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EMF-ECBC Response to EBA Consultation on Guidelines on Loan Origination and Monitoring

30 September 2019

The European Mortgage Federation-European Covered Bond Council (EMF-ECBC)[1] is pleased to provide feedback on the consultation on draft Guidelines on Loan Origination & Monitoring proposed by the European Banking Authority (EBA).

The EMF-ECBC acknowledges the relevance of these practices for both consumers and industry as well as the impact they have on the European economy. With these considerations in mind, below we present a series of observations regarding the proposed guidelines.

Executive Summary

- The EMF-ECBC considers that the proportionality principle as presented in paragraphs 12 to 14 is not properly taken into account in sections 1 to 8. This lack of proportionality would give rise to significant costs for banks, affecting all loan origination and granting processes and ultimately impacting on the end consumer.
- The EMF-ECBC is of the view that in many respects the scope of application of the requirements is excessively broad. Additionally, there are concerns that the granularity applied to some of the requirements goes beyond existing legislation e.g. those related to creditworthiness assessment in Annex 2, while in other areas this granularity does not appear to be sufficient e.g. scope of the asset classes.
- In an attempt to cover many areas of loan origination processes, the guidelines overlap with and contradict existing and forthcoming regulation which would make correct transposition and implementation by banks extremely challenging e.g. MCD, CCD and GDPR. Therefore, alignment with legislation currently in place is necessary.
- The EMF-ECBC welcomes the fact that the EBA is taking account of new technological processes that are being introduced in the industry and welcomes the proposals in this respect. The EMF-ECBC furthermore welcomes that the EBA is taking account of environmental issues in the context of the banking sector. However, in both respects we believe it would be necessary to align these guidelines with ongoing work of the EC i.e. respectively the EC principles developed by the High Level Expert Group on Artificial Intelligence as of April 2019 and the overall EC Action Plan in this area, and the EC Action Plan on Sustainable Finance and the relevant follow-up.
- Finally, the EMF-ECBC would like to express concerns about the short timeframe proposed for the implementation of the guidelines. Given the changes the guidelines will imply as well as the new processes that institutions will have to introduce, the timeframe proposed is unfeasible and an extension is deemed necessary. If the extension were not to be granted, certain elements of the guidelines would need to be deleted in order to permit timely implementation.

[1] Established in 1967, the **European Mortgage Federation** (EMF) is the voice of the European mortgage industry, representing the interests of mortgage lenders and covered bond issuers at European level. The EMF provides data and information on European mortgage markets, which were worth around EUR 7.3 trillion EUR at the end of 2018. In 2004 the EMF founded the **European Covered Bond Council** (ECBC), a platform bringing together covered bond issuers, analysts, investment bankers, rating agencies and a wide range of interested stakeholders. As of August 2019, the ECBC has 122 members across 30 active covered bond jurisdictions and many different market segments. ECBC members represent over 95% of covered bonds outstanding, which were worth c. 2.5 trillion EUR at the end of 2017.

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Specific comments

1 - What are the respondent views on the scope of application of the draft guidelines?

Overall the scope of application of the guidelines is considered too broad, resulting in an overlap with existing and forthcoming regulation in several areas such as between the guidelines on green lending and the EU Taxonomy, between the loan monitoring requirements and the Capital Requirements Regulation (CRR) on matters such as the definition of project finance which seems to be contradictory, or the definition of Commercial Real Estate (CRE) and Residential Real Estate (RRE), to name but a few examples. In order to avoid confusion, we suggest adding clear references to the legislation that is already in place in the different areas to avoid dupliation and contradictory requirements.

In this context, alignment with existing definitions of the main concepts is needed to avoid misinterpretation that a confusing rewording of these concepts could create. As indicted above, particular focus needs to be placed on the definitions of CRE and RRE which as proposed are not in line with market standards and contradict current definitions. The mix of usage of the property and the characteristics of the owner appears difficult and unnecessary leading to contradictions with CRR, since according to the guidelines a rented home owned by a corporation will be classified as CRE and under CRR it would be considered RRE. Therefore, we consider that characteristics of the owner should not be considered. Similarly, the treatment of social housing should also be aligned with the CRR.

