Eighth Quarterly Report from John Trethowan, Credit Reviewer

This is my eighth 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.

My first and second reports outlined my observations on the issues on credit availability both on the supply side by the two main banks, and on the demand side by borrowers for bank lending. These observations remain valid.

My third report detailed the responses AIB and BoI are making to:
a) increase market confidence that they are open for business, and
b) to address skill deficits in cashflow lending following a period of extensive staff movements.

The fourth, fifth and sixth reports moved on to look at what steps are required to support businesses through a recovery stage. The seventh report proposed a system to assist borrowers in the credit application process.

These reports can be found on the publications tab on the Credit Review Office website www.creditreview.ie

	Application Rec'd but held at Office until eligibility confirmed with Bank	Overturned by Internal Appeals/ got credit*	Abandoned /Withdrawn by customer**	Application Received and proceeding through Review process	CRO Decision			Total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Upheld	Bank's Credit Decision Disputed / Bank Subsequently Provided Credit	More work required by Borrower and Bank or withdrawn by customer	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	3	7	8	7	26	37	8	96
BoI	7	9	9	14	22	32	8	101
Total	**10**	**16**	**17**	**21**	**48**	**69**	**16**	**197*** **

*only tracked since May 2011-new procedures
**considered withdrawn/abandoned if no response after 6 months
***includes applications awaiting eligibility confirmation

Formal Appeals	Banks' Credit Decision Upheld	Jobs at risk		Bank's Credit Decision Disputed / Bank Provided Credit	Jobs protected
Total Numbers	**€4,058,953**	**380+30p/t**		**€6,910,500**	**653+30p/t**
AIB	€2,098,200	286+ 17p/t		€3,981,300	300+ 11p/t
BoI	€1,960,753	94+13p/t		€2,929,200	353+19p/t

Banks' Formal Internal Appeals

April to April 2010 2012	Bank's Decision Upheld	Overturned/ Sanctioned with Conditions	Work in Progress	Ineligible/ Withdrawn By borrower	Total
AIB Total	171	113	16	20	320
BoI Total	194	13	1	0	208
Both Banks	365	126	17	20	528

Helpline/ Web Activity

- The helpline has taken 1,544 calls to date.
- The website has had 18,912 visitors since inception, with 24,626 visits made.

The Eighth Report

In the period of the current review I have observed that the two pillar banks are largely being supportive of medium and low risk new lending proposals from well established SMEs and farms which already bank with them. They are also, by default, providing forbearance options to those businesses which have 'legacy debt overhangs' on their lending books from the boom years.

I am however disappointed that there is not more evidence of support for 'enterprise risk taking' on new and increased lending in the banks' current lending policies. This would suggest that their current risk appetite needs to be reassessed in order to support economic and employment recovery.

The Credit Review Office mandate is to ensure viable SMEs have access to credit from the pillar banks. It is not to comply with internal banks' lending policies.

The challenge for banks is to develop approaches which can provide credit for those businesses within the SME sector, whereby they can be seen to lead rather than follow economic recovery; this relates particularly to still viable SMEs within trade sectors which have been worst affected by the downturn; Property, Construction and Hospitality. This is evidenced by our opinions' upholding @60% of borrowers' appeals, with up to 600+ jobs protected.

I am observing a lack of primary focus on assessing performance fundamentals in banks' processing of SME credit applications; and I perceive that banks' priorities to have shifted to attempt to excessively squeeze out credit risk in their assessment in too many cases. This is particularly the case in the challenged sectors mentioned above, and in micro enterprise and the smaller end of the medium business sector.

Whilst I acknowledge that this is a difficult lending environment for lenders, my views are influenced by where we are in the economic cycle, where both trade levels and commercial property values may have now stabilised around their current levels. If this is the case, it should make appraisal of future prospects much easier for lenders to assess risk than anytime since 2008.

My view is also influenced by the reflection that the bank solvency crisis was largely caused by Commercial and Residential property lending; and only to a lesser degree in lending to SMEs – and this mainly through financing the 'non core' property investments made by business owners.

The overhang of legacy debt in banks' lending books is requiring a certain level of forbearance. This legacy debt, together with the weakened condition of many businesses which may also require further remedial lending action, is a challenging backdrop to the banks' lending performance.

This forbearance requires high level of capability and experience by lending officers. Given that the large banks have all announced restructuring plans it is essential that their Boards ensure that adequate capabilities will remain in place to deal with current and future forbearance requirements, as their lending books continue to be scrutinised by the Regulator and Troika.

During this quarter the Government's Loan Guarantee, and microfinance funds schemes were both progressed, and I welcome these initiatives as further measures to support SMEs accessing finance, and give further comfort to bank lenders to identify solutions for their borrowers. The Credit Review Office will use both these schemes to assist borrowers where appropriate, and we have offered both schemes whatever assistance and learnings we have as they prepare for launch.

