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Erste Group's response to the EBA consultation on draft guidelines on loan origination and monitoring

Erste Group welcomes the possibility to express its views on the draft guidelines on loan origination and monitoring. We would like to share with you the following reflections that we hope will be considered by the EBA.

As a general remark, we note:

The objective of the guidelines is defined as "to ensure that newly originated loans are of a high quality". However, credit quality is a topic of risk appetite setting and the guidelines should not restrict the portfolio diversity. The prescriptive nature of these guidelines under the current form and scope provides a very prescriptive list of actions that banks "should" undertake "at least" or "as a minimum", with regard to banks' core business – i.e. providing financing to the economy and to consumers.

The majority of the European banks are privately owned companies and entrepreneurial institutions that are measured based on their business model and financial success. Therefore their success is predominantly dependent on the ability to differentiate from competitors, leveraging on managements view, collective experience and entrepreneur skills. In particular, defining adequate lending standards, based on those views, business knowledge and abilities, make the competitive difference compared to other market participants. This strongly contributes to the success of those entrepreneurial institutions, which are not only the financial intermediaries but also important employers and tax payers for the local societies. Standardized loan granting principles hamper competition and are detrimental also for borrowers who cannot access credit, with huge consequences on the entire EU economy.

Altogether, neglecting proportionality while implementing the draft guidelines requirements could lead to a relocation of loan origination to unregulated market participants and an erosion of banks' business models. Such effects would definitely not contribute to the stability of financial markets. Further harmonization of lending standards and setting regulatory boundaries, risk management expertise including the opportunity of applying specific measures, depending on the risk profile and portfolio quality, will be diminished. In addition, having fully harmonized lending standards in place would cause systemic risks. If parameters are not calibrated to address specific risk dimensions (e.g. market maturity) they will spill over negative or unwanted trends across different markets or portfolios. We view it as a contradictory trend to making sure that the bank's portfolio become less risky and safer, which we believe to actually be the aim of all regulatory initiatives.

Therefore Erste Group strongly recommends streamlining the loan origination guidelines by omitting too detailed requirements for the creditworthiness assessments. An assessment of the borrower's creditworthiness should focus on the specific risk of a transaction in a reasonable and efficient manner. In addition, lending standards are generally influenced by local market standards like national enforcement laws and accounting standards and there are substantial reasons why lending standards differ across Europe. In line with existing supervisory guidelines, banks are expected to set their own risk appetite and strategy and to transform those into respective lending standards and processes. Any further tightening of those requirements would ignore the risk appetite, risk strategy and management expertise of the bank. We would propose that instead of „at least", the phrase "where relevant and appropriate" should be used in each case.

Consultation questions:

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

For the determination of the scope for exclusion from application it is not clear if the scope is defined by groups of connected clients or single clients. There might be constellations where the **group of connected clients (GCC)** is defined as "financial institutions" or "sovereign", whereby its single group members are professionals (i.e. state owned companies). In practice, credit decision on i.e. financial institutions, sovereigns, etc. are taken at the GCC level and based on a different set of criteria and information, as required in these guidelines. In order to ensure efficiency and effectiveness of the credit decision making processes, we would deem it as meaningful to include a clarification on the scope for exclusion from application of these guidelines.

It shall be clarified that the scope of exclusion is to be applied on the level of group of connected clients (i.e. when the first principle is applied in the credit decision process in the sovereign segment). To avoid confusions and future discussions during the regulatory reviews, we propose to include a clarification in the document that if a group of connected clients is segmented as "financial institutions" or "sovereigns" whereby single group members belong to professionals (i.e. state owned companies), the whole group of connected clients is to be excluded from the scope of the application of these guidelines.

