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FRENCH BANKING FEDERATION RESPONSE TO THE CONSULTATIVE DOCUMENT ON THE DRAFT GUIDELINES ON LOAN ORIGINATION AND MONITORING

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorised as banks and doing business in France, i.e. more than 340 commercial, cooperative and mutual banks. FBF member banks have more than 38,000 permanent branches in France. They employ 340,000 people in France and around the world, and serve 48 million customers.

The FBF welcomes the opportunity to share its comments on the EBA consultation paper on draft Guidelines on loan origination and monitoring. Please find our main comments below and our detailed feedback within our answers to the EBA's questions.

1. General Comments

As defined by the EU action plan on NPLs, regulatory requirements have emerged to tackle NPL-related risks. In particular, design of prudential backstops and EBA Guidelines on management and forborne exposures was undertaken. Such measures and requirements are considered as sufficiently extensive and exhaustive to address the NPL issue. Therefore, we question the aim of the "draft Guidelines on loan origination and monitoring" and the relevancy of related requirements to tackle the NPL issue without at some point creating undue complexity and intrusion in credit practices, thus being counterproductive and undermining European banks' profitability. Therefore, we urge the EBA to take into account the following comments:

i. Enhance readability of regulation and avoid additional layers

- Guidelines are only supposed to "assist with interpretation", clarify and harmonise the application of EU law. They should not add obligations to EU directives and Level 1 applicable regulation. Article 16 of the European Parliament legislative resolution of 16 April 2019 on the proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) provides that :"The Authority shall, with a view to establishing consistent, efficient and effective supervisory practices within the ESFS, and to ensuring the common, uniform and consistent application of Union law, issue guidelines…"

Furthermore, the recital 11b provides that : "The measures EBA adopts …should not exceed what is necessary to achieve the objectives of this Regulation or the acts referred to in

Article 1(2) and should take duly into account nature, scale and complexity of risks, business practices, business models and size of financial sector operators and markets."

- Guidelines roles is not to preempt future regulations, but to provide level 2 details of regulations already entered into force Many proposals are prescriptive and potentially highly impactful for banks and the economy. The FBF is concerned that the EBA oversteps its mandate in doing so. We especially fear the need of a revision of the whole processes of loan granting, an increase of the fees and a risk of exclusion, i.e. because of credit worthiness standardisation
- Regarding the measures related to consumer protection, the scope provided for under both the CCD and the MCD should be strictly applied. Paragraph 15 should be removed as it goes far beyond the applicable Directives. For instance, the CCD provides for a full consumer protection legal framework which does not apply to credits below 200 EUR or above 75000 EUR. The EBA guidelines should apply only to those credits which fall under the scope of the level 1 Directives.
- Also, for banks supervised by the ECB on a consolidated basis, prescriptive wording may contradict local regulatory constraints for countries outside EU SSM. Therefore, we encourage coordination between regulators and home/host authorities advocating for recognising local regulation in case of conflicting regulation.
- Moreover, consultation processes have been initiated on whether or not to review the directives that are in the scope of these draft guidelines. For example, the consultation on consumer credit directive deals with the credit worthiness assessment, the consultation on the distance selling directive has been launched and soon to be the mortgage credit directive consultation. Furthermore, work is under way on an EU green taxonomy ('The Taxonomy') while the draft guidelines foresee requirements on "green lending".
- It should be noted that the guidelines refer to terms that are defined already in existing or upcoming regulations (we have listed more than a dozen of existing publications[1]). In this regard, any update of requirements concerning these areas should encompass update of related texts (including consultation process if applicable). We urge the EBA to introduce references to those existing texts, instead of rewriting the texts, in order to keep only soft law requirements in the Guidelines. This would enhance transparency and readability of regulation, which complexity has increased over the years.

ii. **Postpone the implementation deadline to take into consideration the European Commission' consultations and face IT challenges:**
   - The proposed application date at 30 June 2020 should be postponed and adapted to the underlying regulatory evolutions, especially the European Commission 's consultations regarding CCD, DMFSD and MCD.. For example, consumer credit Directive is currently under evaluation and it will be relevant to wait for evaluation results. Mortgage credit Directive will be soon also under evaluation.
   - In addition, a more realistic deadline for implementation would be several years taking into account IT system considerations. Indeed the guidelines detail a significant list of elements that are not available on demand in our IT systems that we will have to be able to justify and document. A complete revision of our practices and huge IT investments would be necessary. Moreover, such implementation will be done in the context of application of IRB repair for which implementation date was postponed given the heavy workload. This will be coupled with preparation for Basel IV, as well as carrying the implementation of other NPL-related regulations

[1] See listing of existing regulation in appendix

iii. **More proportionality and flexibility in the requirements – ensuring a level-playing in the application by supervisors:**

- The implementation of this proportionality should be governed by specific provisions for flexibility within the text, in order to ensure **a level playing field for all EU banks**. There are several degrees to consider in the proportionality. The **principle of proportionality** to be applied to sections 5,6,7 and 8 is described differently in different sections of the guidelines. Furthermore, in addition to applying to the specifics of the credit facilities (type, size, nature, complexity and risk profile of the credit facility), the principle of proportionality should be considered in conjunction with the **risk profile of the borrower**. To avoid any misinterpretation on this **key principle** and complete it, and as invited to by the EBA at the public hearing on 20/09/2019, we suggest in following Section 2. Detailed comments some mark-up to the draft guidelines.
- First of all, the adaptation of the Guidelines to the business activities. In such perspective, reading of such Guidelines by competent authorities will be crucial and shall insure level-playing field in the application.
- Moreover, the EBA is very prescriptive when listing actions that banks "should" undertake "at least" or "as a minimum", or as 'inter alia' without proving enough flexibility or proportionality. While the use of "should" infers flexibility, the requirements are in fact more prescriptive than felt appropriate. Consequently, one of the main concerns arising from this consultation is the prescriptiveness which will in some cases lead to a major overhaul of banks practices which could in turn limit some business activities. This is particularly relevant in terms of the level of application between banks (and how it will be applied by different supervisors) and within banks – retail and non-retail, risk-sensitive and non-risk sensitive business, type of financing – especially with regard to the lists of documentation and information that have to be sourced. A one-fits-it-all cannot be appropriate, the Guidelines should leave room to better customization of requirements and listing criteria which are not intended to be applied systematically. Annexes criteria should only be examples
- The proportionality criteria should copy paste all the criteria defined in the EBA GL on internal Governance and focus especially on risks, the amount of the loan and the nature and complexity of the activities. The size of the institution does not seem accurate as long as risks are concerned.
- Also, in addition to consideration over proportionality at facility level, it is important to introduce in these guidelines the concept of **"materiality" at credit portfolio** level for a Bank. Individual credit files decisions ensure individual credit file quality and compliance with risk strategy and credit policies. In addition to decisions on individual credit files, credit risk limits ensure risk diversification and prevents concentration on portfolio with shared risk characteristics. Credit risk limits are only meaningful for credit portfolios that are material in relation to the size of the institution and its overall credit risk, when smaller, non-material, diversified portfolios should not require specific RAF limits. as invited to by the EBA at the public hearing on 20/09/2019, we suggest in following Section 2. Detailed comments some mark-up to the draft guidelines introducing the concept of "materiality".
- Complying with the requirements regarding the data collection is operationally not achievable for the stock of operations. Therefore, the guidelines should only apply to the loans originated later than the date of entry into force of this text.

iv. **Avoid being counterproductive** - not undermining European banks profitability

- The national cost of risk[2] levels are historically low whereas conjuncture is decreasing, meaning there has also been a general trend improvement in banking risk management

[2] See for example the following studies for France:
- https://www.banque-france.fr/sites/default/files/medias/documents/ers_06_19_fr_book.pdf
- https://acpr.banque-france.fr/sites/default/files/medias/documents/analyses_et_syntheses_n89.pdf

Conversely a squeeze in credit origination that the formalism on these guidelines is likely to induce at macro-economic level is likely to drag on EU growth potential. Moreover, there is no immediate and direct link between present credit origination and existing NPL portfolio, whose levels stems from historical NCR but also from accounting, tax, secondary markets considerations.

- One major role of banks is to finance the economy. The guidelines should not infringe the principle of freedom of trade and credit. However, the extreme risk aversion of the regulatory framework for banks (inc. credit policy, pricing requirements in the EBA Guidelines) could threaten the financing of higher risk borrowers, putting them at risk and with potential economic spillover.
- In addition, too prescriptive guidelines may lead to standardize granting principles which would hamper competition and be detrimental to borrowers and therefore to the entire EU economy. Guidelines must maintain the situation where two different lenders have two different answers to the same demand from the same borrower: one refusing it, the other one granting it. The general framework should aim at avoiding excessive non-performing exposures while maintaining access to credit to higher risk borrowers based on different risk appetite's and portfolio diversification. Too prescriptive guidelines may reduce employees' skills and expertise in credit granting favouring automated decision making. This may also lead to credit exclusion for higher risk borrowers or more complex or specific projects.
- Moreover, these additional constraints on banks financing activities are likely to contribute to an unlevel playing field where other players – less regulated and less supervised – would assume the bulk of higher risk or small tickets transactions thanks to a more favourable pricing, with potential impacts on financial stability risks. It is to be feared that by further forcing already highly regulated entities, which would make the granting of credit more expensive and more complex, and a more difficult customer experience, the result obtained is to increase the presence and market shares of less regulated entities, in the sensitive sector of credit granting, and in particular of relatively small amounts of credit to consumers and small corporates. This would lead to the paradoxical and undesirable situation where consumers in a situation of relative weakness would see their level of protection reduced because of the reduced constraints on the entities which grant them of appropriations.
- We have concerns about the increasing requirements related to the data recorded in IT systems, larger and deeper than the ones defined by the current regulation. Although these guidelines look generally consistent with our practices, this type of requirements should not become excessive as their implementation cost would be significant. The benefit of such data recording should not be overstated either as good origination and loan monitoring requires teams of expert front officers and portfolio managers who currently do it on the basis of in depth analysis, and data recording in IT systems which will never provide a comprehensive view of the risk taken as reality cannot be reduced to a few number of drivers. The risk here would be that banks management decide to reduce the activities which imply a lot of data to be recorded.
- We are concerned with the insertion of formal independence criteria regarding Internal governance, while the CRD only speaks of conflict of interest and independence of mind. Also, the concept of affiliated parties has a too vague and wide definition in the draft GL. The GL should take into consideration the CRD definition.
- Regarding remuneration, article 82 should be deleted.

- https://acpr.banque-france.fr/sites/default/files/medias/documents/2019_as_104_situation-grands-groupes-bancaires-francais-fin-2018.pdf

2. Detailed comments

1. What are the respondents' views on the scope of application of the draft guidelines?

Guidelines articulation with existing and upcoming regulations:

It should be noted that the guidelines refer to existing or upcoming regulations (we have listed more than a dozen of existing publications; **cf. appendix**). In this regard, an alignment with existing scope, requirements and terms and definitions seems necessary. The introduction of references to those existing texts, instead of a rewrite in the guidelines would enhance transparency and readability of those guidelines over the years.

Definitions:

- We would require more precise definitions of following terms :
  - "movable property",
  - "specific actions triggered"
  - "natural person"
  - "professional"
  - "technology-enabled" innovation
  - "ESG"

- **CRE definition**: it is important that the **CRE definition** is changed and made **aligned to the ACPR reporting requirements** and **exclude on page 16 "real estate used by the owners of the property for conducting their business"**. From a credit risk perspective, the criteria for evaluating RE professionals (pure CRE counterparties) are very different from the ones to be used for evaluating the granting of lines collateralized by RE assets to companies operating in other businesses. Moreover, we think that social housing, property owned by end-users, buy-to-let housing should be excluded. As for social housing, it does not fall within the regular assessment of CRE, because other criteria / specificities are applicable. For instance, for some countries, social housing has a special status in law which conditions its risk nature. This type of lending is often guaranteed by local administrations, risks are mutualized through guarantee scheme, the sector is particularly scrutinized by the government. For instance, "Action Logement", which is a social landlord, was rated Aa2 by Moody's on September 2019 (which is the same rating that the French government, given the assumption of implicit government support). Better clarity is also expected on rental / buy-to-let property which appears to be captured under both CRE and RRE definitions. In addition, national differences in structures and legislation related to e.g. tenant-owned housing companies / associations and social housing make the EBA definition problematic.

