Credit Review Office Fourteenth Report
John Trethowan

1. Report Overview (Press Release)

This report notes two of the main issues affecting the SME sector:

(i) the credit requirements of the real economy as growth returns;
(ii) the challenges posed in refinancing some businesses and farms as the banking market contracts.

The Credit Review Office is pleased to observe the impact of the recovery in the improving financial figures on those businesses which have asked for their case to be reviewed. It appears that 2013 saw the adverse domestic trading conditions bottom out, and the financial and management accounts for 2014 are showing improved turnover and profitability, albeit on weakened balance sheets reflecting the difficulties encountered between 2008 and 2013. Profit projections are also now more optimistic; however it will take some years for many SMEs to recover their past liquidity and solvency strength.

Whilst we continue to observe banks being generally supportive, there continues to be a challenge in obtaining finance for those SMEs which have been distressed but are now recovering, and are viable or potentially viable – particularly those with property debt overhangs.

As with any other businesses, these more challenged SMEs now require working capital to grow their turnover and, following years when capital replacement was deferred, some SMEs now also require term lending/asset finance for the continuation and growth of their business.

A trend is emerging of banks tentatively supporting these more challenged businesses by offering short term and restricted credit facilities against performance milestones which, if achieved, will allow more funding for longer periods to be advanced. Such an approach to challenged businesses is prudent and understandable. However this, coupled with the complexity of the cases since the Credit Review Office upper limit was raised to €3M, has meant that reporting outcomes of the credit reviews is becoming more difficult as the nature and period of "work out" for these cases continues to extend.

The other main feature of SME/farm finance is the reducing number of banks servicing the SME/Farm sectors and the concentration of the banking market. This is resulting in many SMEs and farms urgently seeking to refinance from those banks which are remaining. Again, whilst many SMEs and farms are being accommodated by the remaining banks, the challenge comes when an enterprise shows some form of distress in their recent past performance. There is also a likelihood that most refinanced facilities will be obtained at higher rates of interest.

As the number of players in the supply of SME credit is a concern, the Credit Review Office welcomes the recent establishment of the Strategic Banking Corporation of Ireland.

The Credit Review Office also supports the use of debtor finance which relies on the financial strength of the trade debtor, rather than the SME itself, to advance funds. There are a number of innovative new entrants into the debtor finance market, some of which will finance single invoices, and this is welcomed.

I also welcome the Minister for Finance's announcement in Budget 2015 that ptsb will shortly recommence actively lending to the SME sector, and has agreed to participate in the Credit Review Office process, with Ulster Bank actively considering making a similar commitment.

Credit Review Office outcomes

Each application for review received by the Credit Review Office is subjected to an in-depth assessment by an experienced credit reviewer. In the nature of being a rejected application from a bank, the SME in question is often presenting some form of credit challenge. Our recommendations come on the basis of proven banking experience and on evidence of ability to repay. Inevitably some risk remains which my opinions seek to reduce and mitigate, and my recommendations try to balance the credit risk with an assessment of the likely success of the business.

Like the banks, we most times get it right - but on occasion we may, given the risk and changing circumstances, support the applications from a few businesses which do not subsequently survive. However we do not take our decisions to overturn a rejection from the banks lightly and adopt high standards in relation to the recommendations we make.

That is why recent public comments by the Bank of Ireland CEO are of concern to us and have merited some further investigation by my office. This statement by Bank of Ireland surprised the Credit Review Office as the bank had not advised of any concerns at our regular meetings prior to making this public statement.

On the basis of our continuing discussions with Bank of Ireland, it does appear that over 85% of the businesses in which the Credit Review Office overturned the banks initial decision continue to trade.

Monitoring Bank Lending

The Credit Review Office continues to monitor the lending by AIB and Bank of Ireland on a monthly basis, and to receive quarterly detailed funds flow updates on the change in balance sheet lending totals for the SME/ Farm sectors. I also join the Department of Finance quarterly review meetings with the two banks.