Furthermore, we would like to include the following remarks:

- Paragraph 14 – Proportionality: the **proportionality principle for lending standards** (sections 5, 6, 7 and 8) is proposed to depend on the size, nature and complexity of the credit facility. In practice, there are further relevant factors, which influence the lending standards, that are meaningful to differentiate the lending standards, i.e. industries; national accounting standards (in many markets in the EU different local GAAP standards exist); national enforcement laws and market standards (vary in i.e. developed vs. emerging markets) and not solely the credit facility level. We think that harmonized lending standards can form a common baseline, but must allow for adaptation by individual banks to reflect the underlying accounting standards and legal framework, depending on the industry and customer segments. Therefore we deem it utmost important to clarify the use of the proportionality in these guidelines in respect of the national legal and regulatory frameworks, national market characteristics or the risk level. It should be ensured that the proportionality principle allows for such adaptation by individual banks, depending on markets they are active in, in order to reflect the underlying accounting standards and legal framework, depending on the industry and customer segments.

  We would welcome if the proposed proportionality principle can be extended as follows "Institutions should apply sections 5, 6, 7 and 8 of these guidelines in a manner that is comprehensive and proportionate to the size, nature, complexity of credit facilities and the risk profile of the client".

  In addition, for the sake of completeness and transparency in the application, we propose to add in this paragraph the following:

  "(…) Institutions should apply sections 5, 6, 7 and 8, including Annex 1 and 2, of these guidelines in a manner that (…)."

- Paragraph 17 – Definitions:

  The **Commercial Real Estate loan definition** is not in line with market standards and existing applicable legislation. It is viewed to be misleading and partially in contradiction to other requirements set in these guidelines (i.e. in 5.2.5 point 125 "institutions should put emphasis on the borrower's realistic and sustainable future income and future cash flow and not on available collateral"). The phrase "real estate used by the owners of the property for conducting their business" would mean that the financing of production sites for a corporate client will lead to a classification as CRE loan. In addition, the phrase "and secured by a CRE property" eventually might lead to undesired practices, contradictory to strengthening of risk management standards in banking, e.g. to not collateralize a loan to avoid certain undesired regulatory obligations. Moreover, the proposed definition includes social housing, whereas the market practice include social housing in the residential real estate segment (purpose driven) as they might be not income producing.

The treatment of social housing must also be aligned with the CRR. In addition, we propose to adapt the CRE and CRE loan definitions as follows:

- CRE (…) that is not classified as residential real estate (RRE); ~~and includes social housing~~
- A CRE loan means a loan extended ~~(...) or a real estate used by the owners of the property for conducting their business, purpose or activity (or set of such properties), either existing or under construction, and secured by a CRE property (or set of CRE properties).~~

Residential real estate loan definition is only connected to "a natural person", which indicates that every residential real estate loan taken by professionals is to be included in CRE. We propose to amend the definition of the residential real estate loan included in the paragraph 17 as follows: "means a loan ~~to a natural person secured by~~ extended for acquiring a residential real estate property".

Moreover, currently there is no definition of a project and infrastructure finance included in the guidelines. Due to the fact that there is a dedicated section of guidance to project and infrastructure finance in chapter 5.2.8, we propose to include a dedicated definition in the paragraph 17 to avoid potential misinterpretations.

Additionally, we believe social lending/social banking should receive special treatment under these Guideline, especially as there are some banks that serve other purpose than solely a financial success, i.e. improving financial stability and inclusion for people on low income or fostering development and enlarging the impact of social organization. **Social banking** is an important contributor to the local societies and their financial stability in a long-term. Social banking clients cannot be assessed based on full scope of application of these guidelines. Therefore we would deem it as meaningful to have a definition and dedicated chapter for social banking (see our proposal under question 9) in the guidelines. Otherwise some particularly vulnerable client segments as well as social organizations will be threatened by being further excluded from financial services. Moreover, disproportional regulatory requirements could result in higher loan costs for these vulnerable clients or financial exclusion of these segments. We propose the following definition to be included in the definitions in the paragraph 17:

<u>Social Banking</u>**:** Providing financial services (incl. lending) to financially excluded and vulnerable client segments (people at risk of poverty or social exclusion) and social organizations (non-profit sector, non-governmental organizations and social enterprises).

