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We take the opportunity to comment on the **EBA/CP/2019/04 Draft Guidelines on loan origination and monitoring**.

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

The level of details and wording does not take into account the proportionality principles according to para 14. Due to granularity of credit products and client's segments, the appropriate level of creditworthiness assessment, documentation requirements and monitoring must be assessed individually for each institution (local legal, economical, institutional conditions must be taken into account as well). The form of current guidelines EBA/GL/2015/11) are much better - stipulating just general principles (goals) and not describing particular ways how such goals should be achieved.

The wording should clearly support proportionality principles – not „at least perform", „use at least the following" but „to consider for example", „where relevant to use all of some from the following".

The guidelines do not take into account the issue of cost/benefit – the extensive application of full-scope risk mitigation measures would increase cost of credit products for small professionals (either SME or entrepreneurs) for which simple credit products with low financed amounts are offered (especially portfolio-managed products).

Generally, the banks apply 2 basic processes, one simpler focused on plain vanilla retail loans (for individuals, entrepreneurs and small business clients) with small exposure processed via heavily automated procedures (e.g. behavioural scoring techniques) that are further digitalized and second sophisticated one focused on individually processed non-retail loans with significant exposure. The GL does not reflect this natural split (the GL namely covers the non-retail process and retail small business process together with just one rules). Therefore the GL should be split (i) either differently, i.e. set the rules for retail plain vanilla non-consumer loans and then rules for non-retail or (ii) from non-retail (professional) part should be excluded loans for entrepreneurs and retail small business (i.e. retail non-consumer clients) with a credit exposure below EUR 1 million.

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

Yes, for entrepreneurs and retail small business, the proposed rules for financing are not in line with the current praxis (heavily automated procedures based on alternative income verification etc.) that is further digitalized (big data incorporation) and it is not possible to implement them till June 30, 2020 because it would mean complete redesign of current methodology, procedures and IT systems.

Some parts of the guideline still require clarification (refer to the comments to other questions).

The implementation date depends on the date when the final version of guidelines will be published – application date should be at least 1 year after publication.

Further, we have a comment to the Definitions. The definition of "commercial and residential" real estate should (in our opinion) be based on the nature (purpose / use) of the real estate, i.e. if the property is used for housing, incl. rental (and possibly social) then it should still be a residential property, regardless of whether the property is the object / purpose of financing and / or the collateral provided and regardless who is the debtor (natural person or legal entity). On the other hand, in case the financed real estate will be used for commercial purposes regardless of the type of debtor (natural person or legal entity) it should be commercial real estate. In case of change of a/m definitions the respective further Articles should be amended (e.g. 5.2.2, 5.2.6).

We propose following definitions:

Residential real estate (RRE)	means any immovable property available for dwelling purposes, either existing or under construction, acquired, built or renovated, including buy-to-let housing. If a property has a mixed use, it should be considered as different properties (based for example on the surface areas dedicated to each use) whenever it is feasible to make such breakdown; otherwise, the property can be classified according to its dominant use.
Residential real estate (RRE) loan	means a loan for the purpose to finance the residential real estate property.
Commercial real estate (CRE)	means any rental or sale income producing real estate, either existing or under development that is not classified as residential real estate (RRE). If a property has a mixed CRE and RRE use, it should be considered as different properties (based for example on the surface areas dedicated to each use) whenever it is feasible to make such breakdown; otherwise, the property can be classified according to its dominant use.
Commercial real estate (CRE) loan	means a loan aimed at acquiring rental or sale income-producing real estate (or set of properties defined as income-producing real estate), either existing or under development where the income is used for loan repayment.

3. What are the respondents' views on whether the requirements set in the draft guidelines are future proof, in particular in relation to technology enabled innovation (Section 4.3.2) and environmental factors and green lending (Section 4.3.3)?

<u>We have following comments:</u>

1) Ad 4.3.2. Leveraged – there needs to be link to specific EBA GL to Leveraged
2) The requirement 4.3.3.d needs clarification. In practice the existing (here referred to as traditional methods) and new solution run in parallel and can be compared only during the pilot phase. Then the old solution is decommissioned. The regular comparison of the performance of both solutions would then be impossible.
3) Ad 4.3.4. Environmental and green lending typically fall under non-profit sector financing. There are already risk and lending policies for this sector in place. We do not find the requirement to treat these two types of lending with specific policies and procedures necessary. A scope should

be defined where environmental factors are investigated – i.e. specifically to be stated that it is not needed to be investigated within industrial credit process.

4) To be future proof, alternative assessment of the creditworthiness and collection of information/documentation in granting processes based on the technology-enabled innovation should be allowed to the one described in section 5.

