending

Tools to help you prepare for your lending application

Helpful Information

- Our business lending charter
- Better Business Finance
- Community Development Finance Association
- Mentorsme.co.uk
- Appeal a lending decision
- Request a Deed of Priority

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Business Loans

Frequently asked questions

Can I repay my Business Loan early?

You can repay all or part of your Business Loan at any time. Charges may apply. To find out more speak to our Lending Team on 0800 313 4481. Lines open 8am to 6pm Monday to Friday.

Can I get an indicative quotation for a Business Loan?

Is the interest rate fixed for the period of the Business Loan?

How long will it take to receive the Business Loan funds?

When do I have to pay the £100 one-off Business Loan arrangement fee?

More FAQs...

Help and support

Find answers to commonly asked questions, see our online guides and demos, or contact us.

Help and support

Contact us

Speak to our Lending Team on 0800 313 4481 Lines open 8am to 6pm Monday to Friday.

Contact us

Corporate & Commercial

For medium to large sized businesses that would like a relationship managed service or have comprehensive banking, international or lending needs.

Corporate and Commercial Banking

You may also be interested in

Business Overdraft

Find out more

Business Insurance

Find out more

Business Current Accounts

Find out more

1-4 of 4

2C

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Borrowing & Credit

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  - Leases
  - Mortgages
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  - Talk to a Specialist
  - Apply for Small Business Financing

Search

Business Loan Calculator

Our business loan calculator will help you determine the monthly payment and interest cost for various loan options*.

Print

	Loan Option 1	Loan option 2
Loan Amount	$25000.00	$
Annual Interest Rate	4.00 %	%
Term of Loan (years)	3	1
Loan Start Date	Jan 2015	Jan 2015
Payment Type	Principal Plus	Principal Plus

Calculate

Monthly Payment	$694.44	$
Interest Cost	$1541.66	$
Amortization Table	Show Table	Show Table
Take Action	Apply	Apply

Amortization Table Loan 1

Month	Year	Payment	Interest	Balance
Feb	2015	694.44	83.33	24305.56
Mar	2015	694.44	81.02	23611.12
Apr	2015	694.44	78.70	22916.68
May	2015	694.44	76.39	22222.24
Jun	2015	694.44	74.07	21527.80
Jul	2015	694.44	71.76	20833.36
Aug	2015	694.44	69.44	20138.92
Sep	2015	694.44	67.13	19444.48
Oct	2015	694.44	64.81	18750.04

Apply for Financing

Our dedicated specialists are available to help find a flexible borrowing solution for your business.

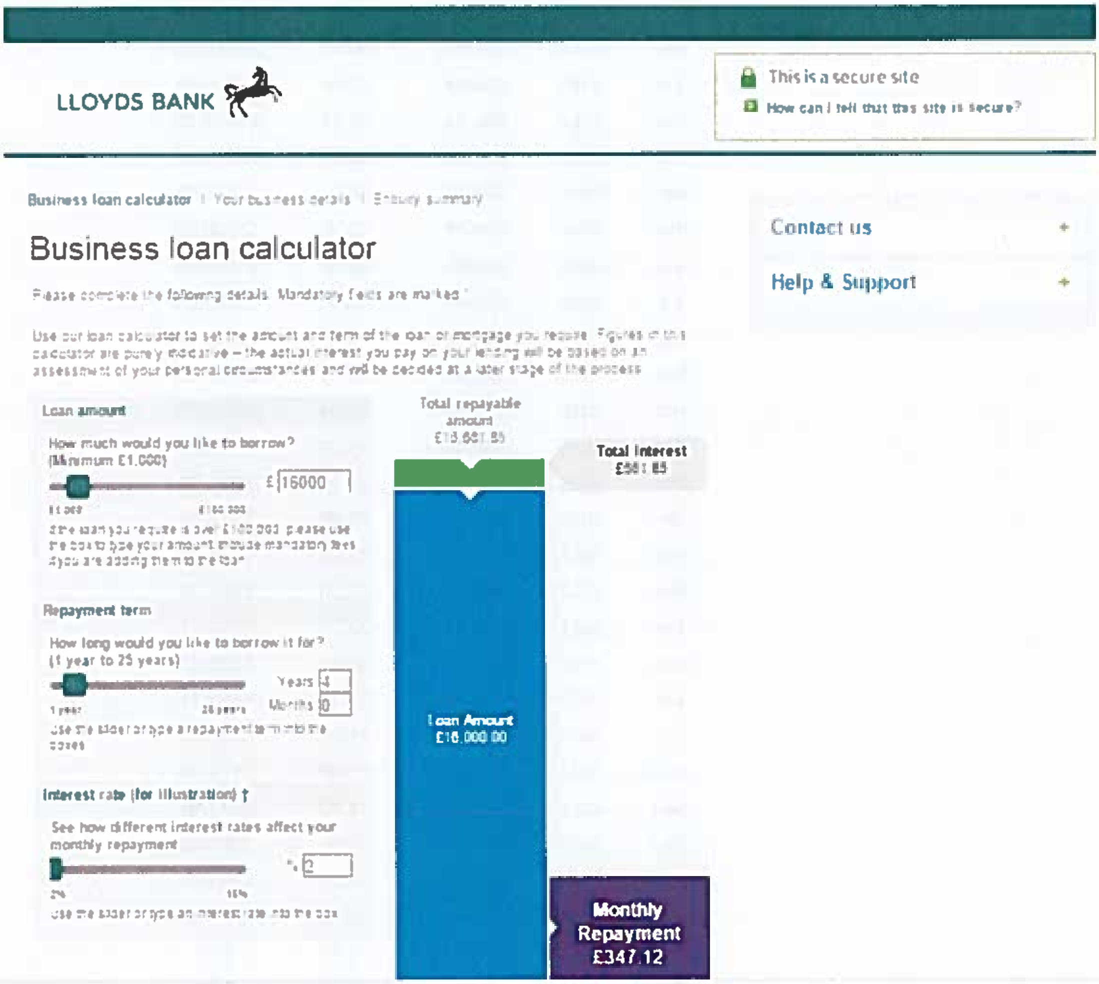
- Apply Online for Loans and Credit
- Visit a Business Banking Centre
- Call 1-866-246-1598
- Send Us an Email

