

# Credit Review Office Twentieth Report

## John Trethowan

### 1. Introduction

This is my twentieth report, which covers the period 1<sup>st</sup> January 2018 to 31<sup>st</sup> December 2018. The Credit Review Office works on individual appeal cases. These cases also provide my team with a holistic view of developing trends in the SME and farm lending markets to provide the basis for these reports. In addition I receive formal reports on SME and farm lending from three State supported Banks each month, and meet with them each quarter with Officials from the Department of Finance. The Credit Review Office also meets regularly with the main SME and Farming Trade bodies.

### SME Performance Overview - SMEs and farms in the current economy

In my fourth report I called for a more formal examination of lending conditions, and since then the Department of Finance has conducted a bi-annual survey of SMEs<sup>1</sup> which has provided an invaluable source of information on SME performance and credit intentions.

These surveys have shown the recession bottoming out in the first half of 2013, and a continual recovery since then, when the seasonal variations between the first and second half of the years are eliminated.

<u>SMEs Trading Performance</u>	Oct 12/ Mar 13	Apr 13/ Sept 13	Oct 13/ Mar 14	Apr 14/ Sept 14	Oct 14/ Mar 15	Apr 15/ Sept 15	Oct 15/ Mar 16	Apr 16/ Sept 16	Oct 16/ Mar 17	Apr 17/ Sept 17	Oct 17/ Mar 18	Apr 18/ Sept 18
Increased T/O in last 12 months	25%	34%	38%	49%	43%	47%	45%	46%	42%	49%	45%	47%
Same turnover	37%	38%	36%	35%	41%	38%	40%	42%	42%	37%	42%	39%
Decreased turnover	38%	28%	26%	16%	16%	15%	16%	12%	16%	14%	14%	14%

The Credit Review Office appeals process also gives my team access to the financial accounts of many SMEs and we have observed this recovery in the increasing profitability and balance sheet strength of these businesses, albeit that some remain challenged from the impact of the downturn on their business, or from failed non-core property investments.

### Credit Overview

A persistent finding in the Department of Finance SME Demand surveys has been a decline in the demand for Bank lending by Irish SMEs. This has fallen from 40% in the initial survey in the depths of the downturn in early 2013 to the current level of 20% in the most recent survey at September 2018.

SMEs Trading Performance	Oct 12/ Mar 13	Apr 13/ Sept 13	Oct 13/ Mar 14	Apr 14/ Sept 14	Oct 14/ Mar 15	Apr 15/ Sept 15	Oct 15/ Mar 16	Apr 16/ Sept 16	Oct 16/ Mar 17	Apr 17/ Sept 17	Oct 17/ Mar 18	Apr 18/ Sept 18
SMEs requesting credit	40%	36%	35%	31%	32%	30%	26%	23%	20%	23%	26%	20%
Anticipate seeking credit (next 6 months)	25%	26%	26%	27%	26%	27%	20%	20%	13%	20%	19%	19%

<sup>1</sup> <https://www.finance.gov.ie/wp-content/uploads/2019/02/20190129-SME-Credit-Demand-Survey-April-to-Sept-2018-Final.pdf>

These figures continue to pose questions as to why demand has remained subdued during a period of good economic growth?

In my nineteenth report, I suggested that the way in which Banks are addressing the SME and Farm markets – particularly the Micro and Small sections of SME and Farm Markets, could be one cause of this subdued demand. I am pleased that the main Banks have taken steps in 2018 to increase their Relationship Managers across the Regions, as this is what their Customers want.

Whilst quick access to credit via telephone and PC applications undoubtedly works for some SMEs and Farms, our experience is that SME and Farm lending is harder to fit into PC based algorithms than say a simple personal mortgage application which relies on relatively fixed inputs such as salary and predictable monthly outgoings. SMEs are each unique, with more moving parts that make up their business and financial profile. Using predictive artificial intelligence which draws on what happened in the past may not capture unique real time changes taking place in the individual SME's business conditions, such as new customers or new competition. Relationship Managers are vital to understanding individual SMEs and Farms.

In our meetings with Banks, they too are concerned at the lack of demand for credit and cite that SMEs and Farms remain cautious to take on new lending at this time of increasing uncertainty arising from Brexit and international trade restrictions. Recent disappointing economic news from China and major European economies could signal a more challenging business environment in 2019.

Brexit and the uncertainty around Brexit is undoubtedly affecting the confidence for businesses to take on new lending. The Credit Review Office is focused on the cashflow impacts on SMEs which Brexit may bring, particularly a Brexit without some form of free-trade or customs union with GB and N.I. SMEs cashflow and profitability may be affected in two ways:

- 1) The impact on turnover and margins from having to either pass on or absorb higher costs, from exchange rate volatility, imposition of tariffs, higher transport costs, and possible higher internal administration costs, or Agents costs, in Customs Compliance.
- 2) Any delays in the business trading cycle from changes to how Irish VAT is collected on imports, transportation delays at borders, and holding any extra stocks to mitigate delays.  
Without some form of trade deal, SMEs will require additional working capital, and need to be opening a dialogue with their Banks, if additional external support is needed. Enterprise Ireland and SBCI have a Brexit Loan scheme, delivered through our Banks, however to qualify SMEs must be judged as being viable.

