Quarterly Report from John Trethowan, Credit Reviewer

This is my second quarterly report on the activity within the Credit Review Office, and on my role in ensuring that Allied Irish Banks and Bank of Ireland achieve the objectives set for them each to make 3bn new lending each year over the next two years.

A. The activity levels within the Credit Review Office
The Credit Review Office, commenced operations on 1st April 2010.

Activity Levels to Date
The process is borrower initiated and is accessed through the Credit Review Office website. To date the website has had 5,589 visits and been accessed by 4,130 different users.
The helpline has taken 467 calls from borrowers.

The outcomes of the initial cases are shown in this table:

	Application Rec'd but held at Office until eligibility confirmed with Bank	Application Received and proceeding through Review process	CRO Decision			Total
			Bank's Credit Decision Upheld	Bank's Credit Decision Disputed	More work required by Borrower and Bank	
AIB	2	3	5	2	2	14
BOI	4	9	7	3	0	23
Total	6	12	12	5	2	37

As part of the preparatory work in setting up the CRO, I worked with the two banks to ensure that their internal appeals systems for borrowers were placed on a more formal footing. The outcomes of these appeals are relevant to the performance of the Credit Review Office, and the position up to the end of October is:

	Refusal Upheld	Initial Decline Decision Overturned/ Sanctioned with Conditions	Work in Progress	Total
AIB	26	15	8	49
BoI	60	5	0	65
Total	86	20	8	114

Activity in this quarter.

Following feedback that not enough businesses were aware of the Credit Review Office, I have completed the following actions to promote visibility of the service:
(i) Two extensive national/local radio and press advertising campaigns were held in July and September.
(ii) I have visited Cork, Waterford, Letterkenny and Laois/Carlow Chambers.
(iii) I spoke at the SFA annual conference in September.
(iv) I spoke at the CIMA conference in October.
(iv) I have given numerous, national and local, press and radio interviews.

As a result the number of enquiries to the Credit Review Office has substantially increased however the number of formal applications remain low. I have had some telephone research conducted as to the causes of this, and the two principal findings are :

(a) a fear that using the internal appeal and Credit Review Office processes may damage the borrowers relationship with the banks- especially with front-line staff.
(b) a weariness to enter another process to have the lending request assessed.

Each of the banks have shown a positive attitude to the Credit Review Office appeals process, and the their Executives have been asked to ensure that this attitude is shared with their front-line staff.

This positive attitude by banks to appeal processes is evidenced in Ulster Bank, which although not part of the NAMA process have established their own internal appeals process based on the principles of the Credit Review Office.

Work is ongoing to identify any barriers to SME lending, and I have added a generic loan application form onto the Credit Review Office website to assist borrowers in making an initial written approach to any bank for lending, to overcome the 'casual refusal' sometimes experienced by verbal enquiries at bank branch and business centre counters.

Bank of Ireland already have a web based loan application and they have made this more visible on their website, and I have also included links to this webpage on the Credit Review Office website. AIB are currently developing their own web based loan application and I will also insert links to this application when it is available.

Evidence emerging

In my first report I outlined seven findings:

1. Many SMEs are undercapitalised following two very difficult years trading in which losses have eroded capital and reserves.
2. Some businesses have tied their reserves up in residential property, which cannot be accessed due to market conditions.
3. There is some lack of experience in banks' front line staff especially in dealing with more challenging lending requests.
4. There are some examples of poor responsiveness and serial information requests, which is unhelpful for SMEs.
5. Banks need to explain their loan restructuring activities better.
6. Banks need to assess credit on future prospects, rather than solely concentrating on the businesses performance in the past two difficult years.
7. I am concerned on the diminishing number of banks supplying the SME market.

These conditions remain, however both banks are investing heavily and making progress on training frontline staff, and in keeping them in situ longer to allow a relationship to be built with their customers.

As the Credit Review Office experience base grows I can add some further findings in this quarter:

1. My view is that recapitalisation strategy for the two main banks is now achieving its objective of ensuring that a functioning banking system is in place to support economic activity.
   Current market perceptions that banks are not lending to SMEs is based on experiences from six to nine months ago, and the current situation whilst still not

entirely perfect, is now continually improving.
The market can now best understood by where each of the main players is in their recapitalisation, with Bank of Ireland furtherest down the road, and Allied Irish (and Ulster Bank), now also pro-actively re-entering the lending market.