The performance of the two banks is closely monitored, and this year is showing record levels of sanctioning activity, which is being driven by three main factors:

(i) The economic recovery, with continuing strong demand from the dairy sector in farming in advance of the abolition of milk quotas in 2015. (ii) Refinancing of exiting bank debt. This is crucial to the survival of many SMEs and Farms. (iii) The remaining long term debt restructuring of distressed SMEs.

The levels of 'new money' being lent by each of the two banks are also at the highest levels since monitoring started in 2010, although some of this will include refinancing activity from exiting banks. If SMEs/ Farm are unable to get debt refinanced or restructured, then there is a real threat of the appointment of receivers to realise any value in the businesses with a resultant impact on the jobs and livelihoods of the employees.

However, on new money, the banks continue to report subdued demand arising from a lack of confidence to invest at this stage in the economic cycle. This lack of demand for investment capital is borne out in the Dept of Finance ½ yearly surveys of SME activity.

Endorsements of Credit Review Office Service since last report

HPP Tolling

I cannot speak highly enough of the service, advice and support provided to our company HPP Tolling by the Credit Review Office. We were a new start up company looking to raise finance for our business which provides Irish Food Companies convenient access to an innovative technology called High Pressure Processing (HPP), which can be used to improve the safety, quality and shelf life of a wide variety of food products. Our business is the first of its kind in Ireland and along with being a start up this brought many challenges in raising the necessary funding to get our business off the ground.

The Credit Review Office reviewed all aspects of our business plan in fine detail and following a number of discussions with ourselves and our bank worked through all obstacles and concerns to hammer out an agreement that was acceptable to all stakeholders. Throughout the whole process we were kept fully briefed on developments and were always treated in a very professional and courteous manner. I have no hesitation in strongly recommending the services of the Credit Review Office to any SME looking to raise finance for their business. They have been an invaluable support to our company and we sincerely thank them for all their help and advice without which we would not be open for business today.

Liam Murphy
HPP Tolling

Carambola

After our initial application with the bank for a stocking loan was turned down, we contacted the Credit Review Office to appeal this decision.

The Credit Review Office were very supportive and after a review of the business that covered the history, the current position and future projections, they were satisfied with our profitability and repayment capacity and recommended to the bank that they reverse their decision, which the bank did.

We found the Credit Review Office to be very professional and thorough and the process forced us to look at our business from every angle, they gave us some useful advice for the future and ultimately it was reassuring to get their backing in our appeal.

In summary they 'looked under every blade of grass on the pitch', they backed us, and the outcome was we got the funding we needed.

We would have no hesitation in availing of, or indeed recommending, their service in future.

Colm O'Brien
Founder and MD www.carambola.ie

2. Progress Update - The Quarterly Report

Key Overall Developments / trends in the Quarter:

While an economic recovery is gaining momentum across all sectors of the Irish economy, it is important to recognise that this positive tipping point will bring its own challenges. In a number of ways we have never been in a situation like this before. Economic growth will take place against a backdrop of a concentrated banking system and a weakened SME sector which has battled through 5 years of difficult trading conditions. My view is that policymakers are alert to this changing environment. We are moving to a different set of challenges that will require different thinking and initiatives to address.

The supply side – the banks

A backdrop to the recovery in the domestic economy is the ongoing concentration of the supply of finance to the SME credit market by the withdrawal of international banks which are retreating to their core home markets.

This market failure in the lack of supply is manifesting itself in a number of ways – some of which have been around for a while and others are emerging:

1. Whilst SMEs generally welcome access to their accounts and credit through digital applications, the rationalisation of physical distribution channels has led to some breakdown in the banker-customer relationship, with widespread criticism that SMEs feel processed to a binary yes/no answer on a credit, which is dissuading some SMEs from even seeking the credit they may require.
2. With only three main banks in the market, and the others withdrawing, there are many SMEs and farms with the banks which are exiting that will need to be refinanced with the remaining three active banks. With significant numbers of the SMEs which borrow exhibiting some form of financially challenged condition, coupled with the active banks' strict lending policies and limited risk appetites, this will be a challenge for the wider economy and recovery.

