



Consumer Protection - Banking & Policy
Central Bank of Ireland
PO Box 559
Dame Street
Dublin 2

Business Banking
40 Mespil Road
Dublin 4
Tel +353 (0)1 665 3438
Fax +353 (0)1 665 3480
www.bankofireland.ie

24 August 2011

Re. Consultation Paper CP55 – Partial Review of the Code of Conduct for Business Lending to Small and Medium Enterprises

Dear Sir/Madam,

Further to your request for views on Consultation Paper CP55, the following are Bank of Ireland's comments and observations.

Bank of Ireland welcomes the review of the SME Code in respect of provisions relating to the handling of arrears cases and the open engagement the Central Bank of Ireland (the "Central Bank") has had with the industry to date. We recognise that the Central Bank is striving to bring consistency in language and approach across banking regulations in general and to this end has transposed many of the provisions of the Code of Conduct on Mortgage Arrears ("CCMA") into the proposed SME Code.

We are aware of the perceived issues that CP55 is striving to address and we are willing to play a full part in a consultative process to identify a workable process that addresses the need while also recognising the essential differences between the issues and needs of business and personal customers. We make some initial proposals in this document in that direction and we would be very happy to participate in a collaborative process that would produce final proposals acceptable to all parties

However, we would wish to mention that we believe, based on customer and staff feedback, that the existing SME Code has been more than adequate to regulate the market in the current economic climate. The market place has adapted to the requirement to work with SMEs in arrears and we believe it is generally accepted that the handling of arrears cases in this sector is being managed well. Furthermore, there has been positive feedback from the Credit Review Office in terms of lending and supporting SMEs in general and the number of individual arrears cases that attract media coverage is low.

We are strongly of the view that the existing SME Code is wholly adequate for the handling of arrears cases for Medium sized enterprises through its current operation and the flexibility shown by the banks.



Potential Support for Smaller Enterprises

We recognise that there may be a perception that there is a need for greater clarity regarding banking support for smaller enterprises (to be defined) and the importance of the availability of information to smaller enterprises to enable them to make informed decisions. In this regard, a process or guidelines outlining what customers in difficulty can expect from their bank could have some merit. These guidelines could include:

- The type of information required from a business customer who is facing financial difficulties;
- The means of contact with a financial institution (clarity for the borrower with regards the 'first steps' and whom to contact in the event of financial difficulties or the first signs of financial difficulties);
- The likely timelines for dealing with the borrower's particular case (consistent with past experience of the lender);

These thoughts are obviously only preliminary and would clearly benefit from further discussion.

The following sets out our key concerns and why the proposed SME Code is not appropriate in its current form.

(1) Distinction between SMEs / Personal Consumers

We do not support the transposition of pre-defined procedures to the arrears handling process for SMEs, as introduced by the CCMA for the protection of personal consumers.

As you are aware from our earlier submissions, there are a range of individual case-by-case solutions we are implementing with borrowers in financial difficulties. These need to be considered in a flexible manner. We firmly believe that this approach is key to supporting SMEs through the current climate and that the pre-defined procedures proposed by Consultation Paper CP55 will undermine this approach to the detriment of the borrower as well as the lender. Also key is recognising that assessing the 'viability' or otherwise of an SME in financial difficulty cannot be compared to assessing the repayment capacity of a personal consumer who is in arrears on his/her mortgage loan account.

SMEs make payment decisions every day in their business which impact on their overall financial situation. The SME can be multi-banked and have a number of (competing) creditors and exposure to a number of debtors. Security on the loan can be spread across a number of assets (debentures, guarantees etc.).

In the case of a personal consumer in arrears on their mortgage, the individual's financial situation is captured in the Standard Financial Statement and does not change day to day. The lender's concern is limited to the mortgage arrears situation and the security for the mortgage loan is confined to the Principal Private Residence of the borrower.

(2) Distinction between different sizes of enterprise

Should there be a desire to introduce more defined processes and procedures, there should be a distinction made between smaller, less financially sophisticated businesses and medium sized businesses that have access to a broad range of professional advice (e.g. accountants, solicitors, independent financial advisors etc.). Our preliminary proposal outlined above regarding a process or guidelines would be specifically targeted at these smaller businesses.

These small businesses could be categorised by using the European Commission's definition of a 'micro enterprise' or perhaps more easily, by utilising a maximum lending threshold of €100k. In the case of Bank of Ireland, this would capture c. 80-90% of our customers.