Finally, another important aspect to consider linked to the scope of application and in fact relevant throughout the draft guidelines, is the use of the proportionality principle. According to the guidelines, the proportionality principle is based on the size, nature and complexity of the banks with regard to internal governance requirements (section 4), and on the type, size and complexity of the individual credit facilities, for the requirements on the creditworthiness assessment, pricing, valuation of immovable and movable property collaterals and credit risk monitoring, contained in the following sections (5, 6, 7, 8). However, the draft guidelines do not leave room for the application of the above-mentioned principle as differences in parameters such as the size of the credit institution, product characteristics, the national legal framework, national market characteristics or the risk level are neither reflected in the wording used nor in the requirements proposed, and yet they constitute meaningful and transversal parameters for lending standards.

In several instances, the guidelines state the criteria listed are to be applied on a “at least” basis. The expression “at least” could imply that the information has always to be collected and does not allow for the application of the proportionality principle. This could generate uncertainty in the banking activity, with the risk that competent Supervisor Authorities could consider entities to be non-compliant.

In relation to the above, it would be appropriate to provide further indications on the application of the proportionality principle. In any case, it would be advisable to introduce specific thresholds in terms of loan amount below which the EBA requirements are not applied “tout court”.

In general terms, the guidelines are appropriate in relation to significant-amount transactions, which justify the additional costs connected with further detailed creditworthiness analysis and wider information collection required. On the other hand, some of the required information may not be available at all for small and medium enterprises.

This issue is particularly relevant in countries where the business environment is mainly characterised by SMEs. Consequently, the guidelines implementation could have negative effects on credit granting, if they are not properly calibrated to the business portfolio of banks.

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

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The industry recognises the dual focus of the guidelines bringing together prudential and consumer protection aspects of credit granting, in line with the EBA's new scope of action. However, significant obstacles to the implementation of the guidelines within the timeframe proposed have been identified, especially given the broad scope of action. These obstacles are both internal and external to the guidelines.

Among the external ones, several developments that are taking place could potentially change the current context and therefore complicate the implementation of the guidelines. These developments are the ongoing evaluation of the Consumer Credit Directive (CCD), the review of the Mortgage Credit Directive (MCD), the EU Taxonomy and the Benchmarks Regulation among others. The new texts of the CCD and MCD could change the playing field in the coming months and result in a misalignment with the guidelines. Likewise, the final version of the EU Taxonomy is expected by the end of 2019 in order to become applicable from January 2022, which does not match the implementation timeline of the proposed guidelines on green lending. Similarly, the deadline for the application of the Benchmarks regulation has been postponed until January 2022 due to revisions that have been deemed necessary.

Intrinsic aspects of the guidelines will also complicate their implementation in the timeframe proposed since several requirements will impact considerably on loan granting and management processes, requiring significant adaptation and therefore investment in order to adjust organisational procedures, especially in respect of IT infrastructures.

Considering the complexity of the guidelines and the factors outlined above an extension of the deadline would be required in order to facilitate the implementation process and allow countries to comply with them. If an extension of the deadline were not be approved, the removal of those elements of the guidelines which pertain to regulation which is under review or yet to be applied, would be essential.

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)?

The EMF-ECBC appreciates the fact that the EBA is taking account of new technological processes that are being introduced in the industry and welcomes the proposals in this respect. However, we believe it would be necessary to align these guidelines with the EC principles developed by the High Level Expert Group on Artificial Intelligence as of April 2019 and the overall EC Action Plan in this area. Indeed, despite an alignment with regard to content, the wording and terms used are different. A better alignment in these respects would avoid confusion and potential misunderstanding. Below we report some key aspects in the definitions, as suggested in the European Commission Guidelines:

- **Explainability**: This concerns the ability to explain both the technical processes of an AI system and the related human decisions (e.g. application areas of an AI system). Technical explainability requires that the decisions made by an AI system can be understood and traced by human beings. Whenever an AI system has a significant impact on people's lives, it should be possible to demand a suitable explanation of the AI system's decision-making process. Analysing this definition, it is important to stress the following key point: the focus should not be on the need to explain in every detail the decision itself, but rather, to document and understand the decision process.

- **Traceability:** The data sets and the processes that yield the AI system's decision, including those of data gathering and data labelling as well as the algorithms used, should be documented to the best possible standard to allow for traceability and an increase in transparency. This also applies to the decisions made by the AI system. This enables identification of the reasons why an AI-decision was erroneous which, in turn, could help prevent future mistakes. Traceability hence facilitates auditability and explainability.

