Quarterly Report from John Trethowan, Credit Reviewer

This is my third 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.

Credit Review Office Activity

The Credit Review Office has been receiving cases for six months. Whilst there has been a focus on the numbers of borrowers using the formal process, most commentators have failed to appreciate the importance that the existence of the Credit Review Office has already had on influencing the behaviours of AIB and BoI. Any borrower has the right and potential to appeal their treatment and credit decision to the Credit Review Office, this in itself has a positive influence on the behaviours of these two banks.

Helpline/ Web Activity

- The Credit Review Office helpline has taken 531 calls to date.
- The Credit Review Office website cumulative total now stands at 4,793 visitors after forty three weeks. These web visitors have made 6,573 visits.

(a) Borrowers' Issues resolved outside Formal Appeal Process with CRO assistance = 11 cases

(b) Formal Applications

4/2/2011	Application Rec'd but held at Office until eligibility confirmed with Bank	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Upheld	Bank's Credit Decision Disputed / Bank Subsequently Provided Credit	More work required by Borrower and Bank or withdrawn by customer	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	2	4	7	4	2	19
BoI	2	7	11	8	1	29
Total	**4**	**11**	**18**	**12**	**3**	**48***

*includes applications awaiting eligibility confirmation

Formal Appeals	Banks' Credit Decision Upheld	Jobs		Bank's Credit Decision Disputed / Bank Provided Credit	Jobs protected
Total Numbers	**€1,363,753**	**109+8 p/t**		**€978,300**	**85+9 p/t**
AIB	€ 354,000	53+1 p/t		€297,000	28+1 p/t
BoI	€1,009,753	56+7 p/t		€681,300	57+8 p/t

(c) Banks' Formal Internal Appeals

April to January	Upheld	Overturned/ Sanctioned with Conditions	Work in Progress	Total
AIB	48	21	12	81
BoI	83	6	0	89
Total	131	27	12	170

I have made two previous reports, and their findings continue to be a reflection of the general state of the market, and also the gradual improvement in the supply of credit from the banks engaged with the Credit Review Office. I have attached a summary of these findings, with updated comments, as an appendix for ease of reference. The two additional findings I make in this quarter are:

(a) I have general concerns on the size and quality of the debtors' book in some businesses. Businesses should ensure that they collect from debtors when the funds are due to ensure that bad debts are minimised. A build up of stale, or indeed bad debtors, can jeopardise an otherwise good business.
(b) The perception of bank borrowing being difficult to access has led to some businesses investing working capital into fixed asset projects. This is a very risky strategy. The Credit Review Office is here to help any viable business to gain access to funding for capital investment in fixed assets, as well as for additional working capital for trading.

Since my last report on conditions at the end of September 2010, both banks have faced further funding and capital challenges in the last quarter, however the two banks have each reiterated their commitment to support the domestic SME sector. These challenges have not presented as a barrier to lending to viable propositions from SMEs and I have asked both banks to publicly reiterate their support for this sector.

Both banks have honoured commitments made in their plans which they submitted to the Department of Finance and myself last May. These commitments include training programmes for front line lenders and support staff; and wide ranging business development roadshows to encourage their SME customers. I have shown progress against these commitments in more detail later in the report.

I welcome the publication 'Your Business, Your Bank' which had been written by the Credit Supply Group, and launched by DETI. This publication is designed to give borrowers all the information they need to improve their confidence to approach their bankers for credit. This publication, together with a template for borrowers to make an initial enquiry for credit is available at www.creditreview.ie.

My remit extends only to the NAMA banks which are currently lending into the SME market. To date none of the non NAMA banks have volunteered to join the Credit Review Office process. This is very disappointing, and to address this I will write to the Financial Regulator with suggestions to simplify and strengthen the code of practice for SME lending for all banks.

I am uniquely placed to comment on the lending performance of the two banks in reviewing actual applications which have been declined by them, and which have been appealed to the Credit Review Office; and also being supplied with a range of lending performance statistics by the two banks each month as I monitor progress towards the lending targets set for them by the Minister of Finance.

The mantra that 'banks aren't lending' is a widely quoted piece of conventional wisdom used in the media without challenge or clarification, or any empiric evidence. Certain surveys are also routinely used as a commentary on the market without any question as to their underlying quality, or to which banks the findings refer to, and more importantly the market's underlying demand for credit. Whilst there were undoubtedly major credit supply problems in the market in 2008/9, the conventional wisdom has failed to recognise the progress made since then – at least in the two main banks which I monitor. The situation may or may not prevail elsewhere in those banks which have not been subject to the Credit Review Office influence.

Whilst exporters and farms are enjoying better business conditions, the domestic micro to small business sector remains under pressure due to low demand from customers, and trade with other businesses. To survive SMEs have contracted their stock levels and cost base, reducing their demand for working capital and bank lending. The low level of business activity is also dampening demand for investment funding for improvements or expansion.

As a recovery develops businesses will require more credit to increase stock holding and their debtor books, the Credit Review Office is here to help if any business faces problems in accessing such funding.

