**EBA Consultation Paper**

**Draft Guidelines on loan origination and monitoring**

**Comments from the Slovak Banking Association**

**Questions for public consultation**

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

Yes, there are multiple obstacles, generally related to the fact that all banks in Slovakia are running some kind of loan origination and monitoring processes that are supervised and in case of deficiencies subject to the improvements in line with defined action plans. The existing processes are obviously to a large degree in line with Guidelines expectations, yet, the differences are manifold and should be removed in line with their materiality. Just analysis differences, suggestion of solutions, budgeting and implementation would take much longer time than envisaged by the draft GL. The reasonable postponement should be considered of about one to two years.

**Section 3, Point 18**: date of implementation is very tight, for consumer (already covered by consumer protection law is possible to implement), for professionals and business companies it is change of business model in the bank – more time for implementation is needed.

**Our proposal:** “18. These guidelines apply from 01 January 2022.”

**Section 4.2, point 28:** “The credit risk appetite and strategy should include, where applicable, appropriate specific credit risk metrics and limits, which should be a combination of backward-looking and forward-looking indicators. Such indicators should include key aspects” - It is not clear how and to what extent backward/forward looking indicators shall be used. Some aspects in Slovak conditions do not make sense.

**Our proposal:** “28. The credit risk appetite and strategy should include, where applicable, appropriate specific credit risk metrics and limits, which should be a combination of backward-looking and forward-looking indicators. Such indicators should include key aspects of the credit facilities considering their geographical coverage, business lines, asset classes, sectors, client segments, currency, credit risk mitigation instruments and products. These indicators should be tailored to the business model and the complexity of the institution.”

**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 4.3.2) and environmental factors and green lending (Section 4.3.3)?**

**Section 4.3.2, Point 44**: “In particular, institutions should define acceptable leverage levels, including at sector level, when relevant.” - Leverage financing is already regulated by EBA guideline, it is not necessary to regulate/describe it in this guideline. Furthermore it should be on the bank to what extent is relevant to define details specifically in case when such portfolio is insignificant.

**Section 4.3.2, Point 46**: “specific approval requirements and processes in place.” - What is meant by specific approval requirements and process? What is the reason for this deviation from standard underwriting process?

**Section 4.3.3, Point 47:** As for the technology-enabled innovation, we find this part confusing. Firstly, technology-enabled innovation is not properly defined. What is it? For example, from the point of view of 1980s, automated scoring and credit granting would be technology-enabled innovation, yet today it is considered mainstream.

**Section 4.3.4, Points 51-53:** The real impact of environmental factors is difficult to capture in the existing data and experience as we are living during the unprecedented changes in the climate (from the mankind point of view). It is extremely difficult to transmit the expected/forecasted changes to the specific credit decisions, especially in the more granular areas of lending (retail). This part should be reformulated to apply proportionally the existing knowledge and expectations, not guesses.

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

**Section 4.3.5, Point 54**: “The data infrastructure should ensure the continuity, integrity and security of information on the exposure, borrower and collateral from the point of origination and throughout the life cycle of the credit facility.” - What is acceptable level of integrity and security? The key point is that 100 % is impossible.

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

**Section 4.4, Point 59**: “For the purposes of delegated credit decision-making bodies, institutions should set limits on the time period for the delegated powers and the number of delegated approvals.” - This does not make any sense. It only creates useless bureaucracy. Delegated credit decision-making bodies are usually limited in their powers by other parameters, namely perceived risk-levels and volumes of credit-risk cases. We propose to delete the Point 59.

**Section 4.5, Point 76**: “k. performing stress tests on the aggregate credit portfolio as well as on relevant sub-portfolios and geographical segments;” - In case geographical segments (e.g. small countries/economies) do not make sense, they should not be used.

**Our proposal:** “k. performing stress tests on the aggregate credit portfolio as well as on relevant sub-portfolios;”.

**Section 4.5, Point 76**: “l. monitoring of individual exposures through regular credit reviews, including sample reviews of credit lines;” - If the reviews are done in standard process what is to be understood under the sample reviews of credit lines?