(3) Specific concerns re. the general implications of the proposed SME Code

We are of the view that there are a number of key reasons why the proposed changes to the SME Code are inappropriate:

- It will reduce flexibility resulting in the lender being prevented from fully assessing the particular circumstances of an individual SME;
- It introduces additional terms and definitions which, in contrast to legally defined terms, are wholly subjective in nature, and will not facilitate resolution in the event of dispute;
- The SME Code appears to override individually negotiated contracts based on contractual provisions enshrined in Irish Law; and
- The SME Code restricts the application of charges which have been approved by the Central Bank under Section 149 of the Consumer Credit Act 1995 to permit the lender to recover the costs of the administration of loan accounts in arrears.

We propose to expand on each of these points individually below.

Codification of Processes reduces flexibility

As already mentioned, SME customers require flexibility to accommodate their financial situation which can change from day to day. Their financial needs can be time critical due to exposure to debtors and other creditors. The proposed provisions restrict flexibility and options available, for example, paying cheques that put the account in excess of the approved limit.

In addition, the cornerstone of the successful resolution of an arrears situation is working with the borrower locally which is conducive to reaching a flexible arrangement. A dedicated unit (Provision 18) implies central management of arrears cases, which would limit this crucial involvement at a local level.

It is also suggested that, once the lender obtains the general information required for assessment of any arrears case, the lender is restricted from requesting further information or clarification from the borrower in respect of their particular case. In the

absence of further information the lender could be prevented from exploring further options, which could be to the detriment of the borrower.

The timelines suggested for assessment (15 business days) may not allow for the full and complete assessment of a borrower's particular circumstances and the scope for negotiations resulting from differences of opinion or availability of information through the Appeal's process both internally and externally makes for a lengthier process, which could be open to abuse.

Attempts at resolution can be further exacerbated by the restrictions on the number of unsolicited contacts and by not allowing contact on a Saturday, which is typically a working day for SMEs.

The subjective nature of additional terms and definitions

The proposed SME Code introduces a number of new key terms and definitions, such as 'viability', 'Not co-operating' and 'Financial Difficulties'. Irrespective of any effort to define these terms clearly and interpret these definitions correctly, these will always be subjective concepts leaving scope for dispute.

'Viability' is a concept which is core to lending, but cannot easily and consistently be determined by a fixed set of criteria. Judgement is a key factor.

With regard to 'Not co-operating', the burden of proof is on the lender. There is no specific provision in the proposed SME Code that requires the borrower to engage in a meaningful manner with the lender. It is unclear how the lender can determine that the borrower has or has not made a "...full and honest disclosure of information, that would have a significant impact on the borrower's financial situation....". It is also unclear as to whether or when a lender may deem a borrower to no longer be in 'Financial Difficulty'.

We do not believe that the introduction of such terms adds value to the overall process for handling arrears cases from the borrower's or the lender's perspective.

Overriding Irish Contractual Law

In the event of dispute, the facility letter or contract between the borrower and the lender is the core legal document which sets out the responsibilities of the parties and crucially is relied upon by both parties in the event of a breach by either party in reaching a resolution. The contract will also outline the implications of an event of default on repayments and the borrower's signature indicates his acceptance of these terms.

The existing SME Code acknowledged the lender's legal rights (Clause 17) in accordance with the underlying legal contracts. This clause appears to have been deleted from the proposed SME Code.

The lender has a fundamental right to debt recovery and in so doing must protect itself against accusations of fraudulent preference by other creditors. In order to operate as a bank, the lender also needs to be in a position to call certain facilities on demand. It would appear that these rights are overridden in the proposed SME Code.

The proposed SME Code does not provide for the recovery of costs associated with the handling of arrears cases

Provision 24 of the proposed SME Code seems to restrict the regulated entity in the application of surcharge/penalty interest, provided the borrower is co-operating. This provision is based on a subjective view, as already mentioned, and limits the application of bona fide charges approved by the Central Bank in accordance with Section 149 of the Consumer Credit Act 1995. This limits the recovery of costs associated with arrears and financial difficulty cases, which was the basis for the approval of such charges in the first place.

Conclusion

We believe that the existing SME Code is wholly adequate for the handling of arrears cases for Medium sized enterprises and that this view is supported by the work done by lenders to date to reach flexible arrangements to sustain businesses in this unprecedented environment.

We recognise the perceived issues that CP55 is striving to address and should there be a perception of a need for greater support for smaller enterprises (to be defined), we have included some preliminary proposals as to what form this support might take to enable the SME to make an informed decision, without introducing inflexible and pre-defined requirements. As we have indicated, we would be happy to participate in a collaborative process that would produce final proposals acceptable in this regard to all parties.

Consistent with our earlier submission and our meeting with your representatives, we remain strongly of the belief that banks and financial institutions are adapting internal policies and processes to take account of the unprecedented economic environment and as such there is no overarching requirement for the codification of this process.

Yours faithfully,



Mark Cunningham
Director of Business Banking (Ireland & UK)