EBA/GL/2020/06

29 May 2020

Final Report

Guidelines on loan origination and monitoring

Contents

Executive Summary

The European Banking Authority (EBA) developed the Guidelines on loan origination and monitoring in response to the Council of the European Union's Action Plan on tackling the high level of non-performing exposures. The European Council, in its July 2017 Action Plan, invited the EBA to 'issue detailed guidelines on banks' loan origination, monitoring and internal governance which could in particular address issues such as transparency and borrower affordability assessment'.

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 standards for credit risk taking, management and monitoring, and that newly originated loans are of high credit quality. The guidelines also aim to ensure that the institutions' practices are aligned with consumer protection rules and respect fair treatment of consumers. Through these objectives, the EBA aims to improve the financial stability and resilience of the EU banking system.

The guidelines specify the internal governance arrangements, processes and mechanisms, as laid down in Article 74(1) of Directive 2013/36/EU (Capital Requirements Directive, CRD) and further specified in the EBA Guidelines on internal governance, and requirements on credit and counterparty risk, as laid down in Article 79 of Directive 2013/36/EU in relation to the granting and monitoring of credit facilities throughout their life cycle.

The guidelines introduce requirements for assessing the borrowers' creditworthiness, together with the handling of information and data for the purposes of such assessments. These guidelines also further specify how to assess the creditworthiness of consumers and use consumer information laid down in Articles 18 and 20 of Directive 2014/17/EU (Mortgage Credit Directive, MCD). Furthermore, the guidelines also recognise the extension of the EBA's scope of action in the review of the European Supervisory Authorities' (ESAs') Founding Regulations and incorporate guidance for the creditworthiness assessment in relation to consumer credit, in accordance with Article 8 of Directive 2008/48/EC on consumer credits (Consumer Credit Directive, CCD).

To support the dual focus of the guidelines, bringing together the prudential framework and consumer protection aspects of credit granting, the guidelines, in particular:

a. clarify the internal governance and control framework for the credit-granting and credit decision-making process, building on the requirements of the EBA Guidelines on internal governance (Section 4);

b. specify requirements for the creditworthiness assessment of borrowers, differentiating between lending to (1) consumers, (2) micro and small enterprises and (3) medium-sized and large enterprises, and set out the requirements for handling information and data for such assessments (Section 5);

c. set out supervisory expectations for the risk-based pricing of loans (Section 6);

d. provide guidance on the approaches to the valuation of immovable and movable property collateral at the point of credit granting, and the monitoring and review of the value of such collateral, based on the outcomes of the monitoring (Section 7);

e. specify the ongoing monitoring of credit risk and credit exposures, including regular credit reviews of borrowers (Section 8).

The EBA has developed these guidelines building on existing national practices and supervisory experience, and also addressing shortcomings in institutions' credit-granting policies and practices, highlighted by the recent financial crisis. At the same time, the guidelines also reflect supervisory priorities and recent policy developments related to credit granting. In particular, the guidelines account for the growing importance of environmental, social and governance factors, and environmentally sustainable lending, anti-money laundering and counter-terrorist financing, as well as the growing use of automated and statistical models and technology-based innovation in the credit granting and collateral valuation.

Next steps

The guidelines will be translated into the official EU languages and published on the EBA's website. The deadline for competent authorities to report whether they comply with the guidelines will be 2 months after the publication of the translations. The guidelines will apply from 30 June 2021.

Background and rationale

1. As part of the EU's response to tackling the high level of non-performing exposures, the Council of the European Union in its July 2017 Action Plan[1] invited the EBA to 'issue detailed guidelines on banks' loan origination, monitoring and internal governance which could in particular address issues such as transparency and borrower affordability assessment'. The Council stressed that 'these guidelines should leverage on existing national experiences where relevant'.

2. Within the framework of the Council's Action Plan, the EBA has already published Guidelines on management of non-performing and forborne exposures[2], Guidelines on disclosures of non-performing and forborne exposures[3] and developed non-performing loan (NPL) transaction templates[4], with a view to improving data quality and information symmetry between institutions and investors in the NPL secondary markets in Europe. These previous initiatives aim to tackle problems around loans once they become non-performing, while the Guidelines on loan origination and monitoring have been developed in order to ensure that institutions have prudential loan origination standards in place, in order to prevent newly originated performing loans from becoming non-performing in the future.

3. The guidelines specify the internal governance arrangements, processes and mechanisms, as laid down in Article 74(1) of Directive 2013/36/EU (CRD)[5] and further specified in the EBA Guidelines on internal governance[6], and requirements on credit and counterparty risk, as laid down in Article 79 of Directive 2013/36/EU in relation to the granting and monitoring of credit facilities throughout their life cycle. The guidelines also set out requirements for the creditworthiness assessment of borrowers, together with the collection of information and data for the purposes of such creditworthiness assessments. These guidelines also further specify the creditworthiness assessment of consumers laid down in Articles 18 and 20 of Directive 2014/17/EU (MCD)[7] and Article 8 of Directive 2008/48/EC on consumer credits (CCD)[8].

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

[1] The Council of the EU's Action Plan to tackle non-performing loans in Europe (https://www.consilium.europa.eu/en/press/press-releases/2017/07/11/conclusions-non-performing-loans/).

[2] EBA/GL/2018/06.

[3] EBA/GL/2018/10.

[4] https://eba.europa.eu/risk-analysis-and-data/eba-work-on-npls

[5] OJ L 176, 27.6.2013 p. 338-436.

[6] EBA/GL/2017/11.

[7] OJ L 60, 28.2.2014 p. 34-85.

[8] OJ L 133, 22.5.2008 p. 66-92.

monitoring, and that newly originated loans are of high credit quality, while respecting and protecting the interests of consumers. By achieving these objectives, the EBA aims to improve the financial stability and resilience of the EU financial system.

5. In accordance with Article 8(1)(a) of the EBA Founding Regulation, the EBA, when carrying out its tasks, may take into account the integration of environmental, social and governance (ESG)-related factors. To this end, in accordance with Article 8(1)(a), these guidelines take into account environmental factors for loan origination and also put in place guidance for monitoring material ESG-related risks.

Structure of the guidelines

6. The main body of the guidelines comprises five sections:

   a. Section 4 provides the details for the application of the general internal governance framework, as set out in the EBA Guidelines on internal governance in relation to the credit-granting process. This section looks into the following topics: (1) credit risk governance and culture, also explaining the specific roles of the management body; (2) credit risk appetite, strategy and credit risk limits, explaining how these concepts fit into the institutions' overall risk appetite framework (RAF) and strategy; (3) credit risk policies and procedures, setting out general and specific criteria to be considered in these policies; (4) the credit decision-making process, highlighting the principle of independence between different (e.g. business and risk) functions in decision-making; (5) setting out the requirements for robust and effective credit risk management and internal control frameworks, as part of the institutions' overall risk management and control frameworks; (6) the resources, skills and information technology (IT) and data infrastructure that institutions should have in place for prudent and robust credit decision-making processes; and (7) the application of general remuneration requirements to credit risk granting, with a view to mitigating excessive risk taking in lending activities.

   In Section 4, the guidelines also set out supervisory expectations for institutions, when their lending activities involve leveraged transactions, technology-enabled innovations, use of automated models in creditworthiness assessments and credit decision-making, an approach to ESG factors and environmentally sustainable lending, and their data infrastructure. Furthermore, Section 4 refers to the application of the anti-money laundering (ALM) and countering the financing of terrorism (CFT) requirements in the context of credit granting. Institutions should note that loans that pose no credit risk may nevertheless pose money laundering (ML) and terrorist financing risk (TF) risk.

   In these guidelines, the EBA is introducing prominently environmentally sustainable lending dimensions, and is setting requirements for institutions to consider ESG factors, environmentally sustainable lending and associated risks in their credit policies and procedures. This is a significant step considering the importance of the topic for the EU, with the three ESAs separately being mandated to develop reports, guidelines and technical standards related to sustainability.

b. The focus of Section 5 is loan origination practices. It specifies (1) the handling and use of documentation of information and data from borrowers for the creditworthiness assessment; (2) assessment of borrowers' creditworthiness; and (3) setting out requirements for credit decisions and loan agreements. The section covers lending to consumers and, with a view to applying the principle of proportionality, provides specific requirements for lending to (1) micro and small enterprises and (2) medium-sized and large enterprises, including both secured and unsecured lending. A set of general requirements for lending to consumers is followed by asset class-/product-specific requirements, including lending to consumers secured by immovable property, lending to consumers secured by other property and unsecured lending to consumers.

   Similarly, the section sets general requirements for lending to micro and small enterprises and medium-sized and large enterprises. The general requirements are followed by asset class-/product-specific requirements, including commercial real estate (CRE), real estate development, leveraged finance, shipping and project finance.

   While all sections of the guidelines apply in relation to the granting and monitoring of all credit facilities, excluding derivatives, debt securities and securities financing transactions, Sections 5 and 6 apply in relation to loans and advances only. Furthermore, 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 and 6, as the creditworthiness assessment of these borrowers would significantly differ from the assessment of traditional loans to consumers and enterprises.

c. Section 6 sets out supervisory expectations for the risk-based pricing of loans, listing a set of risk-based elements that institutions should consider and reflect when pricing newly originated loans, without prescribing any specific pricing strategies and interfering with business decision-making responsibilities. The objective of this section is to ensure that institutions implement a comprehensive framework for the pricing of loans. This section does not prescribe any particular pricing strategies, as that remains the business responsibility of institutions themselves.

d. Section 7 looks at the requirements for the valuation of immovable and movable property collateral (excluding financial collateral) at the point of origination of credit facilities as well as throughout the life cycle of the loans, including monitoring and revaluation (i.e. a review of the value of the collateral). In this section, the guidelines spell out supervisory expectations for independent valuers and conditions that allow advanced statistical models to be used by institutions for the valuation, monitoring and revaluation of various forms of collateral.

e. Section 8 of the guidelines focuses on supervisory requirements for the ongoing monitoring of credit risk and credit exposures, including regular credit reviews of at least medium-sized and large enterprises. In this section, the EBA also sets out supervisory expectations for the management information systems to be used for monitoring and the framework of early warning indicators/watch lists, thus building the link between the ongoing monitoring and early detection of loans with deteriorating credit quality that are also covered in the EBA Guidelines on management of non-performing and forborne exposures.

7. The guidelines are supported by three annexes presenting a set of considerations for credit-granting criteria (Annex 1), information and data needs for the purposes of creditworthiness assessment (Annex 2), and metrics that can be used in credit granting and monitoring (Annex 3).

Interaction between prudential and consumer protection frameworks

8. Sound lending practices employed by institutions for effective assessment of a borrowers' creditworthiness at the point of loan origination are important from both a prudential point of view and a consumer protection perspective. Failure to complete an accurate and thorough creditworthiness assessment may have negative consequences for institutions and borrowers, and affect overall financial stability, as borrowers may not be able to meet their contractual commitments under the loan agreements. As a result, the level of non-performing exposures in the markets may increase. The EBA statutory objectives include both prudential and financial stability as well as consumer protection. To this end, it is important that the guidelines reflect these objectives and address the issues of loan origination and creditworthiness assessments, from both a prudential and a consumer protection angle, as indicated in the Council's Action Plan.

9. The creditor's obligation, prior to the conclusion of the agreement, to assess a borrower's creditworthiness is intended to protect consumers against the risks of over-indebtedness and bankruptcy, and therefore ensure responsible lending. The consumer protection perspective of these guidelines is of particular importance when specifying the requirements for the creditworthiness assessment in the context of lending to consumers and the collection of information and data for this assessment. The requirements of these guidelines provide further details on the creditworthiness assessment of consumers and the verification of consumer information, as laid down in Articles 18 and 20 of Directive 2014/17/EU when dealing with lending secured by residential immovable property and Article 8 of Directive 2008/48/EC when dealing with unsecured consumer lending.

10. The EBA has previously issued guidelines specifying creditworthiness assessment for credit agreements with consumers in respect of credit agreements that fall under the scope of

Article 3 of Directive 2014/17/EU: EBA Guidelines on creditworthiness assessment[9]. Given the dual focus of the Guidelines on loan origination and monitoring, the EBA decided to fully incorporate the EBA Guidelines on creditworthiness assessment into the new guidelines and repeal them, with effect from the date of application of these guidelines.

11. Incorporating consumer protection aspects into these guidelines and integrating (and repealing) the Guidelines on creditworthiness assessment under the MCD ensure that there is a comprehensive set of guidelines covering creditworthiness assessment from prudential and consumer protection angles, across different types of institutions, asset classes and loan products. This is of particular importance for institutions subject to the CRD, the MCD and the CCD (e.g. credit institutions offering loans falling within the scope of the MCD or consumer loans), which will need to implement only one set of guidelines on creditworthiness assessment.

12. These guidelines take into account the EBA's scope of action, which has been amended through a review of the ESA Founding Regulations. The review brings Directive 2008/48/EC on consumer credits (the CCD) into the EBA's scope of action. The new EBA scope of action is applicable as of 1 January 2020, which means that the new scope is applicable before the application date of these guidelines.

13. While taking into account the protection of consumers' interests, notably with regard to creditworthiness assessment, these guidelines go further, as they require institutions to also take account of those interests in the credit risk policies and procedures, credit-granting criteria and the design of the credit products that are offered to consumers.

Proportionality and implementation

14. The implementation of these guidelines is subject to the principle of proportionality, and the proportionality principle is interpreted and applied differently for various sections of the guidelines. First, for the implementation of the requirements related to internal governance, risk management and control, institutions and competent authorities should consider a proportionality principle that is based on, inter alia, the size, nature and complexity of the institutions and other criteria set out for the purposes of the principle of proportionality, defined in the EBA Guidelines on internal governance.

15. Second, when implementing the requirements for the creditworthiness assessment, collateral valuation and credit risk monitoring, competent authorities and institutions, instead of the size and complexity of institutions, should consider the type, size and complexity of the credit facilities being originated or monitored, because these are the main drivers that could give rise to a disproportionate application of the guidelines. Furthermore, the proportionality in the collateral valuation is also driven by the size, nature and complexity of the collateral and the relationship between the loan and collateral, whereas the degree of sophistication of the

[9] EBA/GL/2015/11.

monitoring framework and intensity of the actual monitoring will also be driven by the type, size and risk profile of the borrower.

16. 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, complexity and risk profile of the loans that the institutions are originating or credit facilities that they are monitoring.

17. However, under the MCD and the CCD, the concept of proportionality and appropriateness applies in a general way, and not only in relation to size a loan has for the institution or creditor. This is because the main objective of these directives is founded on consumer protection. Building on that, and in order to ensure the full effect of these guidelines with regard to consumer protection, these guidelines also provide that the proportionate application to the size of loan, as set out above, should not result in any impairment of consumer protection, as envisaged in the MCD and the CCD.

18. These guidelines apply from 30 June 2021, meaning that (1) the competent authorities should implement these guidelines by incorporating them into their supervisory processes and procedures, and (2) institutions should implement them in their business practices by 30 June 2021. The guidelines also envisage specific phase-in requirements for addressing data gaps in the monitoring of already existing credit facilities up until 30 June 2024.

19. It should be noted that the requirements for loan origination in Section 5 of these guidelines apply also to loans and advances that already exist on the application date if their terms and conditions have been changed after the application date, provided that the changes follow a specific credit decision approval, and if their implementation requires a new loan agreement with the borrower or an addendum to the existing agreement.

Guidelines

EBA/GL/2020/06

29 May 2020

Guidelines

on loan origination and monitoring

1. Compliance and reporting obligations

Status of these guidelines

1. This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010[10]. In accordance with Article 16(3) of Regulation (EU) No 1093/2010, competent authorities and financial institutions must make every effort to comply with the guidelines.

2. The guidelines set the European Banking Authority's (EBA's) view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. Competent authorities, as defined in Article 4(2) of Regulation (EU) No 1093/2010, to whom guidelines apply should comply by incorporating them into their practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including when guidelines are directed primarily at institutions.

Reporting requirements

3. According to Article 16(3) of Regulation (EU) No 1093/2010, competent authorities must notify the EBA whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance, by (. In the absence of any notification by this deadline, competent authorities will be considered by the EBA to be non-compliant. Notifications should be sent by submitting the form available on the EBA website to compliance@eba.europa.eu, with the reference 'EBA/GL/2020/06'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities. Any change in the status of compliance must also be reported to the EBA.

4. Notifications will be published on the EBA website, in line with Article 16(3) of Regulation (EU) No 1093/2010.

[10] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, (OJ L 331, 15.12.2010, p. 12).

2. Subject matter, scope and definitions

Subject matter

5. These guidelines specify the internal governance arrangements, processes and mechanisms, as laid down in Article 74(1) of Directive 2013/36/EU[11], requirements on credit and counterparty risk, as laid down in Article 79 of that directive, and requirements in relation to the creditworthiness assessment of the consumer, as laid down in Chapter 6 of Directive 2014/17/EU[12] and Article 8 of Directive 2008/48/EC[13].

Scope of application

6. These guidelines apply to institutions, as defined in point 3 of Article 4(1) of Regulation (EU) No 575/2013. When the loan falls under the scope of Directive 2014/17/EU (the Mortgage Credit Directive, MCD), Section 5 applies to creditors, as defined in Article 4(2) of this directive, except for paragraph 93. When the loan falls under the scope of Directive 2008/48/EC (the Consumer Credit Directive, CCD), Section 5 applies to creditors, as defined in point (b) of Article 3 of that directive, except for paragraphs 93.

7. These guidelines apply to institutions' internal governance arrangement and procedures in relation to credit-granting processes, and throughout the life cycle of credit facilities. Furthermore, these guidelines apply to the risk management practices, policies, processes and procedures for loan origination and monitoring of performing exposures, and their integration into the overall management and risk management frameworks.

8. Sections 4 and 8 apply in relation to all credit risk being taken by institutions, excluding debt securities, derivatives and securities financing transactions.

9. Sections 5 and 6 apply to loans to consumers, micro and small enterprises, and medium-sized and large enterprises. Sections 5 and 6 do not apply to loans and advances to credit institutions, investment firms, financial institutions, insurance and reinsurance undertakings, and central banks, and loans and advances to sovereigns, including central governments, regional and local authorities, and public sector entities. Sections 5 and 6 do not apply to forborne and non-performing loans.

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[11] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, (OJ L 176, 27.6.2013, p. 338-436).

[12] Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010, (OJ L 60, 28.2.2014, p. 34-85).

[13] Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC, (OJ L 133, 23.4.2008, p. 66-92).

10. Competent authorities may consider applying Sections 6 and 7 to creditors that fall within the scope of Directive 2014/17/EU and Directive 2008/48/EU and are not credit institutions.

