Embargoed until 2pm 29th November 2011

Sixth Quarterly Report from John Trethowan, Credit Reviewer

This is my sixth 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 and fifth reports 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

Activity to date:

	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Rec'd but held at Office until eligibility confirmed with Bank	Overturned by Internal Appeals/ got credit*	Abandoned /Withdrawn by customer**	Application Received and proceeding through Review process	CRO Decision			Total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Upheld	Bank's Credit Decision Disputed / Bank Subsequently Provided Credit	More work required by Borrower and Bank or withdrawn by customer	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	1	5	5	5	20	19	12	67
BoI	5	6	5	4	16	22	6	64
Total	**6**	**11**	**10**	**9**	**36**	**41**	**18**	**131*** **

*only tracked since May 2011-new procedures
**considered withdrawn/abandoned if no response after 6 months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	**€2,541,753**	**174+7p/t**		**€3,497,000**	**417+21p/t**
AIB	€1,344,000	106+7p/t		€1,508,300	174+9p/t
BoI	€1,197,753	68		€1,988,700	243+12p/t

(c) Banks' Formal Internal Appeals

April to Oct 2010 2011	Bank's Decision Upheld	Overturned/ Sanctioned with Conditions	Work in Progress	Ineligible/ Withdrawn By borrower	Total
AIB	117	84	1	14	216
BoI	158	11	0	0	169
Total	275	95	1	14	385

Helpline/ Web Activity

- The helpline has taken 1,231 calls to date.
- The website has had 11,257 visitors since inception. These web visitors have made 15,409 visits.

In addition to the formal and informal caseload, the Credit Review Office has:

- Devised the credit appeals process, which has now been streamlined and simplified to reflect user comments and feedback.
- Ensured that an internal credit appeals process is operating in AIB and BoI, and assisted Ulster Bank in introducing an internal appeals process.
- Obtained approval for the Credit Review Office limit to be raised by the Minister from €250k to €500K
- Requested a demand survey to measure SME Lending Demand. The Department of Finance has now initiated this survey.
- Assisted AIB & BoI in introducing a common application form for SME lending.
- Provided an overview service for Government Departments on bank decision making and behaviour on specific high profile liquidations / receivership situations where many jobs were at risk.

I remain mindful that the existence of the Credit Review Office is a symptom of 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 experienced Credit Reviewers who are paid on a case by case basis.

The Sixth Report

I do not propose to re-state my previous findings, or seek to be novel for the sake of it in this report. The Borrowing environment remains difficult but broadly the same as in the previous few quarters. My previous findings thus remain valid observations of the credit supply market in Ireland at this time.

The mantra that ‘banks aren’t lending’ is not unique to Ireland and is broadly mirrored in similar comments in UK and most countries across the EU, where there is general concern on the supply of credit to the SME sector. Similar SME lending mediation services to that of the Credit Review Office are now also available in Belgium, France, Germany and Spain, all providing an independent impartial service to examine individuals and companies refused credit and to determine underlying causations of the problem.

My sixth report refers to the two main pillar banks, AIB & BoI, lending into the SME /Farm market, (and to some extent Ulster Bank). The remaining ‘foreign banks’ have not as yet engaged with the Credit Review Office. It would be helpful if these other foreign owned banks were to state their respective positions to the Irish SME/farm market, as some of the generic criticisms on bank lending may be a reflection on these banks current lending performance.

Banking skills
The overhang of debt, the weakened condition of many SME/farms, and a slow domestic economy make this a hugely challenging environment for lending by banks and individual lenders.

The two Pillar Banks' central Head Office messages to SMEs/Farms are that 'they are open for lending to viable businesses'. This is reinforced by publicity campaigns and regular corporate Roadshows and events, which is commendable.

The two banks however need to ensure that tenor of their corporate messaging is matched by their frontline staff interfacing with customers, where the message is far from clear that there is a desire to do business – indeed sometimes quite the reverse.

The Pillar Banks were recapitalised to provide a strategic platform to service the borrowing, and payments systems, requirements of the economy. My previous reports recognised that the banks required time and support to resolve their capital and skills deficits. As the economy moves back into growth I believe the agenda is now moving on to encourage the banks to be more proactive in ensuring that all viable businesses are able to access credit they will need to recover and grow.

