

Luxembourg, 27 September 2019

ABBL Comments on the EBA Consultation on Loan Origination and Monitoring

Question 1: what are the respondent views on the scope of application of the draft guidelines?

While the requirements of the Guidelines seem relevant for large loans, they **lack sufficient granularity** to capture the specificities of loans to SMEs or to individuals, among others. The proposed scope might thus result in a disproportionate application of the Guidelines to such transactions, which should benefit from alleviated requirements to cope with the reality of market practices. As a consequence, we suggest that the Guidelines calibrate the requirements according to a more granular typology of borrowers.

Moreover, we observe that **proper application of the principle of proportionality** will be **difficult to achieve** due to the detailed list of requirements included in **Annexes 1 and 2** of the Guidelines. While these annexes would make sense **for illustrative purposes only**, we understand that they are de facto binding requirements due to the specification **“at least”** in sections 4.3 and 5.1 of the Guidelines. In this respect, we recommend amending paragraphs 35.b, 92 and 94 by making it clear that Annexes 1 and 2 serve **for illustrative purposes only**.

Comments on paragraph 14

We propose to insert at the end of paragraph 14 the sentence:

“Each Institution is free to set up its own internal policy in terms of size, threshold, and of nature/complexity for using the proportionality criterion at the credit facility level.”

Question 2: Do you see any significant obstacles to the implementation of the guidelines by the application date and if so, what are they?

In order to facilitate the implementation of the Guidelines, it would be useful to clearly identify the requirements that must be considered as mandatory and those that can be considered as optional (to be adapted by the institution to the specific type of client, sector, product, the level of experience and business model of the institution itself).

Full compliance with all the requirements listed in the Guidelines, for all type of clients/sectors/transactions and regardless of the institution's business model, would imply huge investments and lengthy implementation, without adding real value to the risk framework.

Furthermore, the Guidelines imply relevant IT infrastructure implementations (4.3.5) that are not deemed feasible within the proposed application date of June 2020. Therefore, we suggest **postponing the date of application to 31 December 2021 at the earliest**, especially for banks using the Standardized Approach for credit risk, which are less familiar with the proposed framework. The additional delay aims also to cover, pedagogic aspects, with a strong change of practice. In addition, the IT teams are already busy by the current regulatory schedules, by digital

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transformation, by new challengers that come with FinTech, ...

Comments on definitions

“Professional means non-consumer”

We suggest a convergence of the vocabulary with the existing definition i.e. Household instead of Consumer and Enterprise instead of Professional. There are already a lot of to do for maintaining clean data. If we mix the various approach, operational mistakes will raise.

We suggest that EBA sticks on the definition of Enterprise by opposition to households.:

COMMISSION RECOMMENDATION of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (notified under document number C(2003) 1422) (Text with EEA relevance) (2003/361/EC)

TITLE I

DEFINITION OF MICRO, SMALL AND MEDIUM-SIZED ENTERPRISES ADOPTED BY THE COMMISSION

Article 1

Enterprise

An enterprise is considered to be any entity engaged in an economic activity, irrespective of its legal form. This includes, in particular, self-employed persons and family businesses engaged in craft or other activities, and partnerships or associations regularly engaged in an economic activity.

Question 3: What are the respondents' views on whether the requirements set in the draft guidelines are future proof, in particular in relation to technology enabled innovation (Section 4.3.3) and environmental factors and green lending (Section 4.3.4)?

At this early stage of the elaboration of a complete framework for sustainable finance, being compliant with the requested “holistic approach” on ESG considerations is very challenging: **we strongly recommend postponing these requirements pending the publication of the dedicated EU regulatory framework on sustainable finance.**

As far as green lending is concerned, the Guidelines require the acquisition of a large amount of data and specific industrial competencies to evaluate risks like Legal Risk or Technology Risk that can be very difficult to gather and assess on a large number of clients (small and fragmented on different industries). So, we suggest identifying possible priority criteria to define a more limited and focused scope of application.

