



January 2016

Central Bank Regulations Regarding Lending to Small and Medium Sized Enterprises

Background

The Central Bank of Ireland (the “**Central Bank**”) has recently issued the Central Bank (Supervision and Enforcement) Act 2013 (Section 48) (Lending to Small and Medium Sized Enterprises) Regulations 2015 (the “**Regulations**”). The purpose of the Regulations is to bolster the protections for small and medium sized enterprises (“**SME**”s) when borrowing from regulated financial service providers (“**Regulated Lenders**”) which are providing credit to or entering into alternative arrangements (explained below) with SMEs. The Regulations become operational on 1 July 2016 for regulated entities other than Credit Unions for whom 1 July 2017 is the operative date.

Brief Overview

Part 1 of the Regulations contains preliminary and general provisions; Part 2 of the Regulations details provisions applicable to micro and small enterprises and Part 3 of the Regulations deals with medium sized enterprises. A micro and small enterprise is an enterprise which employs fewer than 50 persons and which has an annual turnover and an annual balance sheet total which does not exceed €10,000,000 (a “**Micro Enterprise**”). A medium sized enterprise is an enterprise which employs fewer than 250 persons and which has an annual turnover not exceeding €50,000,000 and an annual balance sheet total not exceeding €43,000,000 and which is not a Micro Enterprise. The Regulations will oblige Regulated Lenders to ensure that their internal systems are calibrated to meet the requirements of the Regulations when lending to applicable SME borrowers.

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While there is a significant degree of overlap between Parts 2 and 3 of the Regulations, Micro Enterprises have materially more protection than medium sized enterprises. This additional protection will result in an important distinction for Regulated Lenders when developing their internal systems to ensure compliance with the Regulations.

Micro Enterprises

The provisions relating to unsolicited credit (Regulation 7), specialist training for staff when lending to Micro Enterprises (Regulation 8) and advertising (Regulation 11) are particular to Micro Enterprises. Additionally, materially more information must be provided to Micro Enterprises prior to and as part of their application for (and provision of) of credit than is required for medium sized enterprises.

Information Requirements

When entering into a credit facility with a borrower, a Regulated Lender is obliged to provide the borrower with information regarding the facility including the total amount of the credit, the duration of the credit facility agreement, details of fees, charges and interest rate including an explanation of the basis for calculation of the interest charge. The nature and extent of the detail to be provided is augmented in the case of Micro Enterprises. A Regulated Lender is obliged to include warnings, amongst other things, set out in the Regulations in the credit information provided by it to SME borrowers.

A Regulated Lender is obliged to publish on its website and generally to make available to SME borrowers certain information regarding the application process for credit, including the timelines that apply to an assessment of the credit application. In the case of Micro Enterprises, prior to entering a credit agreement, a Regulated Lender is obliged to gather sufficient information to enable it assess whether the credit being applied for is suitable for the relevant borrower.

Security is often required to support the payment obligations of a borrower, including SME borrowers. Where a Regulated Lender requires security (including a guarantee) in support of an application for credit, the Regulated Lender is obliged to (i) ensure that any security being sought is reasonable and proportionate having regard to the nature, liquidity and value of the security offered and the value of the credit offered and (ii) to provide a written explanation to the SME borrower as to why this security is required and the consequences for such borrower of providing such security.

Ongoing Review

Where credit has been extended to a borrower, Regulated Lenders are required to offer a borrower, on an annual basis, a meeting which shall include credit review comprising a review of the facility and security arrangements and if relevant, any arrangements entered into to deal with a borrower in arrears or in financial difficulty. In the case of Micro Enterprises, the credit review must be completed within a reasonable timeframe, which must be notified to the borrower. On completion of the credit review, the Regulated Lender has, subject to certain exceptions, to advise the relevant Micro Enterprise borrower of the outcome of the review. An equivalent obligation in respect of medium sized enterprises is not specifically provided in the Regulations.

Arrears

Where a borrower informs a Regulated Lender that it is at risk of going into arrears, the Regulated Lender is obliged to offer the borrower the option of an immediate review of the borrower's credit facility, security and alternative arrangements (if any). If a borrower agrees to the review, the Regulated Lender is obliged to assess the borrower's circumstances and assess whether the provisions of the Regulations regarding borrowers in financial difficulties apply to the particular borrower. Regulated Lenders are required to have policies and procedures with the core objective of assisting a borrower resolving its financial difficulties. A Regulated Lender is also obliged to identify the options available to the Micro Enterprise to address arrears or financial difficulties having regard to the circumstances of the Micro Enterprise.

Not Co-operating

Amongst the information to be provided to Micro Enterprises is a clear explanation of the meaning of "not co-operating" and implications for an applicable borrower of not co-operating including the (i) impact on the Regulated Lender's consideration of an alternative arrangement (explained below); (ii) impact of such classification on the Regulated Lender's consideration and exercise of any legal or contractual rights and (iii) where security is realised an explanation that such borrower (and any guarantor) will remain liable for any outstanding debt. Prior to classifying a Micro Enterprise as not co-operating, the Regulated Lender is obliged to issue a warning letter informing the relevant borrower and any guarantor that the borrower will be classified as not co-operating if it does not perform specific actions (which must be reasonable and proportionate) to enable the Regulated Lender complete an assessment of the borrower's financial circumstances and setting out the timeframe within which any specific actions are to be carried out. The timeframe for performance of specific actions must be at least 20 working days from the date of issue of the warning letter. Where a borrower has been classified as not co-operating, following compliance by the Regulated Lender with the Regulations, the Regulated Lender is obliged to notify the borrower and any guarantor that the borrower has been classified as not co-operating and outline the impact of such classification.

Alternative Arrangements

The Regulations detail the minimum information to be provided to borrowers where an alternative arrangement (i.e. an arrangement with a borrower to modify the terms of the loan) is being offered. This includes the timeframe for the borrower to avail of the offer of the alternative arrangement, details of the revised repayment amounts on the credit facility, the impact on the arrears amount and the operation of the facility and the amount of or determination of any residual debt remaining on the expiry on the alternative arrangement. A Regulated Lender is obliged to inform a borrower, if it decides not to offer an alternative arrangement or if a borrower declines to accept the offer of an alternative arrangement, of the implications for the borrower, of those decisions.

Appeals

The Regulations place obligations on Regulated Lenders to establish and implement internal appeals process to allow a borrower appeal certain decisions. The Regulations also outline procedures for handling complaints.

General Observations

While the Regulations cover many of the areas addressed in the Code of Conduct for Business Lending to Small and Medium Enterprises (the “**SME Code**”) the Regulations are significantly more prescriptive than the SME Code, in particular for Micro Enterprises. The Regulations establish a robust legislative framework to allow more clarity for SME borrowers when obtaining credit from Regulated Lenders. While Regulated Lenders have time to establish systems to implement the measure promulgated by the Regulations, the practical implementation of and compliance with the Regulations may create challenges for Regulated Lenders.

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