11. When, in the context of real estate lending, a property has a mixed use, such as residential and commercial real estate (CRE), the property should be either classified in line with its dominant use or considered as separate properties, based on the area dedicated to each use. If such an assessment cannot be objectively performed (e.g. certain parts of the property may be available for common use by everybody), the property could be classified in line with its dominant use.

12. Competent authorities should ensure that institutions apply these guidelines on individual, sub-consolidated and consolidated bases, in accordance with Article 109 of Directive 2013/36/EU, unless competent authorities make use of the derogations, as defined in Article 21 and Article 109 of Directive 2013/36/EU. Competent authorities should also ensure that the institutions apply these guidelines at sub-consolidated and individual levels, in line with the consolidated-level group policies and practices, taking into account the characteristics of these institutions and their credit portfolios.

Addressees

13. These guidelines are addressed to competent authorities, as defined in points (i), (iii), (vi) and (vii) of Article 4(2) of Regulation (EU) No 1093/2010, and financial institutions, as defined in Article 4(1) of Regulation No 1093/2010.

Definitions

14. Unless otherwise specified, terms used and defined in Regulation (EU) No 575/2013, Directive 2013/36/EU, Directive 2014/17/EU, Directive 2008/48/EC, the EBA Guidelines on internal governance under Directive 2013/36/EU[14], the EBA Guidelines on connected clients under point 39 of Article 4(1) of Regulation (EU) No 575/2013[15], the EBA and European Securities and Markets Authority (ESMA) Guidelines on the assessment of the suitability of members of the management body and key function holder[16], the EBA Guidelines on sound remuneration policies under Articles 74(3) and 75(2) of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) No 575/2013[17], the EBA Guidelines on remuneration policies and practices for sales staff[18], the EBA Guidelines on outsourcing arrangements[19], the EBA Guidelines on institutions' stress testing[20], and the Commission Recommendation of 6 May

[14] EBA/GL/2017/11.
[15] EBA/GL/2017/15.
[16] EBA/GL/2017/12.
[17] EBA/GL/2015/22.
[18] EBA/GL/2016/06.
[19] EBA/GL/2019/02.
[20] EBA/GL/2018/04.

2003 concerning the definition of micro, small and medium-sized enterprises[21] have the same meaning in these guidelines.

15. In addition, for the purposes of these guidelines, the following definitions apply:

Credit decision-maker	means a credit committee or committees and individual staff members with delegated credit decision-making powers, as set out within the credit decision-making framework specified in the institutions' policies and procedures.
Commercial real estate	has the same meaning as under point (4) of paragraph (1) of Section 2, 1. Definitions Recommendation ESRB/2016/14[22].
Environmentally sustainable lending	means lending to finance environmentally sustainable economic activities. It is part of the wider concept of 'sustainable finance', meaning any financial instrument or investment, including equity, debt, guarantee or a risk management tool, issued in exchange for the delivery of financing activities that meeting criteria for being environmentally sustainable.
Loan	means loans and advances, as defined in Annex V to Commission Implementing Regulation (EU) No 680/2014.
Project finance	means the financing of all activities of micro, small, medium-sized and large enterprises (including special purpose vehicles established for the project) involved in projects in which the financial servicing of credit facilities is primarily dependent on the cash flow from sales of the project, and all the assets of the project are pledged to the institution financing the project.
Single customer view	means a single, consistent view of all of a customer's assets and liabilities held at an institution or a creditor on a consolidated basis, including information on all financial commitments, including their repayment history at the institution or the creditor.
Shipping finance	means the financing of all activities involved in the building, acquisition and operation of ships and offshore installations, when the financial servicing of credit facilities

[21] Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (OJ L 124, 20/05/2003, p. 0036-0041).

[22] Recommendation of the European Systemic Risk Board amending Recommendation ESRB/2016/14 on closing real estate data gaps ESRB/2019/3 (OJ C 271, 13.8.2019).

	is primarily dependent on the cash flow from operating or selling these ships or offshore installations, or when the collateral is structured around the ships or offshore installations, shipbuilding or various charter arrangements.
Source of repayment capacity	means the borrower's total funds, cash flow and payment behaviour considerations, as registered by the credit provider at the moment of the loan origination, covering all sources of cash inflows (such as income, regular private transfers — alimonies, rental income from real estate property, income from financial investments, income from private businesses or partnerships, income from other sources), funds (such as saving accounts, investment products) and regular expenses.

Proportionality

16. In order to ensure a proportionate application of these guidelines, the following criteria should be taken into account:

    a. for Section 4, the criteria as set out in Title I of the EBA Guidelines on internal governance;

    b. for Section 5, the size, nature and complexity of the credit facility, without prejudice to Articles 18 and 20 of Directive 2014/17/EU and Article 8 of Directive 2008/48/EU;

    c. for Section 7, the size, nature and complexity of the credit facility and the collateral;

    d. for Section 8, the size, nature and complexity of the institution; the size, nature, complexity of the credit facility; and the type, size and risk profile of the borrower.

17. In relation to lending to consumers, institutions and creditors should ensure that the application of paragraph 16 does not impair the objective of consumer protection, as laid down in Directive 2008/48/EU, Directive 2014/17/EU and further specified in these guidelines, and in particular in Section 5.1 and Sections 5.2.1, 5.2.2, 5.2.3 and 5.2.4.

3. Implementation

Date of application

18. These guidelines apply from 30 June 2021.

19. Sections 5 and 6 apply to loans and advances that are originated after 30 June 2021. Section 5 also applies to loans and advances that already exist on 30 June 2021 if their terms and conditions have been changed after 30 June 2022, provided that the changes follow a specific credit decision approval, and if their implementation requires a new loan agreement with the borrower or an addendum to the existing agreement.

20. Section 7 applies to any valuation, monitoring and revaluation of immovable property and movable property collateral, excluding financial collateral, conducted after 30 June 2021.

21. Section 8 applies to all credit facilities originated after 30 June 2021.

Transitional provisions

22. These specific provisions of the guidelines are subject to the following transitional arrangements, though competent authorities may accelerate this transition at their own discretion:

    In relation to Section 8, if institutions do not have all the relevant information and data, as specified in these guidelines, to be used for the monitoring of existing borrowers or credit facilities granted before the application date, institutions should collect missing information and data until 30 June 2024, through regular credit review of borrowers, as set out in these guidelines.

Repeal

23. The following guidelines are repealed, with effect from the date of application of these guidelines:

    Guidelines on creditworthiness assessment (EBA/GL/2015/11).

4. Internal governance for credit granting and monitoring

24. In addition to the provisions set out in the EBA Guidelines on internal governance, institutions should apply further conditions in relation to credit granting and monitoring, as set out in this section.

4.1 Credit risk governance and culture

4.1.1 Responsibilities of the management body

25. The management body, as referred to in the EBA Guidelines on internal governance, in relation to credit granting, should:

    a. approve the institution's credit risk strategy, within the overall risk strategy, and business strategy, to ensure that they are in line with the institution's risk appetite framework (RAF), capital and liquidity planning, and are in line with the internal capital adequacy assessment process (ICAAP) and internal liquidity adequacy assessment process (ILAAP), when relevant;

    b. set the credit risk appetite within the overall RAF, including credit-granting standards, qualitative statements, quantitative metrics and limits, and escalation thresholds, without business performance biases;

    c. approve the framework for the credit approval process, including, when relevant, the internal structures for credit granting and monitoring, and defining delegated decision-making authorities;

    d. ensure an effective oversight of credit risk quality, in particular at the point of credit granting, and provisioning;

    e. ensure adequate credit approval, monitoring and control processes, for the purposes of effective credit risk management;

    f. ensure that all staff involved in credit risk taking, and the managing, monitoring and controlling of credit risk, are adequately skilled, resourced and experienced;

    g. set, approve and oversee the implementation of the institution's risk culture, core values and expectations regarding credit risk;

h. ensure that the remuneration framework, including any relevant performance targets, and the performance assessment framework for credit decision-makers who are identified staff remain aligned with the credit risk and credit risk appetite.

4.1.2 Credit risk culture

26. Institutions should develop a credit risk culture as part of the overall risk culture through policies, communication and staff training, in accordance with the EBA Guidelines on internal governance.

27. The credit risk culture should include an adequate 'tone from the top' and ensure that credit is granted to borrowers who, to the institution's best knowledge at the time of granting the credit, will be able to fulfil the terms and conditions of the credit agreement, and is secured, when relevant, by sufficient and appropriate collateral, where relevant, and considering the impact on the institution's capital position and profitability, and sustainability, and related environmental, social and governance (ESG) factors.

28. Institutions should ensure that a credit risk culture is implemented effectively across all levels of the institution, and that all members of staff involved in the credit risk-taking, credit risk management and monitoring processes are fully aware of it and they will be held accountable for their actions.

29. Institutions should adopt policies and processes to monitor adherence of all staff members involved in credit-granting, monitoring and control processes to the institution's credit risk culture (e.g. by means of self-assessments carried out by staff members). In situations in which there are noted deficiencies in the credit culture, evidenced either via an institution's self-assessment or via supervisory actions, the institution should take well-defined, outcome-driven and timely actions to remediate these deficiencies. The credit risk strategy, credit policies and procedures should be tailored to mitigate any potential negative effects arising from a poor credit culture.

4.2 Credit risk appetite, strategy and credit risk limits

30. The credit risk appetite, credit risk strategy and the overall credit risk policy should be aligned with the institution's overall RAF. The institution's credit risk appetite should specify the scope and focus of the credit risk of the institution, the composition of the credit portfolio, including its concentration, and diversification objectives in relation to business lines, geographies, economic sectors and products.

31. The credit risk appetite should be implemented with the support of appropriate credit risk metrics and limits. These metrics and limits should cover key aspects of the credit risk appetite, as well as client segments, currency, collateral types and credit risk mitigation instruments. When relevant, credit metrics should be a combination of backward-looking and forward-

looking indicators and should be tailored to the business model and complexity of the institution.

32. Institutions should ensure that the credit risk appetite and associated metrics and limits are appropriately cascaded down within the institution, including all relevant group entities and business lines and units bearing credit risk.

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

4.3 Credit risk policies and procedures

34. Institutions should set out, in their credit risk policies and procedures, the criteria for identifying, assessing, approving, monitoring, reporting and mitigating credit risk, and the criteria for measuring allowances for both accounting and capital adequacy purposes. Institutions should document the framework and update it regularly.

35. The objective followed in credit risk policies and procedures should be to promote a proactive approach to monitoring credit quality, identifying deteriorating credit early and managing the overall credit quality and associated risk profile of the portfolio, including through new credit-granting activities.

36. Credit risk policies and procedures should cover all lending activities, asset classes, client segments, products and specific credit facilities, credit risk management practices, and associated responsibilities and controls.

37. Credit risk policies and procedures should include specific lending policies and procedures, with sufficient granularity to capture the specific business lines of the institution, for different sectors, in line with their varying complexities and sizes, and risks of different market segments related to the credit facility.

38. Credit risk policies and procedures should specify:

    a. policies and procedures and rules for the approval of credit granting and decision-making, including appropriate authorisation levels set in accordance with the credit risk appetite and limits;

    b. credit-granting criteria, taking into account the items referred to in Annex 1;

    c. requirements for the handling of information and data needed for the creditworthiness assessment, as set out in Section 5.1;

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

e. requirements for exposure aggregation and credit risk limits and the management of credit risk concentrations;

f. requirements and procedures regarding the acceptance and use of collateral and credit risk mitigation measures, to determine their effectiveness in minimising the inherent risk of a credit facility — such requirements and procedures should be asset class-specific and product type-specific and should duly consider the type, size and complexity of the credit facilities being granted;

g. conditions for the application of automated decision-making in the credit-granting process, including identifying products, segments and limits for which automated decision-making is allowed;

h. a risk-based approach, addressing possible deviations from standard credit policies and procedures and credit-granting criteria, including:

    i. conditions defining the approval process for deviations and exceptions and the specific documentation requirements, including the audit trail;

    ii. criteria for rejections and criteria for the escalation of deviations/exceptions to higher levels of the decision-making authority (including overrides, overrules, exposures possibly approved as an exception to general lending standards and other non-standard business under a special process with different approval authorities);

    iii. requirements for the monitoring of circumstances and conditions for an exceptional credit-granting decision, including requirements for their review by the relevant functions during the regular review of the application and compliance with policies and limits;

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

j. requirements for monitoring credit-granting activities — the internal control framework should ensure that it covers all phases after the granting of credit;

k. where applicable, the criteria as set out in Sections 4.3.2, 4.3.3, 4.3.4, 4.3.5 and 4.3.6;

l. criteria as set out in Section 4.3.1 and 4.3.7.

39. Within their credit risk policies and procedures and building on the credit risk strategy, institutions should also take into account principles of responsible lending. In particular:

    a. they should consider the specific situation of a borrower, such as the fair treatment of borrowers that are in economic difficulties;

    b. they should design credit products that are offered to consumers in a responsible way.

40. For the credit products that are offered to consumers, institutions should ensure that the credit-granting criteria are not inducing undue hardship and over-indebtedness for the borrowers and their households.

41. In their credit risk policies and procedures dealing with credit decision-making as referred to in paragraph 38(a) and creditworthiness assessments as referred to in paragraph 38(d), institutions should also specify the use of any automated models in the creditworthiness assessment and credit decision-making processes in a way that is appropriate to the size, nature and complexity of the credit facility and the types of borrowers. In particular, institutions should set out appropriate governance arrangements for the design and use of such models and the management of the associated model risk, taking into account the criteria set out in Section 4.3.4, and for model risk-related aspects of the EBA Guidelines on the supervisory review and evaluation process[23].

42. Institutions should ensure that the credit risk policies and procedures are designed to minimise the risk of internal or external fraud in the credit-granting process. Institutions should have adequate processes in place to monitor any suspicious or fraudulent behaviour.

43. Institutions should review the credit risk policies and procedures on a regular basis, and for this purpose should clearly identify the functions and staff members tasked with maintaining specific policies and procedures to date and their roles and responsibilities in this regard.

4.3.1 Anti-money laundering and counter-terrorist financing policies and procedures

44. Institutions should also specify in their policies how they identify, assess and manage the money laundering and terrorist financing (ML/TF) risks to which they are exposed as a result of their credit-granting activities[24]. In particular, institutions should:

    a. at the level of their business, identify, assess and manage the ML/TF risk associated with the type of customers they serve, the lending products they provide, the geographies to which they are exposed and the distribution channels they use;

[23] EBA/GL/2014/13.

[24] Directive (EU) 2015/849 requires institutions to put in place and maintain effective policies and procedures to prevent ML/TF and to detect and deter it should it occur. Institutions should also refer to the ESAs' Joint Risk Factors Guidelines (JC 2017 37) for further information on these points.

b. at the level of the individual relationship, identify, assess and manage the ML/TF risk associated with this relationship — as part of this, institutions should:

   i. consider the purpose of the credit;

   ii. consider the extent to which the association of a natural person or legal person that is neither the borrower nor the institution with the credit facility gives rise to ML/TF risk;

   iii. in particular, in situations in which the ML/TF risk associated with the individual relationship is established, institutions should take risk-sensitive measures to understand if the funds used to repay the credit, including cash or equivalents provided as collateral, are from legitimate sources. When considering the legitimacy of the source of funds, institutions should have regard to the activity that generated the funds and whether this information is credible and consistent with the institution's knowledge of the customer and the customer's professional activity.

45. Institutions should have internal processes to ensure that the information obtained for the purposes of creditworthiness assessment, such as the information specified in Section 5.1 and Annex 2 of these guidelines, also informs their anti-money laundering and countering financing of terrorism (AML/CFT) processes.

46. Institutions should have policies and procedures in place to ensure that the disbursement of loans is made in line with the credit decision and the loan agreement. They should also ensure that there are appropriate checks in place to identify, assess and manage ML/TF risks, and that relevant records are kept, in line with institutions' wider AML/CFT obligations under Directive (EU) 2015/849.

4.3.2 Leveraged transactions

47. As part of their policies and procedures, institutions should have in place an overarching definition of leveraged transactions that takes into consideration the level of leverage of the borrower and the purpose of the transaction. This definition should encompass all business lines and units bearing credit risk.

48. The scope and implementation of the definition of a leveraged transaction by an institution should be regularly reviewed to ensure that no undue exclusion has been made.

49. Institutions should define their appetite and strategy for leveraged transactions in a way that encompasses all relevant business units involved in such operations. Institutions should define which types of leveraged transactions they are prepared to enter into, as well as acceptable values for parameters, such as rating note, probability of default, level of collateralisation and leverage levels, including at sector level, when relevant.

50. Institutions should define their risk appetite for syndicating leveraged transactions and derive a comprehensive limit framework, including dedicated underwriting limits and a granular set of sub-limits, detailing both maximum limits and the nature of transactions that the institution is prepared to participate in.

51. Institutions should establish a sound governance structure for leveraged transactions, enabling a comprehensive and consistent oversight of all leveraged transactions originated, syndicated or purchased by them, including, when relevant, 'best efforts' deals and 'club deals', as well as standard bilateral loans to micro, small, medium-sized and large enterprises.

52. Institutions should ensure that all leveraged transactions are adequately reviewed, in line with institutions' risk appetite, strategies and policies, and approved by relevant credit decision-makers. For transactions including syndication and underwriting risks, there should be specific approval requirements and processes in place.

4.3.3 Technology-enabled innovation for credit granting

53. When using technology-enabled innovation for credit-granting purposes, institutions should do the following:

    a. Adequately capture, in their risk management and control frameworks, the inherent risks associated with the technology-enabled innovation in use. This should be commensurate with the business model, credit risk exposure, complexity of the methods and the extent of the use of technology-enabled innovation.

    b. Ensure that the management body has a sufficient understanding of the use of technology-enabled innovation, its limitation and the impact it has on credit-granting procedures.

    c. Understand the underlying models used, including their capabilities, assumptions and limitations, along with ensuring their traceability, auditability, and robustness and resilience.

    d. Ensure that the models are fit for purpose, taking into account the identified task and other criteria, such as its performance and use. If explanations are required during the models' use, then consideration should be given to developing an interpretable model.

    e. Understand the quality of data and inputs to the model and detect and prevent bias in the credit decision-making process, ensuring that appropriate safeguards are in place to provide confidentiality, integrity and availability of information and systems.

    f. Ensure the performance of the model, including the validity and quality of its outputs, is continuously monitored and appropriate remediation measures are taken in a timely manner in the case of detected issues (e.g. worsening or deviating from expected behaviour).