2. Most commentary on SME lending dwells on the supply side. There is little or no research or knowledge of the actual level of borrower demand, which all banks report as subdued. This is similar in the GB market.
   We are approaching a tipping point whereby the issue is moving from being a supply side problem to a demand side issue. SMEs, to survive in the current economic climate, have improved their cashflow management, trimmed their discretionary costs, slowed the velocity of money and deferred investment decisions, all of which is reducing demand for working capital and term lending at the present time.
3. I would consider all of the cases reviewed to date have being difficult lending decisions. I find no evidence that banks have been indiscriminately refusing credit on formal loan applications.
4. Whilst my opinions are not mandatory, both banks have cooperated when the Credit Review Office has asked the banks to reconsider their lending decline decisions.
5. Where my opinions have suggested that banks decisions be reversed, some have been the result of the Credit Review Office having taken the time to uncouple (i) past losses, from future prospects (ii) where there is more than one business e.g. a farm and a secondary enterprise, to examine each element of the business to determine the future cash generation and profit prospects for each separately.
6. Banks have now returned to be prudent cashflow lenders, SMEs in turn must learn to be cashflow borrowers once again. I continue to see far too many cases where cashflow forecasts have been produced to satisfy bank requirements, and are not being used by business owners to mange their business. In many cases the business owner has not matched actual sales etc. to the forecast for the elapsed period.
   There is a requirement for trade bodies, banks, and government agencies to make easily accessible and understandable cashflow models available and to encourage SME owner managers to attend seminars on cash flow lending.
7. There have been many calls for a loan guarantee scheme to be established and this is being promoted as a panacea for the perceived difficulty in obtaining credit. Those calling for a loan guarantee scheme should ensure that they have first defined the problem correctly before suggesting the solution.
   In the cases I have reviewed to date there is little evidence that lack of collateral has been a principal cause of the loan decline.
   The principal issues affecting loans which have been declined are solvency (i) insufficient capital either from inadequate owners stake, and /or (ii) capital having been eroded from trading losses.
8. Margin increases. Banks have experienced pricing increases in their retail deposit and long term market funding costs. These costs are now being passed through to borrowers when their facilities are being reviewed. I have asked both banks to try to minimise the impact of these increases where possible, for example by increasing the length of the loan to spread this cost. One bank is offering an option to some borrowers to renew for 1 year or 5 years to allow borrowers to avail of better rates for the shorter term borrowing.

Progress on ensuring the two banks have plans in place to achieve the €3bn p.a. new lending targets over the next two years.

Both banks have supplied spreadsheets with monthly SME lending figures. These figures align with separate reporting the banks send to the Central Bank. These figures are transcribed onto a series of charts for each bank which visually show the following:

1. Balance sheet growth for the SME sector.
2. Amount sanctioned.
3. Amount drawndown.
4. Numbers of Loans Overdraft and Leasing deals completed.
5. The amounts lent to the various trade segments (comparing to Jan 2010 as a base month).
6. The amounts lent to each of the banks' regions (comparing to Jan 2010 as a base month).

General Comment.

- These are market sensitive figures and cannot be disclosed in detail.
- Both banks report subdued demand for lending from viable SMEs.
- No trade sector or region has been adversely affected.
  The sectoral and geographic measurements show that there has been no appreciable movement in the % share of lending to the various SME sectors, and geographic regions since the base month in January 2010.
- Growing balance sheet volumes is proving to be a huge challenge. The €3bn targets would never achieve an absolute growth in balance sheets as there are a number of variables affecting such growth:

Positive Factors	Negative Factors
• Baseline balance sheet position • New sanctions drawn down • Interest charged on loans	• Loan repayments • Unused overdraft facilities / Undrawn sanctioned lending • Lending written off/transferred to NAMA • Credit Quality of Non NAMA book • High levels of 'Old new Lending' being the restructuring of overdraft lending already on the balance sheets.

End of Report