Question 4: What are the respondents' views on the requirements for credit risk policies and procedures (Section 4.3)?

We suggest harmonizing these Guidelines with the “Reporting instructions on Credit Underwriting data collection” recently issued by ECB (April 2019), to avoid possible mismatches on these topics. We also recommend to better detail the main definitions (for example, it would be very useful to include the definition of “new business volume origination”).

As regards data infrastructure, the requisites are consistent. Nevertheless, each regulatory text or guideline adds additional data requirements that are not always available in a structured way or not yet captured. Logging and renewing all the data with the requested level of granularity would be significantly costly without improving substantially the risk management framework. In addition, following all the requested metrics would be difficult to explain to clients in a context of low interest rates and of competitive environment, and it could possibly damage the level playing

field among institutions.

Comments on paragraph 27

“When defining the credit risk appetite, institutions should ensure that both top-down (e.g. setting high-level targets) and **bottom-up perspectives** (e.g. operationalization of these high-level targets).”

The top-down is generally well established. However, the banks need more time than 6 months to implement the bottom-up.

Comments on paragraph 28

“The credit risk appetite and strategy should include, where applicable, appropriate specific credit risk metrics and limits, **which should be a combination of backward-looking and forward-looking indicators**. Such indicators should include key aspects of the credit facilities including their geographical coverage, business lines, asset classes, sectors, client segments, currency, credit risk mitigation instruments and products. **These indicators should be tailored to the business model and the complexity of the institution.**”

Banks need more time than 6 months to implement such indicators. Some are already there, but not all. Paragraph 29 asks for metrics and limits in a wider practice than today.

Comments on paragraph 29

“Institutions should ensure that credit risk appetite and **associated metrics and limits** are **adequately cascaded down within the organisation**, including all group entities and business lines.”

The Credit Risk Appetite is a global assessment paper, and here, it is requested a more granular approach. For such, we ask for a phasing-in period for implementation.

Comments on paragraph 33

Although we have policies that govern the entire lending activity (e.g. global credit policy), specific policies only exist where size and specificities/nature of activity justify the need and definition of a specific policy.

Comments on paragraph 35

As regards Annex 1 – the Guidelines give an extended list of binding criteria (“at least”) and limits. This list should not be prescriptive as (i) not all the criteria are relevant in all situations and (ii) many of them are not currently followed. Being compliant with the full list will result in significant time and financial costs.

Comments on paragraph 35.b

In light of our previous comment, we propose the following **amendment**:

“**b.** credit granting criteria; while specifying these criteria, institutions should ~~at least consider~~ **define the list of internal metrics to apply such as, for example, the** items referred to in Annex 1;”

Comments on paragraph 35.d

“**d.** requirements for the creditworthiness assessment, including **sensitivity analysis as referred to in Section 5.2;**”

The introduction of the sensitivity analysis as referred to in section 5.2 is a complete change of methodology. For such reason, we ask for a phasing-in period for implementation. Section 5.2 considers scenarios at the loan level, whereas today it is performed at the portfolio level.

Comments on paragraph 35.i

“i. requirements relating to what is to be documented and recorded as part of the credit granting process including for sampling and audit purposes. This should include at a minimum the requirements for the completion of credit applications, **the qualitative and quantitative rationale/analysis and all supportive documentation** that served as a basis for approving or declining the credit facility;”

This requirement represents significant work and IT costs for setting-up a full process of registration. At the moment, IRBA banks are close to achieve this requirement, but banks using the Standardized Approach do not have yet the full IT capacity to implement it. For such reason, we ask for a transitional period (for defining an adequate infrastructure, budget assessment, timing of implementation).

Comments on paragraph 48

“Institutions should adopt a **holistic approach**, and incorporate ESG considerations in their credit risk policies and procedures.”

The word ‘holistic’ is extremely strong. If we want to avoid a “*die before birth*” market, we should be really cautious about the requirement. Otherwise, no initiative will rise.