4.3.4 Models for creditworthiness assessment and credit decision-making

54. When using automated models for creditworthiness assessment and credit decision-making, institutions should understand the models used, and their methodology, input data, assumptions, limitations and outputs, and should have in place:

    a. internal policies and procedures detecting and preventing bias and ensuring the quality of the input data;

    b. measures to ensure the traceability, auditability, and robustness and resilience of the inputs and outputs;

    c. internal policies and procedures ensuring that the quality of the model output is regularly assessed, using measures appropriate to the model's use, including backtesting the performance of the model;

    d. control mechanisms, model overrides and escalation procedures within the regular credit decision-making framework, including qualitative approaches, qualitative risk assessment tools (including expert judgement and critical analysis) and quantitative limits.

55. Institutions should have adequate model documentation that covers:

    a. methodology, assumptions and data inputs, and an approach to detecting and preventing bias and ensuring the quality of input data;

    b. the use of model outputs in the decision-making process and the monitoring of these automated decisions on the overall quality of the portfolio or products in which these models are used.

4.3.5 Environmental, social and governance factors

56. Institutions should incorporate ESG factors and associated risks in their credit risk appetite and risk management policies, credit risk policies and procedures, adopting a holistic approach.

57. Institutions should take into account the risks associated with ESG factors on the financial conditions of borrowers, and in particular the potential impact of environmental factors and climate change, in their credit risk appetite, policies and procedures. The risks of climate change for the financial performance of borrowers can primarily materialise as physical risks, such as risks to the borrower that arise from the physical effects of climate change, including liability risks for contributing to climate change, or transition risks, e.g. risks to the borrower that arise from the transition to a low-carbon and climate-resilient economy. In addition, other risks can occur, such as changes in market and consumer preferences and legal risks that may affect the performance of underlying assets.

4.3.6 Environmentally sustainable lending

58. Institutions that originate or plan to originate environmentally sustainable credit facilities should develop, as part of their credit risk policies and procedures, specific details of their environmentally sustainable lending policies and procedures, covering the granting and monitoring of such credit facilities. These policies and procedures should, in particular:

    a. Provide a list of the projects and activities, as well as the criteria, that the institution considers eligible for environmentally sustainable lending or a reference to relevant existing standards on environmentally sustainable lending that define what type of lending is considered to be environmentally sustainable;.

    b. Specify the process by which the institutions evaluating that the proceeds of the environmentally sustainable credit facilities they have originated are used for environmentally sustainable activities. In cases of lending to enterprises, the process should include:

        i. collecting information about the climate-related and environmental or otherwise sustainable business objectives of the borrowers;

        ii. assessing the conformity of the borrowers' funding projects with the qualifying environmentally sustainable projects or activities and related criteria;

        iii. ensuring that the borrowers have the willingness and capacity to appropriately monitor and report the allocation of the proceeds towards the environmentally sustainable projects or activities;

        iv. monitoring, on a regular basis, that the proceeds are allocated properly (which may consist of requesting that borrowers provide updated information on the use of the proceeds until the relevant credit facility is repaid).

59. 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, when relevant, 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 in line with or is contributing to their overall climate-related and environmentally sustainable objectives.

4.3.7 Data infrastructure

60. Institutions should have appropriate data infrastructure as well as relevant policies and procedures to support the credit-granting process and for the purposes of credit risk management and monitoring throughout the life cycle of the credit facilities (e.g. loan origination and creditworthiness assessment, risk assessment, credit review and monitoring). 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.

61. The data infrastructure should be detailed and sufficiently granular to capture specific loan-by-loan information, in particular actual credit-granting criteria applied at the point of origination, allowing data regarding the borrower to be linked with data regarding collateral, to support the effective monitoring of credit risk (see Section 8) and enable effective audit trailing, operational and credit performance and efficiency measurement, as well as the tracking of policy deviations, exceptions and overrides (including credit/transaction rating or scoring overrides).

62. For the purposes of designing and maintaining this data infrastructure, institutions should consider using the relevant data fields from the EBA's NPL transaction templates[25].

4.4 Credit decision-making

63. Institutions should establish a clear and well-documented credit decision-making framework that should set out a clear and sound structure for the credit decision-making responsibilities within an institution, including a description of the hierarchy of the credit decision-makers and their allocation within the institution's organisational and business structure and their reporting lines.

64. The structure of credit decision-makers should be in line with and integrated into credit risk appetite, policies and limits and reflect the business model of the institutions. The allocation of credit decision-makers to the organisational and business structure should reflect the cascading credit risk appetite and limits within an organisation and be based on objective criteria, including risk indicators.

65. The credit decision-making framework should clearly articulate the decision-making powers and limitations of each decision-maker and of any automated models for credit decision-making purposes, in line with the criteria for such models set out in Section 4.3.4. These powers and limitations should account for the characteristics of the credit portfolio, including its concentration and diversification objectives, in relation to business lines, geographies, economic sectors and products, as well as credit limits and maximum exposures. Where relevant, institutions should set time limits for the delegated powers or the size of delegated approvals.

66. When delegating credit decision-making powers, including limits, to members of staff, institutions should consider the specificities of the credit facilities subject to this individual decision-making, including their size and complexity, and the types and risk profiles of borrowers. Institutions should also ensure that these staff members are adequately trained and hold relevant expertise and seniority in relation to the specific authority delegated to them.

[25] https://eba.europa.eu/risk-analysis-and-data/eba-work-on-npls

67. The credit decision-making framework should account for the risk perspective in the decision-making. It should also take into account the specificities of credit products and borrowers, including the type of product, the size of credit facility or limit, and the risk profile of the borrower.

68. The framework should also specify the working modalities of the credit committees and the roles of their members, including, when applicable, aspects such as voting procedures (unanimity or simple majority of votes).

69. If the institutions grant specific veto rights in relation to positive credit decisions to the head of the risk management function, institutions should consider granting such veto rights to additional staff members within the risk management function for specific credit decisions, to ensure that such a veto can be exercised, if appropriate, at all levels of the credit decision-making framework below the management body. Institutions should specify the scope of these veto rights, the escalation or appeal procedures, and how the management body will be involved.

4.4.1 Objectivity and impartiality in credit decision-making

70. Institutions should ensure that decisions taken by credit decision-makers are impartial and objective and not adversely affected by any conflict of interest, in line with the EBA Guidelines on internal governance. More specifically, for the purposes of these guidelines, institutions should ensure that any individual involved in credit decision-making, such as members of staff and members of the management body, should not take part in credit decisions if any of the following occurs:

    a. any individual involved in credit decision-making has a personal or professional relationship (outside the professional relationship when representing the institution) with the borrower;

    b. any individual involved in credit decision-making has an economic or any other interest, including direct or indirect, actual or potential, financial or non-financial, associated with the borrower;

    c. any individual involved in credit decision-making has undue political influence on or a political relationship with the borrower.

71. Notwithstanding the governance structures implemented in institutions to operationalise the credit decision-making framework, institutions should have policies, procedures and organisational controls in place that guarantee and ensure objectivity and impartiality in the credit decision-making process. These policies, procedures and organisational controls, including any mitigating measures, should be clearly defined and understood, and should address any potential conflicts of interest. Institutions should ensure effective oversight of the decisions taken by credit decision-makers, including credit granting, to ensure their objectivity and impartiality.

4.5 Credit risk management and internal control frameworks

72. In accordance with the EBA Guidelines on internal governance, institutions should implement a robust and comprehensive internal control framework, including credit risk management, respecting inter alia the principles of accountability, segregation and independence of functions and responsibilities, challenge and assurance of outcomes.

73. Risk management and internal controls for credit risk should be integrated into the institution's overall risk management and internal control frameworks, as well as into the organisational and decision-making structure. Institutions should ensure that the internal control framework, including credit risk management, supports robust and appropriate credit risk taking, analysis, and monitoring throughout the life cycle of a credit facility, including the design and development of the specific product, sales and administration.

74. Institutions should establish regular and transparent reporting mechanisms so that the management body, its risk committee, if established, and all relevant units or functions are provided with reports in a timely, accurate and concise manner and can take informed and effective actions within their respective mandates, to ensure the identification, measurement or assessment, monitoring and management of credit risk (see also Section 8).

75. Institutions should define, in a clear and transparent manner, the allocation of responsibilities and authority within the organisation, including within and between business lines, units and functions, including risk management. To this end, institutions should clearly define functions responsible for performing the various tasks related to credit risk taking and the credit decision-making process, specified in a way that does not lead to a conflict of interest and ensures the effective management of credit risk.

76. The business lines and units originating the credit risk should be primarily responsible for managing the credit risk generated by their activities throughout the lifetime of the credit. These business lines and units should have adequate internal controls in place to ensure adherence with internal policies and relevant external requirements.

77. The institutions should have a risk management function, in line with the EBA Guidelines on internal governance, that is responsible for ensuring the proper controls of credit risk. The risk management function should be independent of the business-originating units.

78. For the purposes of paragraph 75, institutions should consider the following areas/tasks:

    a. developing and maintaining credit-granting and monitoring processes and procedures;

    b. defining and developing processes, mechanisms and methodologies for credit risk appetite, credit risk strategy and credit risk policies, including the overall cascading-down process for policies and procedures, and business strategy;

c. designing and implementing an appropriate credit decision-making framework in accordance with these guidelines;

d. designing, defining and performing credit risk monitoring and reporting, including early warning systems, credit portfolio and aggregate risk monitoring, including in relation to ICAAP and any applicable regulatory metrics, e.g. large exposures rules;

e. performing an assessment of creditworthiness and a credit risk analysis for scoring or rating purposes;

f. providing an independent/second opinion on the creditworthiness assessment and credit risk analysis for the purposes of credit decision-making, specifying in which circumstances, considering the specificities of the credit facility, its size and the risk profile of the borrower, this independent/second opinion is relevant;

g. assessing the appropriateness of allowances in accordance with the relevant accounting framework;

h. developing new credit products, also considering the requirements for the new product approval process, and ongoing monitoring of the appropriateness of credit products;

i. managing early arrears and non-performing exposures, and granting and monitoring forbearance measures, in line with the provisions of the EBA Guidelines on management of non-performing and forborne exposures[26] and the EBA Guidelines on arrears and foreclosure under Directive 2014/17/EU[27], and the institution's internal policies – in relation to lending to consumers, such tasks may also include liaising with independent debt-counselling and debt advice services when relevant;

j. performing stress tests on the aggregate credit portfolio as well as on relevant sub-portfolios and geographical segments;

k. monitoring individual exposures through regular credit reviews, in accordance with the requirements set out in Section 8, including sample reviews of credit lines;

l. ensuring the integrity and reliability of the internal ratings assignment process, as described in Article 173 of Regulation (EU) No 575/2013, where relevant for institutions with permission to use an internal ratings-based approach, and the integrity and reliability of the rating scale and ratings assignment process used by the institution, for the institutions using the standardised approach;

m. performing quality assurance of credit assessments, taking into account an appropriate sample size, and ensuring that credit risk is properly identified, measured, monitored

[26] EBA/GL/2018/06.
[27] EBA/GL/2015/12.

and managed within the institution’s business origination activities, and that regular reporting is communicated to the institution’s management body.

4.6 Resources and skills

79. Institutions should have sufficient resources and staff allocated to credit risk taking and, in particular, credit decision-making, credit risk management and internal control. The organisational structure should be reviewed periodically to ensure that there are adequate resources, competencies and expertise within the credit risk management functions to effectively manage credit risk.

80. Institutions should ensure that the staff members involved in credit granting, in particular decision-making, risk management and internal control, have an appropriate level of experience, skills and credit-related competence.

81. Staff involved in credit granting, including credit decision-making, credit risk management and internal control, should frequently receive appropriate training, which includes considering changes to the applicable legal and regulatory frameworks. Training should be aligned with the institutions’ credit culture and business strategy and should be conducted on a regular basis to ensure that all relevant staff are appropriately skilled and familiar with the institutions’ credit policies, procedures and processes.

4.7 Remuneration

82. As part of the requirements of institutions’ remuneration policies set out in Articles 74, 75 and 92 of Directive 2013/36/EU and the EBA Guidelines on remuneration policies and practices related to the sale and provision of retail banking products and services, the EBA Guidelines on sound remuneration policies under Articles 74(3) and 75(2) of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) No 575/2013, and Article 7 of Directive 2014/17/EU, institutions’ remuneration policies and practices should be in line with the approach to credit risk management, credit risk appetite and strategies, and should not create a conflict of interest. Remuneration policies and practices applicable to staff, and in particular identified staff engaged in credit granting, credit administration and monitoring, should be consistent and not provide incentives for risk taking that exceeds the tolerated risk of the institution, and should be aligned with the business strategy, objectives and long-term interests of the institution. In addition, remuneration policies and practices should incorporate measures to manage conflicts of interest, with a view to protecting consumers from undesirable detriment arising from the remuneration of sales staff.

83. Institutions’ remuneration policies and practices should, in particular, ensure that the performance and risk measurement process to determine the variable remuneration of the staff involved in credit granting includes appropriate credit quality metrics that are in line with the institution’s credit risk appetite.

5. Loan origination procedures

5.1 Information and documentation

84. Institutions and creditors should have sufficient, accurate and up-to-date information and data necessary to assess the borrower's creditworthiness and risk profile before concluding a loan agreement.

85. For the purposes of the creditworthiness assessment of consumers, institutions and creditors should have available, and use, information supported by necessary and appropriate evidence, in relation to at least the following:

    a. purpose of the loan, when relevant to the type of product;
    b. employment;
    c. source of repayment capacity;
    d. composition of a household and dependents;
    e. financial commitments and expenses for their servicing;
    f. regular expenses;
    g. collateral (for secured lending);
    h. other risk mitigants, such as guarantees, when available.

    Institutions and creditors can consider the use of specific information, data items and evidence set out in Annex 2.

86. For the purposes of the creditworthiness assessment of micro, small, medium-sized and large enterprises, institutions should have available, and use, information, supported by necessary and appropriate evidence, in relation to at least the following:

    a. purpose of the loan, when relevant to the type of product;
    b. income and cash flow;
    c. financial position and commitments, including assets pledged and contingent liabilities;
    d. business model and, when relevant, corporate structure;
    e. business plans supported by financial projections;
    f. collateral (for secured lending);
    g. other risk mitigants, such as guarantees, when available;
    h. product type-specific legal documentation (e.g. permits, contracts).

Institutions can consider the use of specific information, data items and evidence set out in Annex 2.

87. Institutions and creditors may use the already available information and data for existing customers and borrowers, in accordance with the requirements of Regulation (EU) No 2016/679, and when such information and data are relevant and up to date.

88. If the information and data are not readily available, institutions and creditors should collect the necessary information and data from the borrower and/or third parties, including relevant databases, when relevant. For the collection of information and data on the borrower from third parties, institutions and creditors should ensure that the requirements of Regulation (EU) No 2016/679 are met.

89. If institutions and creditors have concerns regarding the accuracy and reliability of the information and data, they should make necessary checks and reasonable enquiries with the borrower and third parties (e.g. employer, public authorities, relevant databases), and take reasonable steps to verify the information and data collected. Before making such enquiries with third parties regarding borrower's personal data, institutions and creditors should ensure that the requirements, in particular with regard to informing and seeking permission from the borrower, of Regulation (EU) No 2016/679 are met.

90. Institutions and creditors should have an accurate single customer view that enables an assessment of the borrower's ability to service and repay financial commitments. This single customer view applies to single borrowers, households, as appropriate, and members of consolidated groups for enterprises. The single customer view should be supplemented by the information provided by the borrower on the assets and liabilities held at other institutions or creditors.

91. If the borrower is likely to face financial difficulties in meeting the contractual loan obligations, institutions and creditors should request, from the borrower, reliable documentation demonstrating realistic projections of their ability to maintain solvency. In this case, both information from third parties, such as tax advisors, auditors and other experts, and information from borrowers may be used.

92. If a loan agreement involves guarantees from third parties, institutions and creditors should have a sufficient level of information and data necessary to assess the guarantee and, when relevant, the financial position of the guarantor.

93. If the borrower is a member of a group of connected clients, institutions should collect the necessary information on relevant related connected clients, in accordance with the EBA Guidelines on connected clients, especially when repayment is reliant on cash flow emanating from other connected parties in the same group.

94. Institutions and creditors should document the information and data that lead to credit approval, including the actions and assessments carried out by them, and maintain this documentation in an accessible form (readily available for competent authorities) for at least the duration of the loan agreement.

5.2 Assessment of borrower's creditworthiness

5.2.1 General provisions for lending to consumers

95. Institutions should analyse the loan application of the borrower in order to ensure that the application is in line with the institutions' credit risk appetite, policies, credit-granting criteria, limits and relevant metrics, as well as any relevant macroprudential measures where applied by the designated macroprudential authority.

96. Institutions and creditors should, in line with the relevant consumer protection legislation, assess the borrower's ability and prospect to meet the obligations under the loan agreement, covering, in particular, an assessment of the borrower's source of repayment capacity, taking into account specificities of the loan, such as nature, maturity and interest rate.

97. Collateral, in the case of secured lending, by itself should not be a predominant criterion for approving a loan and cannot by itself justify the approval of any loan agreement. Collateral should be considered the institution's second way out in case of default or material deterioration of the risk profile, and not the primary source of repayment, with the exception of when the loan agreement envisages that the repayment of the loan is based on the sale of the property pledged as collateral or liquid collateral provided.

98. When assessing the borrower's ability to meet obligations under the loan agreement, institutions and creditors should take into account relevant factors that could influence the present and future repayment capacity of the borrower, and should avoid inducing undue hardship and over-indebtedness. The factors should include other servicing obligations, their remaining duration, their interest rates and the outstanding amounts, and repayment behaviour, e.g. evidence of any missed payments and their circumstances, as well as directly relevant taxes and insurance if known.

99. If the loan application is submitted jointly by more than one borrower, institutions and creditors should perform the creditworthiness assessment on the basis of the joint repayment capacity of the borrowers.

100. If a loan agreement involves any form of guarantees from third parties, institutions should assess the level of protection provided by the guarantee, and if relevant, conduct a creditworthiness assessment of the guarantor, applying the relevant provisions of these guidelines, depending on whether the guarantor is a natural person or an enterprise.

101. For assessing the borrower's ability to meet obligations under the loan agreement, institutions and creditors should adopt suitable methods and approaches, which may include models, as long as these guidelines are met. The selection of the suitable and adequate method should depend on the risk level, size and type of loan.

5.2.2 Lending to consumers in relation to residential immovable property

102. This section further specifies factors relevant to assessing the prospect of the borrower to meet obligations under a loan agreement as referred to in Article 18(1) and 20(1) of

Directive 2014/17/EU. In relation to loan agreements subject to national laws transposing that Directive, institutions and creditors should apply, in addition to provisions set out in Section 5.2.1, provisions set out in this section.

103. When necessary, in particular in cases of borrowers who are self-employed or have seasonal or other irregular income, institutions and creditors should make reasonable enquiries and take reasonable steps to verify the information regarding the source of repayment capacity.

