Fifth Quarterly Report from John Trethowan, Credit Reviewer

This is my fifth quarterly report on the activity of the Credit Review Office, and the market conditions observed in the work performed in the reviews and target monitoring.

My first and second reports outlined my observations on the issues on credit availability both on the supply side by the two main banks, and on the demand side by borrowers for bank lending.

My third report detailed the responses AIB and BoI are making to:
a) increase market confidence that they are open for business, and
b) to address skill deficits in cashflow lending following a period of extensive staff movements.

The fourth report moved on to look at what steps are required to support businesses through a recovery stage.

These reports can be found on the Credit Review Office website www.creditreview.ie

Credit Review Office Activity

	Application Rec'd but held at Office until eligibility confirmed with Bank	Overturned by Internal Appeals/ got credit*	Abandoned /Withdrawn by customer**	Application Received and proceeding through Review process	CRO Decision			Total
					Banks' Credit Decision Upheld	Bank's Credit Decision Disputed / Bank Subsequently Provided Credit	More work required by Borrower and Bank or withdrawn by customer	
AIB	8	2	3	5	13	14	4	49
BoI	6	1	1	8	14	16	3	49
Total	**14**	**3**	**4**	**13**	**27**	**30**	**7**	**98*** **

*only tracked since May 2011-new procedures
**considered abandoned if no response after 6 months
***includes applications awaiting eligibility confirmation

Formal Appeals	Banks' Credit Decision Upheld	Jobs at risk		Bank's Credit Decision Disputed / Bank Provided Credit	Jobs protected
Total Numbers	**€1,833,753**	**137+7p/t**		**€2,525,500**	**351+15p/t**
AIB	€701,000	76+7p/t		€1,065,300	150+5p/t
BoI	€1,132,753	61		€1,460,200	201+10p/t

(c) Banks' Formal Internal Appeals

April to July 2010 2011	Bank's Decision Upheld	Overturned/ Sanctioned with Conditions	Work in Progress	Ineligible/ Withdrawn By borrower	Total
AIB	97	54	16	8	175
BoI	129	11	0	0	140
Total	226	65	16	8	315

Helpline/ Web Activity

- The helpline has taken 997 calls to date.
- The website has had 8,959 web visitors since inception. These web visitors have made 12,209 visits.

After a year's operations and following feedback from service users and others I have revised and simplified the application process for users. Previously we asked borrowers to ensure that they had gone through the banks' own internal appeal process before we dealt with their appeal. We now enter borrowers' appeals into the bank's process for them, if not already done so.

We have also simplified the borrower inputs to seek only the most basic information. This has resulted in much more informal work on behalf of borrowers by the Credit Review Office which is not measured in the activity above. Many businesses have been assisted in obtaining credit by the Credit Review Office without having to resort to the formal appeals process. These informal resolutions and the jobs they protect are not tracked by the Credit Review Office.

I remain of the view that the existence of the Credit Review Office, and its potential to review any refusals of credit, is having a generally beneficial impact for all SME and farm borrowers in AIB and BoI, whether these borrowers are aware of the existence, or use the services, of the Credit Review Office or not.

I was very pleased that on 7th July, the Minister of Finance responded to the request in my fourth report to increase the €250k appeals limit to €500K. This is for new and additional credit up to €500K, and it is expected that this will increase the volume of formal applications through the Credit Review Office. We would also expect that the larger SMEs in this lending bracket will have more confidence to challenge bank decisions and have robust management information to support their propositions.

Whilst the maximum limit has increased, the Minister decided not to increase the maximum fee of €250 for appeals, and to retain the minimum €100 fee.

A radio and press advertising campaign will commence in early September to ensure the market is aware of these new limits.

I remain mindful that the Credit Review Office is a symptom of a banking and general business systems which have not yet returned to normality. The Credit Review Office is not to be viewed as permanent feature and it will be a measure of success of the recovery of the economy when it can be stood down. The permanent staffing in the Credit Review Office remains minimal, consisting of myself and two very able full time staff who are supported by a panel of Assistant Reviewers who are paid on a case by case basis.

The Fifth Report

I do not propose to re-state my previous findings over the past year, or seek to be novel for the sake of it in this report. The Borrowing environment remains broadly the same, but with the observation that things are at least stabilising and not deteriorating. My previous findings thus remain valid observations of the credit supply market in Ireland at this time. These findings are not unique to Ireland and are broadly mirrored in similar conditions in GB.

My ongoing understanding of this market continues to be drawn from a number of sources - the formal appeal applications dealt with; my meetings with the two banks and other policy makers and trade bodies; the feedback from the office team who resolve many of the queries informally; and the experience of my Assistant Reviewers – all of whom are experienced lenders and some of whom have regular dealings with front-line staff in all of the banks as part of their day–to-day business.

