

Public Response of Ulster Bank Group to Central Bank of Ireland Consultation Paper 55 on Financial Difficulties Requirements of the Code of Conduct for Business Lending to Small and Medium Enterprises

Introduction

We welcome the opportunity to respond to your Consultation Paper 55 on Financial Difficulties Requirements of the Code of Conduct for Business Lending to Small and Medium Enterprises (“CP55”).

Noting the importance of compliance with the Code and the significant changes outlined, it has been challenging to consider and assess in detail the wide variety of changes in a truncated time period and would recommend caution with regards to the impacts of the proposals, given the vital importance of this sector to the economy.

We hope that our response is useful in your development of the final rules and we would welcome any opportunity to discuss with you any aspect of our submission that you would like to probe further.

Key issues

From internal discussions on the proposals in CP55, a number of issues have been raised.

1. Overlap with Code of Conduct for Mortgage Arrears and Consumer Protection Code

At the time the CCMA was being reviewed, we noted that the provision in the SME Lending Code relating to an overlap with the CCMA (Provision 10. “*Any enforcement of a personal guarantee over a principal private residence must be in accordance with the [CCMA]*”) was unclear and inconsistent in terms of scope and application. As CP55 deals with arrears handling requirements, we would request that Provision 10 be amended to ensure there is a clear and workable provision explaining how any overlap between CCMA and the SME Lending Code in respect of arrears handling should be properly dealt with, and in the event of an overlap or conflict between codes, which requirements specifically take precedence.

It would also be useful if a practical clarification of how overlaps between the forthcoming revised arrears handling provisions of the Consumer Protection Code and the CP55 requirements should be addressed.

2. Scope and definitions

There are a number of scope-related / definitional items which we would like to see addressed in the final rules:

- *Definition of borrower with respect to agents and representatives*

We would seek clarity that the provisions of the code only apply to borrowers in respect of the business debt. As currently worded, the personal debt of a director or other agent of company could be viewed as technically falling under this Code, as “credit facility” is not a defined term, and while business lending is defined, the Code does not actually use this term in setting scope (our assumption is that your intention is to limit the application of the requirements to arrears on business lending only).

- *definition of SME*

As the definition of SME is set at EU level, it is very wide in comparison with the typical understanding of “SME” for the purpose of Irish business. For example, it significantly exceeds the existing scope of protected business customers under the current Consumer Protection Code.

Our understanding is that the effect of this wide definition would be to bring the large majority of commercial, business and corporate customers in Ireland within scope of all requirements. We are unsure whether this is intended.

We believe due regard should be given to the appropriateness of applying all of the proposed requirements to all such customers.

- *de minimus limit for excesses on overdrafts constituting financial difficulties*

There are many reasons why a business customer may have an individual account which is in excess for a period of 31 days but is not actually in financial difficulties.

For example, a business customer may maintain multiple accounts, and while one specific account may be in a very small excess, all other accounts may be significantly in credit. Where such minor excesses exist, it does not seem correct that the customer should automatically be considered to be in financial difficulties, and it seems disproportionate that the full rigour of the requirements (particularly the communications requirements) would apply in such circumstances.

It could also result in a substantial amount of unexpected (and unwarranted / unwanted) correspondence to a large number of customers. In many cases this may trigger unnecessary and harmful alarm for some customers, particularly those with a long standing history of occasional minor excesses.

We therefore believe you should consider either applying a general de minimus monetary limit or provide some provision which would allow a customer's overall position to be considered in the assessment of whether they are in financial difficulties or not.

- *definition of "has not attempted to reduce" an excess on an overdraft (for the purpose of not co-operating)*

Given the critical importance of the distinction between "co-operating" and "not co-operating", we believe further clarity is required in respect of your expectations as regards what constitutes a genuine attempt by a borrower to reduce the balance of the overdraft to the approved credit limit or below.

- *invoice discounting: relevant customer and position of factoring (recourse / non-recourse)*

We note that invoice discounting is included as an in-scope credit product. It would be helpful for the requirements to clarify whether factoring is included in scope. It would also be useful for the requirements to specify, in the event of recourse lending coupled with debt collection activity, that the requirements apply only to the “principal customer” (and not to the business customer’s own debtors), and that in the event of non-recourse lending, that the requirements do not apply at all (i.e. in respect of the business customer’s own debtors).

- *exemption for action taken “in the case of a liquidation, receivership, examinership or similar insolvency event”*

We welcome this general exemption, however as currently drafted the exemption might be read only to apply where such an event has already occurred. In reality, where the bank has reasonable concerns that a liquidation, examinership, insolvency etc. is pending in the short term, or where we reasonably believe the likelihood of such an event occurring has ratcheted up significantly, consequential actions that we would wish to take should not be subject to the requirements of the Code. We also believe that there would be significant merit in legal protection from suit being afforded under the Code to lenders making such judgments on a reasonable basis.

On a related matter, we believe that dissolved or struck-off companies, or bankrupt sole traders / partners, should be explicitly excluded from the definition of SME.

- *additional situations where a customer should be deemed as not co-operating*

We believe that the Code should specifically provide that where the bank and the customer have been unable to reach an agreement on possible alternative arrangements, and appeal mechanisms under the code have been exhausted (or the time allowed to appeal has expired), this should result in customer being classified as not co-operating.

We also believe the rider provided under c) ii. in the current draft definition of not co-operating is open to abuse at present (i.e. as long as a customer can say they have responded to communications, they cannot be deemed as not co-operating, even if those responses are perfunctory or non-constructive in nature), and instead should reflect the unsuccessful exhaustion of discussions around possible arrangements as outlined above.