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

The guidelines suggest an application date (30 June 2020) which is not suitable for certain fields, in particular green lending. For the **green lending**, the final version of the taxonomy is expected to be issued by the end of the year and is to become applicable by 1 January 2022 in order to give sufficient time to the market actors to perform the requested IT developments. The Benchmarking Regulation, which was to become fully applicable by 1 January 2020, has been revised in order to postpone the application date to 1 January 2022 – in line with the taxonomy.
Therefore, EBA should either decide to remove the drafted elements in the open contents mentioned above from the final guidelines or to add references of the related ongoing regulatory efforts and modify the application date in a consistent way.

Furthermore, if adopted, the requirements in these guidelines significantly impact the credit granting and managing process, with huge investments in the organizational procedures.
In particular, the greatest impacts are expected in relation with the broader data collection and processing in the detailed creditworthiness analysis, which for sure are appropriate in relation to significant amount transactions and large corporates. For loans granted to SMEs, which represent a significant proportion of the loan portfolio for many banks, some information listed in Annex 2 lead to disproportionate collecting costs compared to the economic value of the financing transaction or to the added value in the creditworthiness analysis.
Lending policies, processes and the supporting IT systems in use for underwriting and portfolio monitoring purposes will have to be expanded and the staff will have to be trained on the mandatory data collection and i.e. assessment of ratios that we deem as not meaningful.

The linked costs to implement the requirement to carry out sensitivity analyses for professional client segments (micros, SME, corporates) by far outweigh the benefits, banks will have to develop a projection methodology for situations when there is information available from the client, which is strongly believed to be unproductive and of limited value added for assessment of risks.
Therefore, EBA should consider when setting the implementation date that banks will have sufficient time to adapt to the new standards.

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)?

Section 4.3.3. Technology-enabled innovation for credit granting:

- Paragraph 47:
  It is not exactly specified what is considered under "technology-enabled innovation for credit granting purposes", which may lead to different interpretations as the credit granting covers broad spectrum of activities. To avoid misunderstanding and to be able to clearly define the scope of application of the regulatory expectations we propose a more detailed description what is considered as "technology-enabled innovation" in the view of these guidelines.

- Paragraph 47 c: There are different tools in place that can be applied when developing a technology enabled innovation in credit granting. One of those include machine learning, which is often used by the FinTech companies competing for the same clients as banks with quite good results. One aspect of the machine learning is its ability to modify itself while being used. Machine learning is dynamic and does not require human intervention to make certain changes. Therefore when applying artificial intelligence for the purpose of credit granting, it will not be possible to fully understand and explain the entire underlying model, meaning each component of the model compared to other methodologies already in use for this purpose. However, we agree that when applying artificial intelligence technology, banks need to ensure that the models are re-producible and auditable. We also agree that the banks must understand the structure of the artificial intelligence based models and be able to explain it, but due to the nature of the underlying technology, explanation of each component of the model may not be possible to the same degree as this requirement could be interpreted. Therefore this requirement would hinder banks at applying the artificial intelligence for the innovation and therefore hinder them at keeping pace in terms of technology advancement with the growing competition of e.g. FinTechs.

  The nature and specifics of machine learning should be reflected when setting the requirements for application of the technology based innovation in a way that it does not limit its use in the credit granting process. Therefore we propose to add "to the extent that is proportionate given the purpose, size, complexity, term and potential risk associated with the loan."

- Paragraph 47 d: The requirement to compare the performance and outputs with traditional tools will lead to an inefficient and costly parallel world of two approaches. This requirement is in dis-proportion due to the unduly increased cost of maintaining two methods and potentially inhibits banks to take the generally high investment costs to establish "enabled innovation for credit granting" and will hinder the application of innovative technology to credit granting. The main benefits like the resource efficiency and the valuable outputs would be diminished. Furthermore the requirement would lead to an additional burden for credit institutions which hinder them to keep pace in terms of technology advancement with the growing competition of e.g. FinTechs.

  We understand the rationale of back testing and comparing the outputs and performance of "technology enabled innovation", but these should be limited to the implementation and transition phase and not be a constant requirement during regular operations.

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

- Paragraph 35, point h: This requirement would mean that any exception, even the one that does not result in an elevated risk, has to undergo a special process with different approval authority.