Comments on paragraph 54 to 56 and 229

With respect to data infrastructure and IT items, it will not be possible to log and renew all the data with the requested level of granularity. If we had to do this, it would cost millions of Euros in a context of cost containment/reduction (IT and staff) and it would not significantly improve the risk management framework. To the contrary the staff (business and risk) working on logging, renewing and controlling data would not be working on real risk management and follow up.

Question 5: What are the respondents’ views on the requirements for governance for credit granting and monitoring (Section 4)?

Paragraph 63.b enumerates the situations where members of staff and members of the management body should not take part in credit decisions. We observe that the requirements of this paragraph are not adequate for loans that institutions grant to their employees, where individuals involved in the credit decision-making (i.e. the institution’s employees) may be by nature not independent from the lender (the institution). Such loans are covered by specific internal rules, which are tailored to the nature of the institution’s policy on fringe benefits.

As a consequence, we suggest **inserting at the end of paragraph 63.b:**
“The requirements of this paragraph do not apply to loans granted to institutions’ employees.”

Question 6: What are the respondent’s views on how the guidelines capture the role of the risk management function in credit granting process?

The link between the variable remuneration of the staff involved in credit granting and the long-term quality of credit exposures is in most cases little practicable, since the credit cycle in some products can be very long and dependent on the economic cycle. However, this could be addressed by limiting this to a set number of years (e.g. 3 years could be viable from a practitioner

point of view).

Question 7: What are the respondent's views on the requirements for collection of information and documentation for the purposes of creditworthiness assessment (section 5.1)?

Paragraph 93 requires the collection and verification of information that might not be appropriate / available for the smaller firms (e.g. financial projection, product type specific legal documentation). Therefore, we propose to limit the requirement according to the size and to the complexity of the client.

Similarly, considering **the information listed in the Annex 2**, we suggest a diversification based on the size / structural complexity of the borrower. We also outline that the following information and the corresponding documentation could be not available in some cases, e.g.:

- For Consumers: the purpose of the loan is known but not the exact usage: overdraft, credit card, child maintenance, education fees, alimonies
- For Professionals: for some loans, the purpose is known but not the exact usage, i.e. an overdraft can be used for working capital purpose as well as for stock management, printer purchases, etc.

Finally, we suggest the following amendments:

Amendment to paragraph 92

"92. For the purposes of the collection and verification of information, institutions and creditors should ~~at least~~ consider collecting the information and data as set out in Annex 2."

⇒ *Application of the principle of proportionality, the detailed information listed in Annex 2 must be used for illustrative purposes only*

Amendments to paragraph 94

"94. For the purposes of the collection and verification of information, institutions should ~~at least~~ consider collecting the information and data as set out in Annex 2."

⇒ *Application of the principle of proportionality, the detailed information listed in Annex 2 must be used for illustrative purposes only*

Amendments to paragraph 88:

- "Institutions and creditors should assess the plausibility of any information and data provided by the borrower and should ~~make any necessary checks~~ **take reasonable steps** to collect and to verify the authenticity of **relevant** information."

⇒ *Application of the principle of proportionality*

- Insert at the end of paragraph 88:
"This paragraph shall not apply where it is demonstrated that the borrower knowingly withheld or falsified the information."

⇒ *To align the Guidelines with the provisions of the Mortgage Credit Directive (article 18.4), which exempts the institution's responsibility in case the borrower does not provide the right information*

Question 8: What are the respondent's views on the requirements for assessment of borrower's creditworthiness (section 5.2)?

In paragraph 112, item c. is problematic since the certification of the costs associated with the development is not easy to obtain and it could be very expensive for the borrower.

The sensitivity analyses requested in several paragraphs might lead in any case to a decision not to do the transaction as the combination of all the listed elements would undoubtedly lead to drastic worsening of the financial position of the borrower. We suggest reviewing the related paragraphs (121/ 143/ 144/ 145/ 146/...).

