# 1. Report Overview (Press Release)

In his 11th report, Trethowan observes more appeals requests for credit for working capital increases and business investment in response to improving confidence in he economy.

He expresses concerns on the small number of active banks and other lenders currently supplying new credit to the SME market. He foresees increasing challenges to refinance existing debt, and meet new lending demands from borrowers currently banked with non-trading banks and banks which are strategically exiting the Irish SME lending market. As many of these refinancing requests will exceed the current Credit Review Office limit of €500K, Trethowan has requested that this upper threshold for appeals be increased to €3M.

Whilst a number of Government and other non-bank credit initiatives have been introduced over the past few months, he is concerned about the availability of such finance in the gap between the up to €25K microfinance loan scheme and c€750k where angel finance and venture funds become viable.

During the quarter the Credit Review Office has managed incoming appeals at the same time as procuring new Credit Reviewers to meet anticipated demand from SMEs seeking refinancing, additional working capital or investment capital for expansion; and to implement those recommendations within his powers in the Grant Thornton report on the Credit Review Office.
The Credit Reviewers team has been increased to 14 and media campaigns to promote the Credit Review Office can now recommence.

**Credit Availability**

- Banks continue to lend to low/medium risk credit applications.
- AIB & BOI appear to be now more supportive of SME/Farm credit requests, and the presence of the Credit Review Office is playing a part in this.
- Property related debt overhang continues to be a major issue for SMEs and farmers. It is vitally important that banks uncouple these legacy debts when assessing credit requests for SMEs & farms to ensure that viable or potentially viable business are supported.
- There is still evidence that more effort is required by banks to find ways to improve or enhance credit applications that are not supportable as submitted.
- Front line experience is still an issue as increasing numbers of experienced managers are retiring. Banks are working hard to address this.
- Response times to credit applications are still an issue that needs to be addressed.
- Borrowers also need to understand that the business/banking world has changed, and that quality business plans and up to date financial information and other information properly presented are a prerequisite to applying for credit.

## (ii) Banks' €4bn Sanction targets:

AIB and BoI are targeted with sanctioning €4bn each in 2013.

- **This has been the best Q1 sanctioning performance in the three years of monitoring Q1 figures.**
- The decline in both banks overall SME balances is tailing off, in fact both SME balance sheets show some sporadic growth in the past months.
- At the end of quarter 1, both banks' sanctions are on or near where they would be expected to meet the target, taking account of the seasonality which has been identified over the past two years. (typically Q4 is the strongest quarter for sanctions).
- 33% of the sanctions in Q1 2013 are reported as new lending
- Of the new lending reported in Q1 2013, c. 24% is farm related (up from 20% in overall 2012) – there may be Q1 seasonality in farm lending.

The targets will be met from new lending, restructuring existing debt, and refinancing loans from other non active banks. All are important for the economy.

## Endorsements of Credit Review Office service this quarter.

‘As a small restaurant owner I have endured the last three years wondering when, rather than if , it was going to be my turn to close the door and lose everything I had spent the last twenty years building up.
As most people in business know when you work for yourself it is a vocation not a vacation - when things go well you keep going and when things go bad you have to get up again and try again. This recession is different.
Self employed people were left with nowhere to turn. Having cut costs as much as possible and worked morning noon and night I tried to survive and hoped to ride out the bad times but things didn't change.
I needed to get funding to try and revive my business and having tried all banks was met with a closed door.
I applied to CRO to look at my case and having submitted my case awaited a response.
One Friday afternoon I got a call from the person assigned my case and from that day on a weight was lifted off my shoulders.
I had found someone who would look at my case and see the merits in my business as well as its risks.
I got approval for my loan and am now still working as hard but have something to aim at. There is a future now and hopefully I will be able to increase the workforce to half pre- recession levels and if every small business could do that the dole queues would be greatly reduced.
No big fanfare of job announcements or pictures all over the press - the Credit Review Office are working away quietly and are doing more for job creation and Irelands recovery than they are getting credit .
For this I thank you.’
**Denis Kiely, Tom Skinny’s Pizza Parlour in Clonmel**

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‘We are a dry cleaning and laundry company specialising in the corporate and hospitality sectors. From 2009 onwards our company suffered as a result of the downturn in the economy. We reached rock bottom in December 2011 and as a result we were forced to cut our costs and most notably put our employees on 'short time'.