- **Auditability**: Auditability entails the enablement of the assessment of algorithms, data and design processes. This does not necessarily imply that information about business models and intellectual property related to the AI system must always be openly available. Evaluation by internal and external auditors and the availability of such evaluation reports can contribute to the trustworthiness of the technology. In applications affecting fundamental rights, including safety-critical applications, AI systems should be able to be independently audited.

- **Robustness:** a crucial component of achieving Trustworthy AI is technical robustness, which is closely linked to the principle of prevention of harm. Technical robustness requires that AI systems be developed with a preventative approach to risks and in a manner such that they reliably behave as intended while minimising unintentional and unexpected harm, and preventing unacceptable harm. This should also apply to potential changes in their operating environment or the presence of other agents (human and artificial) that may interact with the system in an adversarial manner. In addition, the physical and mental integrity of humans should be ensured.

- **Resilience**: AI systems, like all software systems, should be protected against vulnerabilities that can allow them to be exploited by adversaries, e.g. hacking. Attacks may target the data (data poisoning), the model (model leakage) or the underlying infrastructure, both software and hardware. If an AI system is attacked, e.g. in adversarial attacks, the data as well as system behaviour can be changed, leading the system to make different decisions, or causing it to shut down altogether. Systems and data can also become corrupted by malicious intention or by exposure to unexpected situations. Insufficient security processes can also result in erroneous decisions or even physical harm.

The EMF-ECBC also welcomes the fact that the EBA recognises the importance of environmental issues in the banking industry. It is our view that as a result of the intrinsic link between mortgages and properties, the EU mortgage industry in particular has the potential to play a game-changing role in helping to finance the improvement of the EU's building stock and therefore supporting the EU in meetings its energy savings targets.

In this respect, we would like to draw attention to the Energy Efficient Mortgages Initiative (EEMI)[1], led by the EMF-ECBC together with a large network of relevant stakeholders, which is intended to support the development of an energy efficient mortgage product and framework, as well as a robust infrastructure for the gathering, processing and disclosing of relevant large-scale data linking energy efficiency and related products' financial performance.

From the experience gained so far under the EEMI, we would however like to highlight the complexity of what the EBA is proposing in terms of requirements at the current time and highlight that much consideration is needed on how this can be achieved in practice in a consistent, effective and proportionate way. Indeed, the ability of institutions to include environmental, social and governance factors (ESG), as specified in the draft guidelines, in their risk management policies, and credit risk policies and procedures, is contingent in many respects on external factors beyond credit institutions' control, which also may or may not be in place at the current time e.g. centralised access to Energy Performance Certificates (EPC).

Efforts under the EEMI have been underway for four years and will continue into the future, pointing to the scale of the challenges associated with the issue at hand. In this respect and in light of the advanced stage of development of the EEMI and the commitment to it of 47 lending institutions and 16 national, European or international authorities in the EEMI Advisory Council, we would urge the EBA to take account of our knowledge and learning so far and would like to offer any support we can provide in this area. Specfically, we would invite the EBA to join the EEMI Advisory Council.

In a similar vein, it would be necessary to carefully consider the proposed requirements around green lending against the background of the work of the European Commission on sustainable finance in order to avoid future difficulties in interpretation and application.

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

We consider that overall harmonisation with the "Reporting instructions on Credit Underwriting data collection" issued by the ECB earlier in April 2019 is necessary in order to avoid overlaps and contradictions, especially on the definitions. Similarly, alignment on the treatment of NPLs with the recently issued guidelines on the matter would be necessary.

[1] www.energyefficientmortgages.eu

In our opinion, the anti-money laundering policies and procedures being a cross cutting issue, should be separated and not necessarily be integrated in the loan policies and procedures, especially in relation to the monitoring framework. Lending operation and processes are in fact only a part of the all the banking activities covered by AML Framework.

With respect to data infrastructure, it would be particularly relevant to have a clarification on the supervisory expectations, especially with respect to the monitoring throughout the life cycle of credit facilities in particular on specific portfolios for which the information is not available.

Finally, some of the requirements proposed go far beyond what it is considered necessary and given the current wording they appear to have a binding nature, as is the case in paragraph 35b, since in certain situations methods such as a score based credit worthiness assessment in lending to professionals can simply not be executed. Therefore, clarity on these aspects should be provided.

5 - What are the respondents' views on the requirements for governance for credit granting and monitoring (Section 4)?