There are no panaceas to the current issues facing SMEs and their bankers in the supply of credit. To resolve any problem, it first must be clearly understood.

1) The demand for SME/Farm credit remains un-measured. A recent credible survey by the SME Finance Monitor for the Business Finance Taskforce in the UK has pointed to a lack of demand for credit there.
In Ireland, there is widespread agreement that the saving rate in businesses and individuals is too high for an economic recovery to occur, but little recognition that a symptom of this is subdued demand for new lending. My interaction with the two banks on their €3bn lending targets also provides feedback on a sluggish demand for credit and the slow drawdown of sanctioned facilities.
Until the demand for credit is fully understood there is little point in some commentators being fixated on the amount of New Credit as opposed to restructuring sanctions. It is obviously impossible to grow New Credit in an economy where such credit is not being demanded.

2) A recognition that there is, and always has been, a background level of banks' declining credit which is typically @ 20% -25%.
The CSO survey earlier this year headlined a reduction of sanctioning activity from @ 95% in 2007 to @ 55% in 2010. The abnormally high level of sanctioning activity in 2007 has cost this nation and its taxpayers dearly over the past three years – a level of decline in sanctioning activity is thus a sign of a more prudent and healthy banking system.
A more careful reading of this report showed that in 2010 a more normal 74.6% of those surveyed accessed credit – including some 19% who had partially received credit (following request modifications), again not an unusual feature in banking.

3) There has been much debate, and many differing statistics, on the supply of credit to SMEs and farms. In an attempt to reconcile these differing views it is becoming apparent that SMEs and Farms which present a well argued proposition supported by proper financial information and credible projections are being successful in their applications.
Businesses which became accustomed to the easy credit era and are presenting

elemental, or worse still casual proposals are being refused.

There appears to be a disparity on the level of information input banks now expect from their borrowers, to the recognition of what is required and the ability to provide such information from some SMEs and Farms. It appears that the banking train has left the station on the requirements for credit applications, and as left some of its SME / Farm borrowing passengers on the platform, wondering what happened.

Business Organisations and accountancy bodies should be working to upskill the SME population on their business planning and financial skills. This is critical to the survival of all individual SME/farms, but also collectively in strengthening the business stock of the nation for the future. Individuals and business organisations pointing to the behaviour of banks as the sole source of the problems facing some SMEs and farms are in denial of the scope of the problems facing our economy. Without a clear and honest identification of the problems, finding remedies and solutions will not take place.

The requirement for SME promoters and farms to be more 'hands-on' in the management of their enterprises has never been so important as in these challenging times for the economy. It is essential that the State supports the public and private sector to upskill management capabilities especially to smaller enterprise promoters to ensure they understand and can deal with their obligations as Directors and business decision makers.
My Reviewers continue to see too many cases where the financial accounts have been produced only for a tax computation, and the cashflow forecasts have been produced at the bank's request. These vital resources are not being used as management tools and discussed with advisers and accountants to manage the business going forward.

The Minister of State for Small Business has put together a Small Business Advisory Group to suggest areas in both supply and demand where policy can be created to support and encourage small business and entrepreneurship, and I was delighted to be asked to join this Group. There is a real commitment to producing outcomes in the near future from this Group.

Banks' €3bn Sanctioning Targets

I gave a comprehensive report on progress against the completion of the first year of these targets in my last report in May.

The two banks continue to report their progress monthly, and in formal performance meetings which are held between the banks and the Department of Finance and myself each Quarter.

We continue to extract assurances from both banks that whilst their Boards have a policy of downsizing their overall balance sheets that this is not affecting their appetite to fully support the SME / Farm sectors of the domestic economy. Recent Government and market supports have ensured that these is adequate capital for each bank to increase their lending. Both banks have outlined major programmes which are continuing nation-wide to reach out to customers with the message that they are open for business.

Both Banks are however experiencing a continuing slowing demand for credit from SMEs, although farm credit is more buoyant reflecting increasing confidence in this sector. This slowdown in demand, coupled with high repayment inflows on existing lending, is reflected in a contraction of the SME /Farm books as existing loans continue to be repaid at a faster pace than new loans are being demanded.

The rate of credit sales, and sanctioning, is lower this year than the figures from the previous year, and it will be a challenge for each of the banks to reach their €3Bn sanction target for new and restructured facilities in the current year. It may be that some of the term loan restructuring activity conducted last year has dealt with the issue and consequently has fallen out of this years sanctioning figures.

We have discussed the impact of downsizing and re-structuring of staff, to ensure that their executives ensure that their front–line lenders have adequate skills and experience and are adequately incentivised to provide new lending to viable SME and Farm businesses. The banks have advised that they do not anticipate any ‘swirling’ of their front-line staff in their restructuring and they continue to invest heavily in up-skilling these staff to deal with SMEs and farms in this challenging economic climate.