- Paragraph 9, page 14: the EBA introduces a new classification of credit counterparts by distinguishing between consumers and professionals. This classification is not in line with banks practices or regulatory definitions. Indeed, the professionals category (which would include large corporates as well as SMEs) is too wide. Moreover, for the sake of consistency with other regulation (CCD), the guidelines should not apply to credits below 200 EUR.

Proportionality:

Concerning the **principle of proportionality** to be applied to sections 5 (Loan origination procedures), 6 (Pricing), 7 (Valuation of immovable and movable property) and 8 (Monitoring framework), we note that it is described differently in various sections of the guidelines. To avoid any misinterpretation on this **key principle**, we would suggest rephrasing the following paragraphs

Executive Summary

> *For the implementation of these guidelines, the proportionality principle is interpreted and applied differently in relation to various sections of the guidelines. First, for the implementation of the requirements related to the internal governance, risk management and control, institutions and competent authorities should consider a proportionality principle that is based on the size, nature and complexity of the institutions. Second, when implementing the requirements for the creditworthiness assessment, loan pricing, collateral valuation and credit risk monitoring, competent authorities and institutions should consider the type, size, nature, ~~and~~ complexity and risk profile of the credit facilities being granted or monitored, in conjunction with the risk profile of the borrower.*

Background and rationale

> *13. Second, when implementing the requirements for the creditworthiness assessment, loan pricing, collateral valuation and credit risk monitoring, competent authorities and institutions instead of size and complexity of institutions, should consider the type, size, nature~~, and~~ complexity and risk profile of the credit facilities being originated or monitored, in conjunction with the risk profile of the borrower, because this is the main driver that could give rise to disproportionate application of the guidelines.*
>
> *14. The above differentiation in the application of proportionality aims to ensure that while even smaller and less complex institutions have a robust and effective credit granting process, loan origination and monitoring criteria are proportionate to the type, size, nature~~, and~~ complexity of the loans that the institutions are originating or credit facilities they are monitoring, in conjunction with the risk profile of the borrower.*

Scope of application

> *14. Institutions should apply section 4 of these guidelines in line with the proportionality principle described in Title I of EBA Guidelines on internal governance. Institutions should apply sections 5, 6, 7 and 8 and related Annexes 1, 2 and 3 of these guidelines in a manner that is ~~comprehensive and~~ proportionate [NB: if proportionate, then cannot be comprehensive] to the type, size, nature, ~~and~~ complexity and risk profile of the credit facility.*

Loan origination procedures

> *86. Information and data should be accurate, timely and relevant to the asset class and specific product, and proportionate given the purpose, type, size, complexity, and potential risk associated with the loan in conjunction with the risk profile of the borrower.*

Sensitivity analysis in creditworthiness assessment

> *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, type, size, complexity, term and potential risk associated with the loan in conjunction with the risk profile of the borrower.*

Credit review of professionals

> *245. The review process and frequency should be specific and proportionate to the type and risk profile of borrower and the type, size, and complexity and risk profile of the credit facility, and should be specified in relevant policies and procedures. Institutions should carry out more frequent reviews if the they identify a deterioration in the credit and asset quality. The overall credit risk monitoring framework and data infrastructure should allow institutions to verify that the regular credit reviews have been performed in accordance with the credit risk policies and procedures, and for the identification of any outliers/exceptions to be flagged for follow up.*

Annex 1, 2 and 3

- During the Public hearing organized on September 20th we understood that the EBA introduced the 3 annexes to provide banks and supervisors with indicatives lists of criteria / indicators. However, section 2 should make clearer the fact that that the lists provided in Annex 1, 2 and 3 should be taken as a reference to be complied with proportionally to the type, size, nature, complexity and risk profile of the credit facility and **not a prescriptive list** to be complied with at all times for all types of lending. Consequently we would suggest the following amendment to para 6 of Section "Background and rationale":

  > *"6. The guidelines are supported by three annexes presenting a set of considerations for credit granting criteria (Annex 1), for the types of documents to be collected by the institutions for the purposes of creditworthiness assessment (Annex 2), and metrics that can be used in credit granting and monitoring (Annex 3). This set of considerations does not constitute prescriptive lists to be complied with for all types of lending, but should be considered and complied with proportionally to the type, size, nature, complexity and risk profile of the credit facility. Conversely, this set of considerations is not exhaustive and should be complemented with additional considerations where appropriate."*

Other comments on scope of application

- The overly prescriptive approach could turn-out counter-productive in non-European markets where it would not adjust necessarily to market practices, risks reality and locally available information. Indeed, the adequacy of overly prescriptive wording with local regulatory constraints outside the EU SSM countries, which are however monitored by the ECB as part of a consolidated activity, could pose a problem. In the event of a conflict with the regulations in force, the local regulations prevail.

- These draft guidelines overlap with existing regulations[3] or project of regulation, like the green lending definition (overlap with the taxonomy project) or the project finance definition (already described in CRR and existing EBA guidelines). To avoid confusion, we suggest adding clear references to these regulations or guidelines rather than duplicating definitions with a risk of mismatching.

- It should be ensured that the Guidelines are consistent with the Regulation amending Regulation n°575/2013 as regards minimum loss coverage for non-performing exposures, with other measures adopted within the European Council Action Plan on tackling the high level of non-performing exposures and with other European texts relating to green lending.

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[3] we have listed more than a dozen of existing publications

- We consider that **only new loans should be covered by these guidelines**. EBA should not consider that the volume of existing loans where terms are renegotiated after the application date is low and easily adapted as regards the new guidelines; for instance, in the current context of low interest rates the amount of mortgage loans renegotiated is very material.

  In order to avoid this risk, we would suggest rephrasing the following paragraphs:

  Background and rationale

  > *4. The objective of the guidelines is to improve institutions' practices and associated governance arrangements, processes and mechanisms in relation to credit granting in order to ensure that institutions have robust and prudent approaches to credit risk taking, management and monitoring~~, and newly originated loans are of high credit quality,~~ whilst respecting and protecting the interests of consumers. Through achieving these objectives, the EBA aims at improving the financial stability and resilience of the EU financial system.* Complying with the requirements regarding the collection is operationally not achievable for the stock of operations that were originated before these guidelines. We would as a result suggest the following amendments to paragraph 10
  >
  > *"10. Section 5 and Annex 2 appl~~ies~~y to loans and advances that are originated after the application date of these guidelines. ~~Section 5 and Annex 2 also appliesy to loan agreements where terms are renegotiated or which require specific actions triggered by the regular credit review of the borrower after the application date, even if they have been originated before the application date."~~*

- Paragraph 15 on proportionality: n any case, EBA Guidelines should fully comply with level 1 prescription and therefore not go beyond their scope of application. This should be clearly stated in the guidelines.

- It should also be made clear that derivatives and Securities Financing Transactions (SFT) are out of scope. We would suggest the following amendment to para 7 :

  > *Debt securities, derivatives and Securities Financing Transactions (SFT) are excluded from the scope of application of these guidelines.*

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

We understand that the EBA issued these draft guidelines in response to the European Council Action Plan to tackle NPLs, published in July 2017. We well noted the comment page 7 « *The Council stressed that "these guidelines should leverage on existing national experiences where relevant"* ». We also understand and appreciate the dual focus of the guidelines bringing together prudential framework and consumer protection aspects of credit granting, in line with the new EBA scope of action applicable from 1 January 2020. However, while responding to such a wide demand, and in particular the integration of recent supervisory priorities or reflexions related to credit granting, the guidelines suggest a very ambitious application date (30 June 2020) given the impacts of the Guidelines and to the extent that institutions should apply them on an individual, sub-consolidated and consolidated basis which is not suitable for certain fields.

Moreover, the scope of guidelines overlaps with other regulatory texts (level 1 and 2) under development (DCC, MCD, NDOD, CSR, green financing) that should first come to conclusion before full application of guidelines can be envisaged. For this reason, we consider that before to put in place an

application date (30/06/2022), EBA will wait for result of regulatory text under evaluation (Consumer Credit Directive and Mortgage Credit Directive) and under development (NDOD, CSR, green financing).

Indeed, for green lending, even if we do not expect that the Taxonomy will be the unique reference (as it is only sector-centric and it does not sufficiently integrate the financing of firms' transition or their engagement to substantially reduce carbon emissions over a specific time period), we still believe that the EBA should wait for its applicable final version before setting credit guidelines in that area in order to ensure consistency in the regulatory framework. However, the official application date of the Taxonomy is not yet set and will depend on the outcome of the legislators' trilogue negotiations. Also, in its first legally applicable version it will focus only on certain aspects of "green" and on a non-exhaustive list of activities contributing to climate change mitigation or adaptation. We consider it is too premature to introduce such requirements at this stage. . We also recommend postponing the guidelines on green lending beyond June 2021, which is the date at which the EBA will publish its report on the inclusion of ESG factors in SREP.

Moreover, owing to the consumer credit directive (CCD) on-going evaluation, it seems difficult to have guidelines on points that are still discussed and may be reviewed in this context. First works preparing the mortgage credit directive (MCD) revision are only beginning.

Also, we would like to stress again on the challenges in relation to data collection and management need an IT structure that should be in some cases newly designed and in other cases adequate to the new requirements introduced by the Guidelines. Furthermore, such detailed information will raise among data protection issues. In addition to provide more proportionate requirements, we suggest postponing the deadline in such a way that banks have sufficient time to align their investment and operational structure to new reasonable standards. This would also allow for appropriate consideration of any links (or 'knock-on effects') with the IRB modelling for which the EBA has postponed the final deadline the end of 2021 as well as preparation for Basel IV and the ongoing implementation of other NPL-related regulations. Multiyear implementation could therefore be considered.

As such the choice of an application date seems to be premature. Therefore, the EBA should either decide to remove from the final guidelines the above-mentioned aspects which have not been properly defined in an EU legislation yet or to add references to the related on-going legislative processes and modify the application date in a consistent way.

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)?

Paragraph 47 page 24 and section 4.3.3 – Technology-enabled innovation for credit granting:

We are not clear on what exactly "*technology enabled innovation*" includes -does it cover all models, AI, systems, data sources, algorithms, optimizations and how does it relates to 'traditional methods'. The terminology "*technology-enabled innovation for credit granting*" is yet to be defined, comprising examples and real cases. Also, the already existing constraints over model risk management framework are considered as exhaustive, we suggest avoiding adding layers of constraint at this stage as they could limit or bias further development in such areas.

Moreover, the wording of paragraph 47(d) should be refined in order to be consistent with the real needs of model monitoring.

Therefore, we suggest deleting the paragraph 47 or at least reword the beginning of the paragraph by:

> "*When using technology-enabled innovation for credit granting purposes, if model risk is not yet mitigated by an adequate framework, institutions should inter alia […] "*
>
> *a. adequately capture in their risk management and controls framework the risks associated with the alternative approaches involving statistical models in use;*
>
> *b. manage the potential for bias (e.g. as a result of using models ~~of the technology-enabled innovation~~ relying on certain types of data or data sources) in the credit decision-making process, ensuring that appropriate safeguards are in place for the integrity of data and systems;*
>
> *c. be able to explain the outcome, understand the underlying ~~model of the technology-enabled innovation~~ statistical models used and ensure their traceability, auditability, robustness and resilience;*
>
> *d. verify and regularly monitor the related outputs and compare their performance with those of traditional methods/tools, except when an AI model is already natively explicable (for which a comparison with traditional methods is less/not relevant). Regarding black-box models, the comparison should be carried out at the development stage ("build") only or when the monitoring of the performances shows a decrease, and that a rebuild is needed;*
>
> *e. properly document and periodically review the related processes and models ~~of the technology-enabled innovation~~ of the alternative approaches involving statistical models;*
>
> *f. ensure that the management body understands how the underlying ~~technology-enabled innovation~~ statistical models are used and impact institutions' credit granting procedures;*
>
> *g. ensure that the credit risk management function understands and is able to explain the behaviour ~~of the technology-enabled innovation~~ of the statistical models in use".*

For the sake of technological neutrality, we also suggest introducing the following paragraph under section 4.3.3:

> "*In addition to the proportionality principles, and based on demonstrated merits, the use of alternative approaches involving statistical models in compliance with § 47 may also be taken into consideration when implementing the guidelines applying to loan origination procedures as set forth in Chapter 5*".