This requirement can be applied in the consumer business (mass business), where the borrowers form a homogeneous portfolio. The top segment of professionals (international large corporates) is looking for tailor-made lending solutions that meet their individual requirements and therefore cannot be treated by strict rules but must be rather supported with a set of guidelines applied in a modular system.
Therefore the requirement as set in this point is not deemed meaningful for professionals, as not every exception to general (group-wide) risk policies immediately results in an elevated risk (especially if policies with lending standards cover diverse portfolios, which require an application of the "one size fits all" rule in order to achieve some degree of harmonization). Strict application of this requirement would result in some form of disproportionality, impairing the efficiency of the underwriting process that is viewed as not necessary for the achievement of the risk and regulatory objectives and may therefore compromise the competitive advantage of the banks. In addition, it could also result in a practice of setting limits and rules by banks that can rarely be breached or overridden, which we view as a contradictory trend to making sure that the bank's portfolio become less risky and safer, perceived to be the overall aim of all regulatory initiatives.

We propose to amend this requirement to clarify that only exceptions or breaches resulting in an elevated risk need to be approved in a special process with different approval authorities. It is well understood that each bank must explicitly set criteria which may lead to an elevated risk and define an approval process for those. A bank can decide also to not allow for exceptions and breaches of its policies.

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

We see that the requirement on credit decision making may limit proven and well-functioning lending activities. In more detail:

- Paragraph 59: For handling professional clients (especially corporates), setting limits on the number of the credit decisions made under the delegated approval authority is not deemed as a meaningful instrument for controlling and managing risks. Credit approvals have a direct relation to the business volume processed within the institution, where credit turnaround times play a key role in providing a meaningful and timely service to customers. Thus setting limits on the number of credit approvals decided by the delegated authority would significantly impair the capability of the institution to timely process the requests from clients and does not reflect the quality / qualification of the staff that has been given the delegated approval authority and rather supports the decision making strongly relying on the organizational hierarchy. It also interferes with the goals of implementing a risk culture where all employees are expected to take the right decisions for the bank to mitigate risks, and is deemed to contradict the meaningful regulatory expectation that the staff involved in the credit decision processes should be adequately skilled, resourced and experienced (see section 4.1.1, paragraph 21, point f).

  We propose to amend this requirement set in this paragraph to exclude the quantitative limits of decisions made in delegated approval authorities and to keep only the limitation of the time period for delegated powers, which means in practice that the delegation should be periodically re-viewed, i.e. on annual basis, and confirmed.

  "(…) on the time period for the delegated powers ~~and the number of delegated approvals~~."

- Paragraph 63, point b, i: The wording is rather unfortunate as each account manager has a professional relationship with the borrower. This would mean that they cannot participate in the credit decision process which would be in contradiction with the requirement set in paragraph 60, where a good balance between risk management and business is emphasized.

  We would recommend to focus on the paragraph 63, point b, ii where such conflict of interest in the credit decision making process exists only in case the decision maker has an economic or political interest with the borrower and delete "i":

- Paragraph 68: The materiality principle based on the size, nature and complexity of the credit facility (see paragraph 14) is not applicable to section 4, in which the standards for lending to

the affiliated parties are included in 4.4.3. Therefore this requirement reads that any lending to affiliated parties (including intra-group) should be approved by the entire management body or its empowered committee, even if the amount is rather minor (starting from €1). Such a rule is not practicable. Such lending should be subject to setting up appropriate approval authorities including de minimis rules and delegation, where appropriate. Hence, we propose the following amendment of the paragraph 68:

"Lending affiliated parties, or any material changes of the terms of the existing credit facilities to affiliated parties should be subject to approval of the management body or a committee of the management body empowered to deal with affiliated party lending, where appropriate." Alternatively, this paragraph should be moved to the section 5, which is subject to the proportionality principle.

Finally, we would like to include the following considerations:

- Paragraph 82 – Institutions' remuneration policies and practices: The draft guidelines currently define the scope as 'all staff engaged in the credit granting, ad-ministration & monitoring process'. However, credit institutions are actually developing and close to launch a fully digital (automated and pre-approved), end to end process for customers in the retail loan granting process. Checks and decisions are generally fully automated or centrally decided and the role of the account manager in the front office is in this context, in general, limited to collect informations and documents from the customer. Therefore, we request that the scope should be limited to the (retail) staff with decision making competence and receiving a relevant bonus payment.