These cost reductions, in addition to the fact that we were able to secure a significant amount of new business, enabled us to turn our business around over the a relatively short period of 6 months. From that point onwards, we managed to increase our year-on-year sales dramatically and put all our employees back on full-time hours.

Due to the massive increase in new business secured we found ourselves in the enviable position of needing to expand our business. We duly went to our bank to look for a business loan to help finance this expansion. After much delay, on their part, we were flatly declined. We were confident of our figures and so contacted a senior manager at the bank's head office, put forward our arguments and requested our case be reviewed again. We were then offered something that fell massively short of our expectations.

Finally, we decided to contact the Credit Review Office to have our case formally reviewed. I am glad we took the time to go through this process, as it resulted in us securing funding significantly more than the bank was prepared to offer. We have always found the Credit Review Office to be very professional, helpful and

straightforward to deal with. Without their assistance we would not have been a position to further expand our business, secure our existing employees jobs and create 2/3 new positions. We would actively encourage any company with a viable business, that has had a loan rejected by their bank, to consider having their case reviewed by the Credit Review Office.'
**John Kehoe of Kehoes Dry Cleaning, Ballycoolin, Dublin 11**

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'We run a childcare facility in Cork with 22 employees. We were leasing our premises and nearly a year ago the premises were up for sale. We applied to the bank for a mortgage to buy the premises as it was more affordable than paying rent for the rest of our lives. The Bank took a long time to come up with a decision and were always looking for more information. Eventually after a few months, they refused our application. In the meantime other parties were interested in the premises, and if we didn't buy the premises, our business would have been at risk.

We applied to the Credit Review Office and explained our urgency in this case. Our case was taken very seriously, and after I sent in all the forms, there was only a few questions that needed answering. They called me on a Saturday afternoon so they could speed up the process, which I was delighted with. All questions were answered and within 2 weeks we had a decision and the bank overturned their decision. We are currently waiting for contracts, since our offer was accepted. We couldn't have done it without The Credit Review Office, and I don't know if our business would have succeeded without their help. I cannot thank these guys enough for their service, efficiency and professional manner.'
**Glenn Muliett of Réaltaí Cúram Leanaí , Mallow Co. Cork**

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'We are a small company in the car business. We were recently turned down by one of the taxpayer bailed out banks for a loan.

We applied to the Credit Review Office. We found that they were exactly like what we expected a bank should be like. They were extremely thorough, but were generally looking for ways to make the application work rather than not work, while all the time asking probing questions where they thought there may have been a weakness in our application, giving us an opportunity to satisfy any doubts they had. We do have an extremely effective Accounts and Stock Control system in place, which was vital. The Credit Review Office are very thorough and diligent, but they can only work with the information that they are given, so the clearest manner that this is presented is vital.

The whole process was very thorough, but speedy. If the CRO had given us an opinion that they felt our application shouldn't have been approved, the whole process was so thorough, detailed and explanatory, we would actually have been more understanding, rather than the remote hands off feeling we had in dealing with the bank.

Simply put, our loan application deserved to be approved, but we only got it approved with the assistance of the CRO. It would not have happened without them.'
**(Client has asked to remain anonymous)-**

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# 2. Progress Update - The Quarterly Report

## Key Overall Developments / trends in the Quarter:

### (i) Credit Availability

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- Of the new lending reported in Q1 2013, c. 24% is farm related (up from 20% in overall 2012) – there may be Q1 seasonality in farm lending.

The targets will be met from new lending, restructuring existing debt, and refinancing loans from other non-active banks. All are important for the economy:

**New Lending** is important in being economically generative.
The size and condition of the Irish SME market would not support annual New Lending of €8bn pa.

As it is, in Ireland like all of our EU counterparts, there is little economic evidence of what the ‘system demand capacity’ for new lending to SMEs actually is, on which to base an exclusively New Lending target. This system demand will vary from nation to nation based on the general strength of the economy and the financial condition of the SME stock.

Indeed it has been argued that if New Lending of €8bn pa. were to be achieved in Ireland, it would require a lending/borrowing rate of approximately twice that of the EU’s most successful economy, Germany, on a like for like scale basis.
Unlike Ireland, Germany has had steady growth through the post crash period and is renowned for the structural strength of the SME Mittelstand.

What we do have is the independent biannual SME survey conducted on behalf of the Department of Finance which shows a consistent demand for SME credit between 35% and 40% over the three year period. This is understandable as economic conditions have dictated paying down legacy debts rather than investing in new projects, or requiring additional working capital for trade expansion. This is evidenced in the funds flow statements which the two banks report quarterly. This level of demand certainly does not suggest a New Lending figure anywhere close to €8bn pa.

