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Consumer Protection- Banking and Policy,
Central Bank of Ireland,
PO Box 559,
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24th August 2011

Dear Sirs,

Re:- Consultation Paper 55 ("CP 55") - Code of Conduct for Business lending to Small and Medium Enterprises

KBC Bank Ireland plc ("KBCI") welcomes the opportunity to respond to the Central Bank of Ireland's Consultation on Financial Difficulties Requirements of the Code of Conduct for Business Lending to Small and Medium Enterprises. KBCI at all times seeks to assist its customers who are Small and Medium Enterprises ('SME's) and are experiencing financial difficulties and to work with them to find a solution to any arrears problems they may encounter.

Timeframes

KBCI is supportive of an enhanced framework being put in place to assist SME's who are experiencing financial difficulties. However, any further regulation in this area will have significant implications for both SME's and Regulated Entities. It is therefore critical that the development of any framework in this area is done in a considered manner and that adequate time is allowed for consultation as any proposals must take cognisance of the complex nature of lending to SME's.

The short consultation period for CP 55 does not allow adequate time for consideration of such fundamental and important proposals. Any further regulations in this area will have both operational and financial implications for Regulated Entities and bearing in mind the current significant legislative and regulative agenda facing Regulated Entities, adequate time for consideration and implementation of any new requirements must be provided.

Due to the fundamental differences between mortgage lending to consumers and lending to SME's, KBCI do not believe that it is appropriate to base such proposals on the regime that is in place for consumers under the Code of Conduct for Mortgage Arrears ("CCMA"). In addition, we would point out that the implications of the revised provisions of the CCMA remain unknown in terms of any potential for unfavourable consumer behaviour.

Scope and definition of SME

Business lending to SME's is fundamentally different to mortgage lending to private individuals/ consumers and this fundamental difference needs to be recognised in any code that is developed. The definition of SME's that is utilised in the Code of Conduct for Lending to Small and Medium Enterprises is based on the European definition of a small and medium sized enterprise and encompasses a myriad of different types of business entities from sole traders to companies, partnerships, property investment vehicles, trusts and co-ownerships. With such a variety of legal structures and entities coming within the definition of SME's a uniform approach as envisaged by CP 55 as to how SME's who are in financial difficulties is not appropriate. For example, an investment property company is treated in the same way as a sole trader operating a small local retail outlet,

Lending to SME's is further distinguished from mortgage lending to consumers by the fact that most SME's will have complex banking relationships and therefore a greater level of flexibility is required by Regulated Entities when dealing with SME's which could be removed by putting in place a rigid codified process as set out in CP 55. Moreover, an SME will, in most circumstances, have a number of different banking products from a number of different Regulated Entities. The complex nature of an SME's banking arrangements therefore needs to be reflected in any code that is put in place.

It should also be highlighted that an SME is a commercial entity which should have the capacity to manage its financial affairs and if not available internally, the SME can seek legal, financial and other advice from other competent professionals.

Unsolicited Contact

With regard to the proposals in respect of unsolicited contact, KBCI consider such proposals to be fundamentally flawed and not in the best interests of the SME. It is important for an SME to engage with the Regulated Entity in order to try and resolve an arrears issue which has arisen but, a restriction on the number of unsolicited contacts a Regulated Entity may initiate would undermine and impede this engagement. It should be recognised that SME's are commercial entities and capable of handling their business affairs. KBCI would at all times ensure that its level of communication is proportionate and not excessive. However putting a numerical limit on the number of communications is not practical or workable and is unrealistic. Furthermore, the imposition of a numerical limit on contacts with SME's compromises the stated objective of CP 55 to 'ensure that when dealing with arrears cases the aim of a Regulated Entity will be to assist borrowers to meet their obligations, or otherwise deal with the situation in an orderly and appropriate manner.

Viability

KBCI has concerns with regard to the requirements in CP 55 to assess the viability of an SME. This may lead to a number of unintended consequences which would have a significant impact on both the SME and the Regulated Entity. For example, if a Regulated Entity was to assess an SME to be non viable and if the SME is required to disclose such assessment of non-viability to other stakeholders (for example auditors, creditors and other Regulated Entities) there is a risk to the future prospects of the SME. Further, should a Regulated Entity assess an SME to be non-viable, it would lead to questions as to whether the SME could continue as a going concern and possibly leave directors of a corporate SME open to claims of reckless trading should they continue to operate.