  Furthermore, the long-term quality of a credit beyond 12 months is rather driven by macroeconomic factors and the overall bank's strategy decided by its board and therefore not influenced by decisions of individual account managers. Hence we ask for a clarification on how "long-term quality of credit" has to be seen in the variable remuneration of the sales staff, considering that whatever risk prevention role the account manager in the front office can perform relates mainly to fraudulent behavior measured by early warning types of KPIs, while the long-term quality of credit is mainly influenced by economic and social developments in the country.

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

In principle, we agree with the requirements. For specific remarks see response to Questions 4 and 5 above.

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)?

As mentioned in our response to Question 1, compliance with the collection of information and data as set out in Annex 2 should be proportionate to the type, size, nature, complexity and risk profile of the credit facility and of the client. Business plans (93.e) or financial projections (93.f) for instance are not consistently available for all professional firms. It should be clarified that Annex 2 is not a prescriptive list to be complied with at all times for all types of lending. Wording "at least" in para 92 to 94 introduces ambiguity in the applicability of Annex 2 and could be understood as directly contradicting the principle of proportionality.

Moreover, Annex 2 imposes too much information regardless of the type of credit. In addition to the high cost for institutions to collect this information, clients may consider these information requests to be intrusive. The principle of minimization in data collection enshrined in the GDPR must remain in place: only useful and relevant data should be collected.

In addition, we have the following specific remarks on requirements defined in Annex 2:

- Diverse specific requirements (commercial real estate lending to professionals, real estate development lending, project and infrastructure lending should be supplemented by "where relevant", as some of the requested information depend on the type of a real estate, i.e. location

specific review of supply and demand is not relevant for social housing, information on major tenants per property type, property age and location is not relevant for rented apartment construction.

- Lending to professional, point 3: In case of ring-fenced RE structures the submission of financing statements on a consolidated level is difficult / not possible from the contractual point of view.

- Commercial Real Estate Lending to professionals, point 1: submission of all contracts for particular property is currently not possible, also from the contractual point of view.

- Commercial Real Estate Lending to professionals, point 6: the requirement is partially unclear and creates confusion. We would welcome guidance on what the regulatory expectation is meant with the information on the rationale for the property. Additionally this rules should recognize that the bank internal, independent from the market evaluators/surveyors are considered as acceptable.

- Real Estate Development Lending, point 5: submission of all contracts for particular development is currently not possible, also from the contractual point of view.

- Real Estate Development Lending, point 6: the requirement is partially unclear and creates confusion. We would welcome guidance on what the regulatory expectation is meant with the information on the rationale for the property. Additionally this rules should recognize that the bank internal, independent from the market evaluators/surveyors are considered as acceptable.

- Real Estate Development Lending, point 7: in the real estate development lending states independent qualified and reputable quantity surveyor, whereas point 8 in the project and infrastructure finance states qualified and reputable surveyor. We propose to align requirements to ensure consistency. The rules should recognize that bank internal, independent from the market, evaluators /surveyor should be considered as acceptable.

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

In principle, we agree with the requirements that need to be considered when carrying out the creditworthiness assessment subject to the proportionality principle as remarked in our response to Question 1.

- Paragraph 126, point g: in principle we agree with the list of the requirements set in paragraph 126 that need to be considered when carrying out the creditworthiness assessment. However some aspects listed as part of the considerations of the transaction structure in the point g, i.e. leverage level, dividend distribution, capital expenditure, should be taken into account when performing the analysis of the financial position of the borrower as stipulated in the point a, and as defined in the paragraph 132 of these guidelines. We propose the following amendment in the paragraph 126 point g: "g. assess the structure of the transaction including the risk of structural subordination and related terms such as covenants, ~~leverage level, dividend distribution, capital expenditure~~ and, if applicable, third-party guarantees and collateral structure; and"

- Paragraphs 129: In those cases where all of these risk are explicitly taken over by external credit assessment's (ECA), the additional extensive assessment of these risks by a bank is rather of a limited value added. We would propose to amend the requirement to be only applicable in full if no ECA coverage is available.