The Demand Side- SMEs

SMEs benefited from the pre 2008 boom time, however many made strategic errors in over borrowing, and in how they invested the reserves of the business. Some invested in capacity which was required at that time, but has proved far ahead of the sales levels which businesses could subsequently and currently sustain.

SMEs are now showing welcome signs of recovery in their 2013 and 2014 figures, however it will be some time before many can be deemed financially strong and lower risk. The challenges some face are characterised as follows:

1. Viability challenges: Many of the weaker businesses have already failed. Some have been kept alive by banks restructuring past debts, in both the banks' interests and the businesses. Central Bank activity in 2014 has sought a more permanent resolution of these ad-hoc debt arrangements.

2. In terms of credit, many businesses have only survived by the promoter investing in the business through directors loans to the company, either directly or by taking reduced salaries. For those businesses which have not turned the corner the ability of directors to find further funds to support the ongoing existence of the business diminishes through time.

Given the relatively small scale of many Irish SMEs, their financial management capability is limited. Many produce financial accounts only for tax purposes, and these are generally available much longer than a year after their financial year end. Most local accountants do not add value to the production of financial accounts by running some comparative ratios to assist in the identification of trends which could assist business promoters.
Most of the smaller SMEs do not produce or use management accounts, which are vital not only for the running of the business but to access bank finance. Indeed smaller SMEs appear to produce management accounts only as a means to an end to secure bank finance.

SME skills and strategic vision are a key ingredient of any attempt to strengthen this business sector and also to diversify the source of financing, particularly alternative non-bank financing. There is a need to support SMEs in developing a more strategic approach to business financing so that they have a better understanding of how different credit instruments could serve their specific financing needs, the advantages and risks associated with them and how best to leverage these different sources. This will necessitate a stronger emphasis on the integration of general SME capability building, including guidance and financing measures. Consequently the LEO's network will be the key conduit in providing information, support and advice to small businesses on access to finance issues.

Section (ii) What happens next and the challenges going forward

There are two tides flowing against each other on the SME/ Farm demand for credit, these being the interplay between old and new debts, and this is evident on the banks quarterly funds flow statements supplied in the monitoring of bank lending:
a) relatively subdued demand for new credit; which should increase in a recovery to accommodate higher working capital needs, and also to fund new investment projects; and
b) the deleveraging/repayment of legacy debt continues to be a major contra feature.

Against this background the major challenges are:

1. Refinancing of exiting banks loan books.
Typically these exiting banks will settle with the borrower for their loan debt at the market value of the asset they hold as security. It is vital that the remaining banks in the SME/ Farm market refinance as many of the affected SMEs and Farms as possible. It is unlikely that these refinanced facilities will be provided at the beneficial rates which were offered on the original lending by the exiting banks.

2. To support economic growth, there needs to be encouragement of new entrants and providers of non bank credit. The important development here is the establishment of the Strategic Bank Corporation of Ireland (SBCI), which will provide lower cost funding to existing banks and new entrants, but also longer loan periods and more innovative financing solutions to meet the needs of SMEs in the real economy.

Many Irish SMEs are of relatively small size or sub-scale for traditional non bank funding – external investment can have fixed due diligence costs rendering private or stock market investment uneconomic. In addition, many are sole traders or family owned companies and there is a reticence to dilute ownership. This leads to a high reliance on banks for those SMEs which need to borrow for working capital and investment.

I welcome SBCI in offering patient and intelligent capital at a lower cost for a 10-year period, there is a major benefit and a risk mitigant for SMEs. Future Bank funding costs could increase for a whole host of reasons, and to lock in lower cost funding through SBCI will be a major benefit in protecting employment in the SME sector in such circumstances. This should provide increased confidence to the SME sector as it increases the certainty around the availability of funding to that sector even in adverse financial market conditions. This will protect existing employment in the SME sector as well as boosting employment as over time SMEs will be able to finance investments using new types of lending products that are not available at present.

There are also a welcome number of new entrants into the debtor finance market, which are not only bringing additional capacity but also product innovation, such as single invoice discounting. The Credit Review Office supports the use of debtor finance which relies on the financial strength of the trade debtor, rather than the SME itself, to advance funds.