It is our view that certain of the requirements are excessive and could potentially have a negative impact on well-functioning markets.

First of all, the number of credit decisions taken are not correlated with the risk level of the banks' portfolios and therefore should not be limited on such a basis. The limitation of credit decisions will not improve control and management of the risks, but impair the ability of the institution to process requests from clients in a timely fashion. Moreover, this goes against the implementation of risk culture where all employees are expected to take the right decision taking into account risk mitigation. Likewise if the commercial network is excluded as approval authority the complexity of the lending process will remarkably increase with the associated negative consequences for consumers. We would then suggest eliminating any quantitative limit maintaining the periodical review.

Regarding section 4.4.1, some requirements regarding independence in relation to credit decision making go beyond the current EBA guidelines in the context of internal governance and beyond what is set in the CRR. Currently under the CRR, only independence of mind is necessary while the present draft guidelines appear to suggest the need for formal independence (paragraph 63.b.1&2). Any reference to formal independence should be removed.

In section 4.3.1, it would be convenient to specify that information on anti-money laundering and counter-terrorist financing policies and procedures the principle of the usability of the information obtained for AML-CTF purposes also for the granting and monitoring of credit.

Overall, we consider that it would be extremely complex to define organisational control and monitoring structures, policies, and procedures on conflicts of interest with the detailed requirements set out in the guidelines. We would recommend the introduction of clarifications in relation to section 4.

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

The Industry appreciates the efforts to mitigate excessive risk taking in lending activities through the regulation of the role of risk management function in the credit granting process, however, concerns arise regarding the underlying principles and operational framework as well as the objectives of the proposed requirements.

Regarding paragraphs 76c and g, an ex-post and ex-ante supervision of the risk management process appears to be requested. However, this will be extremely difficult to apply in practice: firstly, the previous involvement of the risk control function appears not fully coherent with the separation of responsibilities between the ex ante and ex post

controls and ultimately with the segregation duty; and, secondly, the need to have a second opinion might trigger process inefficiencies related to the duplication of activities, carrying extra staff costs.

Moving to the section on staff remuneration and specifically paragraph 82, the draft guidelines seek to link the remuneration of the staff involved in credit granting with the long-term quality of the credit exposure. However, it appears difficult to introduce the evolution of the quality of the commitments over the long term in a mechanism of variable remuneration components which are short term oriented.

Furthermore, the scope of application of these guidelines should be better defined and limited to retail staff with decision making competences and receiving a relevant bonus payment, and not applied to all bank staff. Since many banks are currently developing and close to launch a fully digital end to end process for customers in the retail loan granting process this should be considered at the time of writing, since checks and decisions will be fully automated making it difficult to fulfil the requirements as proposed.

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)?

The amount of information and documentation required by the guidelines for the purpose of creditworthiness assessments is considered excessive for both consumer and mortgage credit. The level of detail and granularity goes further than any previous requirements in this respect laid down by the MCD, CCD or previous EBA Guidelines on creditworthiness assessment (EBA/GL/2015/11). The level of detail required leaves very little margin to banks and requires disproportionate levels of information.

Furthermore, the requirement to make enquiries to third parties could be difficult to handle in practice from an operational and data protection point of view. The obligation to respect Regulation 2018/1725 in efforts to verify information is duly noted and goes without saying. However, the GDPR also requires the consumer to give consent to the bank in order for these enquiries to be made. If this consent is not given and the information provided cannot be verified, banks will not be able to comply with the guidelines. We therefore understand "reasonable" in paragraph 88 to mean that in such a case verification is not required.

We also believe that the principle of responsible borrowing should apply, and that the customer should remain responsible for information relative to his person that he/she is best placed to provide. Examples are a person's tax status or whether the borrower has loans with other providers. In the context of the latter, it should be recalled that not all credit registers in Europe, whether held by public or commercial entities, provide this information.

We would like to clarify that an overall credit assessment of all borrowers should be carried out in the case of a creditworthiness assessment of a majority of persons. This would be helpful in the light of the European practice of creditworthiness on the borrowers as a whole, such as: for spouses who, as borrowers, jointly take out consumer credit.

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

As indicated above, the amount of information and documentation required by the guidelines for the purpose of creditworthiness assessments is considered excessive for both consumer and mortgage credit. The level of detail and granularity goes further than any previous requirements in this respect laid down by the MCD, CCD or the current EBA Guidelines on creditworthiness assessment.

