

Quarterly Report from John Trethowan, Credit Reviewer

This is my first quarterly report on the activity within the Credit Review Office, and on my role in ensuring that Allied Irish Banks and Bank of Ireland achieve the objectives set for them each to make €3bn new lending each year over the next two years.

A. The activity levels within the Credit Review Office

The Credit Review Office (CRO), commenced operations on 1st April 2010. I have used a slim business model comprising myself, a part time Office Manager, a helpline operator, and a panel of ten retired bankers who are paid on a case by case basis. I have been assisted by Enterprise Ireland which has provided office space and business services for the CRO.

The CRO business model is designed to determine whether declined borrowers can demonstrate that their business or farm is viable as a going concern, and has cash generation capability to service the requested debts.

The reviews follow a pattern of collecting facts on the borrower's financial and trading position and determining the differing positions of the bank and the borrower. As part of this process, the Office works with the borrower to try to make the original loan application into a more bankable proposition.

Activity Levels to Date

The process is borrower initiated and is accessed through the CRO website. To date the website has had 2,650 visits from 2,029 different users, and the helpline has taken 198 calls from borrowers.

The outcomes of the initial cases are shown in this table:

	Application Rec'd but held at Office until eligibility confirmed with Bank	Application Received and proceeding through Review process	CRO Decision			Total
			Bank's Credit Decision Upheld	Bank's Credit Decision Disputed	More work required by Borrower and Bank	
Bol	0	2	2	2	1	7
AIB	0	4	1	0	0	5
Total	0	6	3	2	1	12

As part of the preparatory work in setting up the CRO, I worked with the two banks to ensure that their internal appeals systems for borrowers were placed on a more formal footing. The outcomes of these appeals are relevant to the performance of the CRO and to date the position is:

AIB	Upheld	Overturned/ Sanctioned with Conditions	Work in Progress	Total
April	1	0	0	1
May	6	4	0	10
Jun	2	1	1	4
Total	9	5	1	15

BoI	Refusal Upheld	Overturned/ Sanctioned with Conditions	Work in Progress	Total
April	12	2	0	14
May	12	3	0	15
Jun	6	0	0	6
Total	30	5	0	35

B. Evidence emerging from the initial cases reviewed.

There has been much criticism of banks' recent lending performance. It is important to point out that banks have never sanctioned all of the loan applications made to them. A background level of declines is normal.

The CRO case reviews provide evidence of the challenges facing SMEs and farms having their loans declined at the more difficult end of the risk continuum.

Findings

1) After two difficult years of recession many of the SME and farm businesses have had their net worth, i.e. the businesses' capital, reduced or completely eroded. This leaves banks with difficult decisions on the level of risk they are being asked to assume on lending applications.

2) Some business owners used their profits to invest in rental properties during the boom. These properties are typically subject to mortgages from lenders, leaving reserves illiquid and inaccessible for many businesses owners who invested in property. As a result, these businesses are now deprived of the cash reserves that would have assisted their survival in the downturn.

3) There is evidence of a lack of experience among some front line staff in the banks in dealing with SME's and helping them with the loan application process. However, I found no evidence of bank lending policies which constrained the supply of credit to viable businesses in either of the banks.

4) Sources of frustration for some borrowers in the loan application process are:

- (i) Serial information requests from banks delaying the submission of the application.
- (ii) A refusal to respond to borrowers queries on the progress of the loan application or to discuss the circumstances for the decline of facilities. This includes not being available to take calls and not calling borrowers back.
- (iii) The availability and accessibility of business reserves outlined above has been compounded by some banks asking for cash to be held on deposit to match the amount requested for overdraft facilities.

5) There has been much recent criticism of banks reducing or withdrawing longstanding overdraft facilities from SMEs and farms.

Restructuring hardcore overdraft borrowing is a longstanding banking practice and, if the business has submitted a credible cashflow forecast allowing adequate residual overdraft facilities to be provided, then the debt restructured over a reasonable term should be viewed as a positive remedy, to allow net worth to be rebuilt in the business as it pays down the term lending.

6) As the economy emerges out of recession, SMEs will require more working capital in the near future, to re-stock and take on more debtors, and the requirement for bank support will grow in the coming months.

Banks normally appraise future credit risk on the past couple of years' financial performance. Given the extreme trading conditions of the past two years such an appraisal will be unlikely to provide a true going concern picture of businesses in the future, and I have asked both banks to take this into account in their sanctioning processes.

This more detailed view of recent past performance also includes asking the banks to look behind any adverse Irish Credit Bureau notations, to reflect on the reasons underlying any entries over the past couple of years and not to default to 'not credit worthy', or summarily discounting applications which have negative ICB findings.

7) My efforts have been directed to the lending performance of AIB and BoI in supporting the SME and Farm sectors, and whilst they provide around 60% of the market supply, there has been a contraction in the number of other lenders making loans into the business market with the de facto removal of Anglo Irish and Irish Nationwide from the supply side, and anecdotal evidence of lack-lustre lending performance in some of the non NAMA banks.

There is evidence from calls to the CRO helpline that businesses and farms that borrow from the non Nama banks may face real difficulties in obtaining new loans for increased working capital or new investments. This will result in further demands being placed on AIB and BOI to provide finance, thus concentrating the market further.

C. The outcomes of my review of the two banks' lending policies and guidelines.

I have examined the lending policies and guidelines of Allied Irish Banks and Bank of Ireland at the Minister's request.

I visited both banks during May and inspected their policy documents. These documents are confidential and commercially sensitive to each bank. I have not removed or retained any of the documents, but can inspect them again if necessary. Given the commercially confidential nature of the documents I will not comment on their content in any detail, but I will provide a general commentary on the two banks' lending policies.

Findings:

1. I find no policy or guideline in the papers made available to me which constrains the supply of credit from either of the banks to any sector of the SME / Farm markets. Furthermore the banks say they have not withdrawn lending support from any business sector.
2. I have seen letters from senior management to all lending staff affirming the importance to AIB's future in the support to the SME sector, and providing guidance and rationale for bank policy in this area.
3. I have read four specific areas of support for SME lending in the Bank of Ireland policy documents exempting SME lending from some of the conditions for lending for larger businesses. The bank further advises that it has a long term view, and takes account of identified short term problems in any segment.
4. The banks have advised that whilst they have not excluded any sector in their lending policy, they can only consider viable credit requests from any sector.
5. The banks advised that where change has occurred, it has been in the tightening of adherence to compliance with lending policy criteria in the sanctioning process.
6. The banks say they will still allow exceptions to credit policy, but that this is now less prevalent than previously and such decisions are taken at higher levels in the banks.

D. Progress on ensuring the two banks have plans in place to achieve the €3bn p.a. new lending targets over the next two years.

I received the draft outline lending plans from both banks. The banks then made a formal presentation on the plans to Departmental Officials and myself and subsequently to the Minister for Finance.

These strategy documents contain credible programmes to achieve the Minister's lending growth objectives. They also include strategies to assist future economic growth in response to issues raised by Enterprise Ireland.

As these plans are commercially sensitive to each bank, the banks have been requested to produce synopses which can be made public.

E. Arrangements to monitor and report progress against these plans.

Each month, I will be monitoring the progress in the implementation of these lending targets which will include a commentary on each banks' geographic and sectoral performance. I am in the process of receiving each bank's baseline monthly figures at present.

Each quarter, I will monitor progress against the banks' strategy plans mentioned above. Both banks will continue to be required to report on the aspects of the recapitalisation which do not relate to credit to SMEs.

END