104. If the loan term extends past the borrower's expected retirement age, institutions and creditors should take appropriate account of the adequacy of the borrower's likely source of repayment capacity and ability to continue to meet obligations under the loan agreement in retirement.

105. Institutions and creditors should ensure that the borrower's ability to meet obligations under the loan agreement is not based on an expected significant increase in the borrower's income, unless the documentation provides sufficient evidence.

106. When assessing the borrower's ability to meet obligations under the loan agreement, institutions and creditors should account for committed and other non-discretionary expenditures, such as the borrower's current obligations, including appropriate substantiation and consideration of living expenses.

107. As part of the creditworthiness assessment, institutions and creditors should carry out sensitivity analyses reflecting potential negative events in the future, including a reduction in income; an increase in interest rates in cases of variable rate loan agreements; negative amortisation of the loan; and balloon payments or deferred payments of the principal or interest.

108. In cases of foreign currency loans as defined in Article 4(28) of Directive 2014/17/EU, institutions and creditors should also factor into the assessment of the borrower's capacity to meet the obligations potential negative scenarios of the exchange rate between the currency of the borrower's income and the currency of the loan. Institutions and creditors should also take into account and assess any hedging strategies and actual hedges in place, including natural hedges, to mitigate foreign currency exchange risk.

109. For loan agreements that relate to an immovable property that explicitly state that the immovable property is not to be occupied as a place of residence by the borrower or a family member (i.e. buy-to-let agreements) as referred to in point (b) of Article 3(3) of Directive 2014/17/EU, institutions and creditors should apply the criteria set out in Section 5.2.3.

5.2.3 Other secured lending to consumers

110. In relation to loan agreements secured by immovable property, other than those covered in Section 5.2.2, institutions and creditors should apply, in addition to the provisions set out in Section 5.2.1, provisions set out in this section.

111. If the property is still being constructed and intended to provide, upon completion, an income to its owner in the form of rents or profits from its sale, institutions should assess the development phase and the phase after the completion of the development, when the project converts into an income-producing property. For the purposes of such loan agreements, institutions and creditors should establish that:

a. the borrower has a plausible plan related to the project, including estimates of all costs associated with the development;

b. the borrower has access to builders, architects, engineers and contractors, who will take part in the development;

c. the borrower has obtained or is able to obtain in the future all necessary permits and certificates for the development, as the project progresses.

112. For loan agreements that relate to an immovable property that explicitly state that the immovable property is not to be occupied as a place of residence by the borrower or a family member (i.e. buy-to-let agreements), institutions should assess the relationship between the future rental income from the immovable property and the borrower's ability to meet obligations.

113. As part of the creditworthiness assessment, institutions should carry out sensitivity analyses to reflect potential negative market and idiosyncratic events in the future that are relevant to the type and purpose of the loan. These events may include a reduction in income; an increase in interest rates in cases of variable rate loan agreements; negative amortisation of the loan; balloon payments or deferred payments of the principal or interest; and, when relevant, deterioration in the marketability of the immovable property, an increase in vacancy rates and a reduction in the rental prices for similar properties. When relevant, institutions and creditors should also consider the implication of foreign currency exchange rate risk, as provided in paragraph 108.

5.2.4 Unsecured lending to consumers

114. This section further specifies the requirements to assess the creditworthiness of the borrower referred to in Article 8 of Directive 2008/48/EC. In relation to loan agreements subject to national laws transposing that Directive institutions and creditors should apply, in addition to provisions set out in Section 5.2.1, provisions set out in this section.

115. Where necessary, in particular in cases of borrowers who are self-employed or have seasonal or other irregular income, institutions and creditors should make reasonable enquiries and take reasonable steps to assess and verify the source of repayment capacity.

116. Institutions and creditors should ensure that the borrower's ability to meet obligations under the loan agreement is not based on an expected significant increase in the borrower's income, unless the documentation provides sufficient evidence.

117. As part of the creditworthiness assessment, institutions and creditors, if applicable, should carry out sensitivity analyses to reflect potential negative events specific to the type of loan

that may occur in the future. When relevant, institutions and creditors should also consider the implication of foreign currency exchange rate risk, as provided in paragraph 108.

5.2.5 Lending to micro and small enterprises

118. Institutions should assess the borrower's current and future ability to meet the obligations under the loan agreement. Institutions should also analyse the loan application of the borrower in order to ensure that the application is in line with the institution's credit risk appetite, policies, credit-granting criteria, limits and relevant metrics, as well as any relevant macroprudential measures, where applied by the designated macroprudential authority.

119. Institutions should consider that cash flow from the ordinary business activities of the borrower and, when applicable within the purpose of the loan agreement, any proceeds on the sale of the assets are the primary sources of repayment.

120. When assessing the creditworthiness of the borrower, institutions should put emphasis on the borrower's realistic and sustainable future income and future cash flow, and not on available collateral. Collateral by itself should not be a predominant criterion for approving a loan and cannot by itself justify the approval of any loan agreement. Collateral should be considered the institution's second way out in case of default or material deterioration of the risk profile, and not the primary source of repayment, with the exception of when the loan agreement envisages that the repayment of the loan is based on the sale of the property pledged as collateral or liquid collateral provided.

121. When carrying out the creditworthiness assessment, institutions should:

a. analyse the financial position and credit risk of the borrower, as set out below;

b. analyse the business model and strategy of the borrower, as set out below;

c. determine and assess the borrower's credit scoring or internal rating, where applicable, in accordance with the credit risk policies and procedures;

d. consider all the borrower's financial commitments, such as drawn and undrawn committed facilities with institutions, including working capital facilities, credit exposures of the borrower and the past repayment behaviour of the borrower, as well as other obligations arising from tax or other public authorities or social security funds;

e. when relevant, assess the structure of the transaction, including the risk of structural subordination and related terms, e.g. covenants, and, if applicable, third-party guarantees and collateral structure.

122. Institutions should carry out the creditworthiness assessment in relation to the specificities of the loan, such as nature, maturity and interest rate.

123. For assessing the borrower's ability to meet obligations under the loan agreement, institutions should adopt suitable methods and approaches, which may include models, as long as these guidelines are met. The selection of the suitable and adequate method should depend on the risk level, size and type of loan.

124. If the borrower is a member of a group of connected clients, institutions should carry out the assessment at individual level and, where relevant, at group level, in accordance with the EBA Guidelines on connected clients, especially when repayment is reliant on cash flow emanating from other connected parties. If the borrower is a member of a group of connected clients linked to central banks and sovereigns, including central governments, regional and local authorities, and public sector entities, institutions should assess the individual entity.

125. For lending activities with cross-border elements (e.g. trade finance, export finance), institutions should take into account the political, economic and legal environment in which the foreign counterparty of the institution's client operates. Institutions should assess the buyer's ability to transfer funds, the supplier's capacity to deliver the order, including its capacity to meet the applicable local legal requirements, and the supplier's financial capacity to handle possible delays in transaction.

126. Institutions should assess the borrower's exposure to ESG factors, in particular environmental factors and the impact on climate change, and the appropriateness of the mitigating strategies, as set out by the borrower. This analysis should be performed on a borrower basis; however, when relevant, institutions may also consider performing this analysis on a portfolio basis.

127. In order to identify borrowers that are exposed, directly or indirectly, to increased risk associated with ESG factors, institutions should consider using heat maps that highlight, for example, climate-related and environmental risks of individual economic (sub-)sectors in a chart or on a scaling system. For loans or borrowers associated with a higher ESG risk, a more intensive analysis of the actual business model of the borrower is required, including a review of current and projected greenhouse gas emissions, the market environment, supervisory ESG requirements for the companies under consideration and the likely impacts of ESG regulation on the borrower's financial position.

Analysis of the borrower's financial position

128. For the purposes of the analysis of the financial position within the creditworthiness assessment as specified above, institutions should consider the following:

a. both the current and the projected financial position, including balance sheets, source of repayment capacity to meet contractual obligations, including under possible adverse events, and, where relevant, capital structure, working capital, income and cash flow;

b. where relevant, the borrower's leverage level, dividend distribution, and actual and projected/forecasted capital expenditure, as well as its cash conversion cycle in relation to the facility under consideration;

c. where relevant, the exposure profile until maturity, in relation to potential market movements, such as exposures denominated in foreign currencies and exposures collateralised by repayment vehicles;

d. where applicable, the probability of default, based on credit scoring or internal risk rating;

e. the use of appropriate financial, asset class-specific or product type-specific metrics and indicators, in line with their credit risk appetite, policies and limits set out in accordance with Sections 4.2 and 4.3, including considering metrics in Annex 3 to an extent that is applicable and appropriate to the specific credit proposal.

129. Institutions should ensure that the financial projections used in the analysis are realistic and reasonable. These projections/forecasts should be at least based on projecting historical financial data forward. Institutions should assess if these projections are in line with the institution's economic and market expectations. When institutions have material concerns about the reliability of these financial projections, they should make their own projections of the borrowers' financial position and repayment capacity.

130. If applicable, institutions should assess the financial position when granting loans to holding companies, both as a separate entity, e.g. at consolidated level, and as a single entity, if the holding company is not itself an operating company or institutions do not have guarantees from the operating companies to the holding company.

131. When assessing the borrowers' financial position, institutions should assess the sustainability and feasibility of the future repayment capacity under potential adverse conditions that are relevant to the type and purpose of the loan and may occur in the duration of the loan agreement. These events may include a reduction in income and other cash flow; an increase in interest rates; negative amortisation of the loan; deferred payments of principal or interest; deterioration in the market and operating conditions for the borrower; and foreign currency exchange rate changes, when relevant.

Analysis of the borrower's business model and strategy

132. Institutions should assess the business model and strategy of the borrowers, including in relation to the purpose of the loan.

133. Institutions should assess the borrower's knowledge, experience and capacity to manage business activities, assets or investments linked to the loan agreements (e.g. specific property for a CRE loan).

134. Institutions should assess the feasibility of the business plan and associated financial projections, in line with the specificities of the sector in which the borrower operates.

135. Institutions should assess the borrower's reliance on key contracts, customers or suppliers and how they affect cash flow generation, including any concentrations.

136. Institutions should assess the presence of any potential key-person dependency with regard to the borrower and, when necessary, identify, together with the borrower, possible mitigation measures.

Assessment of guarantees and collateral

137. Institutions should assess any pledged collateral that is used for the purposes of risk mitigation against the requirements for collateral set out in the institution's credit risk appetite, policies and procedures, including the valuation and ownership, and check all relevant documentation (e.g. whether property is registered in appropriate registers).

138. Institutions should assess any guarantees, covenants, negative pledge clauses and debt service agreements that are used for the purposes of risk mitigation.

139. When relevant to credit decisions, institutions should assess the borrower's equity and credit enhancements, such as mortgage insurance, take-out commitments and repayment guarantees from external sources.

140. If a loan agreement involves any form of guarantees from third parties, institutions should assess the level of protection provided by the guarantee, and if relevant, conduct a creditworthiness assessment of the guarantor, applying the relevant provisions of these guidelines, depending on whether the guarantor is a natural person or an enterprise. The creditworthiness assessment of the guarantor should be proportionate to the size of the guarantee in relation to the loan and the type of guarantor.

5.2.6 Lending to medium-sized and large enterprises

141. Institutions should assess the borrower's current and future ability to meet the obligations under the loan agreement. Institutions should also analyse the loan application of the borrower in order to ensure that the application is in line with the institution's credit risk appetite, policies, credit-granting criteria, limits and relevant metrics, as well as any relevant macroprudential measures, where applied by the designated macroprudential authority.

142. Institutions should consider that cash flow from the ordinary business activities of the borrower and, when applicable within the purpose of the loan agreement, any proceeds on the sale of the assets are the primary sources of repayment.

143. When assessing the creditworthiness of the borrower, institutions should put emphasis on the borrower's realistic and sustainable future income and future cash flow, and not on available collateral. Collateral by itself should not be a predominant criterion for approving a loan and cannot by itself justify the approval of any loan agreement. Collateral should be considered the institution's second way out in case of default or material deterioration of the risk profile, and not the primary source of repayment, with the exception of when the loan agreement envisages that the repayment of the loan is based on the sale of the property pledged as collateral or liquid collateral provided.

144. When carrying out the creditworthiness assessment, institutions should:

   a. analyse the financial position and credit risk of the borrower, as set out below;

   b. analyse the organisational structure, business model and strategy of the borrower, as set out below;

c. determine and assess the borrower's credit scoring or internal rating, where applicable, in accordance with the credit risk policies and procedures;

d. consider all the borrower's financial commitments, such as all drawn and undrawn committed facilities with institutions, including working capital facilities, credit exposures of the borrower and the past repayment behaviour of the borrower, as well as other obligations arising from tax or other public authorities or social security funds;

e. assess the structure of the transaction, including the risk of structural subordination and related terms, e.g. covenants, and, if applicable, third-party guarantees and collateral structure.

145. Institutions should carry out the creditworthiness assessment in relation to the specificities of the loan, such as nature, maturity and interest rate.

146. Institutions should assess the borrower's exposure to ESG factors, in particular environmental factors and the impact on climate change, and the appropriateness of the mitigating strategies, as set out by the borrower.

147. If the borrower is a member of a group of connected clients, institutions should carry out the assessment at individual level and, where relevant, at group level, in accordance with the EBA Guidelines on connected clients, especially when repayment is reliant on cash flow emanating from other connected parties. If the borrower is a member of a group of connected clients linked to central banks and sovereigns, including central governments, regional and local authorities, and public sector entities, institutions should assess the individual entity.

148. For lending activities with cross-border elements (e.g. trade finance, export finance), institutions should take into account the political, economic and legal environment in which the foreign counterparty of the institution's client operates. Institutions should assess the buyer's potential to transfer funds, the supplier's capacity to deliver the order, including its capacity to meet the applicable local legal requirements, and the supplier's financial capacity to handle possible delays in transaction.

149. In order to identify borrowers that are exposed, directly or indirectly, to increased risks associated with ESG factors, institutions should consider using heat maps that highlight, for example, climate-related and environmental risks of individual economic (sub-)sectors in a chart or on a scaling system. For loans or borrowers associated with a higher ESG risk, a more intensive analysis of the actual business model of the borrower is required, including a review of current and projected greenhouse gas emissions, the market environment, supervisory ESG requirements for the companies under consideration and the likely impacts of ESG regulation on the borrower's financial position.

Analysis of the borrower's financial position

150. For the purposes of the analysis of the financial position within the creditworthiness assessment as specified above, institutions should consider the following:

a. both the current and the projected financial position, including balance sheets and capital structure, working capital, income, cash flow and the source of repayment capacity to meet contractual obligations, e.g. debt-servicing capacity, including under possible adverse events (see also sensitivity analysis) – items to be analysed should include but not be limited to free cash flow available for debt servicing of the facility under consideration;

b. net operating income and profitability, especially in relation to interest-carrying debt;

c. the borrower's leverage level, dividend distribution, and actual and projected capital expenditure, as well as its cash conversion cycle in relation to the facility under consideration;

d. the exposure profile until maturity, in relation to potential market movements (e.g. exposures denominated in foreign currencies and exposures collateralised by repayment vehicles);

e. where applicable, the probability of default, based on credit scoring or internal risk rating;

f. the use of appropriate financial, asset class- or product type-specific metrics and indicators, in line with their credit risk appetite, policies and limits set out in accordance with Sections 4.2 and 4.3, including considering metrics in Annex 3 to an extent that is applicable and appropriate to the specific credit proposal.

151. Institutions should ensure that the projections used in the analysis are realistic and reasonable and are in line with the institutions' economic and market expectations. When institutions have material concerns about the reliability of these financial projections, they should make their own projections of the borrowers' financial position and, when relevant, use them to challenge the projections provided by the borrowers.

152. Institutions should also assess the borrower's capacity for future profitability, to measure the impact of retained earnings and hence the impact on equity, particularly in cases where the borrower has been unable to generate positive profits over time.

153. Institutions should perform an assessment of the cash conversion cycle of the borrower, to measure the time it takes 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 understand the cash conversion cycle of a borrower to estimate working capital needs and identify recurring costs, in order to assess the ongoing capacity to repay credit facilities over time.

154. Institutions should, when relevant, assess these financial metrics against the metrics and limits set out in their credit risk appetite, credit risk policies and limits, in accordance with Sections 4.2 and 4.3.

155. Institutions should assess the financial position when granting loans to holding companies, both as a separate entity, e.g. at consolidated level, and as a single entity, if the holding

company is not itself an operating company or institutions do not have guarantees from the operating companies to the holding company.

Sensitivity analysis in creditworthiness assessment

156. Institutions should assess the sustainability and feasibility of the borrower's financial position and the future repayment capacity under potential adverse conditions that may occur in the duration of the loan agreement. To this end, institutions should carry out a single- or multifactor sensitivity analysis, considering market and idiosyncratic events, or a combination of any of them.

157. This sensitivity analysis should account for all general and asset class and product-specific aspects that may have an impact on the creditworthiness of the borrower.

158. When carrying out a sensitivity analysis of the borrower's repayment capacity under negative future conditions, institutions should take into account the following events that are most relevant to the specific circumstances and the business model of the borrower:

Idiosyncratic events

a. a severe but plausible decline in a borrower's revenues or profit margins;

b. a severe but plausible operational loss event;

c. the occurrence of severe but plausible management problems;

d. the failures of significant trading partners, customers or suppliers;

e. a severe but plausible reputational damage;

f. a severe but plausible outflow of liquidity, changes in funding or an increase in a borrower's balance sheet leverage;

g. adverse movements in the price of assets to which the borrower is predominantly exposed (e.g. as raw material or end product) and foreign exchange risk;

Market events

h. a severe but plausible macroeconomic downturn;

i. a severe but plausible downturn in the economic sectors in which the borrower and its clients are operating;

j. a significant change in political, regulatory and geographical risk;

k. a severe but plausible increase in the cost of funding, e.g. an increase in the interest rate by 200 basis points on all credit facilities of the borrower.

Analysis of the borrower's business model and strategy

159. Institutions should assess the business model and strategy of the borrowers, including in relation to the purpose of the loan.

160. Institutions should assess the borrower's knowledge, experience and capacity to manage business activities, assets or investments linked to the loan agreements (e.g. specific property for the CRE loan).

161. Institutions should assess the feasibility of the business plan and associated financial projections, in line with the specificities of the sector in which the borrower operates.

162. Institutions should assess the borrower's reliance on key contracts, customers or suppliers and how they affect cash flow generation, including any concentrations.

Assessment of guarantees and collateral

163. Institutions should assess any pledged collateral against the requirements for collateral set out in the institution's credit risk appetite, policies and procedures, including the valuation and ownership, and check all relevant documentation (e.g. whether property is registered in appropriate registers).