Banks' €3Bn lending targets

- AIB and BoI were both instructed to provide €3Bn each for the next two years = €12Bn.
- Start date was 1st April 2010.
- Both Banks submitted plans to myself/ Department of Finance in May 2010.
- Both banks provide monthly figures on balance sheet volumes, sanctioned facilities and geographic and industrial breakdowns of their lending.
- Formal quarterly meetings take place between the banks and myself/ Department of Finance to monitor progress.

These targets are of interest to the general public however they are commercially and market sensitive to both banks. Whilst the Minister of Finance has been briefed in the detail on the figures, my report cannot divulge these detailed figures, but can provide a general commentary on the outcomes.

The Central Bank has recently reported a contraction in the banks' balance sheets and my monthly monitoring has also reflected overall balance sheet reductions in both of the banks. In addition to the figures being reported both banks regularly provide me with Funds Flow statements which detail the underlying causes of the balance sheet movements between the base month and the current month.

It would always have been too simplistic to have expected a net gain of €3Bn in each of the banks' balance sheets. The types of underlying factors influencing the numbers are:
(i) The amount of new lending being drawn down by borrowers.
(ii) The interest being charged on performing loans.
(iii) The level of facilities sanctioned but not yet drawn down, this includes unutilised overdraft facilities.
(iv) The level of repayments on loans by borrowers
(v) The level of non performing lending being written off as bad debts.
(vi) The level of transfers to NAMA.

Both banks report demand for new lending is subdued from SMEs and, with businesses generally deleveraging through repayments on the high levels of borrowing from the pre-recession years, this is the principal cause for the reduction in balance sheet volumes. In the plans submitted to the Department of Finance and myself last May, both banks have committed to promoting that they are 'open for business' and each bank has completed programmes of roadshows for staff and customers to ensure that this positive message is communicated to stimulate demand for new lending.

The Minster's target for new sanctioned lending of €3bn by each of the banks is in line to be achieved by April 2011. This may appear contradictory to the comments elsewhere in this report on balance sheet contractions. The explanation is that much of this sanctioning activity is in debt restructuring to assist many businesses to survive. I have asked both banks to report the amount of 'New' money being sanctioned, and they are presently both amending their systems to provide this information.

The Minister was also concerned that no geographic region, nor any commercial or industrial sector would be disadvantaged in having access to bank lending. Using January 2010 as a base month, I compile details on geographic and industrial lending onto a series of pie charts comparing the % lending to each of the components in January 2010, with their % on the current figures. This analysis shows that, although the size of the total lending has contracted, no region or industry has been disproportionately impacted by the reduction since January 2010.

AIB – Progress Against Plan

Open for Business / Increasing Borrower Confidence

- 20 Roadshows held to communicate 'AIB Open for Business' to outline support for SMEs attended by 1600 SME owners, professional and business support groups. A further 3400 guests will be invited to the Q1 Roadshows.
- National Staff Roadshows held for senior management to deliver leadership on AIB's SME Lending plan and to communicate these commitments to AIB's relationship managers, business centres and credit support staff.
- Key Business Influencers communication programme for professional advisers to SMEs. 195 engagements with local Chambers/ Agencies / media. 209 engagements with accountants etc.
- Advertising and media campaigns to promote business confidence. Local and National media campaigns; and various awards and sponsorships have been completed over the past quarter.
- Opening channels for SMEs with local senior management have also been encouraged.

Upskilling and Training Staff

- 2100 Staff planned for upskilling for SME sector lending over next two years. Programme commenced with the International Standard 'Omega' Lending training programme for 433 staff. AIB Credit Skills programme and more general SME development programme has also commenced.
- The Agricultural advisory team has been increased.
- Improved support for exporters in collaboration with Enterprise Ireland is taking place.
- 3 dedicated teams have been set up to support the SMART economy including cross secondments to Enterprise Ireland.

Specific financial packages and supports

- An additional €20M seed capital is being made available for Enterprise Ireland supported projects. The new funding will be launched in February. AIB's total commitment is €50M in seed funding.
- ~~Provide~~ An additional €100M for environmental funding will be provided after the initial €100M fund has been utilised. Demand for these funds has been slow, and the initial tranche will not be utilised until mid 2011, at which time the additional funds will be made available.
- €500M Small Business Recovery scheme launched. This fund is to assist viable SMEs experiencing cashflow difficulties. This fund is in addition to substantial re-structuring assistance being provided by the bank.
- Agri Asset Fund €60M. This fund is to support machinery finance for viable businesses in the Agri sector. The fund has been launched with peak demand expected in Q1 &Q2 in line with seasonal farm demand.
- SME Asset Finance Equipment Fund €85M to promote demand for purchase and renewal of equipment. This fund was launched on 1st of February 2011.
- SMEs/Professionals Prompt Pay fund to enable large annual costs to be spread across the year. This has been positively received since launch in October 2010.
- Reposition Invoice Discounting by appointing a specialist debtor finance team and expanding qualifying criteria (to include businesses which were loss making in the past 12 months) to invoices up to 120 days (previously 90 days) and qualifying amounts reduced from €150k to €100k. The bank report this commitment has been delivered.