As regards the paragraphs related to the analysis of the borrowers' financial position, we suggest applying the approach stated in paragraph 132 **"considering which metrics would be applicable"** to all the section (131-137), as some of the listed financial metrics may be hard to obtain/ calculate (ex: business plans are not always provided which makes difficult the calculation of the cash flows available for debt service). Forward looking projections are only done where it is deemed relevant considering the amount, the nature and the purpose of the loan.

We also suggest highlighting, in addition to the requirements / criteria already specified in the Guidelines to assess the creditworthiness of the borrower, the relevance of the counterparty's credit rating in the actual evaluation process. Otherwise, it could be understood that the creditworthiness assessment could leave aside the credit rating and not challenge it.

Comments on paragraph 114

"When assessing the borrower's ability to meet obligations under the loan agreement, the institutions and creditors **should carry out sensitivity** analyses reflecting potential negative market and idiosyncratic scenarios in the future,...."

Banks are used to deal with information at the time of the origination. By setting a sensitivity analyses for granting a loan, we change the full credit assessment methodology. This implies reviewing e.g. the methodology, training risk analysts, IT processing and storage, etc. The cost is quite heavy and not reachable without a phase-in transition period. Until now, sensitivity analyses take part of the Stress test/Back test analysis which may lead to increase provisions.

Comments on paragraphs 116 & 121

We suggest **deleting both paragraphs 116 & 121**, which make little sense in the context of consumer loans, in particular with regards to the sensitivity analyses required by paragraph 121.

Comments on paragraph 134

The proportionality principle must here be applied, as the working capital needs are difficult to determine when no balance sheet is available, like for self-employed people. Furthermore, the cash conversion cycle analysis goes beyond the net revenue analysis and the financial capacity to repay the loan, which are the current practices for assessing the risk of loans to SMEs.

Consequently, we propose the following **amendments**:

"134. Institutions should perform, **where relevant**, an assessment of the cash conversion cycle of the borrower to measure the time duration for the business to convert the investment in inventory and other resource inputs into cash through the sale of its specific goods and services. **Where relevant**, Institutions should be able to establish the cash conversion cycle of a borrower to establish working capital needs and to establish recurring costs and assess the on-going capacity to repay credit facilities over time.

Question 9: What are the respondents' views on the scope of the asset classes and products covered in loan origination procedures (Section 5)?

The scope of the asset classes and products covered in loan origination procedures depicted in the Guidelines is very wide. Compared with existing policies, processes, tools and the IT infrastructure, the availability of such a granular data at origination for audit trail and monitoring requires further significant implementation actions with related investments and costs.

We propose to further strengthen the proportionality principle consistently with the level of exposure of the institution in each asset class or product.

Question 10: What are the respondent's views on the requirements for loan pricing (Section 6)?

No comment

Question 11: What are the respondent's views on the requirements for valuation of immovable and movable property collateral (Section 7)?

We urge the EBA to align the section with the different regulatory texts on Non-Performing Loans issued recently. Indeed, Institutions have implemented the recommendations issued in that context and applying the new/ additional requirements proposed in the Guidelines will be very costly to implement.

Comments on paragraph 199

With regard to valuation requirement we propose to consider the well-established German model having a minimum amount ("small loan limit") before requiring a formal full valuation (§ 24 of the "BelWertV", the German Regulation on the Determination of the Mortgage Lending Value) : dispensation for domestic residential mortgage loans below 400 000 €, simplified valuation by a person sufficiently trained and qualified, and physical inspection of the property can be discarded under certain strict requirements.

Comments on paragraph 213

Revaluation by using desktop or drive-by should be allowed as long as there are no indications that the value of the property may have declined materially relative to general market prices.

Question 12: What are the respondents' views on the proposed requirements on monitoring framework (Section 8)?

Considering the diversity of banks' practices due to their size, complexity and to the specificities of national markets, we propose the following amendment to paragraph 231:

"231. The **internal** credit risk monitoring framework **established by banks** should ~~at least~~ **for example** cover the following:"