A lot will come down to the risk appetite within our Banks to support such demand. Should SMEs have difficulty convincing Banks of their viability, the Credit Review Office should be contacted to provide an independent assessment of overdraft or loan servicing capability.

To meet the credit challenges of any future downturn our Banks have been directed to reduce the levels of their non-performing loan exposures. This is a prudent policy which the Credit Review Office fully

supports, however our past casework suggests that Banks could better manage how Non-Performing Loans are identified and communicated to their Borrowers. Non- Performing Loan Exposure is not well understood in the public domain. It is not unusual for a Borrower to be informed their loan is being sold, whilst being unaware that the loans were classified as non-performing due to missed payments some years ago. The present loan condition of some of these Borrowers is that of a performing loan, and the legacy missed repayments could have easily have been rectified, if the Borrower had been made aware of the situation by their Bank.

The Credit Review Office has published an information sheet for any SME or Farms which had difficulties with trading in the past downturn, or were exposed with buy-to-let property problems, that may have caused them to miss repayments in the past, and may have been unknowingly classed as non-performing. (title: *Information Notes Non-Performing Loans (Exposure)*); available at <https://www.creditreview.ie/publications/>)

I will also be seeking that Banks' behaviours on non-performing loans is addressed in the next revision of the Central Bank's code of conduct for SME lending.

Whilst having a loan sold on to a new lender is not the end of the world in itself, there is a likelihood that the debt, which is now 'on demand' will be called in at some point in the future, and a replacement loan will be needed from one of our remaining Banks. Whilst our Banks advise that they are facilitating some of these loan requests, the Credit Review Office has been called on to assist a growing number of Borrowers who are finding it difficult to find replacement loans. These are invariably difficult cases as either the loans are completely declined, or the funds offered to refinance the debt falls short of what is being demanded by the Investment Fund to settle the debt.

One of the key things for any Borrower whose loan has been sold on, is to conform with the terms and conditions of repayments of the original loan, in terms of keeping repayments and any other conditions with the loan's new owner. If this doesn't happen, the request to our Banks for refinance faces two key questions – can't pay? or won't pay? Both questions give issues to Banks before taking on any lending to a specific Borrower, and also makes it more difficult for the Credit Review Office to support any appeal for declined lending.

The relative lack of competition in the Irish Banking market is a challenge for the economy generally and places greater obligations on our Banks to have good customer strategies. I welcome the establishment of the Irish Banking Culture Board, and wish Mr. Justice John Hedigan and his team well in their work. It is important that our Banks not only 'do the right things', but also that they 'do things right'.

### **Monitoring Bank Lending**

The Pillar Banks continue to provide monthly lending approval figures to the Credit Review Office, which are reviewed and sent to the Minister of Finance. PTSB are also now reporting their lending figures, and collectively these Banks account for the vast majority of the SME and Farm lending markets, with Ulster Bank and KBC being the other main finance providers.

Lending approvals to the SME and Farm sectors peaked in 2014/2015 and have been in decline since then. Figures from the Department of Finance SME Credit Demand Survey, and feedback from the main Banks, point to a lessening of demand rather than a supply issue, however I have also observed a general lowering of Banks' risk appetite over the past year. Notwithstanding the investment in local relationship managers, my opinions on how our Banks address the SME and Farm markets, and how this adversely impacts on the demand for lending, has not changed since I outlined the issues in my 19<sup>th</sup> Report.

Undoubtedly, the Banks' current focus on reducing Non-Performing Loans, and improving ongoing credit quality, is weighing heavily on our Banks' decision making. This is a prudent strategy to increase resilience to any downturn; however, in almost all of the Non-Performing loan sale cases the Credit Review Office has dealt with, it has not been the SME or Farm core business which has been the root cause of the problem. In many cases the issue is failed buy-to-let or commercial and residential Buy to Let property investments. I would ask Banks to reflect on this in their loan decision making on core business lending proposals.

## 2. Credit Review Office Activity

This report covers the period from 1<sup>st</sup> January 2018 – 31<sup>st</sup> December 2018.