The existing EBA Guidelines on creditworthiness assessment are based on reasonable enquiries and reasonable steps regarding the collection of information, either for the assessment of the consumer's income or his/her ability to meet his/her obligations under the credit agreement. In contrast, the draft guidelines are very prescriptive and detailed

regarding financial elements to use for the assessment e.g. paragraph 98: "income, disposable income, financial situation, source of repayment capacity to meet contractual obligations.".

In order to be aligned, it should be clarified that the requirements are not meant to be mandatory minimum requirements, but individual considerations that should be taken into account when relevant.

Finally, we would like to make the following specific comments on Annex 2 of the Guidelines:

- Point 3 - Financial statements covering a reasonable period: In the case of specialised lending where a new asset is being financed, there would be no existing financial statements covering the previous years.
- Point 10 - Information on existing covenants, and borrower's compliance with them, where relevant. Having this information available in annual review memos and in PDF version should be considered as sufficient, and banks should not be obliged to record these covenants in IT systems.
- Data from credit registers or credit information bureaus (indicated in point 11 of the list) should cover at least the information on financial liabilities and arrears in payment. However, in some countries, information is only available on credit repayment incidents (negative information), and it is arguably not within the scope of the EBA guidelines to regulate the nature (positive or negative) of the credit registers in Member States.
- Point 14 requests evidence of the value of collateral: This point is linked to Section 7, therefore please refer to our response to question 11 of the consultation paper.
- The requirements in Point 16 regarding information on the enforceability of collateral are disproportionate if applicable to any type of loan origination. Depending on the nature of the collateral (mortgage, privilege of the money lender – PPD, guarantee given by an insurance company or a financial institution) the terms for calling the collateral into play within a Member State should be sufficient, complemented by information on the collateral itself asrequired by point 12.
- Regarding lending to professionals, point 16, information on the enforceability of collateral, in the case of specialised lending, substantial control of the collateral is achieved through different security packages. The power of this security package is notably that it enables lenders to put strong pressure on sponsors (who brought the equity), which makes restructuring easier. The recovery generally best obtained through a restructuring is based on cash flows to be generated by the collateral on which the lenders have a substantial claim through different structures and security packages. The rating and LGDs based notably on the efficiency of such security package, in terms of future cash flows benefit is assessed by the internal legal teams and front officers and validated by the risk department. Therefore, regarding point 16, we suggest adding "in the case of specialised lending, description of the structure and security package of the transaction".
- References to "evidence of": As long as this information is in credit applications or in the annual review memos, this should be considered as sufficient evidence. It should not be necessary to record this information in IT systems. Having the financial accounts of the borrower in PDF format for example should be considered as sufficient.

We strongly believe that creditworthiness assesments should reflect the type, size and complexity of the loan. Indeed, as they stand, the requirements are excessively detailed and impose a level of prescription which would hamper banks' ability to conduct their core business. We furthermore note that the borrower's creditworthiness assessment process appears excessively complex and disproportionate compared to the size of credit facilities in most banks' portfolios.

Overall, we consider that current requirements for the assessment of borrower's creditworthiness in the MCD (and CCD) already promote responsible lending and enforce consumer protection, and therefore no amendments or extensions are required.

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 application of the asset classes is in our view too broad and the granularity insufficient. Therefore, we believe that clearer differentiation among the requirements for the different types of credit should be made.

Furthermore, as indicated above, it seems contradictory to impose such requirements when outcomes as part of the MCD and CCD are still unknown.

Furthermore, the lack of granularity appears to go against the proportionality principle mentioned in the guidelines since the consumer protection aspects appear to be the same for professional and private consumer lending which should not be the case. The guidelines should differentiate between consumers and business in line with other relevant EU legislation.

Taking a closer look at the specific requirements, the following points would require additional attention and further clarification. With regard to the requirement for lending to professionals:

- Paragraphs 126, 127 and 128 - we recommend the introduction of "to the extent possible" since some information cannot be collected as is the case for future capital expenditures of the borrower where the information is not publicly available nor known by the bank. Similarly, the projected financial position or expected cash flows are also not known by the bank.

Moving to the analysis of the borrower's financial position:

- Paragraph 132, "at least" should be replaced by "to the extent possible", because, as for lending to professionals, certain information is not available and cannot be collected.
- Paragraph 135, the term "where relevant" requires clarification as it should be understood as "considering market practices".