3. *Communication to customers*

We note that a series of matters are required to be communicated to customers at different times. There are a number of issues which would like to raise:

- *Detailing the criteria used for the assessment of viability of a borrower*

Given that this is very much a judgmental issue, not necessarily lending itself to strict quantitative analysis, it may not be possible to provide in-depth detailed criteria used. The range and combination of issues that could be the cause of the arrears (and the customer's viability in turn) are considerable and without question judgmental. Viability may also be considered on a short and medium term basis, and the approach may differ depending on the time scale concerned.

While we understand the importance of explaining the type of information that the bank uses (and requires to be provided where it is not already to hand) in making a determination, we do not believe specific criteria used by the bank should be required to be communicated.

Instead, we believe it would be appropriate to communicate, in a more general non-exhaustive manner, the usual high level issues which may be considered in making such a judgment call.

In this regard, we would point to the current definition of a viable business that we outline in the publicly available "Your Business, Your Bank" document¹ (written by the Credit Supply Clearing Group, which was set up by the Department of Enterprise, Trade and Innovation and the

¹ http://www.ulsterbank.com/documents/ROI/Business/YourBusinessYourBank_Dec2010.pdf

Department of Finance, to develop initiatives to help support the funding of Irish businesses) as an acceptable suggested generic explanation of our approach:

A **Viable Business** is a business that is currently in operation and is expected to continue to remain trading for the foreseeable future.

Common characteristics of viable businesses are as follows:

- A history of successful trading and profit and/or cash generation
- A management team that has adjusted its business model and cost structure to the prevailing business climate
- Good credit history over the previous 3-5 years
- For start-ups, this may relate to the promoters personal credit / financial history or any previous business ventures in which they have been involved in
- A realistic business plan and financial/cash flow forecasts that outlines a clear action plan.
- Short-term cash flow projections (i.e. 6-12 months) are of particular importance in the current environment
- An ability to show that the business is capable of maintaining or returning to solvency within a two year trading period

In addition, it is worth noting that the Code generally expects all customers in financial difficulties to be considered on a case-by-case basis, which inevitably leads to an expectation of a complex judgment call in each case rather than reducing the decision to purely a number-crunching exercise according to set defined criteria.

- *Contacting customers as soon as they go into arrears or where a limit has been exceeded*

Introducing automated contact where the customer's position falls under the Code's definition of arrears and excess will be a complex information technology exercise, and we would seek sufficient time to implement a workable and robust solution in this regard.

- *Restrictions on attempts to contact*

By including an "initiated but incomplete" attempt to contact as a contact for the purpose of provision 32, this may mean the customer is not even aware that the bank has been trying to contact them (for example if the bank exhausted its 5 attempts in any one month in this way), which cannot reasonably be viewed as being in the best interests of customers.

This problem may be exacerbated when dealing with businesses who are more than "small" – i.e. where the bank may have multiple contacts within a customer's business (e.g. CEO, financial controller, directors, credit controllers etc.) – this restriction may arbitrarily dilute contacts across a business customer to such a level that it is practically impossible for all the right persons to be engaged in relevant contact.

We therefore believe that the general requirement (under provision 31) to ensure the level of contact and communications is proportionate, and not excessive should be sufficient on its own, and provision 32 should be removed.

4. Establishment of a dedicated unit for SME borrowers in financial difficulties

As the definition of SME is so wide, it does not tie in neatly with the standard approach for relationship management of customers, which may be necessarily segmented by business size and type.

If your requirements are designed to have one sole dedicated support unit alone, this may not ultimately be in the customer's interest.

5. Third party information

Where the customer believes it is necessary, or the bank requires, the provision of information from a third party, and such information is not forthcoming (in full or in a timely manner), this should not prejudice the bank's ability to proceed against the arrears where the information deficit is outside of the bank's control (e.g. where an accountant refuses to release information as they have not been paid) and reasonable time to produce the information has already been provided to the customer. We would ask that this be explicitly outlined in the Code.

6. Periodic review of arrangements

Tied in with the absence of clarity in terms of when a customer may be deemed to have moved out of financial difficulties, it is unclear at what point, if any, periodic formal reviews under draft provision 51 are no longer necessary. We believe that if a customer has fulfilled the criteria suggested for no longer being considered in financial difficulties, then provision 51 should explicitly not apply. Ongoing discussions and reviews would form part of the business-as-usual management of the customer relationship, however this would not be under the classification of financial difficulties.

7. Appeals

Provision 55(c) as drafted would appear to suggest that customer should have an automatic right of referral to the Credit Review Office (where this applies) or the Financial Services Ombudsman ("FSO"). It is not clear whether this right is supposed to be interchangeable or cumulative (i.e. for those banks who do not have referral arrangements in place with the Credit Review Office, do you expect all customers to be informed of a right to refer their case to the FSO, and for those banks who have referral arrangements with the Credit Review Office, do you expect customers to be informed of a right to refer to one or both or each in turn?).

In any event, if an internal appeals mechanism as outlined in Provision 55 is now required, the added value of further appeals or referrals is unclear.

We would therefore suggest that all customers, as part of the general information requirements, should be informed of the right (as with any other aspect of their relationship with the bank) to make relevant complaints to the FSO where they are unhappy with the specific behaviour of the bank at any given time, in line with the bank's complaint resolution process, and if necessary an unrelated internal appeals mechanism can be separately provided.

We would also point out that the wide definition of SME is such that a significant number of such customers do not have access to the FSO. We believe this is correct, as their size is such that alternative dispute resolution is not appropriate for them, principally designed as an avenue for those who cannot afford the more complex and costly legal route.

On this basis we also believe that the scope of appeals process outlined here may be better aligned to only apply to those customers captured by the FSO criteria (i.e. those who fall under categories (b) and (c) in the existing definition of consumer for the purpose of the CPC), and not to the wider SME population as defined in the SME Lending Code.