164. Institutions should assess any guarantees, covenants, negative pledge clauses and debt service agreements that are used for the purposes of risk mitigation. Institutions should also consider if the value of the collateral is in some way correlated with the borrower's business or capacity to generate cash flow.

165. Institutions should assess the borrower's equity and credit enhancements, such as mortgage insurance, take-out commitments and repayment guarantees from external sources.

166. If a loan agreement involves any form of guarantees from third parties, institutions should assess the level of protection provided by the guarantee and, if relevant, conduct a creditworthiness assessment of the guarantor, applying the relevant provisions of these guidelines, depending on whether the guarantor is a natural person or an enterprise. The creditworthiness assessment of the guarantor should be proportionate to the size of the guarantee in relation to the loan and the type of guarantor.

167. If, in the syndicated lending or project finance transactions, the payment streams pass through a third party to the transactions, e.g. a designated agent, institutions (or mandated lead arrangers or their nominated agents) should assess the soundness of the agent. For cross-border lending and project finance transactions, the agent should be the sole issuer of any guarantees, letters of credit or similar documents issued on behalf of the supplier in the transaction.

5.2.7 Commercial real estate lending

168. When assessing the creditworthiness of the borrowers in cases of CRE lending, in addition to the general criteria for the creditworthiness assessment set out in Section 5.2.5 and Section 5.2.6, institutions should apply the specific criteria set out in this section. When assessing the creditworthiness of the borrowers in cases of lending for commercial real estate to be used by the borrower that owns the property for conducting business, institutions should apply the criteria set out in Section 5.2.5 and Section 5.2.6 only.

169. Institutions should assess and verify the borrower's experience in relation to the type, size and geographical location of the CRE. When the borrower is a special purpose vehicle sponsored by another entity, institutions should assess the sponsoring entity's experience in relation to the type, size and geographical location of the CRE.

170. Institutions should carry out an assessment of the income-producing capacity of the property and an assessment of the prospect of refinancing. These assessments should account for the committed term of the CRE loan under the loan application in question.

171. In the assessment of the borrower's repayment capacity, institutions should assess, where relevant:

a. the sustainability of the cash flow;

b. the quality of the tenants, the impact of changes to current rental income on the amortisation schedule, lease terms, maturities and conditions, and payment history of the tenant if already in place;

c. reletting prospects, the cash flow required to service the loan in accordance with the loan agreement if there are needs for reletting, if applicable the performance of the asset in an economic downturn, and fluctuations in rental yields over time, to assess the presence of overly compressed yields;

d. necessary capital expenditure on the property throughout the term of the loan.

172. In the assessment of the prospects of reletting any property, institutions should account for tenants' demand for that property, having regard to the supply of comparable properties, the conditions and specifications of the property, the location of the property and the proximity to relevant infrastructure serving the property.

173. When interest-only loans are advanced for CRE, institutions should assess property cash flow to support a level of amortisation equivalent to the projected economic life cycle of the property, to clear the principal amount and interest of the loan in the event of an increase in the loan to value (LTV) for the property, or to a regular LTV level in the relevant market. Institutions should also consider such analysis when borrowers have additional credit enhancements, e.g. disposal assets that are legally enforceable in a reasonable time period.

174. 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 and Section 5.2.6, take into account the following, as applicable:

a. reletting, including a change in the rental prices, lease length in relation to loan term service charges, an increase in vacancy rates, maintenance and refurbishment costs, rent-free periods and letting inducement;

b. risks and delays associated with refinancing;

c. capital expenditure risk;

d. other relevant criteria.

5.2.8 Lending for real estate development

175. When assessing the creditworthiness of the borrowers in cases of lending for real estate development, in addition to the general provisions on the creditworthiness assessment set out in Section 5.2.5 and Section 5.2.6, institutions should apply the specific provisions of this section.

176. The creditworthiness assessment should cover, in line with the life cycle of the loan, both the development phase, including its stages, when relevant, and the phase after the completion of the development, when the project converts into a CRE loan. The latter stage should be assessed as CRE lending, in accordance with the provisions of these guidelines.

177. In the assessment of the development phase, institutions should establish that the borrower:

   a. has a plausible business plan, including a rationale for the development and a projection of all costs associated with the development verified by an independent expert;

   b. has access to builders, architects, engineers and contractors for the development of the real estate;

   c. has obtained or is able to obtain in the future all necessary permits and certificates for the development, as the project progresses and before disbursement(s).

178. Institutions should ensure that the calculation of costs associated with the development include contingencies for cost overruns. Planned contingencies should be included in the credit limit or equity. Institutions should assess the level of cash reserves and liquidity profile of the borrower to ensure that the borrower has the capacity to fund unplanned contingencies for cost overruns and delays, if any, above the contingency sum.

179. Institutions should perform an assessment of the feasibility of any projected net sale proceed projection, in terms of both value and volume of sales and timelines.

180. Institutions should carry out on-site visits, where relevant accompanied by a suitably qualified person, to verify the main components of the site, including access and site specificities, and retain a summary of the site visit in the file on the borrower.

181. In addition to assessing the creditworthiness of the borrower, institutions, when relevant (e.g. in cases of margin calls), should assess equity investors in the project, focusing on assessing their financial position, relevant expertise and experiences in similar projects, as well as the alignment of interests between the equity investors and the institutions offering lending to the same project.

5.2.9 Leveraged transactions

182. When assessing the creditworthiness of the borrowers in cases of leveraged transactions, in addition to the general provisions on the creditworthiness assessment set out in Section 5.2.5 and Section 5.2.6, institutions should identify excessive leverage at origination,

defined as a ratio: total debt to earnings before interest, taxes, depreciation and amortisation (EBITDA). Transactions with excessive leverage should remain exceptional (and should be in line with an institution's risk appetite) and form part of the credit delegation and risk management escalation framework of an institution.

183. Institutions should conduct a comprehensive assessment of a borrower's capacity to repay or deleverage to sustainable levels of debt within a reasonable period of time.

5.2.10 Shipping finance

184. When assessing the creditworthiness of borrowers in the case of shipping finance, in addition to the general provisions on the creditworthiness assessment set out in Section 5.2.5 and Section 5.2.6, institutions should apply the specific criteria set out in this section. In particular, institutions should assess the following:

a. the vessel's earnings to costs (operation expenses, including insurance, wages, maintenance, lubricants and interest cost) ratio;

b. the ratio of the vessel's current age to its expected useful life;

c. characteristics of the borrower's fleet in relation to the global fleet population (the size of the new build activity, the number of vessels laid up, the number of vessels scrapped for each segment and the age of the vessels will determine over-tonnage and influence freight rates);

d. vessel valuations with or without haircut (if those are included as a repayment source), to reflect selling costs, the time value of money and uncertainties regarding the liquidity and marketability of the asset, unless single valuations are not possible if vessels are operated as part of a larger fleet with widely different types of earnings.

185. Institutions should also consider other factors, such as the supply and demand in the market for the type of vessel in question, present and future trade patterns for the type of vessel in question, the necessity for the loan to be non-recourse or have guarantees, or have a long-term charter with an acceptable end user, and if the ship owner can provide other securities, such as assignments of charters and insurances, charges of shares and cash collateral or mortgages of other assets, such as real property and sister vessels.

186. In the case of loans to shipbuilding, institutions should establish that the borrower:

a. has a plausible business plan, including a rationale for the development and a projection of all associated costs verified by an independent expert;

b. has access to builders, marine architects, engineers and shipbuilding contractors;

c. has obtained or is able to obtain in the future all necessary permits and certificates for the development, as the project progresses.

5.2.11 Project finance

187. When assessing the creditworthiness of the borrowers in cases of project finance, in addition to the general provisions on the creditworthiness assessment set out in Section 5.2.5 and Section 5.2.6, institutions should follow the specific criteria of this section.

188. Institutions should assess the primary source of repayment of the loan, which is the income generated by the assets (project) being financed. Institutions should assess the cash flow associated with the project, including future income-producing capacity once the project is completed, taking into account any applicable regulatory or legal restriction (e.g. price regulation, rate-of-return regulation, revenues being subject to take-or-pay contracts, environmental legislation and regulations affecting the profitability of a project).

189. As far as possible, institutions should ensure that all the assets of the project and the present and future cash flow and accounts are pledged to the institution providing the lending or to the agent/underwriter in the case of a syndicated transaction/club deal. If a special purpose vehicle is established for the project, the shares in that special purpose vehicle should be pledged to the institution, to enable the institution/agent to take possession of the company if needed. In cases of syndicated transactions/club deals, inter-creditor agreements should regulate each creditor’s access to pledged funds and assets.

190. In the assessment of the development phase of the project, institutions should establish that the borrower:

a. has a plausible business plan, including a rationale for the development and a projection of all costs associated with the development verified by an independent expert;

b. has access to builders, architects, engineers and contractors for the project;

c. has obtained or is able to obtain in the future all necessary permits and certificates for the development, as the project progresses.

191. Institutions should ensure that the calculation of costs associated with the development, as provided by the borrower, includes contingencies for cost overruns. Such planned contingencies should be included in the credit limit or equity. Institutions should assess the level of cash reserves and liquidity profile of the borrower or equity investors to ensure that they have the capacity to fund unplanned contingencies for cost overruns and delays, if any, above the contingency sum.

192. In addition to assessing the creditworthiness of the borrower, institutions should assess equity investors in the project, focusing when relevant on assessing their financial position, relevant expertise, experiences in similar projects, ability and willingness to support the project over the project’s lifetime.

5.3 Credit decision and loan agreement

193. In order to carry out a reliable and accurate creditworthiness assessment, institutions and creditors should design relevant documentation regarding credit decisions and loan agreements in a way that helps identify and prevent a misrepresentation of the information by the borrower, credit intermediary or staff members of the institution that is involved with the assessment of the application.

194. The creditworthiness assessment performed in accordance with Section 5.2 should be properly documented and used as the basis of the proposal to approve or decline the loan application by the relevant credit decision-maker. The documented outcomes of the creditworthiness assessment itself should be able to justify the proposal to approve or decline the loan application.

195. The decision to approve or decline the loan application (credit decision) should be taken by the relevant credit decision-maker, in accordance with the policies and procedures and governance arrangements set out in Section 4.3.

196. The credit decision should be clear and well documented and include all the conditions and pre-conditions, including those to mitigate the risks identified in the creditworthiness assessment, such as risks associated with ESG factors, for the loan agreement and disbursement.

197. The credit decision should clearly articulate a maximum period for its validity. If an approved transaction is not executed within this period, a new credit proposal should be submitted for approval. Where relevant, due account should be taken in the provisions of Article 14(6) of Directive 2014/17/EU on the duration of the binding offer.

198. The conclusion of the credit agreement should not take place unless the institutions and creditors have verified that all pre-conditions and conditions that have been set out in the credit decision are fulfilled. The disbursement should take place only after the conclusion of the credit agreement.

6. Pricing

199. Pricing frameworks should reflect institutions' credit risk appetite and business strategies, including profitability and risk perspective. Loan pricing should also be linked to the characteristics of the loan product and consider competition and prevailing market conditions. Institutions should also define their approach to pricing by borrower type and credit quality, and riskiness of the borrower (in the case of individual pricing) when appropriate. Institutions should ensure that the pricing framework is well documented and supported by appropriate governance structures, such as a pricing committee, that are responsible for the maintenance of the overall pricing framework and for individual pricing decisions when relevant.

200. Institutions should consider differentiating between their pricing frameworks, depending on the types of loans and borrowers. For consumers and micro and small enterprises, the pricing should be more portfolio and product based, whereas for medium-sized and large enterprises the pricing should be more transaction and loan specific.

201. Institutions should set out specific approaches to pricing promotional loans, when risk-based and performance considerations specified in this section do not fully apply.

202. Institutions should consider, and reflect in loan pricing, all relevant costs until the next repricing date or maturity, including:

a. the cost of capital (considering both regulatory and economic capital), which should result from the capital allocation in place, according to the established breakdowns, e.g. geography, business line and product;

b. the cost of funding, which should match the key features of the loan, e.g. the expected duration of the loan, taking into account not only contractual terms but also behavioural assumptions, e.g. pre-payment risk;

c. operating and administrative costs, which should result from cost allocation;

d. credit risk costs calculated for different homogeneous risk groups, taking into account historical experience of recognising credit risk losses and when relevant using expected loss models;

e. any other real costs associated with the loan in question, including tax considerations, when relevant;

f. competition and prevailing market conditions, in particular lending segments and for particular loan products.

203. For the purposes of pricing and measuring profitability, including cross-subsidisation between loans or business units/lines, institutions should consider and account for risk-adjusted performance measures in a manner that is proportionate to the size, nature and complexity of the loan and the risk profile of the borrower. Such performance measures could

include economic value added (EVA), return on risk-adjusted capital (RORAC) and risk-adjusted return on capital (RAROC), return on risk-weighted assets (RORWA), return on total assets (ROTA) and other measures that are relevant to the characteristics of the loan. Risk-adjusted performance measures may also depend on and reflect institutions' capital-planning strategies and policies.

204. 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 business lines, and as far as possible individual loans, reflect the correct expected return corresponding to the risk assumed.

205. Institutions should implement *ex ante* transaction tools and regular *ex post* monitoring, linking together transaction risk, pricing and expected overall profitability at an appropriate level, including business lines and product lines. All material transactions below costs should be reported and properly justified, in line with the policies and procedures established by the institution. The monitoring process should provide an 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.

7. Valuation of immovable and movable property

7.1 Valuation at the point of origination

206. When a credit facility is secured by an immovable or movable property collateral, institutions should ensure that the valuation of the collateral is carried out accurately at the point of origination. Institutions should set out internal policies and procedures for valuation of collateral. These policies and procedures should specify the valuation approaches to be used by a valuer and the use of advanced statistical models for each type of collateral. Institutions should ensure that these approaches are prudent and proportionate to the type and potential values of the collateral and in relation to the credit agreements, and are in line with the credit risk policies and procedures and conditions set out in Section 7.4.

207. Institutions should ensure that the property collateral is valued in accordance with applicable international, European and national standards, such as the International Valuation Standards Council, the European Group of Valuers' Associations European Valuation Standards and the Royal Institution of Chartered Surveyors standards.

208. When applicable, institutions should take into account ESG factors affecting the value of the collateral, for example the energy efficiency of buildings.

7.1.1 Immovable property collateral

209. At the point of origination, institutions should ensure that the value of all immovable property collateral for loans to consumers and micro, small, medium-sized and large enterprises is assessed by an internal or external valuer using full visit with internal and external assessment of the property.

210. As a derogation from paragraph 209, for the purposes of a valuation of residential real estate in well-developed and mature property markets, the value may be assessed by means of a desktop valuation, carried out by an internal or external valuer and supported by advanced statistical models. The valuer remains responsible for the valuation, while the advanced statistical models should be used as supporting tools, meeting the conditions set out in Section 7.4, and including a confidence measure to indicate the robustness of the value proposal and other relevant property-specific information. In this case, the value proposal should be assessed, reviewed and approved by the internal or external valuer, who should understand all inputs and assumptions considered in the model. If the confidence measure in the supporting advanced statistical model indicates low robustness, and/or other property-specific information gives rise to uncertainty about the value proposal, the valuer should choose a valuation method other than desktop valuation.

211. When institutions use external valuers, they should establish a panel (a list) of accepted external valuers. The composition of the panel of valuers should ensure that valuers have relevant expertise in relevant segments of the property sector.

212. Institutions should ensure that the valuers provide an impartial, clear, transparent and objective valuation, and each valuation should have a final report providing the necessary information on the valuation process and property. The valuation report should clearly state who ordered the valuation and that the valuation has been requested for the purposes of loan application, renewal or contractual adjustments, or in the case of structural changes. Valuation should be carried out (internal valuation) or ordered (external valuation) by the institution or a collateral agent (in the case of syndicated loans), unless it is subject to a request from the borrower.

213. At the end of the valuation process, institutions should ensure that they have obtained, for each property collateral, a clear and transparent valuation report documenting all elements and parameters that determine the value of the collateral, including all the information necessary and sufficient for easy understanding of these elements and parameters, in particular:

a. the reference value of the collateral;

b. the approaches, methodology and key parameters and assumptions that have been used to assess the value;

c. a description of the collateral, including its current use or multiple uses if applicable, and the property type and quality, including age and state of preservation;

d. a description of the location of the collateral, the local market conditions and the liquidity;

e. the legal and actual attributes of the collateral;

f. any known circumstances that may affect the value in the short term, including drawing attention to and commenting on any issues affecting the degree of certainty or uncertainty.

214. Institutions should critically review the valuation they receive, from the valuer, in particular focusing on aspects such as comprehensibility (whether the approaches and assumptions are clear and transparent), the prudence of assumptions (e.g. as regards cash flow and discount rates), and the clear and reasonable identification of comparable properties used as a value benchmark.

7.1.2 Movable property collateral

215. At the point of origination, institutions should ensure that the value of all movable property collateral is assessed through an appropriate and prudent approach that is proportionate to the nature, type and complexity of the collateral, by an internal or external valuer, appropriate advanced statistical models meeting the conditions set out in Section 7.4 or other standard

methods, such as indexation, taking into account the market value as referred to in Article 229(3) of Regulation (EU) No 575/2013.

216. When applicable, institutions should set out, in their policies and procedures, approaches for the purposes of this valuation, and specify internal thresholds and limits that require an individual valuation of movable property collateral at the point of origination to be performed by a valuer.

217. When institutions use external valuers, they should establish a panel (selection) of accepted external valuers, covering specific property that is being used as collateral, that is relevant to the lending activities of the institution as well as the location of these activities. This panel of experts should be used for the valuation of large and complex movable property collateral, such as vessels, aircraft and plant machinery.

218. For movable property collateral that is subject to an individual valuation by a valuer, institutions should ensure that they have obtained a clear and transparent valuation report documenting all elements and parameters that determine the value of collateral, as outlined in paragraph 213.

219. For movable property subject to a valuation by statistical models, institutions should ensure that they have obtained a clear and transparent model outcome, specifying the value of the collateral. Institutions should understand the methodologies, key parameters, assumptions and limitations of the models used.

220. Institutions should have adequate IT processes, systems and capabilities in place and sufficient and accurate data for the purposes of any statistical model-based valuation.

7.2 Monitoring and revaluation

7.2.1 Immovable property collateral

221. When monitoring property values as laid down in Article 208(3) of Regulation (EU) No 575/2013, institutions should, for the purposes of these guidelines, also set up policies and procedures specifying the approach and the frequency of monitoring of immovable property collateral. These policies and procedures should account, when relevant, for the following elements:

a. the type of property;

b. the credit quality of the loan secured by property;

c. the development status of the property;

d. the value of the property;

e. assumptions made in the appraisal;

f. changes in market conditions.