5) The same comments as to the question 1, GL does not reflect the natural split in granting process for professionals (retail granting process for non-consumer loans and non-retail granting process).

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

The same comments as to the question 1, GL does not reflect the natural split in granting process for professionals (retail granting process for non-consumer loans and non-retail granting process).

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

The same comments as to the question 1, GL does not reflect the natural split in granting process for professionals (retail granting process for non-consumer loans and non-retail granting process).

We would ask for a clarification of "three lines of defence' model" in paragraph 75. The concept is clear but it is not clear how it should be applied in the Retail environment where typically following stakeholders take part in the lending process – branch, Retail credit risk management, CRO, Group risk management. How the three lines of defense be defined in such a case? Can the setup be defined differently for Retail and Corporate lending process?

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

- From the point of view of remuneration, it seems that Art. 81 and 82 are superfluous. The rules regarding the remuneration are already captured in EBA/GL/2015/22 (guidelines on remuneration). These guidelines specifically refer to the risk element which has to be taken into account when setting the variable. It is among others the Title I - Requirements regarding remuneration policies of the guidelines on remuneration which state the general principles. We consider that the guidelines on remuneration already reflect the proposed requirements.
- There is no clear definition/explanation what kind of group of employees can be considered as a staff involved in credit granting. At the same time, it is not clearly identified to which employees the Guidelines apply. Should it be the employees, who sell the loans or the ones, who prepare the concrete parameters of the loan?
- The same comments as to the question 1, GL does not reflect the natural split in granting process for professionals (retail granting process for non-consumer loans and non-retail granting process).

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

Generally, the requirements stated in this part do not correspond to retail small business granting process. The rules are tailored-made for fully individual non-retail process and granting big exposures and subsequently the rules do not correspond at all to heavily automated granting process for entrepreneurs and small business that is further digitalized (big and alternative data incorporation etc.).

Information (even if documented) like income, financial commitments (i.e. expenses) and employment reflect only the past (in best cases also presence) but loans (more preciously instalments) are commitments in the future.

On the other hand, predictive analytics encompasses a variety of statistical techniques from data mining, predictive modelling, and machine learning that analyse current and historical facts to make predictions about future or otherwise unknown events. One of the best-known applications is credit scoring which is used throughout financial services. This efficient tool which (compared to just simple equation: „income – expenses"): a) provides better protection of the client; b) leads to higher stability of banking sector and in the same time c) creates lower costs for the client (time/effort).

The requirement does not fully reflect the changing market environment and technological progress in the field of financial services. This requirement considers collecting paper documents as evidence of declared information (only) which impose another requirement for verification (which generate costs not only for the bank but also for other institutions like e.g. employer of the client) – because documents submitted by clients can be modified/faked (exactly the same as declared data).

This approach can be easily replaced by implementation of efficient scoring model. Unfortunately, this approach is not in line with this guideline.

Level of collection and verification of information should be adequate and reasonable to reflect defined situation (profile of client, loan amount, total exposure…etc.).

Further, we have the following more concrete comments:

1) **Point 85** - Single consumer view is too restrictive – it is not possible to exclude the view on consumers by using statistical models that – which should be emphasized - are significantly more accurate than assessment based on pay slip. In addition, the behavioural score proves to be very beneficial in refining classic scoring and its use should be welcomed.

2) **Point 88** – The banks in the Czech Republic have the legal obligation to look to all registries incl. insight into a positive non-banking register and hence it makes no sense to introduce a consent for every single query and processing.

3) **Point 89** – Collection of info on Group members is not seen plausible esp. in industrialized credit granting process (usually of retail feature), where risk is based on standalone basis of individual client and specific transaction. Therefore the text "on all related connected clients" should be deleted and the text of this Art. will be:

   „If the borrower is a member of a group of connected clients, institutions and creditors should collect the necessary information in accordance with the EBA Guidelines on connected clients,

especially where reliance for repayment is placed on cash flow emanating from other connected parties"

4) **Point 91, 92, 93 and 94** should be amended in terms of deleting the text "at least" (in all points since proposed text of these points is contrary to text of the point 86 stating:

   86. Information and data should be accurate, timely and relevant to the asset class and specific product, and proportionate given the purpose, size, complexity, and potential risk associated with the loan.

   It is not advisable to always ask for specific information on the consumer's expenses, as this may change during time and also depending on the willingness of the consumer to limit himself due to the credit. Alternatively, statistically standard and necessary expenditures can be used instead of specific expenses of a particular person. This makes the assessment result more accurate and much safer for the client.

