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24 August 2011

Code of Conduct for Business Lending to Small and Medium Enterprises

Dear Sir/Madam

AIB welcomes the opportunity to provide comments on Consultation Paper 55, Review of the Financial Difficulties Requirements of the Code of Conduct for Business Lending to Small and Medium Enterprises (the "SME Code").

The existing SME Code has been working well since its introduction in February 2009, and significant resources have been applied to its implementation by regulated firms. Any revisions to the Code should reflect the reality of the day to day relationship between firms and SMEs and be flexible enough to encourage real engagement and case by case solutions. The original Code was carefully composed so as to ensure that there were no conflicts between the provisions of the Code and lenders' legal rights and obligations. We recommend that the proposed new rules should be analysed to ensure the absence of such conflicts.

We support and agree with the objectives and intent of the Central Bank in establishing a framework for supporting SME customers in difficulty. We agree with many of the proposals. At the same time, we have concerns that some of the provisions may not achieve the desired objectives and could have other significant unintended consequences. In our analysis of the proposed revisions to the Code, we have drawn on our experience of the workings of the existing Code. We have set out below our high level, overall concerns with some of the proposals in CP 55. Comments on specific rules are set out in the Appendix.

General Comments

We fully support and agree with the principle that lenders need to work with SME customers in arrears in order to arrive at a solution that is beneficial to both the customer and the bank. We are concerned, however, that while not the intention of the Central Bank, a prescriptive approach in some parts of the Code may, in fact, hinder our relationship with customers in arrears. Our experience shows that positive, proactive dialogue with our customers is critical to arriving at mutually satisfactory and workable solutions. A step-by-step, prescriptive methodology which hinders flexibility is likely to force lenders to adopt a rigid approach that will not be appropriate to each customer's unique situation. CP 55 makes a number of statements about flexibility and dealing with customers on a case by case basis. For example, Rule 16 (c) requires lenders to allow for a flexible approach with borrowers and

handle borrowers in financial difficulties on a case by case basis. However, this is not borne out in the detailed rules of the Code.

We note that many of the proposed changes to the Code are based on similar provisions in the CCMA. We do not agree that it is correct to apply regulation appropriate to mortgage arrears to arrears situations for SME customers. Mortgage lending involves more homogeneous products. Lending to SMEs, on the other hand, involves more complexity in terms of the customer profile, credit product range and the purposes for which borrowings are made.

Many customers have a number of credit facilities with the same lender. The proposed amendments to the Code appear to impinge on the lender's ability to deal with arrears on one facility as part of the management of the borrower's overall portfolio exposure. This will negatively impact on the relationship between borrower and lender.

Definition of Financial Difficulties

We agree that customers who have concerns about getting into an arrears situation should be encouraged to contact their lender at an early stage to prevent an actual arrears situations arising, In these cases, AIB is committed to working with customers to develop appropriate solutions and, where possible, to prevent arrears from arising. However, the definition of "financial difficulties" in the Code means that a customer who comes forward with their concerns is immediately categorised as being in financial difficulties. There is a danger that many SME customers will not wish to be formally categorised as being in financial difficulties, given the potential negative consequences for the financial reputation of their business. The definition of financial difficulties could, therefore, have the unintended consequence of discouraging customers from engaging with their lender. The categorisation of such customers as being in financial difficulties will also have significant capital implications for banks arising from the need to inappropriately regrade them in compliance with the requirements of the Capital Requirements Directive.

Equally, a process is required to allow customers who have entered into alternative repayment arrangements to be recategorised as not being in financial difficulties, where their arrangement has been performing and is viewed by the lender as sustainable. If these customers remain classified as in financial difficulties, there will also be significant implications for the bank's capital position as described above. We also consider that SME customers would seek to be recategorised in order to limit the time period within which they are considered to be in financial difficulties.

Finally, the Code needs to allow for differentiation between situations where a borrower may be experiencing temporary financial/cashflow difficulties as opposed to a persistent, fundamental problem. The Code proposes treating all of these situations in the same manner. In practice, however, it is often feasible for the lender to work with the borrower in temporary difficulties and deal with the problems as part of "business as usual". Customers in these situations would not, based on our experience, wish to be formally classified as being in "financial difficulties".

Given the fact that the definition of "financial difficulties" underpins the entire Code, we consider that further engagement with industry is required to ensure that all implications for SMEs are given due consideration.

Fees and Charges

We understand that the intent of Rule 24 is to prohibit lenders from imposing surcharge interest/referral fees on arrears arising on credit facilities of borrowers in financial difficulties where the borrower is co-operating with the lender. As currently worded, Rule 24 could be open to different interpretations and we have suggested alternative wording in the Appendix.