3. The Government should also consider an expansion of the Microfinance loans scheme limit to at least €50K (possibly €100K). This would provide easier access to finance. An increase in the limit will likely also need the term to be extended beyond the current 3-5 years to ensure that repayment levels are affordable.

4. Ensuring SMEs/Farms do not use their working capital to finance their expansion/ capital replacement, particularly as we now enter better economic conditions. The Credit Review Office sees too many cases where SMEs make this strategic error and quickly run into cashflow difficulties. LEO's local accountants and advisers, and bankers all have a role to play in advising SMEs to avoid using working capital for long range investment.

5. Whilst it understandable for banks to be cautious in lending to recovering SMEs and farms and to part finance for shorter periods to assess progress against milestones, the Credit Review Office would like to see banks taking a more strategic long term view of the financing needs of SMEs and farms returning to growth and financial stability. Short range financing is understandable for some recovering SMEs, but it must be couched within a longer term vision of the partnership between the bank and the business/farm.

(iv) Credit Review Office activity

My last report was issued on 24th March 2014.
This report covers the period to 9th October 2014

Helpline/ Web Activity:

These charts show the level of activity across the 14 reports issued to date. Note that these figures are influenced by our media advertising activity.

The recent Department of Finance biannual SME survey indicates that 64 % of respondents are aware of the Credit Review Office, however 62% of SMEs claim they were not made aware of the Credit Review Office by their banks (since the last survey AIB and BoI have reviewed their decline letters to ensure that the Credit Review Office service is offered. The figure may also reflect that some of the survey respondents may not be in Credit Review Office participating banks, or may not have had credits declined).

The Credit Review Office objective to assist viable SMEs/Farms to obtain credit is clear, however we only report on formal appeal outcomes. In addition to this formal reporting the Credit Review Office helpdesk team continue to resolve many bank queries and credit issues on behalf of borrowers by liaising with the banks' dedicated Credit Review Office liaison teams. While we do not record this activity in these reports; many such cases are resolved without the requirement for a formal appeal and this assists in improving the environment for SMEs seeking to access credit.

It would be remiss not to recognise the very good and continuing cooperation provided by the two dedicated Credit Review Office liaison teams within AIB and BoI.

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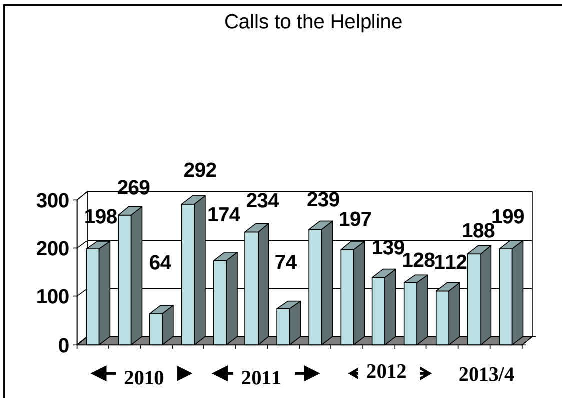

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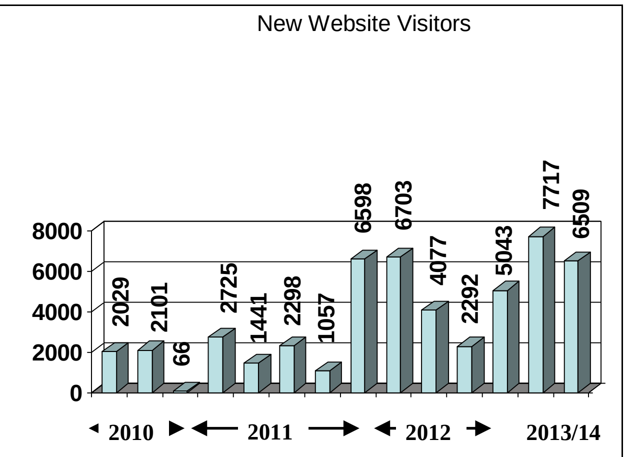