<u>Paragraph 49 page 25 - Environmental factors and green lending:</u>

We understand that this paragraph would apply only for loans with a "green" label based on these guidelines and green lending definition.

We do not believe that the Taxonomy should be presented as the unique reference as long as it remains only sector-centric, has a too restrictive view on the financing of transition or disregards firms' engagement to substantially reduce carbon emissions over a specific time period. Also, in its first official version it will only focus on certain aspects of "green" and on a non-exhaustive list of activities contributing to climate change mitigation or adaptation. We therefore recommend that EBA guidelines on loan origination and monitoring allow a sufficiently high degree of flexibility in the reference to the Taxonomy for the definition of 'green lending' before a more complete and holistic version of the Taxonomy is implemented. In addition, we propose the replacement of 'green' by 'environmentally sustainable'.

From a risk management perspective, we have the following concerns:

- Lack of a precise and exhaustive definition of what « ESG » covers as long as the COM action plan on Sustainable Finance **and the EBA mandates in final CRR2 (Art 449a, Art 501a, Art 501c) and CRD5 (Art 98 - 7c) texts** have not been finalized. This could be the source of diverging interpretations among banks and should be clarified in the guidelines
- ESG risks should be taken into account on loan origination but these emerging risks can not technically be integrated to rating policies and probability of default (no backtesting possible)
- Until clearer criteria are defined and proposed for green lending, the guidelines will not be applicable consistently across the industry, with major risk of greenwashing.
- In any case, **Retail banking activities should deserve a long phase-in period**, as it is premature to assess in 2020 or 2021 on an automatic basis the ESG risks for retail loans. For instance, banks have the information of the energy efficiency of a house when they provide a mortgage loan, this information is indeed included in the contract. However, banks have not centralized this type of information in central data basis. EU banks are at the preliminary stage of defining a common template to gather and report on the Energy Efficiency Certificates for mortgages, as the Energy efficiency Data Protocol and Portal (EeDaPP) initiative (set up with EU funds) is still on going.

EBA should consider phasing in or postponing parts of the guidance, providing reasonable requirements in a later regulatory product for institutions with risk appetite for such lending. This would enable the EBA to revisit the scope and necessity for such requirements at the appropriate time (ensuring consistency between the guidelines to banks and how EBA will consider ESG in the SREP (EBA report due mid-2021). Also, we note that ESMA has concluded in recent technical advice not to mandate ESG factors in ratings as this is already being done.

Hence, providing reasonable requirements in a later regulatory product for institutions with risk appetite for such lending, rather than stating the requirements in this guideline with a longer implementing timeline, would enable the EBA to revisit the scope and necessity for such requirements at the appropriate time. We note that ESMA has concluded in recent technical advice not to mandate ESG factors in ratings as this is already being done, although it will take time to develop. In addition, delaying this section would mean that timing of the ESG requirements for loan origination are aligned to ensure consistency between the guidelines to banks and how EBA will consider ESG in the SREP (EBA report due mid-2021), along with other sustainability measures in the pipeline.

For that purpose, we propose the following wording:

> Paragraph 48) page 25: "*48. Institutions should include, on a best effort basis and according to the proportionality principle, until the final EBA Guidelines (CRD5 (Article 98 (7 c)) based on June 2021 EBA report, environmental, social and governance (ESG) factors as well as risks and opportunities related to ESG in their risk management policies, credit risk policies and procedures. Institutions should adopt a holistic approach, and incorporate ESG considerations in their credit risk policies and procedures.*
>
> Paragraph 49 page 25: "*49. As part of their credit policies and procedures, institutions that originate or plan to originate environmentally sustainable credit facilities should develop specific environmentally sustainable lending policies and procedures covering granting and monitoring of such credit facilities. These policies and procedures could~~, in particular,~~ as a matter of example: […]"*
>
> Paragraph 49 (b) (iv) page 25: It is important not to cause unnecessary monitoring work by this clause. We propose the following additional clarification wording: *"monitoring on a regular basis (once a year unless special circumstances require more regular monitoring) that the proceeds are allocated properly (which may consist in requesting borrowers to provide updated information on the use of the proceeds until the relevant credit facility is repaid)."*

Paragraphs 50 to 53 to be deleted, or alternatively: *50. Institutions should position their environmentally sustainable lending policies and procedures within the context of their overarching objectives, strategy and policy related to sustainable finance. In particular, institutions should set up qualitative and quantitative targets to support the development and the integrity of their environmentally sustainable lending activity and to assess the extent to which this development is line with or is contributing to their overall climate-related and environmentally sustainable objectives.*

Paragraph 51. Institutions should in particular take into account, on a best effort basis and according to the proportionality principle, risks associated with environmental factors and climate change in their credit risk policies and procedures risk management framework. The risks of climate change for the financial performance of borrowers can be classified as physical risks, transition and /or liability risks. Disclosure should be aligned with Article 449 a CRR2 (June 2022)

Paragraph 130. Going forward when borrowers disclose adequate information on their climate-related risks and other ESG risks, Institutions should assess each borrower's exposure to climate-related and environments risks as well as other ESG risks, e.g. the borrower's risk return

Paragraph 55 page 26 – data infrastructure:

The data collection is operationally not achievable for the stock of operations that were originated before these guidelines (availability of the required information). When data is available, the data collection will imply a burdensome and important work with no immediate benefit for banks risk management.

We would suggest the following amendment:

"55. For the new originated loans, the data infrastructure should be detailed and sufficiently granular to capture specific loan-by-loan information at the point of origination allowing linking data regarding the borrower with data regarding collateral to support effective monitoring of credit risk (see Section 8) and enable effective audit trailing, operational and credit performance and efficiency measurement as well tracking of policy deviations, exceptions and overrides (including credit/transaction rating or scoring overrides)".

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

Preliminary remarks

We consider that the requirement for governance and for credit granting are too standardized and too prescriptive and as such not applicable in all cases. EBA must take into account existing framework and organisations already implemented in compliance with prudential rules. This existing framework does work well.

With regards to Data infrastructure, it would be useful 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. Clarity on the proportional application of the data collection requirements would also be welcome.

Explicit reference to the principle of proportionality and the principle of materiality at portfolio level (please refer to Question 5. For details) should be made. To take into account the above, we would propose the following amendments:

Paragraph 35(b) page 21 and annex 1 on credit granting criteria

Paragraph 35(b) and annex 1 are too prescriptive. In particular, when considering the professionals category, the EBA should distinguish between corporates and retail professionals. Indeed, the analysis criteria are not the same for these two sub-categories.

We would suggest the following amendment to paragraph 35:

> *"35: Within the credit risk policies and procedures, institutions should* specify *where appropriate in relation to proportionality and materiality of portfolios ~~at least~~ the following: […]*
>
> *b. credit granting criteria; while specifying these criteria, institutions should ~~at least~~ where relevant consider items referred to in Annex 1"*
>
> *d. requirements for the creditworthiness assessment, including where appropriate sensitivity analysis as referred to in Section 5.2;*

We also suggest an amendment to the introduction of annex 1:

> *"This is an indicative reference list to be modulated according to the types of credit and the nature of the risks."*

Paragraph 40 to paragraph 42 page 23:

The controls should only cover the search of potential third party and never cover the source of funds, save in exceptional cases (politically exposed persons in case of high risk defined in a risks classification).

A risks classification should be defined with the aim to have a thorough knowledge of the borrower in case of high risk (creditworthiness, analysis of the investment's profitability, the use of funds if possible…) and a detection of unusual transactions (particularly complex transactions, unusually large transactions or transactions which have no apparent economic or visible lawful purpose).

The vigilance measures should not apply, if during the relationship which cannot be limited to the credit, there isn't any payment incident, any new application for credit, any change of IBAN or any material change.

The specificity of non-purpose loans and of specialised providers of consumer credit which are not account holders should be taken into account.

A risk based approach and the implementation of risk-proportionate measures are necessary.

Paragraph 47 page 23: see our comments and proposals on question 3.

Paragraph 53 page 26:

Climate change transition and physical risks could concern the retail clients (for instance through residential real estate) and SMEs. Therefore, the guidelines may have a significant impact on retail and SME loan origination conditions. Given these potential impacts more proportionality and implementation postponement is needed for retail and SMEs clients.

Paragraph 54, page 26 - artificial intelligence/ data infrastructure:

The scope of data to be input and available in systems seems very wide. This type of requirements should not become excessive as their implementation cost would be significant for no real benefit for banks. The benefit of such data recording should not be overstated either as good origination and loan monitoring requires teams of expert front officers and portfolio managers who currently do it on the basis of in depth analysis, and data recording in IT systems which will never provide a comprehensive view of the risk taken as reality cannot be reduced to a few number of drivers. The risk here would be that banks management decide to reduce the activities which imply a lot of data to be recorded.

Paragraph 56 page 27:

Data requirements for NPL are extended to performing loans which seems excessive and burdensome. We suggest deleting the paragraph 56 or to specify that the templates should remain optional, as this was originally the case.

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

General comments

It is important to introduce in Section 4 of these guidelines (Governance requirements for credit granting and monitoring) the **concept of "materiality" at portfolio level for a Bank.**

Individual credit files decisions ensure individual credit file quality and compliance with risk strategy and credit policies.

In addition to decisions on individual credit files, credit risk limits ensure **risk diversification** and **prevents concentration** on portfolio with shared risk characteristics. **Credit risk limits are only meaningful for material credit risk portfolios, when smaller, non-material, diversified portfolios should not require specific Risk Appetite Framework ("RAF") limits**.

Applied to a large diversified generalist Bank, the RAF does not cover every single credit portfolio of the bank with dedicated limits. Limits are set-up for material portfolios with shared risk characteristics, i.e. sectors (i) with common risk drivers affecting the clients of these sectors (ii) above a certain materiality threshold (iii) with specific risk sensitive indicators, or that may have to face significant challenges in the future.

Specific comments

We believe that this section 4.2 is **to prescriptive and lacks clarity. In particular:**

- paragraph 28 would require clarification and flexibility as the quoted dimensions (geography, business line…) are not always meaningful (such as sector for individuals) or overlapping (such as asset class with product for mortgages)
- paragraph 29 would require flexibility as Banks group entities and business lines can easily be in the thousands, some of them representing only a small fraction of the credit risk of the bank, or in some case no credit risk at all because of their activities
- paragraph 36 would require clarification or illustration. To note in addition that single credit decisions will often have a totally marginal impact on the institution risk profile

In order to take into account the above, we would propose the following amendments:

- ~~o~~ *26. The credit risk appetite, credit risk strategy and the overall credit risk policy should be aligned to the institution´s overall RAF. Institution's credit risk appetite should specify the scope and focus of the ~~total~~ credit risk of the institution, the desired composition of*

the credit portfolio, including the desired diversification and concentration, and where appropriate for credit portfolios that are material in relation to the total credit risk of the institution, geographical location of the borrower, types and geographic locations of collateral, economic sectors and the type of credit facilities~~, as well as the desired diversification and concentration.~~

- *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). These perspectives should be also supported by an adequate budgeting process.*

- *28. The credit risk appetite and strategy should include, where appropriate ~~applicable~~ for credit portfolios that are material in relation to the total credit risk of the institution, ~~appropriate~~ specific credit risk metrics and limits, which should be a combination of backward-looking and forward-looking indicators. Such indicators should include for the material portfolios key aspects of the credit facilities including where relevant 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, the materiality of the portfolios, and the complexity of the institution.*

- *29. Institutions should ensure that credit risk appetite and associated metrics and limits are adequately cascaded down within the organization, including all material group entities and business lines bearing credit risk.*

- *30. For the purposes of managing concentration risk, institutions should set quantitative internal credit risk limits for their aggregate credit risk, as well as for material portfolios with shared credit risk characteristics, sub-portfolios and individual borrowers. In the case of group entities and connected clients, the limits should account also for the consolidated and sub-consolidated position and the position of the individual entities of the consolidated and sub-consolidated levels.*

- *35 b. credit granting criteria; while specifying these criteria, institutions should ~~at least~~ consider where appropriate items referred to in Annex 1 (list non exhaustive);*

- Paragraph 36 should be deleted:~~*36. The credit granting criteria referred to in paragraph 35(b) should enable institutions to operationalise the credit risk appetite in consistence with the credit risk strategy and should provide input for evaluating the impact of the credit facility in request on the institution´s credit risk profile and credit risk capacity.*~~

Specific comments on remuneration (section 4.7)

Concerning the remuneration part, we fully agree with the principles that remuneration policies and practices should be consistent with the overall credit risk appetite and should not create conflict of interest, and that remuneration policies and practices applicable to all staff engaged in the credit granting, credit administration and monitoring should promote prudent credit growth and appropriate risk-taking behavior and should not encourage excessive risk taking.