There are 3 levels of control in bank:

Level A:

1) Loan origination process,

2) Regular review,

Level B: Monitoring,

Level C: Internal audit and internal control.

We think, this is sufficient.

**Section 4.5, Point 76**: “n. performing assessment of quality assurance of credit assessment taking into account an appropriate sample size, including ensuring that credit risk is properly identified, measured, monitored and managed within the institution´s first line of defence and that relevant regular reporting reaches the institution´s management body.” - We don't understand what is meant by "performing assessment of quality assurance of credit assessment" and how to accomplish it.

**Section 4.7, Point 82**: “a. variable remuneration of the staff involved in credit granting should be linked, among others, to the long-term quality of credit exposures;” - This definitely should not relate to regular staff in underwriting process.

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

**Section 5.1.3, Point 93**: we miss materiality effort/effect definition for professionals or taking into consideration automated credit underwriting process – documentary requirements as well assessment should be in relation to the risk of the customer – rating, ticket size, exposure in relation to clients size should be the driver of the requirements in the area of documentation as well depth of the analysis. List in point 93 is excessive especially for smaller borrowers and should be applied in some proportionality.

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

**Section 5.2.1, Point 99 points a) to d)**: exact definition including examples will be needed:

“99: a. loan to income ratio;

b. loan service to income ratio;”

Only total debt and debt service make sense. How to calculate debt service for overdraft loans, credit cards, off-balance sheet products?

Also **Annex 1:**

**Lending to consumer**: detail definition and explanation of parameters needed,

**Lending to professionals**: we propose to use only relevant and not all of the required risk metrics.

The high level of prescriptiveness of this section raises questions. Let’s take the example of point 99 in relation of the recent exercise of ECB related to Credit Underwriting standards. The cooperation with supervisors has uncovered discrepancy between “common definitions” of risk drivers prescribed by exercise manual, “local legal definitions” required by local legislation (motivated mainly by macro-prudential and consumer protection expectations) and “bank definitions” of other risk drivers used in the bank’s credit underwriting process. While all three types of the definitions aim to capture very similar characteristics, it is questionable whether it makes sense to unify them, taking into account the fact that modelling of risk relies on long time series of risk drivers. Also adding other risk drivers very similar to already existing to the framework does not bring much marginal gains for the effort.

Also, it should be avoided to have two frameworks relying on the similar, yet different parameters, like GL and local framework for curbing the retail lending.

**Section 5.2.5, Points 126, 127**: to apply all this requirements, the asset class Micro (i.e. business loans to the smallest firms and self-employed customers) will be treated corporate like (not retail). Requirements in Points 126 and 127 should apply depending on the segment, product, size of the ticket, i.e. the principle of proportionality should be taken into account.

**Section 5.2.5, Point 128**: single customer view vs. group risk – definition of stand-alone view through indicators is often not reflecting real risk due to most of the corporate transaction relating to „group risk“ (economical connected group of clients) – so we miss possibility to use indicators / assessment has to be made on group level and very limited or no single customer view.

**Section 5.2.5, Point 135**: points a) to h) – from our point of view, part of this financial metrics are already outdated and not used all of them – by implementation new more predictive models and technologies, specific financial metrics can be applied for specific products and data availability. Instead of an exhaustive enumeration, we suggest giving examples.

**Section 5.2.5, Point 136**: “Institutions should assess 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.” - Given that this regulation would lead to either very complicated rules, or it will be only a vague rule burden difficult to follow, we suggest deleting some parts of the sentence.

**Our proposal:** “136. Institutions should assess working capital facility taking into account ability of the borrower to turn the working capital into a cash. 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.”

**Section 5.2.5, Points 138 – 151**: the principle of proportionality should be taken into account:

**Section 5.2.5, Points 138 – 140**: part of the requirements are not realizable, or too complicated to process such metrics and data for smaller entities.

