

Consumer Protection
Banking Insurance Investments and Policy
Central Bank of Ireland
PO Box 9138
6-8 College Green
Dublin 2

Monday, 13th April 2015
[By e-mail & post]

Re: SME Business Lending Regulations

Dear Sir/Madam,

Banking & Payments Federation Ireland (BPFI) and its member banks (we) welcome the opportunity to respond to the Central Bank of Ireland's (CBI) consultation paper (CP91) in relation to the review of the Code of Conduct for Business Lending to Small and Medium Enterprises (the existing SME Code).

The common objective of the CBI, Government and the banking sector is to ensure viable SMEs have access to the credit needed to operate and build their businesses, in the most efficient and streamlined manner possible.

The existing SME Code, in operation since 2009, is fully embedded in banks' processes and empirical evidence suggests that banks are lending to creditworthy SMEs, are transparent in dealings with SMEs and are assisting SMEs in financial difficulty to meet their obligations. The sector has been working for some time now to ensure viable SMEs remain in business, through the provision of affordable credit and a focused restructuring process for SMEs in financial difficulty, for the benefit of SMEs and the economy, whilst also protecting banks' interests in the process.

Although we support the revision of the existing SME Code in principle, we have significant concerns in relation to the text and prescriptive nature of the proposed Regulations. We are concerned that implementation of the proposed Regulations as currently drafted will serve both to disrupt existing lending and greatly hinder the resolution process for SMEs in financial difficulty, thereby adversely impacting SMEs and the recovery of the domestic economy.

The review of the existing SME Code comes at a critical time in the recovery of the SME market. During the pre-review consultation engagement with the CBI, BPFI emphasised that member banks fully recognise the centrality of SMEs to economic recovery and the mutuality of interests in supporting SMEs. It was highlighted that banks have ample capacity and liquidity to assess and to fund viable SMEs; however, demand for credit from SMEs remains low, reflecting ongoing difficulties in the recovery of the domestic economy owing to a continuing lack of consumer confidence and spending. There is evidence of a high level of dependency by SMEs on banks for finance (at 93% at end 2012), but the main focus remains on working capital/refinancing with reduced and diminished

appetite for investment or growth by domestic SMEs. Imposing a set of overly prescriptive Regulations at such a time will serve only to decrease the demand for credit by SMEs and thereby, delay full economic recovery.

In a European context, it would seem that Ireland remains an outlier in its regulation of business lending. In the UK for example, financial institutions are subject to the Lending Code, a voluntary code of practice which sets standards relating to debt collection and debt purchase firms to follow in their dealings with personal and small business customers. Notably, in the context of SMEs, the voluntary code applies to micro enterprises, defined by the EU as “*enterprises that employ fewer than 10 persons and have a turnover and/or annual balance sheet that does not exceed €2 million*”. The application of a similar definition in the proposed Regulations would be much more appropriate and relevant, ensuring those SMEs in most need of support and protection in their financial dealings with lenders are afforded same. In fact, the provisions relating to smaller enterprises in the existing SME Code in Ireland were put in place with the aim of protecting less sophisticated SMEs in their financial dealings with lenders. The proposed Regulations, by suggesting the same protections for all types of enterprise/SME, gives unnecessary protection to a sophisticated cohort of businesses and brings administrative challenges for lenders in applying such Regulations.

In addition, the proposal to implement more consumer focused or CCMA-type provisions to assist SMEs in financial difficulty, which are completely unsuitable for SME customers in circumstances where non-regulated creditors are not required to operate in the same manner, would have a material negative impact on the resolution/restructuring of SMEs in financial difficulties. This may dissuade certain banks from lending to certain SMEs in the future. It is important to realise that business lending is very different in nature from consumer lending. It must also be accepted that, by its nature, business lending will always carry a certain element of risk. SMEs, in particular larger SMEs, are aware of this when applying for credit.

Furthermore, certain elements of the proposed Regulations (where the Regulations are overly prescriptive such as in relation to the taking of security and potentially, allowing for appeal of standard terms & conditions) risk interference with the prudential lending standards of banks, which have been approved at Board level with each bank and by the CBI, and transcend Conduct of Business requirements.

It is evident that there is a continuing need for more financial education and stronger mentoring to develop the financial capabilities of SMEs. A State subsidised training initiative, announced in Budget 2014 and included in the Action Plan for Jobs 2014, will be a welcome addition to the existing range of supports available to SMEs. Ultimately, such measures would serve to inform and protect SMEs to a more useful extent than what is being suggested in the proposed Regulations.

In summary, the key concerns of the banking sector in relation to the proposed Regulations are set out below (not in order of priority). Further details and our specific responses to the questions raised in CP91 are set out in the attached appendices.

BPFI - Key Sector Concerns

1. ***Extension of smaller enterprise protections to all SMEs*** - Given the nature of the Irish market, it is not appropriate to extend the protections granted to smaller enterprises under the existing SME Code to all SMEs (which employ fewer than 250 employees and which have a turnover less than €50 million and/or an annual balance sheet not exceeding €43 million).

Entities with this level of turnover and employees are usually highly sophisticated and financially astute and therefore, we believe there is no merit in extending the protections granted to smaller enterprises to all SMEs.

2. **Legal Protections** - The proposed Regulations must not restrict lenders ability to act to protect/realise their security by placing overly restrictive and lengthy processes on them that are not applied to other creditors, for example trade suppliers. The proposed Regulations must take into account the nature of the underlying entities and not add additional bureaucratic constraints. BPFi requests the reinsertion into the Regulations of the following text from the existing SME Code:

“Nothing in these Regulations prohibits a lender from acting with all necessary speed:

- a) *where in the circumstances of the case it is necessary to initiate a liquidation, receivership, examinership or similar insolvency event or where another lender or other third parties initiate such actions;*
- b) *where it is necessary in order for a lender to protect its legitimate commercial interests;*
or
- c) *where there is reasonable evidence of fraud, terrorist connections, money laundering, terrorist connections and/or misrepresentation,*

and the provisions of these Regulations are without prejudice to a lender’s regulatory and/or legal obligations and legal rights to enforce any agreement including any security taken in connection with any agreement.”

