



Consultation on Financial Difficulties Requirements of the Code of Conduct for
Business Lending to Small and Medium Enterprises

IFA Response

August 2011

Introduction and Overview

IFA welcomes the review of the Code of Conduct for Business Lending to Small and Medium Enterprises, and the proposed expansion of the Code to set out the process for dealing with financial difficulties.

Over the last number of years, due to increased volatility in product prices, in particular the low product prices experienced by all farming enterprises in 2009, many otherwise viable farm businesses found themselves in financial difficulty. To ensure the maintenance of the maximum number of viable businesses into the future, it is of great importance that a workable and appropriate process is agreed between regulated entities and borrowers for dealing with financial difficulties.

Given the lending environment that existed over the last decade, which contributed in part to borrowers finding themselves in financial difficulties, there must be responsibility taken by both the regulated entity and borrower in reaching a solution, including, in some instances, settlement of debt.

A key weakness of the current arrears process has been the absence of clear and timely communication between the regulated entity and borrower, and a lack of understanding of the information requirements necessary to address the arrears problems. IFA believes that the proposed revised code of conduct addresses many of the issues that have arisen from this.

However, it is felt that there is insufficient focus within the proposals on developing an agreed process that has, as a priority, the retention of a viable business. This must be a key principle upon which any arrears process is based, and will significantly increase co-operation between the regulated entity and borrowers.

Many small businesses, in particular farm businesses, operate as sole-traders, and therefore there is a strong link between personal and business borrowing, in particular residential mortgages. It is important that the scope of the revised Code is extended to ensure that it functions in co-operation with the Code of Conduct for Mortgage Arrears.

In addition, IFA believes that many of the proposals contained within this revised Code, e.g. the timing of assessment and responses, contact between regulated entity and borrower, and identification of information requirements, should be applied to other appropriate sections within the rest of the Code of Conduct (e.g. credit applications).

Detailed comments relating to the text of the proposed code are outlined overleaf.

Detailed Comments

General Principles: *A regulated entity must ensure that in all its dealing with customers and within the context of its authorisation it:*

2. *Acts with due skill, care and diligence in the best interest of its customers;*
10. *Ensures that any outsourced activity complies with the requirements of this Code.*

IFA Response: The regulated entity and any outsourced activities/ third parties should employ customer-friendly and understandable correspondence in their dealings with borrowers.

Point 16: *A regulated entity must have and implement procedures for dealing with borrowers in financial difficulties. Such procedures must:*

- e) *set out how the criteria used for the assessment of the viability of a borrower.*

IFA Response: Point 16 e) is not clearly worded in relation to the assessment of viability. It is suggested therefore, this is reworded as: *“clearly outline the criteria that have been used to assess the viability and repayment capacity of the borrower.”*

Point 18: *A regulated entity must establish a dedicated unit for borrowers in financial difficulties, which must be adequately staffed, to assess alternative arrangements and liaise with staff dealing directly with borrowers in financial difficulties.*

IFA Response: It is very important that not only are there adequate numbers of staff to deal with financial difficulties, but that these staff are experienced and trained in this area to deal effectively with the issues arising. The Code should be amended to reflect this.

Point 24: *A regulated entity shall only impose surcharge/penalty interest, unpaid direct debit fees and/or referral fees on arrears arising on a credit facility, for any period in respect of which a borrower in financial difficulties is considered as not co-operating with the regulated entity.*

IFA Response: IFA believe that the imposition of surcharges/penalty interest etc, should be imposed only after the regulated entity has given prior notice, in writing, to the borrower.

Point 37: *A regulated entity must inform the borrower, in writing, when it has appointed a third party to engage with the borrower in relation to their financial difficulties and must explain the role of the third party.*

IFA Response: The use by some regulated entities of third parties has resulted in serious problems in the resolution of financial difficulties. It is hugely important that the use of third parties is communicated clearly to the borrower and in advance of any contact being made by the 3rd party. In addition, the regulated entity must retain contact with and remain accountable to the borrower throughout the process. It is suggested that point 37 is strengthened to reflect these issues.

Points 34 to 41: Information for Borrowers in Financial Difficulties

IFA Response: In order to provide as comprehensive a picture of the arrears process as early as possible to the borrower, the list of information the regulated entity must provide should be expanded to include the timelines involved in looking for information and assessing a case (as outlined in points 42 and 47).

Point 41: *When a borrower notifies a regulated entity that there is a danger that the borrower will not be able to meet repayments and /or the borrower is concerned about going into arrears, the regulated entity must provide the borrower with the information booklet required under provision 35.*

IFA Response: A key part of dealing with financial difficulties is assisting the borrower in advance of these difficulties being realised. It is suggested therefore that, where a borrower has made initial contact with the regulated entity, the regulated entity must offer the borrower the option of a meeting (as per point 40, a), viii)).

Point 46: *A regulated entity must perform its assessment of the borrower in financial difficulties on a case by case basis and on the full circumstances of the borrower including:*
a) the viability of the borrower concerned.

IFA Response: A comprehensive assessment of business viability must take into account reasonable expectations of future viability and repayment capacity (e.g. new contracts that will lead to increased cashflow in the future). It is suggested therefore that point 46 a) should be expanded to read: *“the existing and potential viability of the borrower concerned.”*

In addition, it is suggested that the full circumstances of the borrower should be expanded to include succession, family interests and/or land transfer.

Point 50: *Where an alternative repayment arrangement is offered by a regulated entity, the regulated entity must provide the borrower in financial difficulties with a clear explanation, in writing, of the alternative repayment arrangement, including:*
b) the term of the arrangement;
e) details of how interest will be applied to the credit facility as a result of the arrangement;

IFA Response: The terms of arrangement for an alternative repayment arrangement must be clearly specified for the borrower - e.g. a term of X years, with a review every Y months/years - in order that they have certainty about any increased reporting requirement/ potential for further amendments of the repayment arrangement from the outset.

The details of the interest to be applied should include information on the breakdown of the interest rates, e.g. the funding premium for the revised repayment arrangement.

Point 56: *A regulated entity must allow the borrower a reasonable period of time to submit an appeal on an alternative repayment arrangement decision, which must be at least 10 business days from the date the borrower received notification of the decision of the regulated entity.*

IFA Response: The borrower may require more time to gather information or obtain advice in order to submit an appeal. The proposed 10 working days may be too short a timeframe in some instances. It is proposed that the timeline for submitting an appeal should therefore be extended, taking into account the personal circumstances of the borrower.

Realisation of Security

Point 57: *After the realisation of a security on a credit facility a regulated entity must immediately inform the borrower of the borrower's liability for:*

- a. the balance of any residual debt;*
- b. the interest rate on the residual debt;*
- c. any costs for the realisation of the security which have been added to debt.*

IFA Response: Farm businesses are, in general, capital intensive, with high levels of security attached to borrowing. While it is understood that that the Code does not make an assessment on the levels of security required, it is felt that this section is not sufficiently strong to ensure the protection of borrowers in the event of security being realised as part of the arrears process.

In many cases, both the amount of security realised and the specific security selected will determine whether the borrower will remain viable. It is suggested therefore that the security to be realised must be agreed between the regulated entity and the borrower, with the key principle of allowing the borrower to return to viability. The code of conduct must be amended to reflect this.