**Section 5.2.5, Point 140**: “a. compare the level of turnover in the current account to the turnover of the financial statements taking into account VAT considerations;

b. compare the level of relevant cash outgoings in the account compared to the financial documentation provided;

c. perform an assessment of the level of unpaid and/or fluctuations into arrears; and

d. assess the seasonality of the business activity and verify any other cash activity of the business within the current account performance history.” - Payments are not the only factor based on which the loan is granted. Although it is relevant indicator such requirements can lead into big inefficiency in the bank.

**Section 5.2.5, Point 144**: “Sensitivity analysis should be proportionate given the purposes, size, complexity, term and potential risk associated with the loan.” - This shall not be applicable to SMEs and for small corporates.

**Section 5.2.5, Point 145**: this requirements are contradictory to possible automatization of approval processes, especially for smaller companies, self-employed customers.

**Section 5.2.5, Points 146 – 147**: subordinate title: “Analysis of the borrower’s business model and strategy” - This is not be used for SMEs in general.

**Section 5.2.5, Point 151**: we consider required information as too detailed.

**Section 5.2.5, Point 156**: “institutions should perform a due diligence of the agent or the designated entity.” - We are missing added value of a due diligence. We propose to delete it.

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

**Section 7.1.1, Point 198**: “Institutions should ensure that external valuers on the panel have adequate and valid professional indemnity insurance.” - This should apply according to the country specifics.

For example Slovakia:

a) The external valuers must be insured by law,

b) The bank is required by law to determine the value of immovable property collateral from several sources.

**Section 7.2.1, Point 207**: “b. credit quality of the loan secured by property, e.g. IFRS9 Stage 1 or Stage 2“ - Value of the property is set independently on the credit quality hence it does not bring any added value. Each property is being re-evaluated on regular basis and changes in market conditions are reflected in the revaluation process.

**Section 7.1.1, Point 208**: “b. the frequency of monitoring of properties and parts with high carrying amount or with high LTV ratio is higher than that of similar properties and parts with low carrying amount or with low LTV ratio; and

c. the frequency of monitoring of loans secured by immovable property or parts of the property with lower credit quality is higher than that of similar loans secured by immovable property or parts of the property with higher credit quality.” - The value of the property is independent on LTV so the higher frequency does not bring any added value.

**Section 7.3, Point 225**: “d. they do not have any direct or indirect interest in the property;

e. they are not related to either the buyer or the seller of the property.” - The banks are unable to ensure with 100 % the obligation under letter e) and it is obviously difficult to accept obligation it is impossible to fulfil.

**Our proposal:** “In order to mitigate any conflict of interest sufficiently, institutions should take reasonable steps to ensure that any valuers who are going to carry out the actual appraisal of a given property and their first-degree relatives meet the following requirements:”

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

**Section 8.3:** Credit review as such for Micro companies (i.e. the smallest companies) and self-employed we consider as over treatment (segment is treated as retail). The size, appropriateness and proportionality should be taken into account.

**Section 8.6:** EWS defined in GL draft is more corporate oriented, banks establish a comprehensive EWS systems compliant with IFRS9 and IRB approach, approved by regulators for retail portfolios. The size, appropriateness and proportionality should be taken into account.

**Section 8.6, Point 263**: “As part of their ongoing monitoring of credit risk institutions should consider the following indicators:” - They need to be framed by the proportionality principle, otherwise, in a transaction-by-transaction approach, there is the risk of burdensome procedures, information and reporting requirements. Calibration of the EWS is the responsibility of each bank.

**Section 8.7:** Watch lists are not implemented as a core part of private individuals retail business.

**Annex 2:** Banks collect information, but in some cases it makes no sense. It should be applied appropriately.

**Lending to consumers**:

* **7**: saving accounts are not part of credit process,
* **17**: For PI guarantees and guarantor are not used in general.

**Lending to professionals:**

* **2**: available only for part of loan (specific types of loans), for private individuals not relevant at all, for Micro (i.e. business loans to the smallest firms and self-employed customers) only for specific segments.