Lenders incur costs in managing unscheduled or unauthorised borrowing such as operational, staff and funding costs. If lenders are prohibited from imposing surcharge/penalty interest and referral fees etc, costs incurred by the lender will have to be borne by the entire SME customer base. This could have the effect of increasing the cost of borrowing for all SME customers.

Timetable for Implementation

Many of the proposals in CP55 will require detailed internal process and operational changes as well as significant systems changes requiring IT development. Firms are already facing considerable regulatory change most notably arising from the soon to be finalised Consumer Protection Code. This creates huge challenges for firms and we would request that the Central Bank take this into account when deciding on the implementation date for the new Code. Accordingly, we suggest that a minimum implementation period of nine months from the date of publication of the final Code be provided. Where complex IT changes are required and the nine month timeframe may not be achievable, we suggest that individual institutions liaise with the Central Bank to agree a realistic implementation schedule.

Finally, we note that CP 55 contains extensive proposals governing banks' relationships with SME customers. The SME sector is critically important for the Irish economy and it is crucial that the Code is appropriate for these businesses. Given the short consultation period, we have had limited time to consider these proposals. We would, therefore, very much welcome the opportunity to meet with you to discuss our response and further outline many of the important, practical concerns arising from the CP.

Yours sincerely,

James Meagher
Regulatory Liaison and Assurance

Appendix

Comments on Specific Rules

Scope

We suggest that the introductory wording in section 17 of the previous Code should be reinstated in this Scope section. In particular, we suggest that the Code should state that nothing in the Code should "prejudice a regulated entity's regulatory and/or legal obligations and legal rights".

Please note that the word "executing" in the final paragraph should read "enforcing".

Definition of "Financial difficulties"

We do not agree with the proposed definition of "financial difficulties". The definition does not allow for any possibility of a period of investigation/discussion with the borrower to allow for remediation of what may be a short term arrears situation. Neither does it take into account the materiality of the arrears amount in the context of the borrower's overall exposure. This is particularly relevant where borrowers may not wish to be classified as in financial difficulties and want to remain within the existing business as usual, case management arrangements.

The definition needs further engagement with the Central Bank to outline all the situations that should be taken into consideration when defining financial difficulties.

In accordance with the points made in our covering letter, we suggest that the definition could be reworded as follows:

"Financial difficulties – A borrower must be classified as in financial difficulties where;

(a) Arrears arise on a credit facility of the borrower and these arrears are outstanding for a period of at least 31 consecutive days; or

(b) In the case of an overdraft credit facility, where the approved limit on the facility is materially exceeded by the borrower and remains exceeded for 31 consecutive days; or

(c) The borrower already has a performing alternative arrangement in place with the regulated entity to address arrears."

Definition of "Not co-operating"

The definition of a "Not-co-operating" borrower should be amended to the following:

"**Not co-operating**" – A borrower may be considered as "not co-operating" with the regulated entity when any of the following applies to the borrower's particular case:

(a) The borrower fails to make a full and honest disclosure of information, that would have a significant impact on the borrower's financial situation, to the regulated entity; or

(b) The borrower fails to provide information sought by the regulated entity relevant to assessing the borrower's financial situation; or

(c) A period of three consecutive months elapses during which the borrower:

i. has failed to meet repayments in full as per the credit facility contract or has failed to meet in full repayments as specified in the terms of an alternative repayment arrangement; or

ii. has exceeded the approved credit limit on an overdraft credit facility and has not attempted to reduce the balance of the overdraft to the approved credit limit or below; or

(d) has not, in respect of an arrears situation, responded to any communications from the regulated entity or a third party acting on the regulated entity's behalf with a period of 31 days.

Rules 16(e), 17, 45

It is not clear what is intended by the statements in these rules regarding the lender forming a view of whether or not the SME business "is viable". The lender's primary interest is in whether or not the SME has the ability to meet its obligations to the bank, whether through continued trading or other specific actions. We suggest that the wording in Rule 17 should be changed to "Where a regulated entity assesses a borrower in financial difficulties and is of the view that it is able to make repayments to the lender, and the borrower is co-operating with the regulated entity, a regulated entity must:". Similar changes are required for rules 16 (e) and 45.

Rule 18

We suggest that this rule should allow each lender to structure the dedicated function in a manner appropriate to its business model. This may result in multiple units due to business structure or locations according to the lender's geographical organisation.

Rule 24

The current wording of Rule 24 could be open to a number of interpretations. We believe that the Central Bank's intention is to ensure that lenders do not impose surcharge interest etc on those SME customers in financial difficulties where those customers are co-operating with the lender. We suggest, therefore, that the wording be amended as follows:

"A regulated entity shall not impose surcharge/penalty interest, unpaid direct debit fees and/or referral fees on arrears arising on a credit facility of a borrower in financial difficulties who is co-operating with the lender"

However, we refer you to our concerns outlined above in relation to the definition of financial difficulties.