There are two main issues to be addressed:
(i) the strict imposition of tight credit policies by Head Offices.
(ii) the lack of solution finding and deal making skills in front line staff.

My opinion is that banks have returned to having traditional prudent cashflow lending at the centre of their lending policies. These policies are being somewhat rigidly applied, with an observed lack of solution finding or deal making appetite being evident for SME and Farm borrowers, when they interface with the front line lenders in the banks. This use of rigid credit score based lending policies has the potential to result in some viable businesses being unable to access the credit they need.

Both banks continue to upskill their staff in lending. I commend them in this, however I would urge them to give their staff the confidence and support they need to develop their banking skills beyond the theory of lending. The 'art' of banking is in working with borrowers to seek solutions and an acceptable deal for everyone in terms of risk and pricing. Banks appear to be abandoning these traditional skills.

Whilst it is not the Credit Review Office's role to suggest bank strategy, I can report that the feedback I get, from seminars and talks around the country, is that a more traditional branch manager centric approach to SME/Farm lending, with an appropriately overviewed level of lending discretion devolved to the front line, is what the market wants.
This model could be considered appropriate for the challenges the economy faces today, having served AIB, BOI and the other banks well in the past; and it should be remembered that it was not these smaller level SME/Farm lending decisions that caused the banking crisis.

Pricing Loans and the Funding Costs for Banks
The banks need to clearly spell out the reality of their funding costs to the public through the media. Each bank will have a different mix of variables, and the detail will be commercially sensitive, so the IBF may be the best vehicle to provide a generic model to illustrate a typical bank's cost of funds. Failure to do so will result in further public controversy on this issue.

The public are not banking experts, so all commentators need to do more to help the public understand the composition of funding costs that banks are having to deal with, to show whether borrowers are being treated fairly in arriving at the funding cost of the banks' raw material – money. The reality is that the average cost of funding of all banks is well above the benchmark ECB refinance rate and while the reduction in the ECB rate is welcome it presently has little material impact on the underlying cost of funding for the banks.

I would ask that banks not raise business lending margins in advance of the annual re-negotiation of the lending facilities, and to be mindful of the impact on SME/farms cashflows of increased loan pricing by for example extending the term of the loan to maintain affordability of repayments.

Demand for lending

Much of the criticism of the supply of banks' lending has being made in the absence of any knowledge of the demand for credit. I am pleased that the first proper survey has now been completed for the Department of Finance to measure demand for credit in SMEs. This will need to be repeated at regular intervals.

The Conditions in the SME sector reported in the survey results:

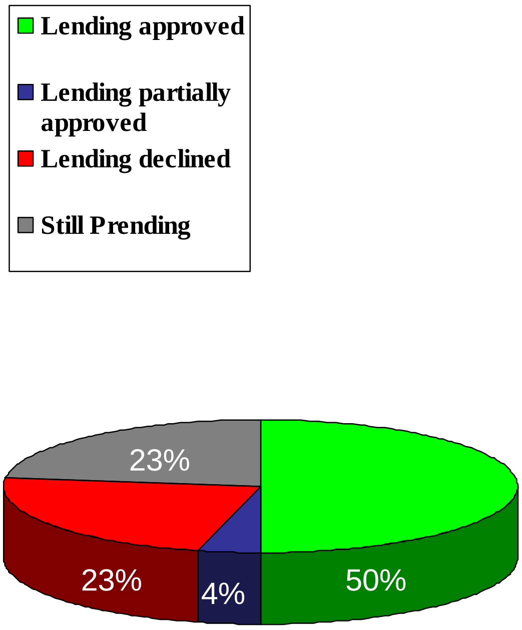
1. 65% of businesses are aware of the Credit Review Office service.
2. 57% of businesses are aware of the code of conduct for SME lending.
3. Most businesses reported difficult trading conditions, with 48% reporting decreased turnover; of which 17% reported turnover decreased by more than 20%.
4. Levelling off in the decline in employment; with only medium businesses taking staff on.
5. 43% of businesses reported that they were making profits, 30% reported breaking even and 28% were making losses.
6. However profitability was increasing in the past 6 months.