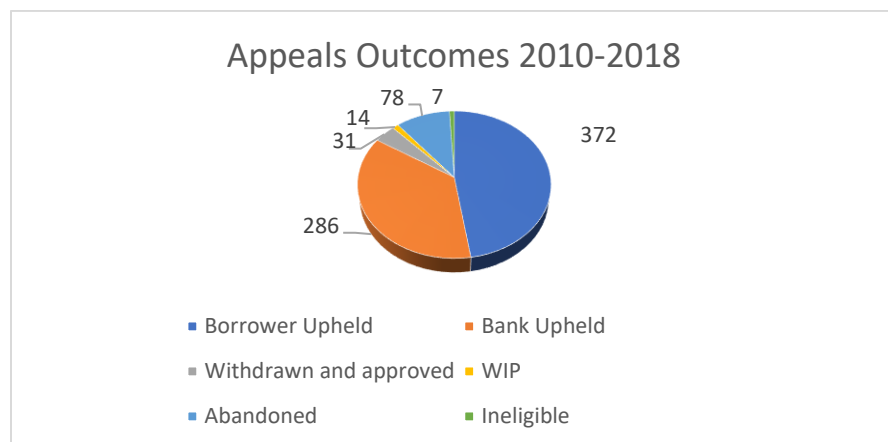
The Credit Review Office appeals have deepened in complexity in recent years so that reporting 'scores' or overturn rates, whilst required, no longer truly represents the situation. There is routinely much more debate and interaction between the banks and the Credit Review Office on the outcomes of appeals as time goes on. I value the cooperation received from the teams in all of the banks we deal with and wish to recognise this cooperation again in this report.

Importantly, this is not about 'wins and loses' for the Banks and the Credit Review Office, but the outcomes for SMES and Farms, and the people they employ.

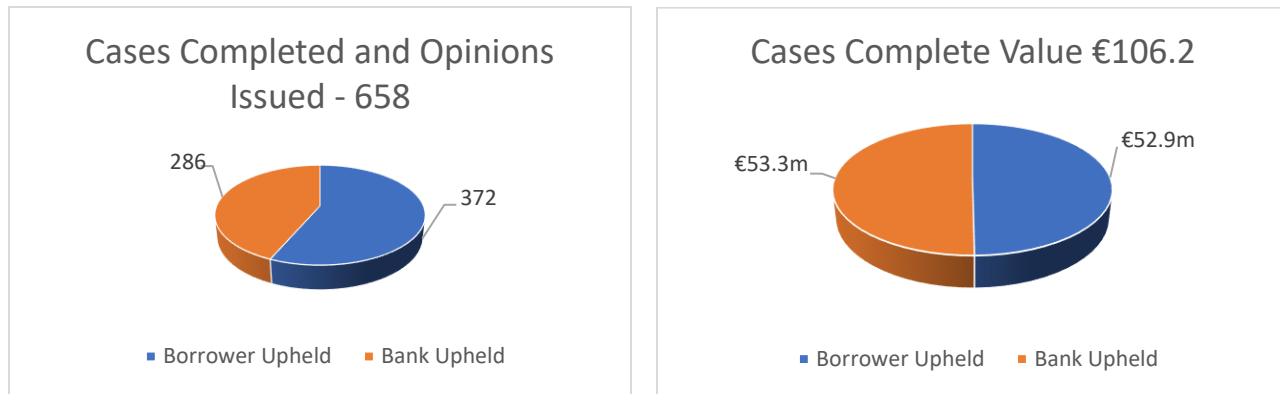
### Credit appeals to the Credit Review Office

We have received 958 formal applications to date. Of these, 658 reached final conclusion and the Credit Review Office has upheld of the appeals in favour of 372 borrowers, including those with a commitment to reassess the lending in the future if agreed performance hurdles are met in the short term.