When over the next few months these schemes are launched, they will be useful additional tools in the SME spectrum, but neither will be the 'silver bullet' to solve the supply of credit to SMEs – the 'silver bullet' does exist, and that is when domestic consumption rates recover and people regain the confidence to start spending money in the economy again. The pillar banks have a vital role to play in ensuring that their credit policies are supportive of demand returning to the economy and provide credit to SMEs who will lead the economic recovery.

An issue which does concern me and will need monitoring relates to the competitive dynamic of the SME lending market in Ireland. With the effective withdrawal of many of the foreign banks from the SME and farm markets, this has left mainly AIB, BoI and Ulster to supply credit. The lack of a greater number of significant and active competitors presents the undesirable prospect of consolidation and a lack of proactivity to support economic recovery. The difficulty of course is that internationally the trend is for banks to deleverage and retrench to national borders and it will require clear signs of economic recovery before there will be visible evidence of additional competitive capacity returning to the domestic banking sector. I will continue to monitor this issue and return to the subject in future reports.

Credit Review Office – Present and Future

An independent formal review of the Credit Review Office is being commissioned under the Action Plan for Jobs, and I welcome this important measurement of our effectiveness.

I have assembled a small team of experienced reviewers with banking and accountancy backgrounds, who are clear on the Credit Review Office mission to help SMEs whenever possible. This entails assessing whether there is viability for the business by applying their lending skills and experience, and being able to spend more time on each case in seeking solutions for the borrowers, and to mitigate the risks we ask the banks to take when we recommend that they make a loan.

Whilst I am clear that the Credit Review Office is not to be viewed as a permanent fixture, my view is that level of peak demand for the service has not yet arrived, and this is supported by the Mazars demand survey results that only 36% of Irish SMEs sought credit in the period April to Sept 2011. As the domestic economy recovers and SMEs seek to increase working capital the demand for lending will increase and two factors will point to Credit Review Office assistance being required:

(i) The relatively poor capital and liquidity condition of some SMEs following three years of the domestic economy flat lining.

(ii) The need to re-bank some SMEs currently banked with IBRC (Anglo) /Certus (BOSI), which will be looking for new/increased credit that these banks will be unable /unwilling to provide when the upturn arrives.

Banks' €3.5bn Targets 2012

Level of disclosure
The information reported to the Department and myself is commercially sensitive on these banks which are stock market listed companies. As such there is limited specific detail that can be divulged in my reports on the tracking of the banks' performances and our regular discussions with the banks.

The Targets
The Minister of Finance has set SME /Farm lending sanction targets for the two pillar banks – AIB and BoI.

1. The initial target was for the period 1st April 2010 to 31st March 2011, being €3bn for each bank.
2. Following a change in Government in 2011, the period of the target was altered for year 2 to run from 1st January to 31st December 2011, being €3bn for each bank.
3. The target for the calendar year 2012 is €3.5bn for each Bank.
4. The target for the calendar year 2013 is €4.0 bn for each Bank

The three major banks have attended the Economic Management Council in November and in February. The Taoiseach has requested the banks to update the EMC on progress on an ongoing basis.

Report on Banks' €3bn 2011 Targets
In my last report I advised that AIB and BoI have both achieved their €3bn on loan sanctions. In accordance with the Action Plan for Jobs, Department officials and myself have engaged further with the two banks to drill down into the numbers and examine the detail on a more granular basis.

System Constraints:
There is widespread public misunderstanding of the capability of bank systems to report on their business. All banks systems are different and some are more advanced than others. Typically investment in bank systems is in the hierarchy:
(i) Customer account based operating systems, which are the systems the public uses in their day to day banking. These account facilities can be a patchwork quilt of many systems reflecting core banking, asset finance, debtor finance, insurance business etc. the outputs of these systems drive the business information reporting.
(ii) Outputs from the business information reporting systems are normally prioritised to regulatory reporting to the Central Bank/ECB/ Troika; then to internal management information reporting; and lastly to ad-hoc reporting such as these targets.

Systems development for new products and services, and business information reporting are subject to queues and priorities due to IT capacity constraints in software development and testing.

More detail on the business underlying these targets:
During this quarter I have spent some time with each bank to understand the lower level of the content of the reporting against these targets.

The typical content of the sanctioned facilities reported to the Credit Review Office are in descending order:
(i) New/Increased Lending for Term Lending & Asset and Commercial Finance
(ii) New & Increased Overdrafts
(iii) Restructures (internal) & refinancing debt from other Banks
(iv) Contingent Liabilities.

Progress in Quarter One against the €3.5Bn Targets:

- The annual combined sanctioning target for 2012 is €1bn higher than last year.
- Combined Loan sanctions levels in quarter one are broadly similar to the figures for quarter one last year.
- If 2011 patterns are repeated this year, lending levels increase after the summer (quarter three).
- Lending transactions recorded by the two banks in quarter one are @15% lower than quarter one last year.
- These numbers are a function of a number of variables:
  (i) A softness in demand for lending reported by the banks, and observed by both Mazars and recent Central Bank reporting.
  (ii) Borrowers paying down debt rather than seeking new loans.
  (iii) The tighter credit conditions in banks.

END