These are core principles which are already included in the CRD, in EBA guidelines, and MIFID regulation, embedded in our remuneration policies, and applicable to all Group employees within the

Group whatever their activity, in particular for staff engaged in credit granting, administration and monitoring. Besides, remuneration policies and practices related to the staff's activities already take into account the rights and interests of consumers, do not incentivize any misselling practices and are already aligned with risk both ex-ante and ex-post in particular for employees identified as Material Risk Takers and take into account both quantitative and qualitative metrics linked to risk management, both at global and at individual level.

However, we do consider that:

- It is not relevant neither appropriate to set a **direct and formal** link between performance management and remuneration and the quality of credits i.e. variable remuneration to the long-term quality of credit exposures (82. a.) or that performance objectives/targets should include credit quality metrics (82.c.),
- Indeed, we consider that this principle could be in opposition to the core business of the banking industry in so far as the purpose of the banking industry is to finance the economy globally, whatever the rating of the clients or counterparts, but not only clients rated AAA. **Integrating metrics on the intrinsic quality of credits could lead to a problem of access to credit for a large number of clients**,
- The **risks taken by the banks when granting a credit are of course evaluated on a long-term basis** when the credit is granted, and guarantees are taken accordingly. There is indeed a specific assessment and validation process involving both front-office functions but also risk functions and management line. It is not the responsibility of a single person to grant the credit;
- However, the quality of a client and of a credit can evolve throughout time, depending on the financial health of the client which can be deteriorated due to external factors impossible to anticipate years in advance (economic downturn, emergence of new competitors, …). It would not be fair to impact the variable remuneration of a staff member years after the granting of a credit for events which are totally independent from the way he/she performed his/her job.
- Unlike trading risk, **credit risks can take longer to materialize**, especially for long-term credits. Long-term credit quality is difficult to monitor, and it is more complex to link remuneration to these long-term risks.
- Depending on the type of business (corporate finance, retail banking, consumer finance) and on the location, the acceptable quality of credit can be extremely variable. In this context, we consider that the element to be taken into consideration is not the quality of credit itself but the quality of the credit analysis in order to balance profitability and risks,
- The employees working in these kinds of activities should be assessed and rewarded according to criteria specific to their activities such as quality of customers' files, completion of KYC indicators and updates of these KYC KPIs all along the credit duration, respect of customers debt thresholds, respect of deadline for the update of credit files, client satisfaction, etc… Labor law in may most Member States requires that employees be assessed only according to quantifiable and manageable criteria.

Consequently, it is important to remind that remuneration policies and practices should be consistent with the overall credit risk appetite and should not create conflict of interest, but it is also essential that performance management and reward of employees involved in credit activities should be based on several criteria and on indicators linked to their activities and the quality of their credit risk analysis but not based on the quality of credit exposures which are independent and disconnected from the employee him/herself, his/her individual performance and the way he or she conducts his/her activity. In addition, the level of requirements regarding remuneration should be proportionate with the real risk taking.

To take into account the above, we suggest deleting paragraph 82. Should such requirement be maintained, we would propose the following amendments:

4.7 Remuneration

82. Institutions' remuneration policies and practices should in particular ensure that:

a. *variable remuneration of the staff involved in credit granting should be linked, among others, ~~to the long-term quality of credit exposures~~ respect of the credit risk policy, guidelines and procedures of the institution as regards of ~~long-term~~ the credit granting process and its monitoring;*
b. *variable remuneration of the staff involved in credit granting that is linked to performance objectives/targets should include criteria on the respect of the credit risk policy, guidelines and procedures of the institution related to the credit granting process and its monitoring in their activities ~~credit quality metrics~~ and be in line with credit risk appetite; and*
c. *remuneration policies and practices related to the staff's activities should take into account the rights and interests of consumers and should not incentivize any misselling practices.*

Other Comments

Paragraph 23 page 19 – Credit risk culture

We ask for clarifications from the EBA on the targeted objectives of paragraph 23

- This paragraph seems to imply that only low risk transactions should be booked. For a good financing of the economy, banks should keep the possibility to finance any level of risk (with rating and LGD reflecting this level of risk). As long as these risks are adequately priced, the Expected Losses (which are covered by the margins generated by the portfolio) will cover the observed losses.
- In addition, the willingness by the regulator of banks taking only low risk assets, together the finalized Basel III framework with F-IRB reclassification of some low risk portfolio or LGD input floors, would imply that banks' lending activity would be very much reduced as low risk transactions will be difficult to finance. Their low margins won't be sufficient to support overestimated levels of regulatory capital. Financing the economy implies, although being selective, to take different levels of risk, price them adequately, and maintain a good diversification of risks.
- With regard to the integration of sustainability factors into loan origination and monitoring, we caution against a temptation to adopt a too binary approach when considering sustainable positive impacts and sustainability risks. The future EU taxonomy will not be appropriate to assess loans' sustainability risks. The Taxonomy is meant to be a reference, but we do not expect it will be the unique one for environmentally-sustainable activities. Firms not aligned with the Taxonomy are not necessarily presenting an environmental risk. Nuances and granularity there are key to reflect the high complexity of the sustainability risk reality.
- On the applicability of the Taxonomy for green lending, we would also like to stress that it would be much more straightforward to use it for project finance (based for example on the Equator principles methodology) than for general purpose financing (loans that are not dedicated to a specific activity or a specific project) to corporates and SMEs. It is going to be very data-challenging and operationally complex for banks' systems to segregate and weigh each borrowing company's activities based on revenues or expenditures, following the exact same classification format as in the Taxonomy. It is also worth recalling the great difficulties for smaller companies to provide this data to lenders with such a level of granularity.

Paragraph 60 page 27:

Regarding the credit decision framework, we underline that there are not necessarily voting procedures.

Paragraphs 63-64 page 28

As far as the notion of independence in credit decision-making is concerned, we would appreciate that the guidelines make a clear reference to the EBA-ESMA Guidelines on suitability assessment for management body members. It should be clearly stated that the notion of independence only refers to the independence of mind and not to the notion of formal independence. Indeed, the CRD speaks only of conflicts of interest and independence of mind.

Criteria laid down in para. 63 go beyond what is provided for in CRD, CRR and in the EBA-ESMA Guidelines on suitability assessment for management body members and may create legal uncertainty. They are also unrealistic and should be removed.

In any case we need clarification about:

- a professional relationship with the borrower to which par. 63 (b)(i). refers ;
- the notion of political influence to which par. 63(b)(ii) refers.

In paragraph 63(c). "those who are subject to remuneration schemes associated with the growth of new business" is potentially very wide.

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

6.1- Use of credit committees and limited sole delegation:

the Guidelines should recognize and include the fact that robust credit decision-making frameworks can also consist of a robust framework of delegated credit responsibilities to duly authorized individuals, and the fact that not all institutions might use 'credit committees' or 'credit decision-making bodies'. Among others, we are welcoming the fact that the EBA Guidelines recognise the use of sole delegated credit authority but our understanding that their use should be proportionate with the risk taken by the bank.

We would also suggest to the EBA to clarify whether an "independent or second opinion" or "an independent and second opinion" is needed. Proportionality and more risk-based approach in the requirements should be seeked. For certain types of activities (e.g. : retail exposures, small corporates etc…), an independent second opinion is deemed excessive given materiality and the risk taking in such cases. Removal or rephrasing of par 76.c, 76.g and 76.n is therefore advisable.

When implementing 'an independent/second opinion to the creditworthiness assessment and credit risk analysis' is considered to be an additional pair of eyes to be involved in the credit process next to the 1st Line of Defence and 2nd Line of Defence, it could lead to an inefficient credit process and longer time. In practice, the approval bodies in the Signatory Approval Process can be viewed as independent and furthermore, the 3rd Line of Defence will be involved afterwards and will have the opportunity to flag and give direction to have corrected any flaws in the credit risk analysis going forward.

Paragraph 57 page 27:

We suggest the rewording "including when applicable structures of credit committees…". Also, we would welcome more clarity on the definition of "delegated credit decision making bodies"

We find the requirements in respect of 4.4 Credit-decision making too prescriptive and not always relevant. In particular:

<u>Paragraph 59:</u> we suggest removing reference to time period limits for the delegated powers as well as limits of number of delegated approvals as such limits will not contribute to improving the soundness of the delegated credit decision making bodies structure.

We would accordingly propose the following amendments:

- *59 […]. These powers and limitations should account for the asset class, product type, type and quality of the borrower, geographic location of the borrower, economic sector and industry and credit limits/maximum exposures. ~~For the purpose of delegated credit decision making bodies, institutions should set limits on the time period for the delegated powers and the number of delegated approvals.~~*
- *60. The credit-decision making framework should also account for the involvement of credit risk function in the decision making and represent a good balance between the business and risk functions. The framework should also specify the working modalities of the committees and roles of its members, including as the case may be such aspects as the voting procedures (unanimity or simple majority of votes).”*

<u>Paragraph 63 page 28:</u>

We suggest rewording the paragraph for clarity sake:

- *63 a. should ~~only~~ have ~~limited~~ an appropriate ~~sole~~ delegated credit authority for credit decisions ~~for small and non-complex credit facilities~~. In particular they could use sole delegated credit authority for credit decisions for facilities in accordance with the risk taken for the bank. The specific criteria, exposure levels and associated aspects should be defined in the relevant delegation policy and be approved by the management body;*
- *63.b.I seems to forbid staff with “professional relationship with the borrower” to take part in credit decision when 63.c seems to allow it under certain circumstances*
- *63.c seems particularly unclear in its grammar (e.g. “any individual, who have”), and lack of precise definitions (loan administration, management body level, remuneration schemes associated with the growth of the business)*
- *63c. a definition of “professional relationship” should be provided. Should front office staff, dealing with the borrower and taking part in credit committees, be considered as having a professional relationship with the borrower?*

<u>Paragraph 76 pages 30-32</u>

- 76 (c): we suggest not to impose an independent review and to add “where applicable” at the end of the paragraph
- 76 (e): we do not understand such requirement and suggest deleting it.
- 76 (g): the requirement to have a second opinion should not be compulsory. Firms mainly rely on credit bureaus information to compare with independent opinions. However, these are not available in all jurisdictions, nor for all cases. Having a second opinion also incurs a cost. The requirement should be based on the risk taken by the institution. We suggest to reword the paragraph “providing second opinion to the creditworthiness assessment and credit analysis in accordance with the risk taken by the institution”
- 76 (n): we suggest to add at the beginning of the sentence “in accordance with the risk taken by the institution”

6.2- Operational framework

While institutions appreciate the view to mitigate excessive risk taking in lending activities, they have some questions and concerns regarding the underlying principles and the operational framework. More specifically and based on paragraph 82-a, institutions understand that they would have to link the remuneration of all the staff involved in credit granting to the long-term quality of credit exposure. Institutions need clarification regarding both the objectives and the expected operational framework. How are institutions expected to integrate the evolution of the quality of the commitments over the long term in a mechanism of variable remuneration components? This would imply deferred premium for employees which is unacceptable. While banks could consider favourably proposals to reinforce the obligation of means at the credit grant time and during the period of exposure, they do not see how this could be switched to an obligation of result assessed over the long term. In addition, the induced effects of such principles are hardly compatible with the financing of the economy: risk taking, possibility of downgrading and default of counterparts are embedded, in the credit granting process.