- Paragraphs 131 et seqq: In general we understand the rationale of the requirements for lending standards setting. Nevertheless, banks define KRIs based on their risk appetite, business plans and risk strategy. Defining a list of mandatory KRIs would ignore the risk appetite, risk strategy and management expertise of the bank. Furthermore the creditworthiness assessment should be based on a sound internal framework which is comprehensive and creates a clear structure for individual easements based on their characteristics (market, products, industries).

Therefore, as an example, the analysis of financial projections cannot be conducted in a "one-size-fits all" approach for all professional clients. A fully harmonized approach would not cover the full spectrum of the heterogeneity of transactions in the market and other relevant legal requirements. Furthermore, in some cases financial projections of the client are not available to the extent required. In particular, stock listed companies are reluctant in principle to explicitly provide financial projections and budgets due to a risk that in case this information is publicly shared, any deviation triggers an ad-hoc announcement to the market. If such information is not pro-vided by the client, we don't view it as meaningful and valuable if the bank itself tries to predict the forward-looking figures for the client. The reliability of such projections is questionable. Therefore in our view, other tools like sensitivity analyses (see our comments to the paragraphs 142-146) or stress scenarios, where relevant, are sufficient to understand the client's key risks. We propose to add to the requirement defined in the paragraph 132 "where appropriate and/or available". This would consider portfolio and/or market specific practices based on the national legal and accounting framework in line with principle of proportionality. As a consequence the ability to apply internal expertise and ensure that certain dynamics are monitored and analyzed regularly, identifying potential adverse developments early on and developing mitigating actions will be retained.

- Paragraphs 133 / 135: Complementary to the comments raised for the paragraph 131, the requirements defined in the paragraph 135 read as a mandatory list of a minimum ratios to be considered in the creditworthiness assessment for all profession-al clients. However some of these ratios do not represent a meaningful metric for a creditworthiness assessment. For example:
  - EBITDA strongly depends on the industry in which the customer operates and is not deemed as an appropriate indicator to compare risk profiles of clients across different industries and within the same client segments (i.e. large corporate);
  - Return on equity and capitalization rate are indicators used by investors who seek for different levels of returns on their investment depending on their appetite; in practice the bench-mark is missing to assess i.e. which level of the return on equity is appropriate to ensure a long-term sustainability and viability of the company; especially now, when more and more companies abandon a singular focus on the interests of shareholders and instead pledged to "deliver value" to all stakeholders and are expected to manage multiple goals, like i.e. innovation, impact on climate change, and look beyond the single-minded focus of the financial bottom line. Moreover these ratios do not provide a meaningful information of the repayment capacity of the borrower as required in inter alia paragraphs 127 and 160, which is a key component for a bank deciding if to provide a financing to the client.
  - In addition, the following ratios only apply to a certain type of facility:
    - DSCR: only for project finance
    - LTV / LTC: only RE financing
  - Furthermore, there are some other ratios that allow for better comparability of the client's risk profile across client segments and therefore have a wider scope of application:
    - Equity ratio as an indicator of a balance sheet (capital) structure

Therefore the listed ratios cannot be understood as a minimum that must be applied when assessing the creditworthiness of any client. Furthermore, we are not in favor of the systematic implementation of these ratios, which do not manage to really translate to the situation of each customer and are not necessarily predictive of the risk of non-payment.

We would like to propose two alternatives for consideration by EBA:

1) New formulation of this requirement that in our view covers the spirit of the intended regulatory expectation, yet allowing the banks to define their own specific lending standards

   "Institutions should use in their assessments of borrower's creditworthiness financial metrics that cover:
   a. Profitability;
   b. Indebtedness or leverage;
   c. Balance sheet (capital) structure;
   d. Cash flow;

e. Working capital;
f. Repayment capacity;
g. LTV and LTC for secured lending."