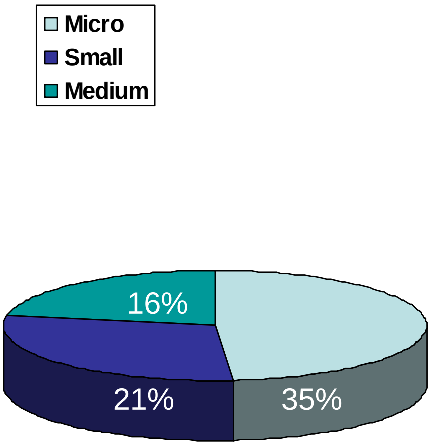
Demand for Lending

7. 36% of businesses requested credit in the past six months. Medium sized businesses were the highest at 44%, followed by small at 41%, and 27% in micro.
8. Prospects in the next 6 months are lower with only 24% of businesses intending to ask for credit. Again, medium sized businesses were the highest at 29%
9. The highest reason for overdraft credit request was to assist with working capital and cashflow; or to restructure an expositing facility.
10. The highest reason for term lending requests was to restructure an existing overdraft facility.
11. Turnaround times by banks on credit applications has slowed significantly.

Supply of Lending (to the 36% of businesses demanding credit)

12. There is no discernable difference between pillar and non pillar banks.
13. The decline rate by business size appears to be different.





Overall Lending Outcomes

Proportionality of the 23% lending declines

Structural Improvements
Minister Perry, the Minister of State for Small Business, has led the Advisory Group for Small Business to produce its first report, which is an action based document that addresses a spectrum of structural issues to improve conditions in the SME sector. There are many important proposals in this first report.

Given that one of the requirements of banks assessing loan applications is for much more detailed information on the financial performance of the SME / Farm to determine their ability to repay; and that these requirements are challenging for smaller businesses, the Credit Review Office assisted AIB and BoI in the introduction of a standard lending application form for SMEs.
I have asked IBF to encourage other banks to also adopt this standard form. The standardisation of the form will assist borrowers, but also more importantly their accountants and financial advisers in knowing what is required to satisfy the banks' information needs in making loans to SMEs. This standardisation should also extend to the basic information required in business cases and cashflow forecasts.

Minister Perry's Group has made further recommendations to assist SMEs in producing the type of SME management skills and performance information banks now routinely require.

Banks' €3bn Sanctioning Targets

In my last report I stated that it would be challenging for each of the two banks to achieve their €3bn lending targets for 2011. At that time I was reporting on figures up to the end of June. This report is commenting on figures up to the end of October.

The banks maintain that demand for lending is subdued, this is now borne out by the findings of the Department of Finance survey.

My observations last time prompted considerable comment in the media, and has also resulted in ongoing meaningful discussions between the two banks, and the Department of Finance Officials and myself.

The banks have identified some new lines of business and seasonal variation in their figures which has since improved the situation to make their year end targets more achievable, however I will reserve final comment until my next report when the remaining two months figures are received to ensure that the improved momentum and the expectations of both banks are achieved.

Next Year the Minister has raised these lending targets to €3.5bn for new and restructured sanctions for each bank. Whilst I have not subscribed to the disparaging of the restructured financing element of how these targets have been achieved to date, I do however accept that a focus should now be brought onto the 'New Money' element to reflect and support the prospects for a continuing economic recovery in 2012.

The restructured element of these targets however must not be underestimated in a lending market which has a significant proportion of distressed small businesses and farms. Whilst it is unfashionable to compliment banks at this time, there are many businesses with many jobs, which have been protected by these restructuring sanctions, providing not only ongoing credit, but more importantly in also sanctioning concessionary terms such as interest only repayment terms to assist SMEs cashflow through the current difficult times for domestic demand.

The levels of distressed SME/ Farm businesses within each banks' lending books is a constrain in making 'new lending'. It doesn't require a banking expert to recognise that it is hard to supply more lending to a business which is having difficulty in servicing its existing facilities.

I continue to monitor the sanctioning activity of both banks by both geographic regions and trade sectors to ensure that no region or trade sector is being adversely affected by bank lending policies. I find no evidence that this is so either by region or trade sector.
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