See also our comments on question 5 (paragraph 82).

7. What are the respondents' views on the requirements for collection of information and documentation for the purposes of creditworthiness assessment (Section 5.1)?

As mentioned above, all consumer protection rules should strictly apply according to the material scope defined at level 1 by the CCD and the MCD.

In addition, 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 available for all "professional firms" and their analysis not always relevant in case of short terms facilities (e.g. Trade Finance or Export Finance)**. It should be made clearer that Annex 2 is not to be understood as 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.

Furthermore, c**ompliance** 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.** The requirements listed in the chapter 5 should leave room for banks to better customization, to manage also different worlds such retail vs non-retail practices, and within these perimeters, different types of lending, obligors etc. The guidelines seem to tend towards less risk-taking banking practices r, while omitting that willing to take risks is also part of a sound lending market. Once again, in the approach, we think that a more risk-based approach should be taken, as to find a balance between a thorough credit assessment and the risk which is taken, in line with risk appetite.

Indeed, the volume of data that the institutions and creditors should "at least" consider for the purposes of the collection and verification of information is not proportionate (19 elements listed in annex 2). The granularity of information requested and the level of experience required by the project of guidelines bear no comparison to what is presently required by the Mortgage Credit Directive (MCD) or the EBA guidelines on creditworthiness assessment (EBA/GL/2015/11). The 2015 guidelines are actually 6 guidelines 2 pages long in total, and they establish the principles of solvency assessment performed through "reasonable enquiries" and by taking "reasonable steps", while the current project give only a very little place to the lender assessment regarding its loan origination rules and policies. With respect to consumer credit, the breadth of information is ever more disproportionate.

Moreover, some requirements seem unrealistic. For example

- **Business plans (93.e) or financial projections (93.f) are not available for all "professional firms" and their analysis not always relevant in case of short terms facilities (e.g. Trade Finance or Export Finance).** It should be made clearer that Annex 2 is not to be understood as 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
- §91 to 94: proportionality principle but also appropriateness should be highlighted as the strict application of the guidelines would represent a regression in risk management for the concerned institutions that have demonstrated a permanent high-quality level in granting process. For instance, we would like to remind that very quick and automatized decision making are fully part of the good quality of small ticket leasing as it allows selecting the customers in the first instance instead of having to deal with customers which have seen their financing request refused by competitors.

  Considering the above we would suggest following amendments:

  - *92. For the purposes of the collection and verification of information, institutions and creditors should ~~at least~~ consider collecting where appropriate the information and data as set out in Annex 2. This list is not prescriptive and contains only examples of good practices that have not to be applied as a whole. It should be complied with proportionally to the type, size, nature, complexity and risk profile of the credit facility. It should also be completed where relevant with additional information.*
  - *93. For the purposes of the creditworthiness assessment of professionals, institutions should collect where available and verify information in relation to ~~at least~~ the following:*
  - *94. For the purposes of the collection and verification of information, institutions and creditors should ~~at least~~ consider collecting where appropriate the information and data as set out in Annex 2. This list is not prescriptive and should be complied with proportionally to the type, size, nature, complexity and risk profile of the credit facility and size and risk profile of the professional client. It should also be completed where relevant with additional information*
- Paragraph 85: the General Data Protection Regulation (GDPR) and other legal constraints limit the possibility to have massive credit data bases. Therefore, borrower own declaration is key to have a comprehensive view of its credit commitments of which some elements may be verified by the lender, some may not. The requirement to have a "single customer view" is impossible to comply with where no positive credit database exists, as in France where such a credit register is forbidden, by the French Constitution. In addition, the declaration may be incomplete. We would propose the following amendment:

  "85.Institutions and creditors should have a sufficiently comprehensive view of the borrower's financial position, including, if relevant, the most accurate and ~~up-to-date~~ comprehensive view of all the borrower's credit commitments (for example, if possible, a single customer view)."

- The request in paragraph 88 to make enquiries to third parties (e.g. employers, public authorities…) to verify the information and data collected would imply the creditor to approach those parties could be very difficult in practice from both an operational and a data protection point of view.
  - Bank secrecy limit the possibility to conduct enquiries among third parties to verify the information and data collected. Inconsistences are an alert to further investigate within the allowed legal framework.

- "The documentation of information" cannot be considered as an obligation for the creditor to collect systematically documents testifying the borrower's declarative information. Such a requirement would not be compatible with small amounts lending business models such as consumer credit at points of sale or online for example. It would not be compatible with small ticket vendor lease either.

While looking more carefully to annex 2:

- Point 3: Financial statements covering a reasonable period: in the case of specialized 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 reviews memos, in PDF version, should be considered as sufficient, and banks should not be obliged to record these covenants in IT Data systems.
- Data from credit registers or credit information bureaux (indicated at point 11 of the list) should cover at least the information on financial liabilities and arrears in payment. Yet, the French negative file of credit repayment incidents only display recorded repayment incidents, and it does not seem within the EBA guidelines scope/power to regulate the nature (positive or negative) of the credit file implemented by a Member State.
- Point 14 requests evidence of the value of collateral: this point is linked to Section 7, so please see our response to question 11 of the consultation paper.
- Point 16 requests information on the enforceability of collateral sound disproportionate if requested for any 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 while complementing information on the collateral itself requested by point 12. Also, regarding lending to professional, point 16, information on the enforceability of collateral, in the case of specialized lending, substantial control of the collateral is achieved through different security packages. The power of this security package is notably to enable lenders to put a strong pressure on sponsors (who brought the equity), which makes a restructuring easier. The recovery generally best obtained through a restructuring is based on the future cash flows to be generated by the collateral on which the lenders have a substantial 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 the point 16, we suggest adding "in the case of specialized lending, description of the structure and security package of the transaction".
- Any point mentioning "evidence of": as long as this information is in the credit applications or in the annual reviews memos, this should be considered as sufficient evidence. There should be no request of recording this information in IT data systems.

  For example, regarding item 6, banks should not be obliged to record the financial projections (balance sheet, profit or loss, cash flow) in data IT systems. Having the financial accounts of the borrower, as published by it, in a PDF version for example, should be considered as sufficient.

To take into account the above, we suggest introducing the following sentence in annex 2, as a preliminary remark: "*This list is not prescriptive and should be complied with proportionally to the type, size, nature, complexity and risk profile of the credit facility and size of the professional client. It should also be completed where relevant with additional information*."

Paragraph 85 page 35 and section 5.2:

Legal restrictions linked to confidentiality could prevent the possibility to consolidate the information between different legal entities of an institution.

The legal framework in some countries may forbid the transfer of specific information on borrowers even between separate legal entities belonging to the same banking group within the same country (see for instance corresponding requirements from the "Commission Nationale Informatique et Libertés", CNIL, in France). Any consideration around consolidated exposure and creditworthiness (inc. questions to the employer and relatives) should then take any such legal impediments into account.

The Guidelines should not require the lender to have an accurate and up-to-date comprehensive view of all the borrower's credit commitments (par. 85) given that it will relies very much on the information the borrower is able to provide, some of which are not verifiable, such as credits provided by other lenders due to the absence of positive credit database in France.

Paragraph 86, 87, 92 page 34 and annex 2:

Not all the requested information is available for the stock of loans. Paragraph 86 states that the information and data can be proportionate given the purpose, size, complexity and potential risk associated with the loan but the requirement under paragraph 92 to collect and verify at least the information as set out in Annex 2 for consumer loans goes against this possibility of proportionality.

Consequently, to avoid any misunderstanding, paragraphs 86 and 87 could be amended as follows:

> *"86. Information and data, when they could be collected, should be accurate, timely and relevant to the asset class and specific product, and proportionate given the purpose, size, complexity, and potential risk associated with the loan."*
>
> *"87. Where a loan agreement involves guarantees from third parties, institutions and creditors should collect sufficient level of information and data necessary to assess the guarantee, if possible, and, where relevant the financial position of the guarantor."*

Moreover, paragraph 92 has to be adjusted to allow differences in information and data collection/verification depending on for example whether the nature, the amount and duration of the loan.

Paragraph 88 page 34:

In the context of the initial credit decision, the employer side of dependent employees must also be examined. If a technically supported portfolio approach is chosen for subsequent checks (e.g. renewals), in which the analysis of borrowers is based on valid statistical data, EBA should also continue to make this portfolio approach an option for analysis, in order to be more proportionate

Paragraphs 93, 122 to 151

In the draft Guidelines the EBA propose financial indicators, relevant for mid and large corporates only. However, applying the same criteria could have detrimental impact on the financing of professionals. Indeed, the data collection would be a burdensome and heavy work, with no real benefit from a risk perspective.

We propose the following amendment:

> *"93. For the purposes of the creditworthiness assessment of professionals, institutions should collect and verify relevant information (which will have to be proportionate to the type of customer). For example, it could be if relevant and applicable ~~in relation to at least~~ the following:*
>
> *a. purpose of the loan, where relevant for the type of product;*
> *b. income and cash flow;*

c. financial position and commitments, including assets pledged and contingent liabilities;
d. business model and corporate structure;
e. business plans;
f. financial projections;
g. collateral (for secured lending);
h. other risk mitigation factors, where available; and
i. product type specific legal documentation (e.g. permits, contracts etc.);
j. other relevant information based on the type of customer."

8. What are the respondents' views on the requirements for assessment of borrower's creditworthiness (Section 5.2)?

Preliminary remarks

Creditworthiness Assessment should remain regulated as it is, with no further standardization. We caution against a uniform creditworthiness assessment at European level. Applying the same criteria poses risks to financial inclusion.

Common standards for creditworthiness assessments would not be based on the most flexible or severe risk policy but would set an average, which would exclude low income borrowers financed by more specialized institutions or borrowers with atypical profiles in reason of irregular income (for example civil servants working abroad with important income when they are there, but back to their basic remuneration on their return to home country- same for artists, individual entrepreneurs ...)

More specifically:

- For Retail / consumer credit exposures, the guidelines are at many levels not adapted. For instance, a customer could be rejected by all consumer credit providers in any EU country. Moreover, we believe that the application of the provisions applicable to mortgage credit/home loans to credit for consumers is disproportionate, given that mortgage credit/home loans and credit for consumer are very different products in terms of risk.

  We consider mandatory assessment of a borrower's creditworthiness to be an essential prerequisite to any decision to grant or extend the credit, in the interests of both the lender, which assumes the risk, and the borrower. However, the Guidelines should take into account the specific nature and characteristics of the product concerned. Consumer loans are typically of short duration and relatively low value and should be distinguished from other types of loans such as mortgage credit/home loans.

  The application of the provisions applicable to mortgage credit/home loans to credit for consumers is likely to create a risk of exclusion, in particular concerning small amount credits for consumers.

- Regarding shipping guidelines, we believe the framework of analysis proposed by EBA should be flexible and adapted to each specific situation. In many cases, financings are provided on a fleet basis, with recourse to a large operator. In these cases, an individual analysis, on a vessel-by-vessel basis, such as the one suggested in 171 a, will not be possible, as each vessel will be operated as part of a larger fleet and can have widely different types of earnings at any given time.
- Regarding commercial real estate lending, we would suggest that a proper analysis may require to take into account other factors than those proposed. We believe that the criteria proposed by EBA should not be read on a prescriptive basis, but as general guidelines to be taken into account within the analysis performed by the bank.

- In respect of Leasing and Factoring business we consider the requirements very generic and don't reflect the specifics of the asset class. We therefore feel a clear need for these Guidelines to provide where relevant, more specific interpretations and where possible exemptions for these individual product types. As was also done in e.g. for the EBA guidelines on the application of the definition of default under Article 178 of Regulation (EU) No 575/2013 (EBA/GL/2016/07)
- Attention should also be paid to non-recourse or limited-recourse transactions: the requirements are mostly not adapted.