222. Institutions should set out appropriate frequencies for monitoring the value of the collateral, considering the type and value of the collateral at origination, and, in relation to the credit agreement, consider the following:

a. the frequency of monitoring of properties and parts in development, e.g. unfinished buildings, is higher than that of similar finished properties and parts;

b. the frequency of monitoring of properties and parts with a high carrying amount or with a high LTV ratio is higher than that of similar properties and parts with a low carrying amount or with a low LTV ratio;

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.

223. Institutions should ensure that any indices and statistical models used to monitor the value of the collateral are sufficiently granular and that the methodology is appropriate for the type of asset and lending product and based on a sufficient time series of observed empirical evidence of previous transactions and appraisals of the collateral or similar collateral.

224. Institutions should have policies and procedures for the revaluation of immovable property collateral, specifying the approaches to revaluation (e.g. desktop valuation, drive-by valuation, full visit with internal and external assessment of the property, statistical models) for different types of immovable property collateral, ensuring that the approach or combination of approaches is prudent and proportionate to the type and potential values of the collateral and in relation to the credit agreements. Furthermore, institutions should set out specific triggers (e.g. a change in the assumptions made in the appraisals), indicating when monitoring leads to revaluation or collateral needs revaluation.

225. When the conditions for a review in accordance with Article 208(3)(b) of Regulation (EU) No 575/2013 are met, institutions should update the value of the immovable property collateral by means of a revaluation carried out by a valuer who is potentially supported by appropriate advanced statistical models that meet the conditions set out in Section 7.4 and account for individual characteristics of the property and geographical area. Institutions should not use these models as the sole means of the revaluation.

226. When the conditions for a review in accordance with Article 208(3)(b) of Regulation (EU) No 575/2013 are not met, institutions may update the value of the immovable property collateral by means of either a revaluation carried out by a valuer or appropriate statistical models that meet the conditions set out in Section 7.4 and account for the individual characteristics of the property and geographical area.

7.2.2 Movable property collateral

227. For the monitoring of movable property collateral, institutions may rely on appropriate statistical models and indices. For the revaluation of movable property collateral, institutions may rely on assessment by valuers, statistical models and indices.

228. Institutions should, in their policies and procedures, set out approaches to using a valuer or statistical models, define the approach (e.g. desktop valuation, drive-by valuation, internal and external assessment of the property) that is most suitable for the specific type of collateral for the revaluations done by the valuers, and set out the frequency of monitoring and revaluation of movable property collateral.

229. Institutions' policies and procedures should include, when applicable, criteria for individual monitoring of the value and revaluation of the movable property collateral by a valuer who possesses the necessary qualifications, ability and experience. Proportionate to the type, nature and complexity of the movable property collateral, such as aircraft, shipping, physical plant and machinery, these criteria should be related, at least, to the value of the movable property collateral during the origination phase, the lifespan, the condition of tangible assets, such as depreciation and maintenance, the necessity of physical inspection and certification.

230. Institutions should have adequate IT processes, systems, capabilities and sufficient data for the purposes of any statistical model-based or index-based revaluation.

7.3 Criteria for valuers

231. Institutions should ensure that a valuer carrying out the valuation or revaluation tasks:

  a. is professionally competent and meets any national or international requirements and accepted professional standards that apply to the valuer or for carrying out a particular valuation assignment;

  b. has the appropriate technical skills and experience to perform the assignment;

  c. has the necessary knowledge, i.e. knowledge of the subject of the valuation, the relevant property market and the purpose of the valuation;

  d. is independent from the credit decision process.

232. Institutions should ensure that the fee or the salary of the valuer and the result of the valuation are not linked in a way that creates a conflict of interest.

233. Institutions should assess the performance of the valuers, in particular the accuracy of the valuations provided, e.g. by backtesting on the value of the collateral through advanced statistical models. As part of such assessments, institutions should also look at the concentration of valuations performed by and fees paid to specific valuers.

234. In order to mitigate any conflict of interest sufficiently, institutions should take reasonable steps, e.g. via contractual terms, to ensure that valuers who are going to carry out the actual appraisal of a given property and their first-degree relatives meet all of the following conditions:

a. they are not involved in the loan application, assessment, decision or administration;

b. they are not guided or influenced by the borrower's creditworthiness;

c. they do not have an actual or potential conflict of interest regarding the property in question, the valuation process and the result of the valuation;

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.

235. Institutions should ensure an adequate rotation of valuers and define the number of sequential individual valuations of the same property that can be performed by the same valuer. Any further revaluations beyond this number should result in the rotation of the valuer, resulting in the appointment of either a different internal valuer or a different external valuer.

7.4 Criteria for advanced statistical models for valuation

236. Institutions should set out, in their policies and procedures, the criteria for using advanced statistical models for the purposes of valuation, revaluation and monitoring the values of collateral. These policies and procedures should account for such models' proven track record, property-specific variables considered, the use of minimum available and accurate information, and models' uncertainty.

237. Institutions should ensure that the advanced statistical models used are:

a. property and location specific at a sufficient level of granularity (e.g. postcode for immovable property collateral);

b. valid and accurate, and subject to robust and regular backtesting against the actual observed transaction prices;

c. based on a sufficiently large and representative sample, based on observed transaction prices;

d. based on up-to-date data of high quality.

238. When using these advanced statistical models, institutions are ultimately responsible for the appropriateness and performance of the models, and the valuer remains responsible for the valuation that is made using an advanced statistical model. Institutions should understand their methodology, input data and assumptions of the models used. Institutions should ensure that the documentation of models is up to date.

239. Institutions should have adequate IT processes, systems and capabilities in place and sufficient and accurate data for the purposes of any statistical model-based valuation or revaluation of collateral.

8. Monitoring framework

8.1 General provisions for the credit risk monitoring framework

240. Institutions should have a robust and effective monitoring framework, supported by an adequate data infrastructure, to ensure that information regarding their credit risk exposures, borrowers and collateral is relevant and up to date, and that the external reporting is reliable, complete, up to date and timely.

241. The monitoring framework should enable institutions to manage and monitor their credit risk exposures in line with their credit risk appetite, strategy, policies and procedures at portfolio and, when relevant and material, individual exposure levels.

242. Institutions should ensure that the credit risk monitoring framework is well defined and documented, is integrated into the institutions' risk management and control frameworks, and allows all credit exposures to be followed throughout their life cycle.

243. Institutions should consider, in the design and implementation of their credit risk monitoring framework, that:

   a. the framework and data infrastructure provide the capability to gather and automatically compile data regarding credit risk without undue delay and with little reliance on manual processes;

   b. the framework and data infrastructure allow the generation of granular risk data that is compatible and used for the institution's own risk management purposes but can also meet the requirements of the competent authorities for regular prudential and statistical reporting, as well as for supervisory stress testing and crisis management purposes;

   c. the framework and data infrastructure ensure effective monitoring of all credit exposures and collateral, and allow the credit decision-making process to be followed;

   d. the framework and data infrastructure ensure that institutions maintain an appropriate time series of reporting for current exposures, new types of lending and early warning indicators (EWIs) over their credit risk planning horizon.

244. The monitoring process should be based on a principle of follow-up action to support and result in a regular and informed feedback loop, to inform the setting/review of credit risk appetite, policies and limits.

245. The credit risk monitoring framework should cover the following:

   a. the payment behaviour of borrowers, including any deviations from the requirements of credit agreements, including late, missed or partial payments;

   b. credit risk associated with both the borrower and the transaction in relation to:

i. individual credit exposures and loss given default, when applicable;

ii. individual borrowers, including their exposure value, probability of default (PD) and credit rating, when applicable;

iii. group of connected clients;

iv. portfolio;

c. credit risk per geographical location and economic sector of ultimate exposure, when applicable;

d. impairments, reversals of impairments, write-offs and other decisions regarding value adjustments for a credit exposure.

246. The monitoring framework and data infrastructure should allow institutions to follow the credit decision-making process, including the monitoring and reporting of all credit decisions, exceptions from the credit policies, and escalations to the higher levels of credit decision-makers. To this end, within the monitoring framework, institutions should ensure the implementation and application of relevant key risk indicators that are asset type or portfolio level specific, to determine the ongoing evolving credit risk profile of the portfolios and institution.

247. Institutions should ensure that the credit risk monitoring framework and data infrastructure also enable a single customer view.

248. As part of credit risk monitoring and reporting, institutions should identify the relevant drivers of its aggregate credit risk as well as the credit risk in its portfolios and sub-portfolios, taking into account macroeconomic (including demographic) factors and the fact that credit risk drivers may change over time. Credit risk drivers should be measured, analysed and monitored, and the credit risk management function should report regularly the outcome of the analysis to the management body.

249. When monitoring credit risk, institutions should have appropriate methodologies and practices, allowing the aggregation of credit risk exposures in business lines, portfolios, sub-portfolios, products, industries and geographical segments, and support the identification of credit risk concentrations. Institutions should ensure that credit risk data and data infrastructure meet the following requirements:

a. depth and breadth so that they cover all the significant risk factors — this should allow, inter alia, exposures to be grouped together in terms of shared credit risk characteristics, such as the institutional sector to which the borrower belongs, the purpose of the transaction and the geographical location of the borrower/collateral, so as to enable an aggregate analysis that allows the identification of the entity’s exposure to these significant risk factors;

b. accuracy, integrity, reliability and timeliness of data;

c. consistency, being based on common sources of information and uniform definitions of the concepts used for credit risk management and, when possible, accounting;

d. traceability, so that the source of the information can be identified.

250. Institutions should ensure that operational metrics relating to credit risk governance are appropriate for their credit profile and applied proportionately. This includes any changes in the definitions of underlying lending metrics, material changes to rating scales or systems or credit risk policies/frameworks that help define/measure credit risk, and changing/altering product terms to avoid breaches of policy or exceptions.

8.2 Monitoring of credit exposures and borrowers

251. As part of the monitoring of credit exposures and borrowers, institutions should monitor all outstanding amounts and limits, and whether the borrower is meeting repayment obligations, as laid down in the credit agreement, and is in line with the conditions set at the point of credit granting, such as adherence to credit metrics and covenants.

252. Institutions should also monitor whether the borrower and collateral are in line with the credit risk policies and conditions set at the point of credit granting, e.g. whether the value of collateral and other credit enhancement techniques are maintained, whether any applicable covenants are maintained, and whether there has been a negative development in these factors or in other factors that affect the risk profile of the borrower and/or credit facilities.

253. Institutions should continuously monitor and assess the quality of credit exposures and the financial situation of borrowers, to ensure that subsequent changes in credit risk, in respect of the initial recognition of the lending exposures, can be identified and quantified.

254. The ongoing monitoring should be based on internal information regarding the credit facilities and borrowers' payment practices, as well as the use of external sources (e.g. credit bureaux, directly from the borrower), when relevant.

255. In addition, institutions should also monitor concentration measures against the values specified in their credit risk appetite, policies and procedures, including, where relevant, by product, geography, industry, collateral features (type, location), and quality of portfolios, sub-portfolios and exposures.

256. Institutions engaged in syndicating leveraged transactions should implement internal standards and monitoring functions for these activities. Institutions should identify transactions subject to failed syndications — that is, transaction that were not syndicated within 90 days following the commitment date. Institutions should establish a dedicated framework to deal with these 'hung transactions' in terms of holding strategy, booking and accounting practices, regulatory classification and subsequent capital requirements calculation.

8.3 Regular credit review of borrowers

257. Institutions should also perform regular credit reviews of borrowers that are at least medium-sized or large enterprises, with a view to identifying any changes in their risk profile, financial position or creditworthiness compared with the criteria and the assessment at the point of loan origination, as well as reviewing and updating any relevant internal credit rating/scoring.

258. The review process and frequency should be specific and proportionate to the type and risk profile of the borrower and the type, size and complexity of the credit facility, and should be specified in relevant policies and procedures. Institutions should carry out more frequent reviews if 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 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.

259. To this end, institutions should also, if appropriate, periodically update relevant financial information on the borrower and assess the new information against the creditworthiness assessment criteria established in accordance with Section 4.3 of these guidelines. The collection and assessment of this information should support the institution in recognising the early warning signs of declining credit quality.

260. Institutions should carry out periodic reviews for the purposes of the assessment of the borrower's risk of default and the potential need for the migration between risk categories and grades.

261. Borrowers' credit reviews should include an assessment of existing debt and borrowers' sensitivity to external factors, such as foreign exchange rate volatility, if relevant, that may affect the size of debt and repayment capacity, also in line with the sensitivity analysis requirements, as specified in Section 5.2.6.

262. Institutions should assess risks associated with the refinancing of existing debt, monitoring loans with bullet/balloon repayment terms separately from other loans on a regular basis. They should analyse potential effects on a borrower's inability to roll over/refinance existing debt, and include inter alia a forward-looking macroeconomic outlook and access to capital markets as well as other types of debt structures. Institutions should closely monitor the borrowers' ability to repay or refinance their debts throughout a loan's lifecycle and not just when the borrower is approaching the end of a loan's term.

263. A regular credit risk review should take into consideration both the individual and the total risk profile of the exposure, including relevant macroeconomic factors and specific economic sectors or activities and how the repayment capacity may be affected by these factors.

264. If applicable, institutions should also review guarantors under the credit facility agreement. In addition to the assessment of the guarantor's continued creditworthiness, an analysis of effectiveness of a guarantee should also take into account the enforceability and the time needed to realise the guarantee.

265. In addition to monitoring credit and financial metrics, institutions should take into account information related to qualitative factors that could have a relevant influence on the repayment of a loan. These factors could include information on the quality of management, agreements/disagreements among owners, an owner's commitment to the borrower, forecast market growth, a company's pricing power, a cost structure and flexibility of costs, the trend, size and nature of capital expenditure and research and development expenditure, and the allocation between debt holders and servicers within the consolidated group of institutions.

8.4 Monitoring of covenants

266. Where relevant and applicable to specific credit agreements, institutions should monitor and follow up on the requirements of collateral insurance, in accordance with the credit agreements or requirements of credit facilities.

267. Where applicable, institutions should monitor borrowers' adherence to the covenants agreed in the credit agreements. The borrower's adherence to covenants, as well as the timely delivery of covenant compliance certificates, where applicable, should be utilised as early warning tools. Early detection of deviations is key to protecting the institution's position towards the borrower and other possible creditors involved. The ongoing monitoring of financial covenants should include all relevant ratios specified in the covenants (e.g. net debt/EBITDA, interest coverage ratio, debt service coverage ratio (DSCR).

268. Institutions should also monitor non-financial covenants not only by collecting the covenant certificate, where applicable, but also by other means, e.g. through close contact with the borrower by the client executive.

8.5 Use of early warning indicators/watch lists in credit monitoring

269. As part of their monitoring framework, institutions should develop, maintain and regularly evaluate relevant quantitative and qualitative EWIs that are supported by an appropriate IT and data infrastructure that would allow the timely detection of increased credit risk in their aggregate portfolio as well as in portfolios, sub-portfolios, industries, geographies and individual exposures.

270. The EWIs should have defined trigger levels set with regard to the levels specified in credit risk appetite, strategy and credit risk policies, and have assigned escalation procedures, including assigned responsibilities for the follow-up actions. These escalation procedures should also include choosing exposures or borrowers for special monitoring — a watch list.

271. The EWI framework should contain a description of the relevance of the indicators in relation to the characteristics of transactions and borrower types, or for homogeneous groups of portfolios, when appropriate.

272. On identifying a triggered EWI event at the level of an individual exposure, portfolio, sub-portfolio or borrower group, institutions should apply more frequent monitoring and, when

necessary, consider placing them on a watch list and undertaking predefined measures and mitigation actions. Monitoring this watch list should lead to specific reports being regularly reviewed by the head of the risk management function, the heads of functions involved in credit granting and the management body.

273. When the actions include interaction with the borrower, institutions should have regard to their individual circumstances. The level of contact and communication with the borrower during payment difficulties should be commensurate to the information requirements, as defined in the EBA Guidelines on arrears and foreclosure.

274. As part of their ongoing monitoring of credit risk, institutions should consider the following credit quality deterioration signals:

a. negative macroeconomic events (including but not limited to economic development, changes in legislation and technological threats to an industry) affecting the future profitability of an industry, a geographical segment, a group of borrowers or an individual corporate borrower, as well as the increased risk of unemployment for groups of individuals;

b. known adverse changes in the financial position of borrowers, such as a significant increase in debt levels or significant increases in debt service ratios;

c. a significant drop in turnover or, in general, in recurring cash flow (including the loss of a major contract/client/tenant);

d. significant narrowing of operating margins or income;

e. a significant deviation in actual earnings from the forecast or a significant delay in the business plan of a project or an investment;

f. changes in the credit risk of a transaction that would cause the terms and conditions to be significantly different if the transaction were newly originated or issued at the reporting date (such as increased amounts of required collateral or guarantees, or a higher recurring income coverage of the borrower);

g. an actual or expected significant decrease in the main transaction’s external credit rating, or in other external market indicators of credit risk for a particular transaction or similar transaction with the same expected life;

h. changes in the conditions of access to markets, a worsening in financing conditions or known reductions in financial support provided by third parties to the borrower;

i. a slowdown in the business or adverse tendencies in the operations of the borrower that may cause a significant change in the borrower’s ability to meet its debt obligations;

j. a significant increase in economic or market volatility that may have a negative impact on the borrower;

k. for transactions secured with collateral, a significant worsening of the ratio of their amount to the value of the collateral due to unfavourable developments in the value of the collateral, or no change or an increase in the outstanding amount due to the payment terms established (such as extended principal payment grace periods, rising or flexible instalments, extended terms);

l. a significant increase in credit risk on other transactions of the same borrower or significant changes in the expected payment behaviour of the borrower, when known;

m. a significant increase in credit risk due to an increase in the difficulties of the group to which the borrower belongs, such as residents of a specific geographical area, or significant unfavourable developments in the performance of the borrower's sector of economic activity or increased difficulties in the group of related borrowers to which the borrower belongs;

n. known legal action that may significantly affect the borrower's financial position;

o. the late delivery of a certificate of adherence, a waiver request or a breach with respect to the covenants, at least regarding the financial covenants, if applicable;

p. negative institution-internal credit grade/risk class migrations in the aggregate credit portfolio or in specific portfolios/segments;

q. an actual or expected internal credit rating/risk classification downgrade for the transaction or borrower or a decrease in behavioural scoring used to assess credit risk internally;

r. concerns raised in the reports by the external auditors of the institution or borrower;

s. one or more borrower-related facilities 30 days past due.