**The breakdown of the formal appeals are as follows:**

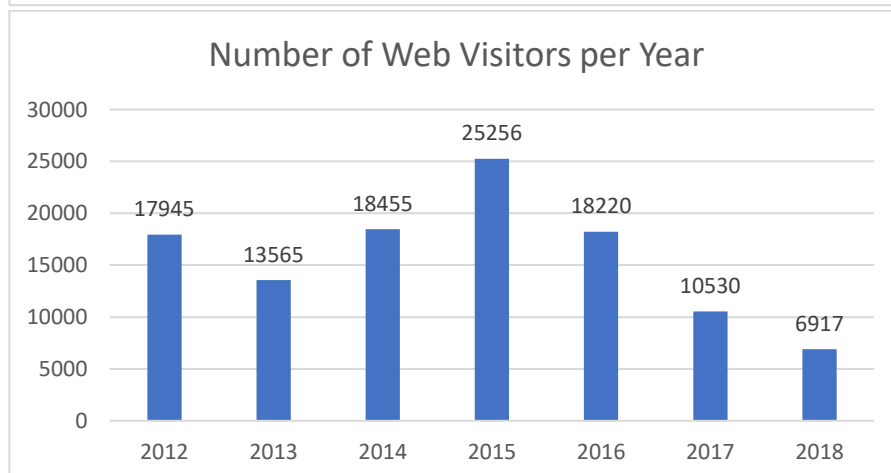
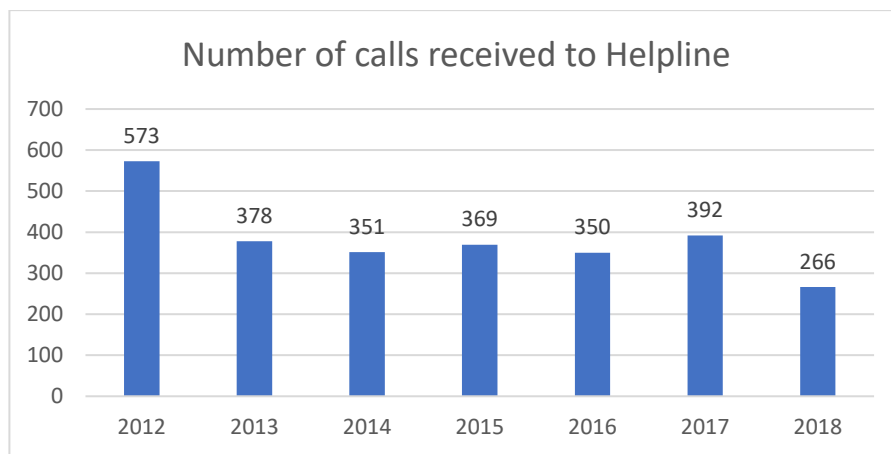


From the preceding chart - 658 cases finalised with Opinion issued - the breakdown is as follows:



The upheld appeals have resulted in €52.9m credit being made available to SMEs and farms, helping to protect/create 3,694 jobs.

In addition to undertaking formal reviews the Credit Review Office also operates an informal ‘Help Line’ service where the Reviewers engage directly with SMEs/farmers who have credit/banking related issues, providing information and guidance on applications. Many of these conversations do not result in formal appeals but the feedback from the individuals who avail of the service is that it is an invaluable source of information.



## Banks Internal Appeals Stats:

AIB	Borrower Appeals Upheld	Borrower Appeals Declined	Total Internal Appeals	BoI	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	61	187	248		27	101	128
2015	53	201	254		33	90	123
2016	43	147	190		38	161	199
2017	23	139	162		57	217	274
2018	43	179	222		56	198	254
TOTAL	485	1347	1832		281	1213	1494

## Other Credit Review Office Activity for the 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 period 1<sup>st</sup> January 2018 – 31<sup>st</sup> December 2018

### Updates/ Meetings

- Weekly reports to Department of Finance
- Ongoing liaison with Department of Business, Enterprise and Innovation
- Attendance at State Bodies Group on SME finance
- Attendance at Quarterly meetings with Department of Finance and each Pillar Bank
- Separate informal 'housekeeping meetings' with banks to improve case management
- Workshops and meetings with newly joined banks and finance providers
- Liaison meetings with SBCI and MFI
- Part of Supporting SMEs Communications team (set up by SBG)
- Ongoing liaison with BPFi
- Attendance at ECB Post Surveillance visit on SME lending
- SME/Farm Trade Bodies – Chambers, IFA, ISME, SFA
- LEO Cork
- Central Bank
- ESRI
- FSPO

### Conferences, Seminars, Workshops

- Taking Care of Business Event (Limerick)
- ISME Annual Conference
- SFA Annual Conference
- BPFi Annual Conference
- National Women's Enterprise Day – Leopardstown

- Enterprise Ireland High Potential Start Up event
- ACORN's funding event
- BIZEXPO

## **Endorsements**

Catherine Harrington & Liam Noone have 20+ years in the hospitality industry and finance industry. We had applied for credit to open a B&B. The following is our story.

Our experience of the credit review facility was very positive. We had a solid business plan but had been refused credit twice. We found the banks very unsupportive of our proposal and difficult to deal with in respect of getting answers. We were confident of our business plan and market research and in our experience but the door to credit was being shut down.

When we looked to see what our options were, we were told by the bank we could try the credit review office. The bank did not go into any further explanation of this facility. Upon looking up the website, we found that we would be eligible to apply for a credit review. We then got in touch with the credit review office, we sent in the application form, all our correspondence with the bank and our business plan. The credit review office acknowledged receipt of our application and explained the process.

The bank continued to be difficult and delayed the credit review office review of our case. However, they did eventually comply with the credit review offices review. The review included an interview and a deep dive into our proposal. This was undertaken by a professional who was experienced in our sector and knew the industry.

The review came back in our favour and the bank agreed to funding. Unfortunately, due to unnecessary delays with the bank's correspondence with the credit review office, the business we had hoped to buy was sold the same week that the funding was approved. However, we were vindicated in our funding proposal.

We would highly recommend using the credit review office.