We believe that the principle of proportionality should apply and that in line with this principle, the assessment of creditworthiness should reflect the type, the size and the complexity of the loan. It is necessary to allow for flexibility in the data taken into account for the assessment and in the adaptation of the criteria to national market particularities:

- The risk and credit granting policy should remain a prerogative of each credit institution, as its commercial policy result from these factors ; standardising the assessment of risk profile would block the market without taking into consideration the peculiarities of each Member State ;
- A single rule for the whole EU, far from facilitating cross-border credit, would 'only' limit credit to the national level of each Member State ;
- Common indicators wouldn't allow to take into consideration the economical and cultural background: same indicators will not mean the same depending of the countries (e.g. savings habits, national rates of divorces, cost of education for children. Differences in income (employment contract, payslips model, ...), taxation (withheld at source or not), social assistance between Member States do not allow to consider that a uniform rule of creditworthiness assessment is possible in the EU.
- An effective creditworthiness assessment can't be based on a mechanically applied criterion, but on the knowledge of the borrower and on the ability to take into account the specificities of his situation. This knowledge inherent to the banker's job can't be standardized.

Therefore, we support a non-prescriptive list relevant all times for all types of lending. Indeed, the list could be supplemented by other criterion depending on the type of lending and specific circumstances and more importantly each criterion in the list should not be considered as systematic. Furthermore, it should be noted that the definitions and expectations set in the guidelines will not be compatible with markets which are not as developed as the EU.

<u>Paragraphs 96 to 99</u>

We consider that the assessment is to prescriptive. The CCD doesn't precise specific metrics to assess creditworthiness. We reaffirm that it is not relevant to treat in a same way small credits. The CCD's scope should be applied. EBA must take into account the type of credit, and the amount. A strict application of the listed metrics and parameter would challenge current concerned institutions scoring models. These models does work well and we are able to limit risks and indebtedness. In addition, the use of metrics proposed would finally become factor of exclusion as they could become standards for indebtedness ratios while economic conditions of consumer could be very different in UE. We suggest removing the paragraph 99 or to precise what is considered as "where appropriate".

<u>Paragraph 100</u>

The requirement to have a "single customer view" is impossible to comply with regarding the GDPR principles (data minimisation) and the prohibition of positive credit register in some Member States such as France where such a data base is forbidden by the French Constitution.

Paragraph 101 page 36, paragraph 121 page 39:

A sensitivity analysis should not be mandatory for small amount or short-term loans insofar it is not necessary from the risk point of view.

For example, we consider that the requirement to analyse potential negative scenarios in the future is not relevant regarding consumer credit. Consumer credit are the most of time short term lending for which the potential negative scenario is not relevant. So, we suggest suppressing this obligation concerning consumer credit as defined in the CCD.

Moreover, the requirement to develop related sensitivity analysis may not be possible, especially in cases where smaller clients do not provide the bank with their own forward-looking projections and where listed companies are not allowed to provide lenders with detailed financial projections. The requirements must be driven by the proportionality principle, as for limited proposals and retail SME customers the requirements are not proportionate to the risk.

Therefore, we propose the following amendments:

> *"101. 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 scenarios in the future, for example, take into account prudent thresholds for a margin of potential degradation of the client's situation (for example, a decrease in revenue).*
>
> *Depending on the nature of the borrower and the type of credit, these analyses can be conducted globally at the level of a client/credit portfolio, resulting in a corresponding calibration of granting rules and processes. ~~including, for example, a reduction of income; an increase in interest rates in the case of variable rate loan agreements; negative amortisation; balloon payments, or deferred payments of principal or interest~~."*

Paragraph 103 page 37:

When requiring the lender to take into account "any variability" in the consumer's prospect to meet his obligations (par. 103), it is important to remember that, unless the consumer is able to provide such information, a lender can reasonably not be expected to know how a particular consumer's situation evolves over time.

Paragraph 105 page 37 and paragraph 118 page 39 :

Paragraphs 105 and 118 of the draft Guidelines introduces a presumption of responsibility of the lender's part in the event of borrower's default, by suggesting that the lender took part in the borrower's hardship or over-indebtedness.

It implies that in the event of payment difficulties or over-indebtedness of the borrower it would be concluded that the creditworthiness assessment had not been appropriately carried out by the creditor;

In addition, it is very difficult for lenders to assess whether undue hardship (which seems a vague principle to apply in practice) and over-indebtedness will occur, because in the vast majority of cases the causes are beyond the lender's control, resulting from macro-economic factors and accidents of life.

Such a burdensome requirement would also not be compatible with small amount credits.

We would propose the following amendment:

> "*105. When assessing the borrower's ability to meet obligations, institutions and creditors should take into account relevant factors that could influence the ~~present and future~~ repayment capacity of the borrower, where possible ~~and without inducing undue hardship and over-indebtedness. The factors should, where relevant, include other servicing obligations, their remaining duration, their interest rates, and the outstanding amounts, evidence of any missed payments as well as directly relevant taxes and insurance, where known.~~*"

Paragraph 106 page 37:

This section requires entity to maintain up-to-date records. In order to avoid misunderstanding, we believe the paragraph should clarify that it should be updated when necessary. We would propose the following amendment:

> *"106. The institutions and creditors should establish sound processes to assess the borrower's ability to meet obligations under the credit agreement and maintain up-to-date records of those processes when necessary. ~~The institutions and creditors should review these processes at regular intervals~~."*

Paragraph 107 page 37:

This paragraph is difficult to apply for countries where there is not legal retirement age. We suggest adding at the beginning of the paragraph "Where possible,…"

> *"107. If the loan term extends past the borrower's expected or predictable retirement age, the institutions and creditors should take appropriate account where possible and taking into account the elements known at the time of the granting of the credit. ~~of the adequacy of the borrower's likely income and ability to continue to meet obligations under the loan agreement in retirement.~~"*

Paragraph 110 page 37:

This paragraph should leave room to no differentiating approach to the creditworthiness analysis for foreign currency loans if the exposures are not deemed material with regards to the risk taking.

Paragraph 112 page 38

We suggest removing the paragraph 112. On item b. **Banks are not qualified to assess the quality of all the stakeholders involved in the development of the property**. Item c. appears more as a theoretical concept rather than a practical one, since the certification of the costs associated with the development is not easy to obtain and it could be very expensive for the borrower

Paragraph 126 page 40

We suggest adding "to the possible extent".

For example, future capital expenditures to be spent by a borrower are not necessarily public and /or known by the bank. In addition, some of the criteria proposed are not appropriate for non-recourse or limited-recourse transactions.

Paragraph 127-128 page 40:

The projected financial position, income and cash flows are not necessarily known (except for structured finance activities where these cash flows projection are part of the analysis). Models used for this analysis are often based on historical data. Therefore, we would propose the following amendment:

"127. For the purposes of the analysis of the financial position within the creditworthiness assessment as specified above, institutions should consider to the possible extent ~~at least~~ the following:
a. current ~~and projected~~ financial position, including income, cash flow and source of repayment capacity to meet contractual obligations~~, including under possible adverse events~~;
b. where applicable, exposure profile ~~until maturity~~ in relation to potential market movements (e.g. exposures denominated in foreign currencies, exposures collateralised by repayment vehicles etc.); and
c. where applicable, probability of default based on credit scoring or internal risk rating."

Paragraph 129 page 41:

Generally, banks avoid taking the risk of performance of the supplier.

Paragraphs 131 to 135, 138 to 141 (SME specific) and Annex 3

Imposing to refer to a list of metrics to analyse a professional borrower's financial position, especially considering SMEs, is over-prescriptive and regressive. The requirement to « consider at least » some of the metrics listed, such as "cash conversion cycles", "cash flow generation", "projected capital expenditure"… is not compatible with credit granting processes of some leasing and factoring large scale, small amounts and short-term activities (for instance small equipment leases through vendor programmes). It would have disproportionate impacts on the organisation and tools on which these activities currently rely, often at least partially automatized and technology-enabled, that have long been developed and have proved their efficiency. It would represent a backward move to less risk sensitive credit granting analyses, for a disproportionate cost in terms of HR and IT in comparison with the potential expected reduction of cost of risk. We would like to remind that very quick and automatized decision making are fully part of the good quality of small ticket leasing as it allows selecting the customers in the first instance instead of having to deal with customers which have seen their financing request refused by competitors.

Proposed amendments

In addition, applicability of the proportionality principle should be made clearer and wording "at least" generally replaced by "where relevant" and "list non exhaustive" to avoid confusion. As such, we would therefore propose the following amendments:

- Paragraph 131.[…]. Institutions should make their own projections of the borrower's financial position and use them to challenge the projections provided by the borrowers *if any*.
- Paragraph 132, page 41 :
  For the purposes of the analysis of the financial position within the creditworthiness assessment as specified above, institutions should consider ~~at least~~ where appropriate the following (list non exhaustive)
  d. […] and also ~~*at least*~~ considering which metrics in Annex 3 would be applicable in the specific credit proposal.
- Paragraph 133, page 41: This paragraph is unclear. We need clarifications from the EBA.
- Paragraph 134 page 41 :
  Institutions should perform where appropriate 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. 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.

- Paragraph 135, page 42:
  For corporate loans, generally DSCR are not calculated whereas they are calculated for project finance. Also, regarding residential real estate the LTV ratio does not properly reflect the borrower's capacity to repay while the risk of non-repayment is the main risk in the RRE portfolio. European banks often use the LTI ratio rather than the LTV ratio.

  135. Institutions, where relevant, could use ~~at least~~ where appropriate certain of the following financial metrics when they exist (list non exhaustive) or other appropriate financial metrics for the purposes of the creditworthiness assessment, and, where relevant, assess them against the metrics and limits as set out in their credit risk appetite, credit risk policies, and limits in accordance with Sections 4.2 and 4.3: […]

    - *a. debt service coverage ratio;*
    - *b. EBITDA (earnings before interest, taxes, depreciation, amortization);*
    - *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;*
    - ~~*h. capitalisation rate (net operating income/market value).*~~

- Paragraph 149 page 44: "*Institutions should assess where appropriate to the risk profile of the credit facility the feasibility of the business plan and associated financial projections in line with the specificities of the sector in which the borrower operates*".

Paragraph 131 (see also paragraph 101):

Projections are not always provided by the client. Especially not in case of smaller (retail) clients, but also in case the client is active in a very stable environment (evidenced by its financial track-record). We suggest being more proportionate and would propose the rewording: "institutions should consider if applicable the following"

Paragraph 136 is very prescriptive and not market practice for large corporates. We would suggest the following amendments:

- *136. Institutions should assess where relevant working capital facility taking into account the cash flow generation ability of the borrower to turn the working capital into a cash positive position on a regular basis. If this is not the case, the institutions should assess the capacity of the borrower to convert the working capital facility into a term loan and repay the term loan on a principal and interest basis.*

Paragraph 143 page 43:

It is difficult to anticipate potential adverse market events.

Paragraph 145 page 43:

These requirements would imply burdensome and important works. We are not sure of the relevance of such sensitivities which quantification would be very subjective and difficult to assess. These sensitivities should be done only where relevant and to the possible extent depending on the available information. Such sensitivities are generally run for Project Finance where an in-depth analysis is possible with detailed base cases of future cash flows, determined on the basis of thorough due diligences on market risk (with market consultants), performance (with Technical Advisors appraisals), etc. In the case of an unsecured corporate loans, such due diligences are not done and there are

generally projected cash flows on the long run. Such sensitivities seem quite difficult to be done for unsecured corporate loans. Moreover, it will be difficult to obtain information about occurrence of severe management problems, the failures of significant trading partners, customers or suppliers and a significant reputational damage.

In general, we suggest remaining proportionate and we also suggest introducing the following rewording: "*Institutions should take into account where applicable…*"

Paragraph 146 page 43:

We suggest remaining proportionate and suggest to introduce the following rewording : "Institutions should take into account where applicable…"

Paragraphs 150:

The dependency to key-person is applicable only to specific financing (e.g. LBO) but not be considered as applicable for all Corporates. We suggest adding in the beginning of the paragraph "*if applicable*".