8.5.1 Follow-up and escalation process on triggered EWIs

275. When an EWI has been triggered for closer monitoring and further investigation, immediate action should be taken in accordance with the institution's policies and procedures, as provided in Section 4.3 of these guidelines. The designated functions should perform an analysis in order to assess the severity of the triggered event and to propose suitable action and follow-up. This analysis should, without undue delay, be presented to the relevant credit decision-makers designated in the policy and procedures.

276. Relevant credit decision-makers should, based on the abovementioned analysis and other relevant accessible information, decide on the appropriate next steps. The decision should be

documented and should be communicated to relevant parts of the institution for action and follow-up.

277. Triggering EWIs should lead to an increased frequency in the reviewing process, including discussions and decisions by credit decision-makers, and more intense information gathering from the borrower. The information gathered should be sufficient to support more frequent credit reviews of the borrowers.

Annex 1 — Credit-granting criteria

This annex provides a set of criteria to be considered in the design and documentation of credit-granting criteria, in accordance with these guidelines.

Lending to consumers

1. Customer acceptance criteria, i.e. customer types, customer age limits, customer credit record
2. Definition of acceptable income
3. Minimum requirements for collateral
4. Minimum requirements for guarantees
5. Maximum loan amounts
6. Maximum loan maturities
7. Amortisation requirements (including interest rate type for the loans)
8. Risk-based limits (concentration, type of product, etc.)
9. Acceptable loan-to-value ratio limits (for secured lending)
10. Acceptable loan-to-income ratio limits
11. Acceptable debt-to-income ratio limits
12. Acceptable income-to-total-credit-obligation ratio limits (including for gross income, income after taxes and premiums, income after financial expenses, income after regular other expenses)
13. Acceptable maximum size of loan to repayment capacity
14. Compliance policy with macroprudential requirements, when relevant

Lending to micro, small, medium-sized and large enterprises

1. Specification of geographical markets and economic sectors
2. Customer acceptance criteria, i.e. for specific PDs, external ratings, customer types, track record, etc.
3. Minimum requirements for revenues, cash flow and financial projections
4. Minimum requirements for collateral
5. Minimum requirements for guarantees and credit enhancements
6. Minimum requirements for acceptable covenants
7. Requirements for the drawdown of the loan to the borrower

8. Maximum loan amounts
9. Appropriate limits on partial recourse or non-recourse loans
10. Maximum loan maturities
11. Amortisation schedules and standards for the acceptability of and limits on non-amortising loans and on the use of interest reserves and cash sweep structures
12. Risk-based limits (towards concentration, type of product, etc.)
13. Acceptable loan-to-value ratio limits (for secured lending)
14. Acceptable debt-servicing coverage ratio limits
15. Acceptable interest coverage ratio limits
16. Acceptable EBITDA limits
17. Acceptable leverage ratio limits
18. Acceptable debt-to-equity ratio limits
19. Acceptable loan-to-cost ratio limits
20. Acceptable cash-flow-to-debt-service ratio limits
21. Acceptable return on equity ratio limits
22. Acceptable capitalisation rate (net operating income/market value) limits
23. Standards to address and mitigate risks associated with environmental risk
24. Compliance policy with macroprudential requirements, when relevant

Commercial real estate lending

In addition to the general criteria for lending to micro, small, medium-sized and large enterprises specified above, institutions should specify the following product type-specific criteria:

1. Specific forms of CRE that an institution intends to finance (office, retail, industrial and multi-family residential, which is not owned and occupied by households; it can be defined as land, and the building(s) on it, that generates profit or income from capital gains or rents)
2. The minimum levels of equity to be provided by the borrower and the market value of the CRE mortgaged property
3. Risk-based limits for lending for speculative development lending
4. Standards to assess the various stages of the CRE development/construction in relation to the loan drawdown
5. Minimum standards regarding requirements for performance and payment bonds and title insurance

6. Minimum standards to ensure a minimum level of oversight of the construction via a contracted presence and an on-site visit of suitable experienced professionals, e.g. architects, quantity surveyors and building site managers
7. Minimum standards to effectively assess the suitability and experience of any contractors or material suppliers
8. Minimum standards for pre-leasing/pre-selling requirements for CRE

Shipping finance

In addition to the general criteria for lending to micro, small, medium-sized and large enterprises specified above, institutions should specify the following product type-specific criteria:

1. The purpose of the finance (i.e. shipbuilding, purchase, operating)
2. The type of financing (mortgage-backed loans, newbuilding financing, unsecured/corporate loans, mezzanine, etc.)
3. Basic terms of the loan agreement (maximum duration based on the life of the vessel), maximum contribution, first lien as a rule, own participation depending on the riskiness of the finance, etc.)
4. Minimum requirements for the certificates needed (classification, pollution, safety, etc.)
5. Minimum requirements for acceptable registries/‘flags’
6. Minimum requirements for acceptable classification societies

Annex 2 — Information and data for the creditworthiness assessment

This annex provides a set of information, data items and evidence to be considered by institutions and creditors when collecting information for the purposes of creditworthiness assessment, in accordance with these guidelines. When relevant and more appropriate, e.g. when using automated models in credit granting, institutions and creditors may use other types/sources of information and data of an economic or financial nature that are necessary for the assessment, in compliance with the applicable legislation and in particular Directive 2008/48/EC, Directive 2014/17/EU and Regulation (EU) 2016/679.

A. Lending to consumers

1. Evidence of identification
2. Evidence of residence
3. Where applicable, information on the purpose of the loan
4. Where applicable, evidence of eligibility for the purposes of the loan
5. Evidence of employment, including the type, sector, status (e.g. full-time, part-time, contractor, self-employed) and duration
6. Evidence of income or other sources of repayment (including annual bonus, commission, overtime, where applicable) covering a reasonable period, including payslips, current bank account statements, and audited or professionally verified accounts (for self-employed persons)
7. Information on financial assets and liabilities, e.g. savings account statements and loan statements indicating outstanding loan balances
8. Information on other financial commitments, such as child maintenance, education fees and alimonies, if relevant
9. Information on household composition and dependants
10. Evidence of tax status
11. Where applicable, evidence of life insurance for the named borrowers
12. Where applicable, data from credit registers or credit information bureaux or other relevant databases, covering the information on financial liabilities and arrears in payment
13. Information on the collateral, if any
14. Evidence of ownership of the collateral
15. Evidence of the value of the collateral

16. Evidence of insurance of the collateral
17. Information on guarantees, other credit risk mitigating factors and guarantors, if any
18. Rental agreement or evidence of potential rental income for buy-to-let loans, if any
19. Permissions and cost estimates, if applicable, for real estate building and improvement loans

B. Lending to micro, small, medium-sized and large enterprises

1. Information on the purpose of the loan
2. Where relevant, evidence of the purpose of the loan
3. Financial statements and accompanying notes on single entity and consolidated levels (balance sheet, profit or loss, cash flow) covering a reasonable period, audited or professionally verified accounts, where applicable
4. Aged debtor reports/statements
5. Business plan both for the borrower and in relation to the purpose of the loan
6. Financial projections (balance sheet, profit or loss, cash flow)
7. Evidence of tax status and tax liabilities
8. Data from credit registers or credit information bureaux, covering at least the information on financial liabilities and arrears in payment
9. Information on the borrower's external credit rating, where applicable
10. Information on existing covenants and the borrower's compliance with them, where relevant
11. Information on major litigations involving the borrower at the time of application
12. Information on the collateral, if any
13. Evidence of ownership of the collateral, where applicable
14. Evidence of the value of the collateral
15. Evidence of insurance of the collateral
16. Information on the enforceability of the collateral (in the case of specialised lending, a description of the structure and security package of the transaction)
17. Information on guarantees, other credit risk mitigating factors and guarantors, if any
18. Information on ownership structure of the borrower for the purposes of AML/CFT

C. Commercial real estate lending

In addition to the items specified in Section B above:

1. Information on rent levels, vacancy and tenants, including contracts for the particular property associated with the purpose of the loan

2. Information on the type of property portfolio
3. Evidence of vacancy and turnover rates for the portfolio, per property type, property age and location
4. Evidence of rent levels per property type, property age and location
5. Information on major tenants per property type, property age and location
6. Information on the rationale for the property associated with the loan, supported by a location-specific review of supply and demand in the market by a reputable estate agent with relevant expertise
7. Evidence of the value of the collateral and separate units of the property collateral, where applicable

D. Real estate development lending

In addition to the items specified in Section B above:

1. Evidence of experience in similar projects and similar asset types, e.g. offices, retail and industrial
2. Information on any ongoing project being developed by the borrower
3. Evidence of planning and building permits
4. Information on builders, architects, engineers and contractors
5. Evidence of contracts with contractors and relevant documentation on the development, including information on penalties, guarantees and the cost of overruns
6. Information on the rationale for the development, supported by a location-specific review of supply and demand in the market by a reputable estate agent with relevant expertise
7. Evidence of cost estimates and a timeline for the development, including contingencies for the development

E. Shipping finance

In addition to the items specified in Section B above:

1. Evidence of experience in a similar type of vessel and segment
2. Evidence of ownership of assets with information on the vessels, e.g. name, registration number, type, age and size
3. Information on insurance and classification of assets by a classification society acceptable to the institution
4. Evidence of compliance with safety and environmental regulations governing the shipping industry

5. Information, based on market data, on each type of vessel and segment outlooks, e.g. geographical location of past and planned future trips
6. Evidence of off-balance-sheet obligations, such as chartered in vessels and forward freight agreement positions

F. Project finance

In addition to the items specified in Section B above:

1. Information on the business plan related to the project
2. Evidence of experience in similar projects
3. Information on any ongoing project being developed by the borrower
4. Evidence of planning and building permits related to the project
5. Information on builders, architects, engineers and contractors
6. Evidence of contracts with contractors and relevant documentation on the development, including information on penalties, guarantees and the cost of overruns
7. Information on the rationale for the development, supported by a location-specific review of supply and demand in the market by a reputable estate agent with relevant expertise
8. Evidence of cost estimates and a timeline, including contingencies for the development, certified by a qualified and reputable quantity surveyor (or similar)

Annex 3 — Metrics for credit granting and monitoring

This annex provides a set of credit-specific metrics to be considered by institutions and creditors when performing creditworthiness assessments and credit risk monitoring, in accordance with these guidelines. Where relevant and more appropriate, institutions and creditors may use other metrics for that purpose.

A. Lending to consumers

1. Loan to income
2. Loan service to income
3. Debt to income
4. Debt service to income
5. LTV

B. Lending to micro, small, medium-sized and large enterprises

6. Equity ratio (shareholders' equity divided by total assets)
7. (Long-term) debt-to-equity ratio
8. EBITDA
9. Debt yield (net operating income/loan amount)
10. Interest bearing debt/EBITDA
11. Enterprise value (sum of market value of common stock, market value of preferred equity, market value of debt, minority interest, less cash and investments)
12. Capitalisation rate (net operating income/market value)
13. Asset quality
14. Total debt service coverage ratio (EBITDA) over total debt service
15. Cash debt coverage ratio (net cash provided by operating activities over the average current liabilities of the company within a certain period of time)
16. Coverage ratio (total current assets divided by total short-term debt)
17. Future cash flow analysis
18. Return on assets
19. Debt service

20. Loan to cost (LTC)
21. Interest coverage ratio
22. Return on equity ratio (net income after interest and tax over average shareholders' equity)
23. Return on capital employed
24. Net profit margin
25. Turnover evolution

C. Real estate development lending

26. Fixed-assets-to-equity ratio
27. LTV
28. Location and quality of properties
29. LTC
30. DSCR for CRE activities
31. Occupancy rates evolution

Profitability

32. Rental income to CRE-related interest expenses

D. Leveraged finance, asset-based lending and project finance

33. Value of acquisition goodwill
34. Ring-fencing
35. LTV
36. Adherence to business plan
37. Leverage ratio (total debt over EBITDA)
38. Repayment capacity

E. Shipping finance

39. Leverage ratio
40. Rating
41. Repayment from operating cash flow
42. Repayment from guarantor
43. Repayment from vessel's sale
44. Outstanding payments

Accompanying documents

Draft cost-benefit analysis/impact assessment

As part of the Council's conclusions on the Action Plan to tackle NPLs in Europe, issued in July 2017, the EBA has been mandated to issue detailed guidelines on financial institutions' loan origination, monitoring and internal governance, with a focus on issues such as transparency and borrower's affordability assessment.

Article 16(2) of the EBA Regulation provides that the EBA should carry out an analysis of 'the potential related costs and benefits' of any guidelines it develops. This analysis should provide an overview of the findings regarding the problem to be dealt with, the solutions proposed and the potential impact of these options.

A. Problem identification

The negative effects of the high level of NPLs in a substantial number of European countries can pose a number of risks to, for example, institutions' profitability and their lending activities, with an impact on the real economy and the financial system in the EU, and altering market perceptions of the European banking sector as a whole.

In addition to economic factors, the persistence of NPLs on institutions' balance sheets are influenced by structural drivers, such as institutions' lending and monitoring policies, supervisory action and transparency of the market for collateral assets[28].

Before the 2008 financial crisis, substandard loan origination practices and weak monitoring played an important role in the build-up of NPL stock in a number of Member States. Furthermore, the lack of transparency in the market for collateral assets and of standardised valuation approaches has hampered confidence in the collateral system, which is essential to lending activities.

Policy objectives

The main objective of the guidelines is to improve institutions' practices and associated governance arrangements, processes and mechanisms in credit granting, in order to ensure that institutions have robust and prudent approaches to credit risk taking, management and monitoring. In doing so, the guidelines aim to ensure that institutions are also prepared for the upcoming challenges in the EU banking sector, such as climate change and the transition to a more sustainable economy, and developments in technology-enabled innovation. Last but not the least, the guidelines aim to ensure that the loans that institutions newly originate remain of high quality while respecting and protecting the interests of consumers. Through achieving these objectives, the EBA aims to improve the financial stability and resilience of the EU financial system.

[28] Report of the FSC Subgroup on Non-Performing Loans (9854/17).

At a more specific level, these guidelines aim to address the identified issues, with a view to fostering and monitoring sound credit origination standards, risk management and internal governance, to ensure that newly originated loans remain of high quality and to minimise the increase in NPL inflows in the future.

When drafting the present guidelines, the EBA considered several policy options under three main areas.

Scope of application of the guidelines

Options considered

Option 1a: These guidelines should apply to new lending only, i.e. loans that have been originated after the date of implementation of these guidelines.

Option 1b: These guidelines should apply to new lending and also to loans that have been originated before the date of implementation of the guidelines.

Baseline scenario

The current EU legislative framework for institutions' internal governance procedures for loan origination and monitoring consists mainly of Article 74(1) of Directive 2013/36/EU and the EBA Guidelines on internal governance.

The institutions' current risk management practices, policies, processes and procedures for the origination of loans are laid down in Article 18 and Article 20 of Directive 2014/17/EU and the EBA Guidelines on creditworthiness assessment (repealed with effect from the date of application of these guidelines). Further legislative requirements for credit and counterparty risk are laid down in Article 79 of Directive 2013/36/EU.

Assessment of options and preferred option

Under Option 1a, the monitoring of the performance of credit facilities and potential underlying collateral is based on the current EU legislative framework. The refinancing of existing loans will also follow the current standards and will not apply the standards for loan origination outlined in these guidelines.

Under Option 1b, financial institutions will apply these guidelines to all existing loans, their refinancing and newly originated loans.

It is expected that a broader scope of application would imply certain operational costs for institutions, such as costs associated with the development of IT and data infrastructure, especially for the creditworthiness assessment, and the monitoring of the stock of existing loans falling under the scope of application. It is also expected that these costs would be limited, as institutions have the opportunity to collect the necessary information on specific loan agreements when a new contract or an addendum to an existing agreement is signed with the borrower. In terms of monitoring the stock of existing loans falling under the scope of application, the guidelines also allow a transition period of 3 years for institutions to take necessary steps as they identify gaps in their monitoring processes. This approach is also an effective way to tackle the credit quality issues on the stock of loans.

Limiting the scope to new credit facilities is expected to have a negative effect on the effectiveness and the consistent application of loan origination standards within and across institutions. This will hamper the creation of a level playing field and the convergence of supervisory practices. This status can prevail for a long time due to institutions' refinancing practices and outstanding loans with long maturity.

Option 1b has been retained.

ESG factors and green lending

Options considered

Option 2a: Include ESG factors in risk management policies, credit risk policies and procedures.

Option 2b: Provide guidance on risk management policies, credit risk policies and procedures without considering ESG factors.

Baseline scenario

A diverse range of sector-specific market and policy factors has motivated the evolution of the sustainable finance agenda, with financial institutions developing methodologies and implementing procedures to integrate environmental factors into risk management systems, including customer credit and lending evaluations. These developments are coherent with the risk that environmental and climate factors pose for financial institutions, as close to 50% of the exposure of euro area institutions to risk is directly or indirectly linked to risks stemming from climate change[29].

Approaches to incorporating those risks vary considerably in terms of scope and breadth of factors considered, governance and management, and relationship to broader sustainability strategies. Further barriers to sustainable finance and, more specifically, green lending are a lack of appropriate information flowing between the market and financial institutions and issues of policy coherence and regulatory alignment[30].

The Action Plan on sustainable finance adopted by the European Commission aims to address these issues. The EBA's role in achieving this plan has, inter alia, been laid out in the revised banking

[29] European Commission Action Plan: Financing sustainable growth, March 2018.

[30] United Nations Environment Programme, *Greening the banking system – taking stock of G20 green banking market practice*, September 2016.

package CRD V (revised CRD/Capital Requirement Regulation, CRR). It mandates the EBA to assess the incorporation of ESG risks into the supervisory process (Art. 98 of the amended CRD) and to assess the prudential treatment of assets associated with environmental or social objectives (Article 50da of the amended CRR). In addition, it requires large institutions to publicly disclose ESG-related risks they are exposed to. Furthermore, Article 8(1)(a) of the amended EBA Founding Regulation specifies that, when carrying out its tasks, the EBA may take into account the integration of ESG-related factors.

Assessment of options and preferred option

The adoption of ESG factors are expected to create one-off costs for institutions with regard to aligning their internal government arrangement or establishing those arrangements to be compliant with these guidelines, and will create ongoing costs for monitoring their ESG-related activities. In relation to loan origination, these costs will be limited to financial institutions that are active (or intend to be active) in green loan origination.

Supervisors are expected to face incremental costs when amending their practices, such as rules, methodologies and manuals, and informing staff members and the sector regarding these changes.

Including principle-based requirements on the ESG factors at the level of policies and procedures, however, will provide an opportunity to promote these practices from the point of origination. They will support counteracting the fragmented landscape of approaches on ESG lending, which present a barrier to coherence and comparability across institutions. By providing additional clarification on climate change associated risks, the guidelines support the creation of a clear understanding of green transactions.