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<td>The helpline has taken 2507 calls to date, an increase of 199 calls since the last report.</td>
<td>The website has had 51,253 different web visitors to date. An increase of 6,509 since the last report</td>
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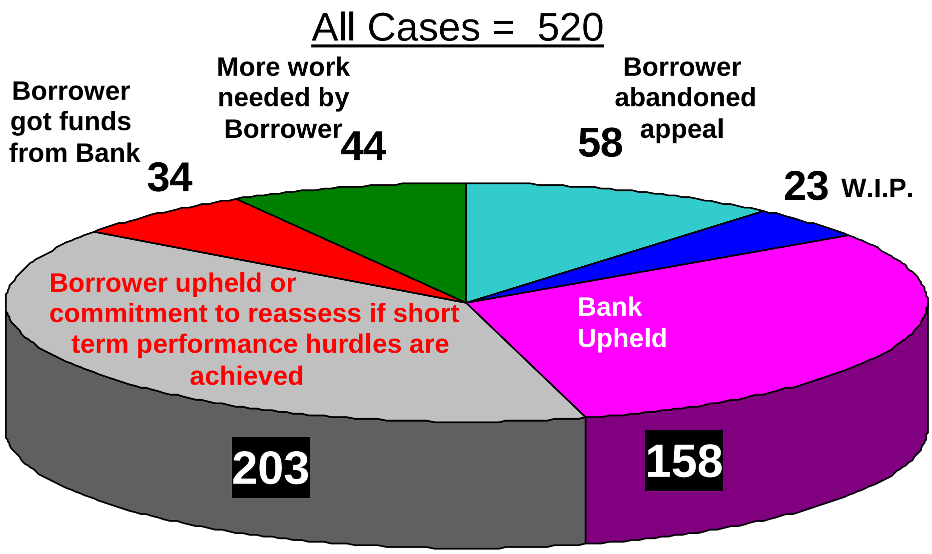
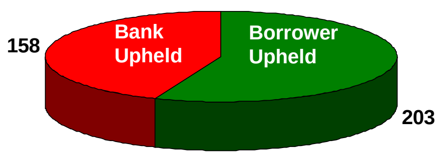
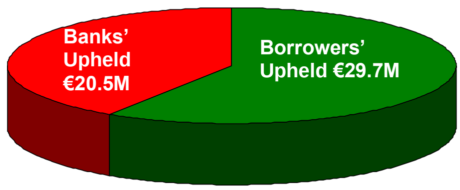
Credit appeals to the Credit Review Office

We have received 520 formal applications to date. Of these, 361 reached final conclusion and the Credit Review Office has upheld 56% of the appeals in favour of borrowers, or with a commitment to reassess the lending in the future if agreed performance hurdles are met in the short term.

Some of the other appeals are work in progress, others are resolved between the borrower and the bank before opinions need to issued. The breakdown is as follows:



From the above chart of the 361 cases which have been finalised as formal reviews with opinion issued, the breakdown is as follows:

	
Cases Completed and Opinions Issued By Number 361	Cases Completed and Opinions Issued By Value = €50M

The upheld appeals have resulted in €29.7M credit being made available to SMEs and farms, helping to protect /create 2,091 jobs. However, since the Credit Review Office upper limit was raised to €3M, and with the weakened state of many businesses seeking new credit to grow, it has meant that reporting outcomes of the credit reviews are becoming less black and white. This has led me to caveat the upheld appeals number, as some lending is now being agreed on the basis of an interim amount to meet short term needs, with performance milestones agreed for the business/farm whereby further funds will be made available on achievement of these measures.