Paragraph 153 page 44:

For banks using the A-IRB approach we remind that correlation can exist between the borrower and the collateral. The correlation is not a prohibition for taking into account such collateral as long as internal models enable to take into account such possible correlation (cf. CRR art. 181(c)).

Paragraph 156 page 44:

Common market practice allows the issuance of the guarantees / LC by one of the lenders in the banking pool. We would propose as the result the following amendment:

- *156. [...] For cross-border lending and project finance transactions, the agent or the designated entity should preferably be the sole issuer of any guarantees, letters of credit or similar documents issued on behalf of the supplier in the transaction.*

Paragraph 158 page 44

The notion of "size" should be clarified in this paragraph

Paragraph 163 page 44

The proposed criteria seem too prescriptive in view of the objective of the simulation.

> *163. For the purposes of the sensitivity analysis under adverse market and idiosyncratic events, institutions should in addition to the events specified in Section 5.2.5 take into account pertinent criteria, for example the following (non exhaustive list) :*
>
> *a. re-letting including change in the rental prices, lease length in relation to loan term, service charges, increase of vacancy rates, maintenance and refurbishment costs, rent-free periods and letting inducement;*
>
> *b. risks and delays associated with refinancing; and*
>
> *c. capital expenditure risk and obsolescence risk.*
>
> *d. other relevant criteria*

Paragraph 166.
Certification by quantity surveyor (or similar) is not market practice in France, where Operational development risk is covered by legal contracts: CPI contrat de promotion immobilière or VEFA vente en l'état futur d'achèvement. We would suggest the following amendments:

166. The assessment of the development phase should cover:

- *a. business plan, including documented rationale for the development supported by a location specific review of supply and demand in the market by a reputable estate agent with a relevant expertise;*
- *b. the background information, builders, architects, engineers, contractors and sub-contractors, who take part in the development;*
- *c. projection of all costs associated with the development certified by a qualified and reputable quantity surveyor (or similar);*
- *d. all necessary permits and certificates necessary for the development, including the ability to obtain them in the future as project progresses.*

Paragraph 169.
The concept of "suitably qualified person" needs to be either detailed or removed. We would suggest the following amendments:

- *169. Institutions should carry out on-site visits ~~accompanied by suitably qualified person~~ to verify the main components of the site including access and site specificities and retain a summary of the site visit on the file of the borrower.*

Paragraphs 176 and 177 page 44:

The definition of a specialised lending exposure is already included in Article 147(8) of the CRR. We consider here that this paragraph goes too far and is too prescriptive as project finance security packages should be assessed as a whole in order to ensure that specialized lending conditions are met.

We suggest deleting this paragraph. Instead we suggest introducing the following requirement:
"*To the extent possible, institutions should ensure that specialized lending conditions (cf. conditions included in article 147(8) of CRR) are met*"

Alternatively, we would suggest the following amendments:

- 176. To the extent possible, institutions should ensure that all the *material* assets of the project, and present and future cash flows and*/or* accounts are pledged to the institution providing the lending or to the agent/underwriter in the case of a syndicated transaction/a club deal. In case where a special purpose vehicle is established for the project, the shares of that special purpose vehicle *preferably* should be pledged to the institution/agent to take the possession of the company, if needed.
- 177.b. the background information, *major parties* ~~builders, architects, engineers, contractors and subcontractors as applicable,~~ taking part in the project."

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

Introductory remark:

The scope of the asset classes, products and clients covered is very wide. The proportionality principle is key to section 5.2 and certain wordings should be modified for clarity sake on their applicability (e.g. "at least" replaced by "where relevant" and "list not exhaustive"): see our comments on question 8.

General Comments

We well noted that loans and advances to credit institutions, investment firms, financial institutions, insurance and reinsurance undertakings, central banks and sovereigns, including central governments, regional and local authorities, and public sector entities, are excluded from the scope of application of

Sections 5 as the creditworthiness assessment of these borrowers would significantly differ from the assessment of tradition private and corporate loans. However, the scope remains extremely large: mortgage loans, with a distinction between a financing of the house of the borrower and other financing, consumer loans, professional loans, commercial real-estate loans, promoters' loans, shipping finance, project finance…

In particular, for consumer loans, using a common framework to regulate the loan origination for mortgage loans and for consumer loans is not adapted to those loans characteristics, which are completely different in terms of amount, duration and impact on the borrower financial situation. The creditworthiness assessment of borrowers significantly differs from consumer credit (industrial approach where the human decision is often mainly based on the result of a scoring) and mortgage credit (tailor-made approach).

One could also wonder if this EBA approach is timely while the European Commission has not yet drawn conclusions from the Consumer Credit Directive (CCD) evaluation exercise launched in June 2018.

Paragraph 14 specifies the application of the proportionality principle based on the nature, size and complexity of the credit facility being originated (section 5). Paragraph 15 indicates that for consumer protection aspects when dealing with the creditworthiness assessment of consumers should not be subject to the application of the principle of proportionality. We need clarification of how those two paragraphs interact.

The consumer protection aspects seem to be the same for both consumer and professional lending, while professional are not to be covered by consumer protection, by nature.

Paragraph 180 page 48:

It is unclear how the way in which loan documentation is designed plays a role in the creditworthiness assessment and could prevent the borrower to provide the lender with falsified information (par. 180).

Paragraph 181 page 48:

The information needed for the decision of the credit committee is generally included in the credit application. Which we consider as sufficient regarding documentation. The recording of such credit applications should be considered as sufficient and no requirement of recording this detailed information in a data infrastructure should be considered here.

10. What are the respondents' views on the requirements for loan pricing (Section 6)?

As the EBA stated it during the Public hearing organised September 20th, it should be clearly mentioned that the guidelines do "not prescribe any specific pricing strategies, as these remain business decisions of the institutions".

The EBA's requirements should not lead to a standardization of pricing practices. This chapter should be proportionate as to insure that simple methods can be used, especially for retail activities.

Otherwise, we can and do find it expedient to put the pricing of a loan into a broader context. For example, the profitability of relationship loans would be reviewed at the client relationship level and not necessarily purely on a transactional level, whereas the profitability of an acquisition financing could be viewed more on a transaction level. More generally, this granularity of analysis should be taken into account at the adequate bearing in mind that the transaction level is not systematically adapted.

We understand that EBA proposal aims to provide an harmonized framework in the EU to prevent aggressive commercial policies but not to prescribe any specific pricing strategies, as these remain business decisions of the institutions. We would welcome this key clarification in the final text:

Structure of the guidelines

> *Section 6 sets out supervisory expectations for the risk-based pricing of loans listing ~~a minimum set of~~ some risk-based elements that institutions should consider and reflect when pricing newly originated loans. The draft guidelines do not prescribe any specific pricing strategies, as these remain business decisions of the institutions*

Paragraph 186, page 50

For some portfolios the determination of margins are not done as a mechanical way but are the result of the process of bidding for a transaction, taking into account the risk of a given loan, and as well taking into account competition from other bidding financial institutions.

Paragraph 187 and 187 (d), page 50

The EBA specifies that institutions "should define their approach to pricing by borrower type and credit quality and riskiness of the borrower". However, some indicators proposed by the EBA are not risk sensitive or may not reflect the idiosyncratic risk of a counterparty.
For example: how are banks supposed to determine the Expected Loss (EL) term mentioned in paragraph 187 (d)?

- Should they use the regulatory expected loss? If so, the pricing could be disconnected from risk perspective. For example, fixed LGD are used under the F-IRB approach and therefore EL are not fully risk-sensitive. It could even be worse in the future since the upcoming implementation of the Basel reform will further reduce the risk sensitivity of the prudential framework.
- Or should they use accounting or risk management EL? If so, the pricing could be inconsistent with the capital requirements and finally the capital allocation.
-

Paragraphs 187 and 188 page 50

- The EBA states that banks "*should consider and account for risk-adjusted performance measures such as EVA, RAROC, RORAC in a manner that is proportionate to the size, nature and complexity of the loans*". The EBA should further clarify that simplified measures could be used, where relevant. For some portfolios, banks may decide to disregard the complex task of overheads allocation. For example, banks may develop simple and understandable models providing for SMEs financing portfolios.
- The granularity of analysis should be taken into account at the adequate bearing in mind that the transaction level is not systematically adapted.

To take into account the above, we would propose the followings amendments:

> *"187. Institutions should consider and reflect in loan pricing relevant cost elements, for example ~~inter alia~~: […]"*
> *188. For the purposes of pricing and measuring profitability, including cross-subsidisation between the loans or business units/lines, institutions should consider and account for risk-adjusted, ~~performance measures such as economic value added (EVA), return on risk-~~*

> *~~adjusted capital (RORAC) and risk-adjusted return on capital (RAROC)~~ in a manner that is proportionate to the size, nature and complexity of the loan. For example, it could be performance measures such as economic value added (EVA), return on risk-adjusted capital (RORAC) and risk-adjusted return on capital (RAROC) or other pertinent methods in relation with the kind of loan. For some loans, the segment approach may also be used when the unitary approach is not relevant (particularly loan to individuals or professionals).*

Paragraph 189 and 190 page 50

The requirement to document the cost allocation framework within the bank, to ensure that the expected return by type of loan and by business line reflects the risk assumed is very intrusive and out of the scope of EBA's mandate. We propose deleting both paragraphs.

Alternatively, we propose rewording them restricting the guidelines at business line level:

> *'189. Institutions should transparently document and review the underlying cost allocation framework. Institutions should establish a fair distribution of costs within the organisation in order to ensure that ~~individual loans~~ and business lines reflect the correct expected return corresponding to the risk assumed.*
>
> *190. Institutions should implement a regular monitoring linking together transaction risk, pricing and expected overall profitability at business line level. ~~All the transactions below costs should be reported and properly justified. Monitoring process should provide input for the review of the adequacy of overall pricing from a business and risk perspective. If needed, institutions should take actions in order to ensure compliance with targets and risk appetite.'~~*

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

Immovable property collateral

The required valuation of the collateral as defined paragraphs 191 to 200 is not compliant with article19 of the Mortgage Credit Directive. The MCD requires the valuation to respect specific standards when the lender decide to do the valuation, but this valuation is not requested for granting the mortgage credit.

Paragraph 194 requires that at the point of origination institutions should ensure that the value of all immovable property collateral is assessed by an independent qualified internal or external valuer. This approach will be very costly. The acquisition price mentioned in an official act (a notarial deed for instance) should be recognised as an acceptable initial value.

We suggest the following amendment:

> *194. At the point of origination, institutions should ensure that the value of all immovable property collateral irrespective whether it is pledged against the loans to consumers or professionals is assessed by an independent qualified expert (for example, internal or external valuer or other specialists) or correspond to the acquisition price.*

Moreover, the valuation requested by the project of guidelines has to be performed through an "on-site" visit, and can't be made through automatized means, which is even more cumbersome.

We also highlight that requirements of regular monitoring of the collateral valuation are already into force if institutions want the collateral to be recognized as a guarantee for prudential indicators computation, or for re-financing as a covered bond.

The project of guidelines goes beyond the MCD requirements and the transposition in the French law; even for a secure mortgage loan, the valuation of the housing is not requested at the loan origination stage. Such valuation is actually performed only in few cases, as for bridging loans when the cost of works is very high compared to the acquisition price.

Practically in most banks, thanks to a dense network of branches, advisors have a good knowledge of the value of properties of their sector. A valuation, at the level of the Bank or beyond, should only be considered in cases where the property is atypical or of a significant amount.

The repayment capacity of the borrower is the major driver for the loan granting decision. In France, the standard is to have an authorized surety organization to guarantee the mortgage credit. Therefore, the request of a systematic valuation of the housing in case of a decrease of the borrower's repayment capacity is even more less justified (paragraph 196).

We suggest the following amendment to paragraph 197

> *"197. Where institutions use external valuers, they ~~should establish a panel of accepted external valuers. The composition of the panel of valuers~~ should ensure that valuers that have expertise in areas of the property sector, which is relevant to the lending activities of the institution ~~as well as the location of these activities~~."*

The notion of "certain circumstances" in paragraph 199 is not clear enough. Therefore, we suggest the following amendment to paragraph 199: "*Valuation should be carried out (internal valuation) or ordered (external valuation) by the institution, unless it is subject to a request from the borrower ~~under certain circumstances~~*".