2) Or the following amendment of the paragraph 131 in order to better aligned with the underlying basis for the proportionality principle defined in the paragraph 14:

   "Institutions, where relevant, use ~~at least~~ the following financial metrics for the purpose of the creditworthiness assessment (…):
   a. debt service coverage ratio;
   ~~b. EBITDA (earnings before interest, taxes, depreciation, amortisation);~~
   c. interest coverage ratio;
   d. loan to value ratio (for secured lending);
   e. debt to equity ratio or leverage ratio;
   f. loan to cost ratio;
   g. ~~return on equity;~~ equity ratio
   ~~h. capitalisation rate (net operating income/market value).~~

- Paragraph 142-146: Complementary to the comments raised for the paragraph 131 et seqq, we consider the requirements defined in this section meaningful only if the client provides the financial projections to the lender. Financial projections are not always provided by every client. As commented above, stock listed companies are reluctant in principle to explicitly provide financial projections and budgets due to a risk that in case this information is publicly shared, any deviation triggers an ad-hoc announcement to the market. Therefore we deem the requirements set in the paragraph 142 ((..) where utilized (…) as meaningful. However the requirements defined in the paragraph 144, despite the proportionality principle explicitly mentioned in this point, seem to contradict the paragraph 142. In addition, the specification set in the paragraph 146 seems to be redundant when considering the requirements set in the paragraphs 142 and 143. Moreover, the events mentioned under paragraph 145 are a direct consequence of the events mentioned in the paragraph 146 (e.g. a macroeconomic downturn [paragraph 146 point a.] triggers a severe decline in borrower's revenues [which is already covered in the paragraph 145 point a.], etc.).

  We propose the following amendment in the paragraph 144: ~~Such sensitivity analysis should account for all general and asset class and product type -specific aspects that may have an impact on the creditworthiness of the borrower.~~ Sensitivity analysis should be proportionate given the purposes, size, complexity, term and potential risk associated with the loan. We propose the deletion of the paragraph 146.

- Paragraph 163: This remark applies only if the definition of the CRE remains as currently included in the draft guidelines (see our comments to the paragraph 17). For e.g. social housing „lease length in relation to loan term" is not a meaningful parameter in our view as although tenants could quit the contract by law, nevertheless due to the market demand, the vacancy rates are negligible. We propose to add "where appropriate" to the paragraph 163.

- Paragraphs 166b / 177b: An assessment of all contactors, builders and architects that participate in the construction is currently not possible, also from the contractual point of view therefore we recommend to add; "where relevant and possible" to these requirements. We propose to add "where appropriate and possible to the extent necessary to reasonably assess the inherent risk".

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

As mentioned in our response to Question 1, we deem it as meaningful to introduce a dedicated chapter for social banking. Please find below a draft proposal for the sub-section on social banking:

5.2.x: Social banking lending

1. The creditworthiness assessment for social organizations should consider the aspect of non-profit organization and assess the repayment capacity by the ability to decrease costs, create savings or generate additional income.

2. The creditworthiness assessment for borrowers in the segment social banking should verify the ability and prospect to meet the obligations under the loan agreement. Regular savings (i.e. one year) and future income projections (i.e. related to training, education and qualification programs) can be considered as income surrogate for financially excluded and vulnerable clients.
3. Institutions are encouraged to consider pro-active support for over-indebted clients. Combined debt advisory services and sustainable restructuring of loans should be considered for over indebted clients, in particular in case of the non-performing due to social causes (i.e. family member death, severe sickness / injury leading to inability to work or natural disaster) as alternative approach to enhanced loan selling activities.
4. Pricing should consider all costs as listed in paragraph 187 in section 6, but may neglect profitability targets for this customer segment.

In addition, we would like to note:

- Paragraphs 104 / 117: in respect of the requirement to make reasonable enquiries and take reasonable steps to verify the borrower's ability to meet obligations (in particular related to self-employed or having seasonal or other irregular income), it is explicitly stated that such verification should include documentation of income, third party verification and tax declaration. In line with our comments on the proportionality principle to explicitly include next to considerations of the credit facilities also some client segments. This requirement is not applicable to social banking, the creditworthiness assessment of the vulnerable clients is based on the ability to prove "regular savings" as "income surrogate" in most cases. In order to adapt these guidelines also for other client segments like social banking, we propose above to explicitly allow the proof of "regular savings" as an adequate "income surrogate" within the creditworthiness assessment. Such proof over a pre-defined period (i.e. one year) can represent a very good surrogate for vulnerable client segments with irregular income.