- Increase EIB Loan funding by €150M to €250M. This provides funds at a more attractive interest rate. The €250M is almost fully committed by drawdowns and sanctions.
- A review and renewed promotion of AIB's start-up package for start-up businesses is planned.

Bank of Ireland Progress Against Plan

Open for Business / Increasing Borrower Confidence

- Third National Enterprise week held during November providing a nationwide platform for the bank to get across message that it is open for business, through advice and mentoring for SMEs. There were 110 events at which 3800 customers attended, 1955 businesses showcased their products & services across the branch network.
- Increased website visibility and continued promotion of the on-line application service for SME Borrowers. This facility also allows borrowers to book meetings.
- Continuation of the pro-active and extensive customer contact programme providing early intervention support for borrowers displaying warning signs. Also, to discuss growth and funding opportunities for SMEs identified as having growth potential.
- 600 Bank of Scotland Ireland customers have been contacted.
- Marketing and sponsorship spend commitments met. Sponsorship of the ISME National Conference & Dublin Chamber lunch; and the new series of 'Dragons Den'.
- Promotion of www.allaboutbusiness.ie ; which provides advice and support to SMEs.

Upskilling and Training Staff

- Continuing progress on 'SME Lending in the Current Environment' programme of five separate courses which builds lenders capabilities in reflecting on lessons learned, business credit assessment, new to bank proposals and credit oversight .
- Continuation of Credit Capability programme for 300 business advisers for small and micro businesses. A further 150 business managers attended workshops on managing for growth; and a further course on dealing with challenged businesses is underway.
- Buddying newer lenders with more experienced staff.
- Developing an on-line business banking toolkit to assist front line lenders.
- A new agricultural consultant has been recruited.

Specific financial packages and supports

- EIB €100M loan fund offering borrowers access to more attractively priced lending. The current tranche has been fully drawn-down or sanctioned. BoI are negotiating a further tranche with EIB.
- €100M Developing Business Fund. €16M has been drawn on this fund during 2010.
- €250M Business support fund. €28M has been drawn on this fund during 2010.
- €100M Environmental Projects Fund. €87M has been drawn-down or sanctioned on this fund to date.
- Ongoing promotion of SME lending funds including launch of new €17M start-up and emerging sectors equity fund.
- Continued progress on the Credit Capability Training Programme.
- Ongoing development of productive relationship with Enterprise Ireland.

Appendix 1 Finding s from the previous Credit Reviewer's reports.

In my first report in July 2010, I outlined seven findings:

1. Many SMEs are undercapitalised following two very difficult years trading in which losses have eroded capital and reserves. This is a continuing problem.
2. Some businesses have tied their reserves up in property, which cannot be accessed due to market conditions. This is a continuing problem.
3. There is some lack of experience in banks' front line staff especially in dealing with more challenging lending requests. Both banks have extensive training programmes underway to address this.
4. There are some examples of poor responsiveness and serial information requests by the banks, which is unhelpful for SMEs. This situation has improved in both banks engaged with the Credit Review Office.
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. I welcome the initiatives shown by AIB and BoI is assisting Bank of Scotland Ireland borrowers, however the diminishing number of banks actively supplying all sectors of the market is an ongoing concern.

In my second report in November 2010, I outlined eight findings:

2. 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. This improvement is continuing.
3. 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.
4. 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. 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. This cooperation is continuing.
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. In some cases additional information has been produced to the Credit Review Office by the borrower, which if it had been furnished to the banks initially would have resulted in the lending being sanctioned by the bank.
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 manage their business. In many cases the business owner has not matched actual sales etc. to the forecast for the elapsed period. This is a continuing problem.
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. 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 decision.

   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. This is a continuing issue. The international system for market funding has been broken since 2007 resulting in dearer money for everyone. I am monitoring how the banks are passing these costs through.

Appendix 2 Key Points on the Credit Review Office

Web www.creditreview.ie Mail info@creditreview.ie Helpline: 1850 211 789

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- Announced in December 2009 Budget.
- Enabling Legislation = Statutory Order under Section 210 of NAMA Legislation, 31st March 2010. Commenced operations 1st April 2010.
- 3 Permanent Staff = Credit Reviewer, Manager, and Helpline Assistant.
- 10 Assistant Credit Reviewers – all paid on a per case basis.
- Uses EU definition of SME, lending = <€250K.
- AIB and BoI are the only two NAMA banks currently lending to SMEs/ Farms.
- Credit Review Office is entirely funded by AIB and BoI on a pro-rata case basis.
- All eligible borrowers declined by these banks are advised of (i) their formal internal appeals process, and (ii) the Credit Review Office process and how to contact us.
- 1st Credit Review Office case = early June 2010.
- 3 Radio/Press campaigns = April, July, September. (4 planned for 2011).
- 2 Progress Reports issued July 2010, November 2010.
- Attendance at Dáil Enterprise Trade and Innovation Committee 21st September 2010.