Movable property collateral

General Comments

i- We remind that there are also guidelines for credit risk mitigation and requirements in the CRR. It seems difficult for banks to manage requirements on the same topics in different guidelines and regulatory texts.

ii- We would welcome more precise definitions of the term "movable property"

iii- Proportionally principle should explicitly apply to Section 7. In particular, **the systematic valuation of movable property by appraisers is deemed neither feasible nor necessary given the volume and the additional associated cost generated**, with limited benefits for most of the cases. We would accordingly propose the following amendment:

- *201. At the point of origination institutions should ensure, **according to the proportionality principle**, that the value […]*
- *220. […] Such criteria should be related, at the minimum, to the value of the movable property collateral at the origination phase, life span, condition of tangible assets, such as depreciation and maintenance, necessity of physical inspection where relevant, and certification.*
- *In addition, the guidelines should distinguish between the collaterals in the case of asset based lending (CRE/Shipping/Aviation) and the securities/liens in the case of non-asset based lending such as cash-flow based lending (Project finance/LBO/Corporate lending).*

Paragraph 198.
To be deleted as indemnity insurance is not market practice.

Paragraph 199.
To be simplified or deleted as too prescriptive and costly. In particular, the criteria to apply by the institution ensure that the valuers "provide an impartial, clear, transparent and objective valuation" should be detailed, or the sentence removed

Paragraph 201 page 53

Overall, we consider that the organisational requirements related to independence of valuers are over-prescriptive and would raise the cost of doing business.

The EBA should acknowledge that an independent valuation is not required if a supplier's invoice is available for a new asset pledged against the loan (for example in the case of physical assets acquisitions). We suggest the following amendment:

> *201. […] that the value of all movable property collateral, irrespective whether it is pledged against the loans to consumers or professionals, is assessed by an adequate evaluation: for example, an invoice or other pertinent documents, or by an independent qualified valuer or appropriate advanced statistical models taking into account Article 229(3) of Regulation (EU) No 575/2013.*

Paragraph 202.
"Where relevant" to be added to the paragraph as this requirement is not applicable to businesses where statistical models are not used (e.g. Shipping and Aviation)
Paragraph 207 and 208, page 54

The requirements for monitoring and revaluation (section 7.2 in particular paragraphs 207 and 208) are very detailed and too granular in terms of elements to take into account. The requirements are very detailed and we also question relevancy for all cases of some breakdown drivers. Therefore, we suggest introducing more proportionate requirements by rewording "*These policies and procedures should account for one or several of the following elements*".

Asking for more frequent valuation of collateral in case of high LTV does not seem appropriate as generally a high LTV is granted for low risks assets.

In addition, the IFRS9 classification is not the sole indicator of credit quality for banks.

To take into account the above, we would propose the following amendments:

> *"207. When monitoring property values as laid down in Article 208(3) of Regulation (EU) No 575/2013, institutions should set appropriate policies and procedures specifying the approach and the frequency of monitoring of immovable property collateral~~. These policies and procedures should account for the following elements:~~ for example:*
> *a. type of property, e.g. RRE, CRE;*
> *b. credit quality of the loan secured by property~~, e.g. IFRS9 Stage 1 or Stage 2;~~*
> *c. development status of the property, e.g. in construction, finished product;*
> *~~d. the value of the property, e.g. in gross carrying amount and LTV ratio;~~*
> *e. changes in market conditions."*

Paragraph 214, page 55:

This paragraph extends to performing loans requirements designed for NPL which seems excessive and burdensome

For both movable and immovable collateral the requirement of the rotation of valuers is problematic for some type of activities. This change in market practices is particularly difficult to implement and would come at a huge additional cost for the activities affected. For example, in the car market, only one single valuer is really reliable at European level (i.e. Autovista). Therefore, we suggest deleting such paragraph.

Paragraph 219, page 56:

For standardized assets such as aircrafts, these assets don't necessarily require a visit and external appraisers valuation of half life assets are considered as sufficient.

Full visits are not market practice. We would propose the following amendment:

> *219. Institutions should in their policies and procedures set out approaches to using a valuer or statistical models, define on the approach (e.g. desktop valuation, drive-by valuation, ~~full visit with internal and external assessment of the property)~~ for the revaluations to be done by the valuers, and set out the frequency or monitoring and revaluation of movable property collateral.*

Paragraph 222 – 225, page 56 – 57:

Valuations are usually requested and paid by the borrower and not by the lender. These experts are independent and belong to a professional body which requires the respect of a code of conduct which ensures that the valuations are objective and independent from the requesting party.

In addition, banks usually agree on the mandated expert when the documentation is being issued. It is a long time applied market practice. It would therefore be very dangerous that the valuation be conducted on behalf of the lender, not to mention the costs increase as clients would not agree to pay for the expertise anymore.

Paragraph 223. should be removed as the bank can not make such verification. Besides, the fee or the salary of the valuer is paid for by the borrower.

Paragraph 224. the added value of this requirement is not clear and the analysis of the concentration of valuations performed is not relevant when the panel of valuers is restricted. We would suggest the following amendment:

> *224. Institution should assess the performance of the valuers on an ongoing basis, in particular accuracy of valuation provided. As part of such assessment and where relevant institutions should also look at the concentration of valuations performed and fees paid to the specific valuers.*

Paragraph 225. c. Such requirement cannot apply to shipping as valuers are also brokers

Lastly, we would comment that there could be insufficient valuation capacity in given markets (ex: Luxembourg) to fulfill requirements of paragraphs 194 & 203.

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

Section 8.4

Regarding requirements of covenant monitoring, they should be proportionate to the nature of loans, types of counterparties and risk taken, in particular in terms of IT system considerations. While it is important to monitor covenants where applicable for specific types of loan, the practice should take into account the bank's overall credit monitoring framework and its accuracy to monitor loan risk and prevent default. To this purpose, covenants provide further security and possibility to monitor the loan and could be considered as one means but not the panacea. For instance, a covenant breach does not

always conduct to default, as well as default could occur even if no covenant is breached. Therefore, the borrower's adherence to covenant cannot be considered as an early warning tool, in particular delivery of covenant compliance certificate is more an ex-post consideration of the loan situation, rather than an early warning indicator. We suggest the EBA to rewrite the section 8.4.

Paragraph 229 a page 58:

Provisions according to which the credit risk monitoring framework and data infrastructure should provide the capability to gather and automatically compile data regarding credit risk without undue delay and with little reliance on manual processes are costly and problematic in terms of IT developments (par. 229 a). The requirements are considered as too granular and would raise question in terms of data protection.

Paragraph 233 page 59:

The terminology "high risk" is misleading as there is a notion of "high risk items" in CRR as per article 128. Also, to avoid any misunderstanding and proportionality, we suggest deleting the first part of the paragraph "Through these key risks indicators" and to add at the beginning "In a manner which is proportionate with the risk taken". Lastly, we suggest to remove the mention to non-investment grade rated given that this notion is irrelevant for large shares of the portfolios (such as SME for instance, which risk level is largely higher than investment grade rating equivalent). We would accordingly propose the following amendment:

> *233. Through these key risk indicators, institutions should monitor and identify high risk in lending activities in the loan book, such as ~~the level of lending to non-investment grade rated borrowers,~~ interest only/bullet repayments, the level of covenant absent or covenant-lite loans, lending with longer maturities, and other KRIs linked to the business lending of the institution*

Paragraph 243 page 61:

More generally, we suggest including a proportionate stance per the following rewording of the paragraph: "[…] including any of the following elements where appropriate: product, […]"

Paragraphs 255 - 256, page 62

Regarding the stress-testing part, we do not consider relevant at all to lead stress-testing on individual exposures to assess risk (paragraph 255). The practice is to consider where relevant, scenarios on concentrated exposures at portfolio level, which prove to be a more effective way to assess risk in a stress situation.

Paragraph 255*. As part of their ongoing monitoring activities, institutions should conduct regular stress testing of their credit portfolios, and, where relevant, individual exposures. Such stress testing should be performed in accordance with the EBA Guidelines on institution's stress testing[24] and at least annually and its results reviewed by the credit risk management function as a means of anticipating potential impact a negative turn of events could have on credit exposures and institutions' ability to withstand such impact. Institutions should conduct stress tests at least on the aggregate credit portfolio and on relevant sub-portfolios, taking into account materiality and risk level, in accordance with the principle of proportionality.*

Paragraph 256 indicates that institutions should benchmark the results of stress tests against the credit risk appetite. We underline that stress testing is a difficult exercise and are somehow reductive. Modeling reality would require a high number of parameters. Stress tests are most of the time a best effort exercise. Although quantitative studies can be analysed, expert based judgement of experienced teams should remain the main driver of credit risk appetite.

Paragraph 257. *In addition to stress testing based on the macroeconomic scenarios, institutions should regularly perform simpler sensitivity analyses based on internal and / or external information where relevant and available (e.g. market overview released by external providers regarding specific sectors or areas) for the early identification of segments or exposures, which could be affected by potential adverse shocks.*

Paragraph 258 page 62:

See comment on paragraph 255. Also, we suggest deleting the last sentence "*Sensitivity analysis in relation to the original business plan.*" as once the creditworthiness assessment made and the bank has entered into such financing, the risk management is based how to prevent default, further update is not deemed useful. Moreover, there seems to be a confusion between stress-testing based on existing portfolios and sensitivity analysis. We thus would suggest the following amendment:

> *258. […] Sensitivity analyses, in case of material adverse variations vs ~~in relation to~~ the original business plan, should also be conducted as appropriate on individual credits when monitoring large project finance and acquisition finance exposures.*

Paragraph 263 page 63:

With respect to the key risk indicators 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 temporary lag that would not ensure promptness.

Furthermore, Section 8.6 appears to discuss EWIs for portfolio monitoring; however, paragraph 263 appears to imply EWIs to be set for individual exposures; while obviously we need to monitor borrowers, setting and managing EWIs for individual borrowers which is not coherent.

We suggest the following rewording: "As part of their on-going monitoring of credit risk institutions should consider one or several of the following indicators […]"

Appendix

The guidelines refer to terms that are defined already in existing or upcoming regulations. Here is a non-exhaustive list of the concerned publications:

- Definition of consumer: we understand that the applicable definition is that defined under Directive 2008/48/EC on consumer credits (CCD)
- Definition of professionals: in order to consider a client as "professional" we should refer to the criteria laid down under Annex II of Directive 2014/65/UE (MiFID II)
- Definition of Commercial Real Estate / Residential Real Estate as defined in ESRB recommendation on closing real estate data gaps (ESRB/2016/14).
- Other definitions in areas such as risks of climate change or ESG (see publications due in the EU Sustainable Action Plan and EBA mandates in relation with ESG considerations included in CRR2-CRD5 which are at an early stage)
- Requirements in relation with the EBA Guidelines on institutions' stress-testing
- Requirements in relation with the EBA Guidelines on credit institutions' credit risk management practices and accounting for expected credit losses (e.g. factors to assess a significant increase in credit risk for a lending exposure)
- Requirements in relation with the EBA Guidelines on management of non-performing and forborne exposures (e.g. as the word "renegotiated" might imply a conceptual connection with the definition of Forborne Exposures, and since paragraph 6 mentions both 'throughout the life cycle' and 'monitoring performing exposures'), as well as the ECB Guidance on NPLs
- Requirements in relation with the EBA Guidelines on internal governance
- Requirements in Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing'
- Requirements in relation with Joint Guidelines under Articles 17 and 18(4) of Directive (EU) 2015/849 on simplified and enhanced customer due diligence and the factors credit and financial institutions should consider when assessing the money laundering and terrorist financing risk associated with individual business relationships and occasional transactions (The Risk Factors Guidelines)
- Requirements regarding EBA Guidelines on connected clients
- Application of BCBS 239 in terms of data collection
- Anacredit reporting
- ECB credit underwriting data collection
- ECB guidance on leveraged transactions