Financial institutions are expected to benefit from the adoption of ESG factors in their loan origination practices, as including and monitoring environmental factors will help them to streamline the processes developed and to ensure that environmental and social due diligence is incorporated into credit decisions. This will help to take those risks adequately into account and thereby avoid or mitigate financial losses, reputational risk, and social and environmental harm.

Furthermore, the disclosure of green performance information by financial institutions and borrowers, including total green lending flows and the degree of adoption and implementation of core practices, is expected to support system-level monitoring and encourage a level playing field.

As these guidelines reflect the forthcoming EU policy actions to stimulate sustainable finance, compliance with these guidelines is expected to support institutions' prudent treatment of ESG-related loans throughout the life cycle of the loan by implementing appropriate standards at the initial stage of the loan origination.

The harmonisation between national-level and EU-level regulatory frameworks positively affects the capacity to advance new products. It is thereby expected to contribute to efficient and effective cooperation among competent authorities.

Option 2a has been retained.

Valuation of immovable property collateral

Options considered

Option 3a: Use advanced statistical models for the purpose of monitoring of the value of immovable property collateral.

Option 3b: Use advanced statistical models for the purpose of the valuation of immovable property collateral for revaluation and monitoring.

Option 3c: Use advanced statistical models for the purpose of the valuation of immovable property collateral at the point of loan origination, for revaluation and monitoring.

Baseline scenario

The EU regulatory landscape for immovable property valuation, in the context of loan origination and collateral monitoring, currently addresses advanced statistical models under several aspects:

1) **MCD — Article 19; Recital (26)**
According to the MCD, valuation needs to meet valuation standards, in particular those developed by the International Valuation Standards Committee (IVSC), the European Group of Valuers' Associations (TEGoVA) or the Royal Institution of Chartered Surveyors (RICS).

2) **CRR — Article 208(3) and Article 299(1)**
Under the CRR, statistical methods may be used to monitor the value of immovable property and identify immovable property that needs revaluation (Article 208(3)). For the revaluation of collateral, statistical approaches can further be applied, in cases where Article 208(3b) does not apply, i.e. where there is no suspected material decline in the value of the immovable property and the loan does not exceed EUR 3 million or is less than 5% of the own funds of an institution. When Article 208 (3) does apply, a statistical model cannot be used as a sole means of undertaking the review of the property valuation.

3) **EBA Guidelines on management of non-performing and forborne exposures — Chapter 9**

The EBA Guidelines on NPLs state that immovable property valuation should be carried out according to applicable international, European and national standards. Valuation and revaluation may be supported by statistical models.

4) **TEGoVA's European valuation standards — EVIP 6**
Statistical methods may be used to monitor the value of the property and identify property that needs revaluation. The use of these methods is not allowed for the valuation at origination.

5) **RICS valuation — global standards — VPS 1**
The Red Book addresses advanced statistical models in relation to the nature and extent of the valuer's work, whereby the valuer's work can be based on valuation provided by advanced statistical models.

The majority of Member States incorporate property valuation standards into their national regulatory framework. In at least seven Member States, additional guidelines apply, which detail the property valuation process beyond the EU specifications. The international and European valuation guidelines provided by RICS and TEGoVA are explicitly incorporated into more than six of these regulatory frameworks.

Three Member States specifically regulate the use of advanced statistical models. In six other Member States, those models are recognised by competent authorities through reviewing or revaluating model standards, issuing advanced statistical model-specific guidance or acknowledging results provided by those models for regulatory reporting.

The majority of EU institutions use advanced statistical models for internal portfolio valuation, mortgage revaluation and mortgage monitoring. In at least six jurisdictions, advanced statistical models are also used to support loan origination. In relation to the immovable property collateral, due to the statistical specifications of the models, the use of advanced statistical models is in practice restricted to the residential immovable property.

Assessment of options

A broader use of an advanced statistical model throughout the life cycle of a loan may be beneficial for financial institutions from an internal business perspective, as they can carry out this valuation method for a range of valuation activities and thereby benefit from a quick and cost-efficient valuation.

In the future, it is expected that progress in information technology and the development of a large property and transaction database will increase the precision of advanced statistical models. A strict restriction on the use of those models could hamper development in this market and the overall progress of the valuation market.

However, from a prudential point of view, the use of those models at the stage of loan origination may create shortcomings in the risk management, so there must be prudential standards in place to ensure the transparency and accuracy of the model outcome. A strict ban on the use of advanced statistical models at the point of origination may increase the cost for consumers.

Option 3c has been retained and summarised in Table 1.

Table 1: Use of advanced statistical models for the purpose of valuation of immovable property collateral

Valuation conducted by:	Initial valuation	Revaluation		Monitoring
		Art. 208(3) applies[(a)]	Art. 208(3) does not apply[(b)]	
Valuer	✓	✓	✓	✓
Valuer supported by advanced statistical models	✓	✓	✓	✓
Advanced statistical models			✓	✓
Other statistical models, including indexation			✓	✓

[(a)]This is whenever the price of the immovable property may have declined materially or for big loans of EUR 3 million or 5% of the own funds of the institution.

[(b)]This is when there is no ‘suspected’ material decline in the value of the immovable property, and the loan does not exceed EUR 3 million or is less than 5% of the own funds of an institution.

Feedback on the public consultation and on the opinion of the BSG

The EBA publicly consulted on the draft proposal presented in this paper. The consultation period lasted 3 months, from 13 June to 30 September 2019. During this period, the EBA received 77 responses, of which 64 were published on the EBA website and 13 were treated confidentially. The EBA Banking Stakeholder Group (BSG) also provided its opinion, which was published on the EBA website.

This section presents a summary of the key points and comments raised in the consultation, the analysis and discussion triggered by these comments, and the actions taken to address them when deemed necessary. When several respondents made similar comments on a specific point, the comments and the EBA's analysis are grouped together and included in the section of this paper where the EBA considers them most appropriate. All changes to the guidelines that have resulted from the assessment of the feedback received from the stakeholders during the public consultation are reflected in this document.

Summary of the BSG opinion

The BSG was largely supportive of the EBA developing the guidelines and putting a dual focus on prudential and consumer protection aspects of loan origination. The BSG stressed that the guidelines should apply to new loans originated by all credit providers, including non-banks and new entrants.

One of the biggest areas of concern for the BSG was the application of the principle of proportionality and the level of application. The BSG noted the extensively wide scope of the guidelines and suggested focusing only on newly originated loans, not setting any new requirements for the existing stock of loans, as any information collection and analysis will be too burdensome and costly, and encouraging further integration with the requirements of the MCD, the CCD and the General Data Protection Regulation (GDPR), in order to avoid any contradiction of the Level 1 legislation. To accommodate a more proportionate approach, the BSG suggested revising the language that makes the requirements very prescriptive.

The BSG requested more flexibility and recognition in the application of the principle of proportionality vis-à-vis the risk profile of the borrower, and the nature and complexity of the credit facility. Furthermore, the BSG requested for more differentiation in relation to requirements for retail and non-retail loans, risk-sensitive and non-risk-sensitive businesses, as well as the materiality of portfolios for the institutions. Furthermore, the BSG argued that the guidelines should adopt a more proportionate approach to the requirements for collecting data from the borrowers for the purposes of borrowers' creditworthiness assessment and monitoring. The BSG also requested clarification on the role and content of annexes in the guidelines, as they do not facilitate current market practices, such as portfolio analysis and model-based analysis, which are used for a certain group of borrowers and a large amount of small consumer/small and medium-sized enterprise (SME) credits. The BSG suggested including the content of the annexes in the guidelines as examples for the institutions.

The BSG suggested that the EBA consider extending the deadline for the implementation of the guidelines and introducing some phase-in arrangements. The main purpose of this is to allow the addressees of the guidelines sufficient time to make necessary arrangements to establish an adequate IT structure and provide training for the staff. Furthermore, the delay would also allow all other ongoing regulatory developments to be taken into account, including developments in the area of sustainable finance. With respect to sustainable finance, the BSG stressed the need to align all ESG-related requirements with the relevant upcoming ESG regulatory initiatives and the EBA mandates in CRR 2/CRD V and avoid front-loading the future regulatory requirements in these guidelines.

The BSG expressed concerns that the requirements for governance and credit granting are too standardised and prescriptive. It is argued that the guidelines do not clarify the difference between credit risk and creditworthiness assessment. On this point, the BSG suggested that the guidelines, instead of introducing detailed governance requirements that may limit proven and well-functioning lending activity, should focus more on protecting consumer interests, including assessing the suitability of products, protecting consumers from loan sharks and mitigating negative consequences of default. The BSG suggested that the EBA emphasise, in the guidelines, the concept of responsible lending.

Furthermore, the BSG made a series of suggestions to improve the consumer protection dimension of the guidelines. The suggestions aim to ensure that the institutions' credit policies and procedures and the creditworthiness assessment do not lead to discrimination against borrowers and appropriately take into account borrowers' characteristics (e.g. life expenditure, household composition), to ensure that the products are suitable for the borrowers and that loan servicing does not induce any undue hardship on the borrowers.

With respect to creditworthiness assessment, the BSG also suggested that there needs to be a clarification in the credit decision-making process between acceptance and refusal thresholds linked to default rates.

The BSG expressed concerns that the section on pricing is detailed and prescriptive, and that the requirements set out in the draft guidelines represent interference with business practices and decisions. The BSG requested clarification that the relevant section represents a set of best practices, as opposed to requirements influencing pricing strategies and decisions.

The BSG also requested more flexibility and streamlining of the requirements for the monitoring framework, as the proposal of the draft guidelines is perceived as overly complex, burdensome and not proportionate to the average size of the loan portfolios. Furthermore, the BSG expressed concerns that the general monitoring requirements do not adequately reflect the specificities of institutions, borrower groups and specific loan products.

Summary of the key issues and the EBA's response

While there was broad support for addressing the topic of loan origination in the wake of the period of high levels of NPLs and the EBA's comprehensive approach in bringing together prudential regulation and consumer protection dimensions, the respondents expressed several concerns and reservations in their comments to the consultation paper. The key concerns are about the following key points: the level of detail, the application of proportionality, the implementation timeline and the scope of application.

The level of detail

Many respondents thought the draft guidelines were broad, in terms of topics covered, and prescriptive and put limitations on prevailing industry practices. To this end, respondents requested more flexibility in the requirements set out in the guidelines, recognition of different current and emerging industry practices and greater proportionality in the application of the guidelines, considering that the scope of the guidelines covers a wide range of loans, from small ticket consumer credit to lending to large corporates. The respondents also cautioned against creating a 'one size fits all' approach to credit risk taking, decision-making and creditworthiness assessment.

The application of proportionality

Respondents not only noted three types of proportionality consideration in the guidelines but also requested that additional dimensions be considered, such as the materiality of portfolios, the risk profile of the borrower and the risk profile of the portfolio or specific loan. Many respondents requested that general proportionality considerations be supplemented with practical examples of how the principle of proportionality can be applied in practice. With respect to proportionality in the creditworthiness assessment, many have pointed to the idea of having simpler approaches when dealing with consumer lending and lending to SMEs, including recognising ongoing developments in model-based assessments and credit decisions. Furthermore, the respondents asked for the nature of the annexes and the widespread use of the words 'at least' throughout the text of the guidelines to be clarified.

The implementation timeline

Many respondents requested a longer implementation period and/or transitional/phase-in arrangements. It was argued that the implementation of the guidelines would be costly and time-consuming, especially for IT developments and the collection of missing information from borrowers. Another argument for the delay was the ongoing and future regulatory developments and the need to ensure better consistency between the requirements of the draft guidelines and (future) Level 1 regulatory requirements. On this point, respondents suggested waiting for the finalisation of the reviews of the MCD and the CCD, in order to ensure consistency with future potential changes to the creditworthiness requirements set out in those directives. Respondents suggested that the EBA delay the introduction, in these guidelines, of any requirements for sustainable finance, green lending and ESG factors as part of credit analysis until the finalisation of other planned developments in the policy area, such as at the EU Commission Taxonomy or the EBA's ongoing and future initiatives and mandates.

The scope of application

With respect to the scope of application, many respondents suggested applying the guidelines only in relation to the loans originated after the application date of the guidelines (and not on renegotiated loans originated before the application date but renegotiated after it). Furthermore, stakeholders asked for clarification of how the guidelines are expected to apply to leasing and factoring.

Further feedback

Many respondents provided detailed feedback to specific sections of the draft guidelines. Thus, in relation to internal governance requirements, respondents asked for further clarification and alignment of the guidelines with the EBA Guidelines on internal governance, in particular with regard to points on decision-making, including independence in credit decisions that seemed to be too onerous. Respondents also requested the introduction of portfolio dimensions and the materiality of portfolios into the requirements for credit risk strategies, credit risk appetite and allocation, as well as clarification of how the 'three lines of defence' model fits into the process and list of tasks specific to the credit-granting process. With respect to the latter, specific concerns have been raised about the role of the risk management function in the credit decision-making process and blurring the tasks for the first and second lines, in particular, getting early independent risk views into the credit decision-making process. Respondents also noted that risk-based remuneration for staff working on credit seems to be problematic, especially considering the long-term credit quality dimension/metrics.

Respondents also asked for more clarity and guidance on interpretation and supervisory expectations in relation to the scope and wording of the requirements for technology-enabled innovation (FinTech), allowing for artificial intelligence (AI), big data and scoring models, etc., and running in parallel or replacing traditional human analysis of the financial position of the borrowers.

With respect to the proposed requirements for the creditworthiness assessment, respondents requested that the EBA revise the text to emphasise a more proportionate approach to data and information collection and creditworthiness assessment, first between small consumer credit and SME loans and lending to large corporates, and second between loans to new borrowers and loans to known/existing borrowers/customers. Respondents emphasised that the guidelines should also recognise different distribution channels, including online banking/products.

It was pointed out that the requirements for information collection and verification are too burdensome and sometimes not justified. Respondents expressed concerns that some of the requirements shift borrowers' responsibilities to institutions, and in some cases institutions are not in a position to obtain or verify the information. As for the creditworthiness assessment of micro, small, medium-sized and large enterprises, many respondents argued that, while some of the requirements, especially those related to financial projections and sensitivity analysis, may be appropriate for large corporates, they are not appropriate for SMEs.

Most respondents raised concerns about the section on collateral valuation, in which the guidelines restrict the use of advance statistical models/automated valuation for the valuation of immovable property collateral at the point of loan origination. Furthermore, respondents requested clarification and further elaboration on the definition and scope of immovable and movable property collateral, i.e. if the scope includes both when the property is used as principal collateral (asset-based lending) and when the borrower provides additional collateral at their discretion to strengthen their loan application (security lien). Respondents further raised a number of points in relation to the requirements on the rotation of valuers, a panel of experts and the application of the proposed requirements for leasing transactions.

With respect to the proposed requirements for monitoring, respondents stressed that the requirements are too burdensome and costly, because they require the monitoring of soft information and information that is not currently collected from borrowers. It was also stressed that monitoring requirements should not lead to additional supervisory reporting. While respondents largely support the approach to early warning indicators, they expressed concerns over the idea of having a minimum list of indicators to be monitored. It was also suggested to split monitoring requirements by segments (consumers, SMEs, etc.). Respondents also requested more clarity on what should be monitored at portfolio level and what at borrower and credit facility levels, as well as the focus of monitoring (behavioural aspects — repayment history — vis-a-vis monitoring of the financial conditions of a borrower). In relation to the monitoring, some have also raised concerns about the interaction of the proposed requirements with data protection rules, in particular in relation to the concept of a ‘single customer view’, used in both monitoring and creditworthiness assessment.

The EBA carefully examined all of the comments received (see the feedback table attached to this document) and amended the text of the guidelines accordingly. In particular, in response to the comments received, the EBA has clarified the scope of application of the guidelines. The EBA also extended the implementation period, with a view to giving institutions and competent authorities 1 year (between the publication of the final report and the application date) for the implementation and an additional phase-in period for the collection of missing information from the borrowers for credit-monitoring purposes.

The EBA significantly revised the guidelines and emphasised the principle of proportionality throughout. In order to account for the principle of proportionality, the EBA both changed the language/wording and restructured the sections.

First, the EBA revised the role and references to the annexes (e.g. the use of the word ‘at least’), to ensure that they are not seen as a list of requirements/parameters against which supervisors should assess the institutions. Second, the EBA has split the section of the creditworthiness assessment of micro, small, medium-sized and large enterprises and set out a simplified approach to the assessment of micro and small enterprises, with significant simplification of the requirements. For this purpose, the EBA used the EU Commission’s SME definition. Furthermore, the EBA has clarified that the creditworthiness assessment can be done by various means, including models, as long as the requirements of these guidelines are met. To this end, the EBA also provided guidance on the model governance consideration, ensuring that the models used for the purposes of creditworthiness assessment and credit decision-making are robust and fit for purpose.

In the area of internal governance, the EBA has clarified the requirements for credit decision-making, and also the requirement for the use of FinTech and model governance, to ensure that the guidelines are both future proof and technology neutral. The EBA also revised the requirements for the credit risk management and control frameworks, to ensure their full alignment with the EBA Guidelines on internal governance and to avoid prescribing any specific organisational structures that remain the responsibility of the institutions themselves.

With respect to the loan origination procedures the EBA first clarified the requirements for handling information for the purposes of creditworthiness assessment, recognising that, for existing customers, information may be already available to the institutions, and then explained the notion of verification of information. The text has been thoroughly reviewed throughout, to ensure that there is no 'one size fits all' approach, and various approaches, including models, can be exploited as long as they meet general prudential requirements set out in the guidelines. The requirements for creditworthiness assessment for consumer lending have been simplified, compared with other asset classes, to ensure a practical application of the principle of proportionality. The EBA also clarified the requirements for the creditworthiness assessment of leveraged transactions that have been previously scattered across various sections.

The section on pricing has been significantly revised to address respondents' concerns. The EBA clarified the requirements and emphasised that the EBA's intention is not to prescribe specific pricing strategies. The EBA also elaborated further on various risk-based metrics to be considered by institutions in their pricing approaches.

With respect to the collateral valuation, the EBA has further revised the guidelines to allow the use of advanced statistical models for the valuation of immovable property collateral at the point of origination, subject to the strict conditions for such use, as far as possible within the requirements of the CRR/CRD and the MCD. The EBA also provided a set of requirements for the advanced statistical models themselves.

Based on the feedback received, the EBA streamlined the requirements for the monitoring framework, introducing more proportionality and consideration of the risk profile of the borrowers and portfolios/individual loans. Further clarifications included the monitoring of soft information, behavioural aspects, leveraged transactions and the use of early warning signals.

The EBA's detailed assessment of the BSG opinion and other responses is presented in the feedback table, *Summary of the responses received to the consultation and the EBA's analysis*, attached to this report and published on the EBA website.