- Paragraph 133: in respect to the requirement to assess the borrower's capacity of profitably in the future (for borrowers who are unable to generate positive profits over time) it shall be pointed out that particular client groups, i.e. social banking clients will not have any profitability by the very nature of their business and applicable law (i.e. non-for-profit organizations, NGOs).

- Paragraph 142-146: in addition, the requirements on a complex sensitivity analysis reflecting potential negative scenarios (combining idiosyncratic and market events) are not deemed meaningful for social banking clients and could result in stricter rejection criteria and exclusion of such clients from the financial services market.

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

We support EBA´s understanding of a comprehensive framework for the pricing of loans.

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

- Paragraphs 201 - 206: The requirements for movable property collateral seem to be extensive for banks with small portion of such collateral; especially the establishment of panels of external valuators and the implementation of advanced statistic models for each and every type of movables seems disproportional to the economic benefit of such a requirement. A more conservative valuation of such collateral (by applying bigger haircuts, limitation of valuation to defined types and age of the assets, etc.) may compensate such rules. We would welcome if the rule is amended to allow for an introduction of materiality thresholds above which an expert valuation is to be mandatory.

- Paragraph 214: The requirements for immovable property collateral are meaningful however the rotation obligation for internal valuators shall be reconsidered as it is not always practicable, especially in small banks that often have only one internal valuator and the rotation does not bring additional risk mitigation (the internal valuators have one superior who is responsible for

the quality of their performance); rotation of external valuators is deemed meaningful. We propose to delete the rotation of internal valuators from the requirement.

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

- Paragraph 233: the term covenant-lite was originated and is common in the leverage finance universe. Therefore, it makes sense to limit the systematic monitoring of covenant lite loans to the leverage finance portfolio. Hence, this requirement should not be extended to the full loan portfolio. We understand that the purpose of such monitoring is to track the performance of loans carrying elevated risk. In our view this purpose perfectly fits into the risk profile of the leveraged finance portfolio.

- Paragraph 263: in general we understand and agree with the listed early warning indicators as potentially relevant aspects that should be considered when implementing the EWS framework. However the current wording of this requirement may be understood that all these indicators must be a minimum binding consideration when setting the early warning frameworks. Our comments should be understood under consideration of comments made above for paragraphs 14, 131, 132, 135, 142-146 and 163. In our view, the defined requirements do not allow for consideration of the principle of proportionality as needed in this context. In line with the current definition of the principle of proportionality in the paragraph 14, the relevant considerations should be based on the size, nature and complexity of the credit facilities. However several of the proposed indicators are not relevant at the credit facility level but need to be considered at the portfolio and/or client level. In addition, several of these indicators strongly depend on the national accounting, market standards and laws, and the extent of the possible data collection (see our comments to the points mentioned above), and therefore their relevancy, strength and correlation to the default may differ across portfolios, industries and clients. For some of the indicators, the data collection may not be possible due to the GDPR and/or information availability constraints. Therefore, in our view, similarly to the requirements formulated in other parts of the guidelines, relevant proportionality considerations must be properly reflected in relation to the proposed list of the EWS indicators. Moreover the current requirement strongly suggests that the EWS systems should be set up based on several single indicators but in practice there are early warning systems in use that are based on the statistical models and yet fulfill the requirements in regard of the early warning framework. This may strongly influence the efficiency of the early warning (watchlist) process as some manual (human) inputs may be necessary in order to fulfill this expectation, which is not deemed as meaningful and necessary for this purpose.

  As a result, we think that the current definition of the regulatory expectations for the early warning framework is unclear and has to be revised in order to avoid confusions.

  We propose to add the following proportionality considerations to this requirement defined in this point: As part of their ongoing monitoring of credit risk institutions should consider the following indicators "to the extent that is proportionate given the relevancy and predictive power of the indicators as well as the risk profile of the credit facility".