3. **Lending Criteria** - Nothing in the proposed Regulations should impact on the ability of each lender to set their own lending criteria, risk appetite and terms around provision of security/guarantees. In addition, guarantees operate differently in business lending than in consumer lending and some provisions of the proposed Regulations, particularly Regulation 12 (4), relating to guarantors are deemed onerous in that context.
4. **On-Line fulfilment and evolving business models** - The proposed Regulations must take into account that banks and SMEs are embracing online service fulfilment, and banks have adopted (and continue to evolve) new business models to reflect customer needs. This is particularly relevant in the context of lending and customer engagements, where online fulfilment will streamline processes and provide flexibility to SMEs.

We advocate that there should not be a requirement to appoint an individual with responsibility for provision of credit, arrears and financial difficulties in each office of the lender which is concerned with lending activity, as provided for under Regulation 6 (1), as this impinges evolving business models, which are designed around the needs of SMEs.

5. **Appeals** - Further to point 3 above, the standard Terms & Conditions which make up part of every lending agreement and apply to all SME customers are integral to the product offering and form a key part of the lending process. SME customers are entitled to appeal bespoke terms and condition of sanction which are particular to them. However, in the interest of fairness to all SME customers and being mindful of prudential lending standards, standard Terms & Conditions should not be subject to potential appeal as might be implied by the proposed Regulations.
6. **Reasons for Decline** - Standardised decline letters are used by banks to facilitate a

meaningful response to customers within a tight timeframe. Customisation of decline responses on a case-by-case basis would be impractical, cause significant technology issues and would serve only to extend the timeframe in which banks can respond to customers.

As the CBI will be aware, two member banks revisited the standard list of reasons for decline and the language used in October last year. The revised list of decline reasons was submitted to the CBI by the relevant banks in November 2014 and the banks in question have proceeded to implement the system changes to reflect the enhanced standard of language used in setting out the reasons for a decline. We assume that compliance by other banks with the standard reasons for decline, as submitted to the CBI last year, is sufficient in the case of communicating a decline.

7. **Arrears** - BPFi is of the view that, as currently drafted, the requirements of Regulation 14 (2) are particularly concerning and are unnecessary from both a borrower and lender perspective. The proposed operative timeframes as set out in Regulation 14 (2) will potentially bring into scope arrears cases which are temporary in nature. For example, SMEs may have temporary cash flow problems which could be rectified on day 11; however, the proposed Regulations would require a formal engagement with the SME at this point, which may be intrusive from the SME's perspective.

We would request that Regulation 14 (2) aligns the process for overdrafts and arrears on other types of accounts. The 10 day timeframe should only apply to overdrafts (i.e., already in excess for 30 days), with the 40 day timeframe applicable to other accounts. We also request that Regulation 14 (2) (c) and Regulation 14 (3) are deleted, as it would be too early at this stage in the arrears process to determine whether the customer is in financial difficulties and would be unfair to the customer to try to conduct such an assessment.

8. **Communication with Borrowers in Financial Difficulties** - Member banks are committed to ensuring that when contacting a borrower in financial difficulties that all contact is proportionate, not excessive, never aggressive or intimidating. Our understanding is that an overarching communications policy which each lender must have in place, as opposed to any individually negotiated communications plan with the borrower, is the optimum way to achieve this. An overarching communications policy ensures a transparent and standard approach for all borrowers, promoting fairness, which can be easily measured.

As currently drafted, the proposed Regulations might imply that lenders are required to agree individual communication plans with borrowers in difficulties. An individually agreed communications plan would be hugely impractical and difficult to implement from both a borrower and lender perspective. It is likely to be problematic to gain agreement between both parties on what constitutes "appropriate" timeframes for communication. This could lead to delays in the agreement of an alternative repayment arrangement and consequently, increased arrears for the borrower. On this basis, we request the CBI to revisit the wording of proposed Regulation 17.

9. **Unnecessary costs for SME customers** - As currently drafted, elements of proposed Regulation 12 (Security) may cause unnecessary costs for SME customers. In particular, it would not be in the best interest of the SME if lenders are required to release security where credit has been repaid (in the absence of a request from the borrower to release same) and where the use of prescribed warning statements might give rise to questions in so far as they relate to "all sums" guarantees.

10. **Implementation Timeframes** - The proposed changes outlined in the revised Regulations will require significant changes to procedures and processes and, critically, will also require IT change for certain provisions.

Based on the experience of our member banks in relation to the implementation of previous codes, it is imperative that member banks are provided adequate time to make appropriate system changes which focus on customer-centric solutions as opposed to meeting the implementation deadline. In this regard, the CBI must be mindful to afford member banks sufficient time to allow for controlled assessment and implementation of the changes presented, to ensure that they are robust and effective.

Also, the revised Companies Act legislation, due for implementation in 2015, will impact on the business community's ability to absorb the proposed Regulations, and financial institutions ability to implement same. We would request that cognisance is taken of this parallel legislative change, with regard to the implementation timeframes afforded for the proposed Regulations from the date of their publication.

We would welcome a meeting to discuss the points raised above and in the enclosed appendices in relation to the proposed SME Regulations. We remain committed to supporting the CBI in preparing Regulations that represent a practical working solution, which has the best interests of the SME at its core, and look forward to working together with you to achieve that aim.

Yours sincerely,

pp Michelle Byrne.

Maurice Crowley
Director, Banking & Payments