Under the section on sensitivity analysis, special focus should be placed on:

- Paragraph 145, all sensitivities mentioned should only be taken into account where relevant and to the extent possible, since under some circumstances and referring to certain kind of loans most would imply burdensome requirements and added very little, if any, value to the creditworthiness assessment.
- Paragraph 153, for banks using A-IRB models correlation can exist between the borrower and the collateral and that should not bid them for taking into account such collateral as long as internal models enable to take into account the possible correlation.
- Paragraph 156 is confusing and requires further explanation.

In section 5.2.8 and under paragraph 176, the definition of specialised lending presented compared to the one in the CRR is too prescriptive. We consider that project finance security packages should be assessed as a whole to ensure that specialised lending conditions are met.

With regard to the last section referring to the credit decision and loan agreement, we consider that the availability of the credit application should be considered sufficient and there should be no requirement to record this information in IT systems. Similarly, the requirement included under paragraph 180 regarding lender responsibility for the misrepresentation of information provided by the borrower should be amended and brought in line with art 18(4) of the MCD.

Overall, further clarification of the terms used as well as of the cases in which the different requirements apply is needed together with a better alignment with current practices and regulation on credit worthiness assessment.

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

The application of the requirements on loan pricing would imply the revision of banks' accounting methods making the implementation timeframe proposed unachievable. We strongly recommend removing section 6 from the guidelines.

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

The requirements for property valuation give rise to several concerns.

As is the case in other sections, the guidelines are overly prescriptive and go beyond the current requirements set by different legislation in place. With this in mind, it is necessary to recall the requirements already established under the MCD and the CRR. Efforts should be taken to avoid overlapping, contradictory regulation.

On the valuation of immovable property collateral as defined in paragraphs 191 to 200, the requirements are not compliant with the MCD. The following paragraphs require special attention:

- Paragraph 191 – It should be clarified exactly what is meant by 'origination' in this paragraph i.e. whether 'origination' means the accurate date and time of the evaluation of the collateral, and not the moment of disbursement). Indeed, a recent valuation made some time e.g. six months, before the point of origination would be sufficient, provided that the institution makes sure the valuation is still reasonable and relevant, or reviewed and supplemented.
- Paragraph 194 – This paragraph goes beyond the MCD, which does not require a valuation for the granting of credit, but rather seeks to ensure that where a valuation is conducted it is done so in accordance with specific standards. As such, this paragraph should be aligned with the MCD.
- Paragraph 195 - The wording regarding the use of AVMs is extremely restrictive. In some countries these models are widely used and very relevant, especially in retail business. Therefore, they should be applicable and explicitly permitted within the guidelines on both, at origination and at revaluation, in order to maintain the current efficiency of these processes. Indeed, it is important that regulators move in a direction that supports smarter and more automated valuation methods in situations where real estate markets are well established, especially for residential real estate. The regulatory burden and costs would increase considerable if banks were required to employ certified valuers in a well-established residential real estate market where this is in fact not needed. The use of eligible AVM methods (not indexation) and registered data is increasing, creating more reliable data. It is important that AVM methodsare put on the same footing as manual valuations (RRE) and considered as independent. The data is supposed to be back-tested by the AVM vendors and/or the bank in the same operation.
- Paragraph 196 - Imposing a requirement to conduct a new systematic valuation in the case of a significant deterioration in the repayment capacity of the borrower is not justified as there are other mechanisms in place such as in France the existence of an authorised organisation to guarantee the mortgage credit.
- Paragraph 197 appears contradictory with national regulations, as is the case in Romania, where the client can choose any authorised valuer and does not necessarily need to select a valuer on a bank's list. But this could not only enter in conflict with national laws but also with syndications. That is why the deletion of the paragraph seems to be the most adequate.
- The requirements proposed in paragraph 200 are too prescriptive and there is a risk that they result in a check list approach instead of ensuring a prudent valuation and documentation process, thus undermining the objective of the guidelines. The term "future use" needs to be clarified as do any associated implications.

With regard to the requirements for monitoring and revaluation, a number of concerns have been raised as the guidelines will impose a completely different identification perimeter in relation to collateral subject to revaluation as well as changes to the frequency of updates, especially regarding valuation at book value or market price.