Banks' Internal Appeals:

AIB	Appeals WIP	Borrower Appeals Upheld	Borrower Appeals Declined	Total Internal Appeals	BoI	Appeals WIP	Borrower Appeals Upheld	Borrower Appeals Declined	Total Internal Appeals
2010		22	45	67			6	83	89
2011		68	85	153			12	167	179
2012		93	191	284			7	101	108
2013		79	173	252			45	95	140
2014	17	39	115	171		0	20	83	103
TOTAL	17	301	609	927		0	90	529	619

AIB End August BOI End August

Other Credit Review Office for those report period:
As part of the Office's activities, in order to gain feedback from all stakeholders and SMEs, the following groups were met with, or their member conferences and seminars addressed/attended in the last quarter:

Updates/ Meetings

- Weekly reports to Department of Finance
- Ongoing liaison with Dept of Jobs, Enterprise and Innovation.
- Monthly attendance at State Bodies Group on SME finance.
- Monthly attendance at Advisory Group for Small Businesses.
- Contribution to 4 Taking Care of Business Roadshows – Access to Finance presentation, and Credit Review Stand
- Contribution to 3 Financing Your Business – SkillsNet Courses
- Attendance at 9 official openings of the Local Enterprise Offices
- Attendance at SME Funding Consultation Committee
- Meeting with the N.I. Ministers of Finance, and Department of Economy, Trade and Investment.
- Regular Meeting with Central Bank Prudential Risk team
- Attendance at Dept of Finance AIB & BoI quarterly formal reviews on lending performance
- Meetings with Senior Executives in Ulster Bank and PTSB
- Housekeeping meetings with AIB and BoI on interaction with Credit Review Office
- Meeting with new providers of SME Debtor Finance.
- Credit Review Office annual meeting for Credit Reviewers.
- Annual Meeting with IFA

Research Assistance

- Attendance at the Credit Guarantee Scheme Steering Group
- Monthly Attendance and input to design and implementation of the Dept of Finance Supporting SME's communication database
- Meeting with NPRF re debt funding for smaller SMEs
- Meeting with ESRI on Financing SMEs in Recovery research project

Contributions at Conferences etc

- Presentation to Institute of Banking in Ireland CPD event for bank directors.
- Presentation to EU conference on Bank Lending Transparency in DG Jobs in Brussels.
- Presentation on banking for SME start ups in Limerick.

- Attendance at hearing on SME credit of Oireachtas joint committee on Jobs Enterprise and Employment, and attendance at the subsequent launch of their report into SME lending
- Attendance and stand at SFA annual conference.
- Attendance at SFA annual lunch.
- Presentation to a delegation of senior Bangladeshi bankers in Dublin.
- Attendance at IVCA Annual Report Launch

General progress since last report.

We continue to implement the findings of the Grant Thornton Report into the Credit Review Office effectiveness.

1. Review the CRO application process

   Complete and ongoing

   Working to use the borrowers application form as the main form the Credit Review Office needs from appellants

2. CRO initiated review of certain cases following the bank internal appeals process – there may be data protection issues for the banks in this suggestion.

   This would apply to borrowers who chose to appeal to the covered banks' internal appeal process, but not to the Credit Review Office for review, (at present @70% of cases choose only the bank internal appeal route). Awaiting Dept of Finance decision.

3. Increased proactive profile raising and stakeholder support of Credit Review Office

   Complete and ongoing – see above activities by the Credit Review Office team.

   The recent Dept of Finance survey indicates that 64% of their respondents are aware of the Credit Review Office.

   See activities above: All reviewers are active in engaging with Government Departments, Trade Representative Bodies and directly with SMEs /Farms at meetings to promote the Credit Review Office. Our new reviewer team have good regional coverage and have attended functions to also promote and take feedback on the credit market and the Credit Review Office.

4. Leveraging the visibility/expertise of the Credit Review Office

   Complete and ongoing

   The Credit Review Office is part of the Dept of Finance team on SME matters including briefing the Troika, developing the new state assistance database and being part of the Loan Guarantee Scheme Steering Group.

   Credit Review Office staff routinely attend the State Bodies Group, and the Action Group for Small Business.

5. Expand the number of participating banks

   The Budget announced that Permanent TSB would commence SME lending and voluntarily join the Credit Review Office scheme.

   We would be willing to provide this service more widely however my understanding is that this will require a change in legislation beyond the amendment of the Statutory Order.

   At present the Credit Review Office covers only 75%+ of the SME and Farm market.

6. Increase the resources of the CRO to meet its expanded remit.

   This is completed with the recruitment of 12 credit reviewers which report to Deputy Credit Reviewer Catherine Collins and myself in credit committees and finalising reviews.