A return to more sustainable levels of domestic demand will lead to businesses requiring more working capital, investment finance of new projects, and many SMEs will also be required to replace obsolete or end-of-life capital goods depleted during the recession. This will increase the ‘system demand capacity’ for new lending.

**Restructuring** is important in being economically supportive.
Whilst it does not increase the stock of SME lending on banks’ balance sheets, restructuring has been vital to those SMEs which have come to the end of lending contracts and technically are expected to have repaid the loans; or have had to formally break existing contracts to alter the term of repayment to continue to trade.

The restructuring figures reported to me are for formal contracts only, and not casual forbearance measures such as temporary interest only periods.

Many businesses have been rescued and jobs saved by the banks’ formal restructuring and informal forbearance. The Troika have now asked for more medium / long term solutions to be put in place to deal with these businesses, and a continuing targeting of this area is vital to ensure as many businesses as possible can be returned to viability.

**Refinancing** is important in being economically supportive.
Whilst this will grow the stock of lending in the 3 active banks currently lending into the SME market, it will not increase the overall national stock of SME lending.

I consider this to be a vital area over the next few years, as many SMEs/farms will need to be accommodated from those banks which are exiting the Irish market; or from funds which have bought banks’ debts and may ‘spring clean’ some more challenging loans from the lending books they bought.
The need for refinancing may also be triggered by new credit needs which are not being supported by exiting banks. .

Given that we have arrived at an unsatisfactory situation of having so few active lenders in the SME / Farm Markets, there is insufficient competition and this may lead to a situation of cherry picking new business and re-financing by those banks which remain active in the SME lending market.

## (iii) Trends in the supply and demand for credit - The challenge for Banks and SMEs in a recovering economy:

As stated in previous reports, as the economy recovers, particularly as domestic demand improves, the demand for credit will increase. Over the past two quarters we are seeing more credit appeals for expansion working capital and for potential investments in fixed assets to grow businesses.

This report will look at the overall supply capacity.

(A) Supply capacity

I remain concerned at the small numbers of finance providers in the Irish SME market. With three main banks and a couple of specialist Debtor Finance providers, my view is that a recovery may be hampered by a significant shortfall in credit availability as there are too few suppliers to meet the demand for bank finance.

To be clear, it is not my expectation that there will be any strategy by our banks to restrict credit – they need to lend at sensible margins to generate profits.

Another emerging development at European level is an increasing focus on the potential role of alternative funding sources for SMEs. Internationally, as in Ireland, banks are deleveraging and have become more risk averse in the allocation of capital. As a result, non-bank funding channels for SMEs could provide valuable alternative mechanisms to support the funding requirements of SMEs across Europe. Whilst bank funding will retain the lion’s share of SME financing, I would expect to see greater investigation of the possibilities at both national and international level.
A matrix of state supports for SMEs was prepared by DOF and is available on the Department’s website and smallbusinessfinance.ie.

The microenterprise loan scheme providing funding up to €25K has been a helpful introduction, however there is a huge gap between this €25K package through to c. €750K where angel finance, private equity and venture funding becomes cost effective.
Good work is being achieved by the NPRF in attracting funding, through a number of packages announced in this quarter however, given the nature of these funds, only one of these packages is reaching below the €1M threshold.

Whilst not a silver bullet in itself, the arrival of peer to peer finance in the quarter is also to be welcomed as a further source of finance. All new and additional forms of credit are needed, and are to be welcomed. During the quarter I have also met with the Business Angels movement and this may also be an increasing source of Non Bank financing under €1m.

My second concern is that competition amongst the few in an undersupplied market here in Ireland can lead to unplanned but unhelpful behaviours as regards credit appetite, and management and staff behaviours, when the remaining banks no longer have to try too hard to maintain and gain business.
Some cherry picking of SME business is already evident; and I have also commented on the borrowers poor experience in applying for loans in previous reports and have written to bank CEOs to highlight the concerns raised by SMEs on these experiences.

It is highly unlikely that we will see a branch based retail bank enter the Irish market, however at a time when the economy is looking up and Irish asset prices and trading conditions provide a realistic starting point for new credit assessment – the Irish Banking market need not be as scary for new credit providers as current perceptions imply.

(B) Challenges which growth may bring to some SMEs
Over this quarter we have seen more appeals seeking increased working capital in anticipation of increasing sales.