In addition, it is only possible for a Regulated Entity to assess the viability of an SME at a point in time as the business of an SME is not static and changes on a continuing basis (for example obtaining new contracts or losing significant clients). Also given the multi bank nature of SME lending, criteria may differ from one institution to another which could lead to borrower confusion and it is not clear under the current proposals how that situation would be resolved.

Moreover in making a determination as to the viability of an SME it could be argued that the Regulated Entity is acting as a shadow director of a corporate SME and therefore assumes the liabilities that would attach to being a director of the SME under the Companies Acts.

A corporate SME also has the protection of the courts through the examinership process and it is the responsibility of the court to determine whether, on the basis of the evidence provided, that the corporate SME is viable and it is not for the Regulated Entity to make such a determination.

KBCI therefore recommends that the requirement for a Regulated Entity to assess the viability of an SME, which goes beyond the usual credit assessment that a Regulated Entity would carry out in the normal course, be removed from any proposals to assist SME's in financial difficulties.

Legal Rights

The proposals contained in CP 55 or any other proposals to assist SME's who are in financial difficulties must be without prejudice to any rights that a Regulated Entity has under the terms of its loan agreement and/or security documentation. A Regulated Entity must retain the right for example to appoint a receiver or take any necessary action to protect its security if it deems it appropriate in the circumstances.

Clause 17 of the current Code of Conduct for Business Lending to Small and Medium Enterprises specifically acknowledged and recognised this, however while there is some mention in the 'Scope' clause of CP 55 that a Regulated Entity may act 'with all necessary speed' in certain instances, CP 55 does not clearly state that the processes set out are without prejudice to the rights of the Regulated Entity. Due to the nature of lending to SME's it is imperative that a

Regulated Entity can act immediately if it needs to and can rely on the terms of its contractual agreements with SME's.

In addition an SME will have multiple creditors and a Regulated Entity requires the flexibility to act to protect its position should another creditor of the SME move to recover their debt. It should be further recognised that Regulated Entities already have to deal with the complexity of the examinership process.

Regulations which would impinge or be perceived as impinging upon a Regulated Entities ability to rely on or enforce its contractual and legal rights could also affect the international perception of Ireland as an international business centre.

Any proposals put forward to assist an SME experiencing financial difficulties should not impact upon, amend or change the nature of the contractual rights and obligations which both parties freely agreed to when monies were advanced.

Appropriate Balance between the rights of SME's and Regulated Entities

It is imperative that the provisions of any regulations to assist an SME in financial difficulties cannot be manipulated by an SME to the disadvantage of Regulated Entities. A number of provisions as currently drafted could be exploited and possibly manipulated by SME's.

Suspension of Penalty Fees and Charges

Any proposals to suspend penalty fees and surcharges for borrowers in financial difficulties must have regard to Regulated Entities prudential obligations. Such fees and surcharges, which are negotiated and accepted at the outset by SME's when entering into loan agreements, are necessary so that Regulated Entities can absorb the additional costs associated with managing loans that fall into arrears as well as compensating for the additional capital that is required to be set aside for such loans. In order to maintain a sustainable business model, these costs must be recovered and in the absence of an ability to do so from customers in financial difficulty, Regulated Entities may have to pass on these costs to its customers which are not experiencing financial difficulties and who are meeting their obligations.

Moreover, the imposition of penalty fees also act as an incentive for an SME to engage with a Regulated Entity to resolve an arrears problem and by removing the ability of a Regulated Entity to charge such fees, it will make it harder for a Regulated Entity to persuade an SME to work with them to resolve their financial difficulties.

Conclusion

In conclusion, while KBCI is receptive to the idea of proposals to assist SME's in financial difficulties, we believe the current proposals as outlined in CP 55, which are based on a code applicable to consumers, are unworkable in practice and will lead to negative unintended consequences for both the SME and the Regulated Entity.

We would also caution that the imposition of restrictions on Regulated Entities in terms of how they engage with SME's or recover monies owed to them will have implications for the fundamentals or attractiveness of the business model for lending to SME's.

It is therefore critical and essential that there is further engagement between the Central Bank of Ireland and Regulated Entities in developing proposals to assist SME's experiencing financial difficulties and KBCI would be pleased to be involved in such discussions.

In the meantime, please do not hesitate to contact us should you require any clarification on the points raised above.

Yours faithfully,

Christine Moran
Executive Director