Many banks have only recently modified their evaluation processes on the basis of the recent NPE guidance. Any new changes would require high IT costs and longer time for implementation. For example, performing full appraisals for revaluation purposes as set out in paragraph 213 instead of the current desktop ones would significantly increase the annual cost of appraisals and delivery time could be delayed. Additionally, mainly in case of NPL, the debtor/asset owner would not permit an internal visit of the real estate asset.

Focus also needs to be placed on the following paragraphs:

- Paragraph 208: The requirement for more frequent valuations of collateral with higher LTVs is not appropriate since in general higher LTVs are granted for low risk assets. Market volatility and risk of deterioration regarding industry, technical infrastructure and location as well as respective market price developments are deemed more suitable.
- Paragraph 211: The text should allow for the revaluation of properties based on external data and not only on external valuers and advanced statistical models.
- Paragraph 214: It should be clarified that the adequate rotation of valuers should not always be required. In order to ensure high quality valuations it is essential that valuers obtain a deep knowledge of specific local real estate markets – hence the same immovable property could be monitored/revalued by the same valuer over a significant time period in order to maintain and enhance knowledge of the market being the requirement of rotation not necessary. Furthermore, bank processes have only recently been updated in line with the principle of rotation in the EBA NPL Guideline. The expansion of the principle to all exposures would result in yet more process changes. The existing requirement for NPLs only is deemed to be appropriate and should not be extended.
- Paragraph 207 - We ask for clarification as to whether the requirements refer to "monitoring" rather than "review". If "monitoring" is meant, we do not consider the requirements to be effective since monitoring real estate markets is a constant process. Rather, in practice, the (event-related) review of real estate values is mainly linked to the elements listed under Paragraph 207 (a) and (e). To use book values and LTV ratios as a measure of the frequency of review and monitoring, however, we see as a disproportionate effort. Therefore, Paragraph 207 (d) should be deleted.
- Paragraph 225 - In order to avoid conflicts of interest, institutions should ensure that all valuers performing the actual valuation of a given property and their first-degree relatives meet the requirements set out in paragraph 225. Instead of the phrase "institutions should ensure", we suggest calling for a contractual commitment from the contractors, since it is unclear how a security should be provided by the institute.

Finally, valuation requirements for NPLs have only recently been modified by the EBA Guidelines on management of non-performing and forborne exposures. Additional requirements implying further revisions, including of IT systems, after such a short period of time is not appropriate.

12 - What are the respondent's views on the requirements on monitoring framework (Section 8)?

Several concerns have been raised regarding the requirements on the monitoring framework, particularly concerning stress testing and the use of early warning indicators in credit monitoring.

On the former further clarification is needed on the application of the sensitivity analysis covered in section 8.5. The EBA should specify if these tests should be carried out at country or HO level.

The monitoring should not be carried out with respect to the initial recognition of the lending exposure. In fact it is a principle applied for accounting purposes (as in IFRS9) but is not appropriate for the monitoring framework whose aim is to assess/monitor the exposure evolution by comparing the current exposure with the most recent information so that to allow banks to undertake the necessary actions more promptly.

Furthermore, the collection and analysis of the huge amount of data required to properly model reality in order to carry out the above-mentioned tests would be complex and costly, imposing burdensome obligations for banks. This difficulty of the process would probably make the results not informative enough while diminishing efficiency in the whole monitoring process. Moreover, even if proper collection and analysis could be carried out it would be difficult to establish the benchmark as mentioned under paragraph 256 and measure the performance of the stress tests against it. Overall, costs would outweight benefits, and that is why we consider that expert base judgement should remain the main driver of credit risk appetite.

With respect to the key risk indicators in the paragraph 263, we deem that the list proposed by the EBA does not allow for a timely detection of increased credit risk in their aggregate portfolio. For example, a significant drop in turnover would have a lag in the temporary lag that would not ensure promptness. On the use of early warning indicators

clarification also deems necessary, especially, a clear distinction between the situations in which these warning should be performed at portfolio level and those in which they should be performed at loan level. Finally, the supervisory expectations under the watch list should be revisited as they are unclear: in our understanding, while the whole section 8 is on monitoring and reporting (therefore mainly at portfolio level), the paragraph 8.7 asks for operational actions/assessment in the context of "in the monitoring of watch list" (not in the monitoring of watch list clients).

All in all, we believe that further clarification on the practical application of section 8 of the guidelines is needed.