Many Irish SMEs are undercapitalised after absorbing losses from subdued trading, or failed property plays; paradoxically, having survived through the downturn, this undercapitalisation could pose a greater challenge for these businesses in the future as they seek to borrow new funds to partake in growth in the domestic economy to rebuild their balance sheets. I will outline some of the challenges which growth will bring to undercapitalised SMEs.

It appears that those SMEs with healthy solvency and liquidity ratios are accessing additional working capital with little difficulty from our banks; however bearing in mind that the cases coming to the Credit Review Office all carry some form of credit challenge, the appeals we see for increased working capital have three emerging trends:

(i) Promoters Stake: The businesses are undercapitalised for growth, and the level of borrowing required to support growth.
Our banks are typically seeking to lend 65% to 70% of the finance for any project (gearing). Undercapitalised businesses typically do not have the free assets (cash) to meet the businesses' stake in the borrowing. This leaves the need for 'new capital' to be introduced either from the promoters' personal assets, funds from 'friends and family' or enterprise capital from EIIS type schemes, or newly emerging channels such as peer to peer finance.

The Government Microenterprise loan scheme is a valuable source of seed capital for start-ups, and can also provide alternative top up capital to achieve more suitable gearing and thus unlock access to bank funding for more established SMEs which have had their capital eroded.

The Government Temporary Partial Credit Guarantee Scheme has also now been implemented to principally overcome security/collateral barriers to credit by viable SMEs.

(ii) Validating Businesses' projections: As we move into better times, the credibility of the SMEs' future cashflow projections are difficult to validate. It is difficult for borrowers and banks to predict what level of projected turnover will be actually achieved following a long period of subdued turnover from low domestic demand.
The probability is that some elapsed period of improved turnover will be required to validate the projections – I appreciate this is somewhat of a chicken and egg situation.

(iii) SME Loan Restructuring: There are many causes of the difficulties which the SMEs that appeal to the Credit Review Office present with. One in particular is from successful businesses which borrowed to invest in additional capacity in the buoyant market conditions leading up to 2008. These are good businesses and good business people.
Unfortunately, as demand slumped and public expenditure was cut back, many of these businesses have seen large reductions in turnover and have had to continue to service their loans as best they can, whilst at the same time watching the value of the asset they invested in fall away (typically their commercial property).
The challenge for the banking sector is to effect real and meaningful debt restructuring where there is a substantive viable core business. This can only be done on a case by case basis but requires skill, expertise and transparency on both sides. The price of such restructuring can be the transformation of the balance sheets of the SME and the release of their potential to grow their viable core business. For banks, these revitalised SMEs are a source of ongoing future bank profits with the prospect of such new performing loans being available as collateral should new EU-level market financing initiatives arise.

## (iv) Credit Review Office activity

### Helpline/ Web Activity

These charts show the level of activity across the 11 reports issued to date. Note that these figures are influenced by our media advertising activity. During this quarter we have held back on campaigns whilst we concentrated our efforts on recruiting additional credit reviewers.