Lenders incur costs in managing unscheduled or unauthorised borrowing such as operational, staff and funding costs. If lenders are prohibited from imposing surcharge/penalty interest and referral fees etc, costs incurred by the lender will have to be borne by the entire SME customer base. This will have the effect of increasing the cost of borrowing for all SME customers. All customers are advised on how they can avoid incurring these charges by ensuring their accounts operate within their sanctioned limit or in credit. It is important to ensure that the provisions of the Code do not have the unintended effect of encouraging inappropriate customer behaviour.

Rule 29

This rule is not consistent with the definition of "financial difficulties". The latter states with regard to overdraft facilities that a borrower is classified as being in financial difficulties where the approved limit on the facility is exceeded and remains exceeded for 31 consecutive days. It is already normal business practice for lenders to

contact customers by phone where an overdraft limit has been exceeded. Rule 29 does not add anything over and above what is already normal practice and should be deleted.

Rule 32

We do not believe that the restrictions on communications proposed in rule 32 would be in the best interests of our SME customers. In our experience, SME customers welcome and benefit from close engagement in the event of difficulties arising. Such engagements will typically be protracted and extensive. Lenders will usually require additional information from SMEs, particularly in instances where an SME's financial position has changed and the lender is being made aware of same. Depending on the size and structure of the SME, lenders will often need to contact different individuals within the SME. Rule 32 would unintentionally serve to thwart such SME engagements in situations of financial difficulty and make it more difficult to reach an appropriate solution with the borrower.

Rule 31 already requires lenders to ensure that the level of contact with borrowers in financial difficulties is proportionate and not excessive. There is, therefore, no need for Rule 32 and it should be deleted. This would be consistent with the Code's desire to allow for flexible, case by case interactions with borrowers.

Rule 33

The proposed restrictions on only allowing contact with borrower between the hours of 9am to 7pm Monday to Friday does not take into account the nature of typical SME operations, which often do not operate to traditional 9-5 hours. These customers often prefer to take calls in the evening, for example. We strongly urge that the Code should be consistent with section 46 of the Consumer Credit Act in order to reflect actual SME operating hours.

Rule 34

It may not always be possible to respond to a borrower's request to contact them within a 3 business day timeframe. We suggest that the wording in this rule should be amended to "within 5 business days".

Rule 39 (x)

In order to ensure consistency with the definition of a "Not co-operating" borrower, the borrower should be require to respond to the request for a review meeting within a period of 31 days.

Rule 41

We propose that rule 41 should be under a new section entitled "Borrowers Concerned About Going Into Arrears".

Where a borrower notifies the lender that there is a danger that they will not be able to meet repayments and/or is concerned about going into arrears, we propose that the lender be obliged to meet the borrower promptly to understand the basis for their concerns and to agree appropriate measures, if necessary, to prevent arrears arising.

Rule 42

These information requests would typically be dealt with on a one to one basis verbally. Furthermore, as the discussions with the borrower evolve, it may be necessary to request further information. The word "complete" in this rule seems to

prohibit these additional information requests. We suggest that the rule be amended to read as follows:

"Where a borrower contacts a regulated entity, or contact is established with the borrower by the regulated entity, by whatever means, to discuss an alternative arrangement to address financial difficulties, a regulated entity must provide the borrower with a list of the information the borrower is required to provide for the regulated entity's assessment of their case."

Rule 47

When considering alternative arrangements for a borrower, it will often be necessary to seek further information and engage in discussions with the borrower. It will not always be feasible, therefore, to provide a full response to the borrower within a 15 business day period, for example where there has been a material change in the SME's circumstances, which is not known to the lender. We suggest that lenders be allowed to request further information within the initial 15 day period. Upon receipt of this additional information, the lender should then be required to respond to the borrower within 15 business days.

Rule 50

See comment under Rule 51 below.

Rule 51

We do not believe that a formal review of the appropriateness of the arrangement is required every 6 months. Such a review would involve a full re-assessment of the credit and the repayment capacity of the borrower which is a detailed and in-depth process. In practice, alternative arrangements are monitored on an ongoing basis to ensure that the borrower is meeting their commitments.

Where a borrower's financial circumstances may have changed since the arrangement was put in place, which might affect the 'appropriateness' of the arrangement, it is the borrower's responsibility to notify the lender. We suggest, therefore, that Rule 50 should include a provision requiring the borrower to contact the lender where their financial circumstances have changed since the alternative arrangement was put in place. The second sentence in Rule 51 (commencing "As part of the review...") should be deleted.