Nov	2015	694.44	62.50	18055.60
Dec	2015	694.44	60.19	17361.16
Jan	2016	694.44	57.87	16666.72
Feb	2016	694.44	55.56	15972.28
Mar	2016	694.44	53.24	15277.84
Apr	2016	694.44	50.93	14583.40
May	2016	694.44	48.61	13888.96
Jun	2016	694.44	46.30	13194.52
Jul	2016	694.44	43.98	12500.08
Aug	2016	694.44	41.67	11805.64
Sep	2016	694.44	39.35	11111.20
Oct	2016	694.44	37.04	10416.76
Nov	2016	694.44	34.72	9722.32
Dec	2016	694.44	32.41	9027.88
Jan	2017	694.44	30.09	8333.44
Feb	2017	694.44	27.78	7639.00
Mar	2017	694.44	25.46	6944.56
Apr	2017	694.44	23.15	6250.12
May	2017	694.44	20.83	5555.68
Jun	2017	694.44	18.52	4861.24
Jul	2017	694.44	16.20	4166.80
Aug	2017	694.44	13.89	3472.36
Sep	2017	694.44	11.57	2777.92
Oct	2017	694.44	9.26	2083.48
Nov	2017	694.44	6.94	1389.04
Dec	2017	694.44	4.63	694.60
Jan	2018	694.44	2.32	0.16
Feb	2018	0.16	0.00	0.00

* The business loan calculator assumes: (i) a constant interest rate throughout the amortization period and (ii) that interest payments will be made monthly for both payment types (Principal Plus Interest or Blended). The calculations produced do not account for, among other things, the following factors that may impact amortization: (i) non-scheduled payment reductions such as lump sum payments, (ii) Business Loan Insurance Plan premium payments, (iii) leap years, (iv) maturities on dates other than payment due dates or (v) interest adjustments. **Due to the foregoing, the amortization schedule produced by the business loan calculator may differ from an actual payment schedule.**

The calculations and amortization schedule produced are: (i) based on the accuracy and completeness of the data you have entered, (ii) based on assumptions that are believed to be reasonable, and (iii) for estimation purposes only and should not be relied upon for specific financial or other advice. When you make your credit application, interest rates may have changed or may be different due to information contained in your application.

Royal Bank of Canada does not make any express or implied warranties or representations with respect to any information or calculations in connection with this business loan calculator. Royal Bank of Canada will not be liable for any losses or damages arising from any errors or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How can I tell that this site is secure?
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Contact us
Help & Support
Business loan calculator
Loan amount
How much would you like to borrow?
£ 16000
Repayment term
How long would you like to borrow it for?
(1 year to 25 years)
Years 4
Months 0
Interest rate (for illustration)
See how different interest rates affect your monthly repayment
% 2
Total repayable amount
Total Interest
Loan Amount
£16,000.00
Monthly Repayment
£347.12