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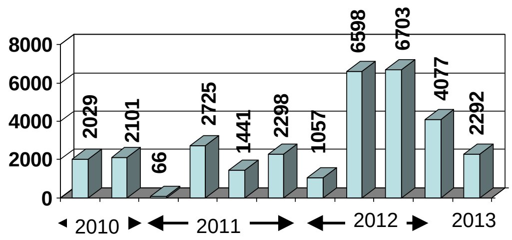
<td>
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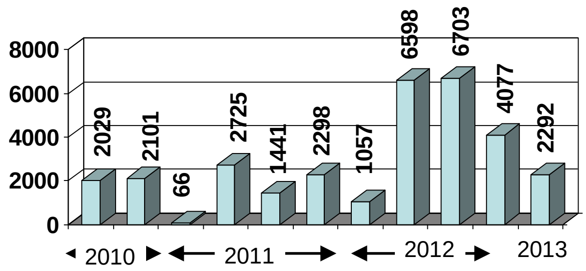
<td>
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<tr>
<td>The helpline has taken 2008 calls to date</td>
<td>The website has had 31,984 different web visitors.</td>
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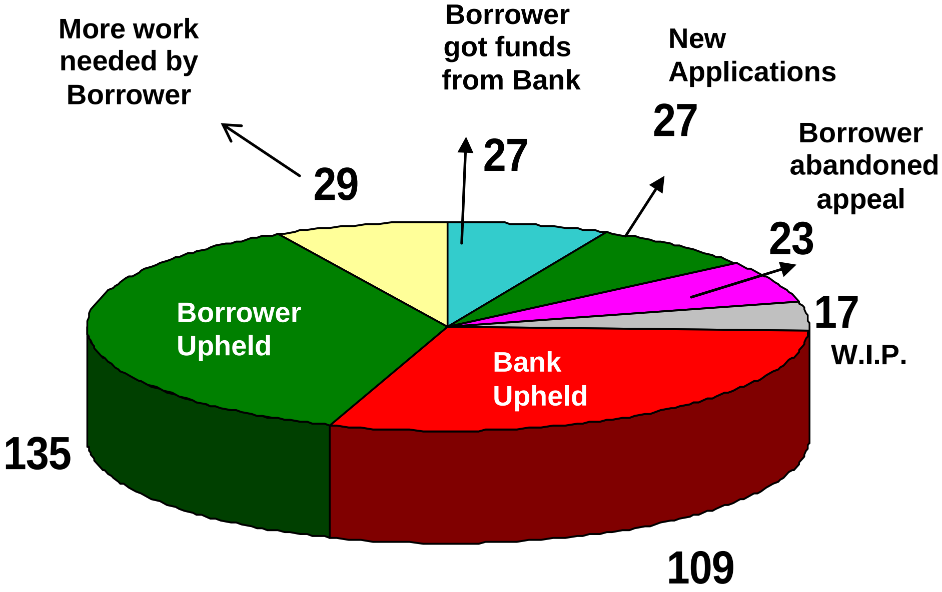
### Banks' Internal Appeals

| 2010-2013 | Cases Reviewed | Bank Decision Upheld | Bank Decision Overturned | % Overturned |
|---|---|---|---|---|
| AIB Bank | 630 | 406 | 224 | 36% |
| BOI | 348 | 314 | 34 | 10% |
| Total | 978 | 720 | 258 | 26% |

## Credit appeals to the Credit Review Office

We have received 367 applications to date. Some of these are w.i.p, others are resolved between the borrower and the bank before opinions need to issued. The breakdown is as follows:

All Cases = 367




From the above chart of the 244 cases which have been finalised, the breakdown is as follows:

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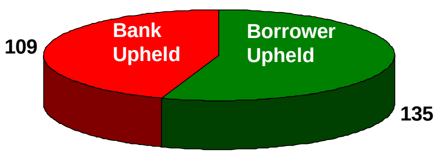
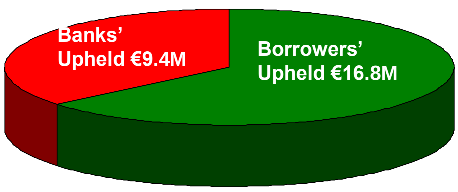
|  |  |
| Cases Completed and Opinions Issued By Number 244 | Cases Completed and Opinions Issued By Value = €26M |

- **The upheld appeals have resulted in €16.8 M credit being made available to SMEs and farms, protecting 1,297 jobs.**

**Other Credit Review Office activity during the quarter**
As part of the Offices activities, in order to gain feedback from all stakeholders and SME's, 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
- Department of Jobs Employment and Innovation.
- Minister Bruton
- Enterprise Ireland
- National Pension Reserve Fund
- Halo Business Angels Network
- Chambers Ireland, ISME, SFA
- SFA Small Business awards
- UK Credit Reviewer Counterpart
- UK BIS representative
- Troika
- AIB & BoI re lending plans

Research Assistance

- Inter-trade Ireland
- EU Credit Rating Survey

Contributions at Conferences etc

- Donegal Chambers
- EU SME Forum Conference
- ERSI Conference

**General progress since last report**
Due to the increase in caseload this year, the Credit Review Office has just completed a public procurement tender process (advertised on OJEU) and is putting in place a multi-operator framework from which to draw Credit Reviewers on an 'as-needs' basis. Training will commence in June.

After new Credit Reviewer induction training is complete I will progress the implementation of the remainder of the Grant Thornton recommendations which are within my remit.

Similarly, we have gone through the public procurement process seeking media buying services. This process is now complete and a contract has been awarded.

Given the growing importance of refinancing of SME debt from those banks which have ceased trading or have withdrawn from supplying SME finance, I have asked for the Credit Review Office limit of appeals to be raised to €3m. The current upper limit of €500K is too low to accommodate the demand for assistance to be re-banked.