5) **Point 91 and 93** should be amended in terms that respective information is not verified automatically in each case of the loan to adhere to the principle of proportionality and adequacy. We proposed to change the text as follows:

   91. Institutions and creditors should collect information in relation to the following and in case of need verify it: ……

   93. For the purposes of the creditworthiness assessment of professionals, institutions should collect information in relation to the following and in case of need verify it:

6) **Point 99** states 4 types of ratio (e.g. loan to income ratio) which are not explained. This explanation should be added.

7) It should be allowed to use an alternative than described assessment/collection of information/documentation collection in granting processes based on the technology-enabled innovation. We propose to clarify that it is possible to use models and automatic processes in a given area.

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

With respect to the principles of proportionality outlined in para 14, the guidelines stated in section 5.2.5. on assessment of borrower´s creditworthiness to professionals are excessive for portfolio-managed exposures given the characteristics of these clients and exposures (simple products, small exposures). The risk management approach to theses exposures rather respects the approach outlined for consumers.

Formulas for calculation of the following parameters are missing: a) loan to income ratio; b) loan service to income ratio; c) debt to income ratio; d) debt service to income ratio. For harmonisation purposes it is necessary to clarify the formulas in the guideline.

Further, we have the following specific comments:

1) The metrics mentioned in **point 99** are generally used in the lending process. According to our opinion not all of these metrics must be used at the same time. We propose to clarify in the paragraph that the institution can choose only some of them for the risk management purposes.

2) According to **point 109** "*the institutions and creditors should account for committed and other non-discretionary expenditures, such as the borrower's actual obligations, including appropriate substantiation and consideration of the living expenses*". We would welcome if EBA would further clarify what should be considered as "committed and non-discretionary expenditures". Regarding the living expenses we would welcome a clarification that assessment of living expenses may be based also on statistical models rather than examining of specific expenses of a specific borrower.

3) **Point 111** – We recommend to specify immovable property in Art. 111 as the immovable property that will not be occupied as a place of residence by the borrower or family members and will produce income (e.g. rental). The reason: Art. 112 – 114 in Section 5.2.3. describe obligations of the loan providers concerning income producing property. But in fact, immovable property which is not to be occupied as a place of the residence by the borrower or a family member is not necessary an income producing property. It can be land that will be used for future construction of the house, cottage, country house, which are not intended as the place of residence, but will be used by the borrower.

4) The requirements stipulated in **points 112-114** (e.g. analysis of the future rental income, potential negative market scenarios etc.) are disproportionately extensive and go into details that the provider is not able to asses (e.g. the whole spectrum of entities involved in the construction). They may lead to a heavy additional workload in the credit approval process. Such analysis is not in line with Retail processes as well this type of lending occur in Retail. The banks should have an option to replace these analyses with an alternative (conservative) approach that is less analytically demanding.

5) **Point 115** – To avoid misunderstanding, we recommend to use the words „repay the loan" instead of „refinance the loan". The whole sentence will be: *„For loan agreements secured by movable property, the institutions and creditors should assess the purpose of the loan, the income capacity of the borrower to repay the loan including any other relevant financial obligations that may affect the borrower's income capacity to meet his/her obligations."*

6) **Points 126, 127, 132, 135** should be amended in terms of deleting the text "at least" (in all Art.) since this text is in contrary to the remaining text of the relevant sentences in these Art. For instance, the text of Art. 135 should be as follows: *„Institutions, where relevant, use the following financial metrics for the purposes of the creditworthiness assessment, and, where relevant, assess them ……."*

7) **Point 128 -** Institutions should carry out the assessment primary at borrower's level. Assessment at group level should be carried especially in cases where reliance for repayment is placed on cash flow emanating from other connected parties. For this reason, we propose the following text of this Art.: *„If the borrower is a member of a group of connected clients, institutions should carry out the assessment at individual level and if relevant at group level, in accordance with the EBA Guidelines on connected clients, especially where reliance for repayment is placed on cash flow emanating from other connected parties."*

8) The sensitivity analysis described in **points 142-146** is justifiable for mid-size companies but we find it too strict in case of micro-companies.

9) **Point 156** – Part of the 1st sentence should be deleted – this relates to the obligation that institutions should perform a due diligence of the agent or the designated entity in case of the syndicated lending or project finance transactions, where the payment streams pass through the agent or another designated entity. Further, the agent is an administrative role, therefore should be excluded from the first part of the second sentence. There are very common cases with more issuing banks (not just one sole issuer). Therefore the text of the Art. is proposed as follows: *„Where in the syndicated lending or project finance transactions, the payment streams pass through the agent or another designated entity, for cross-border lending and project finance transactions, the designated entity might be the sole issuer of any guarantees, letters of credit or similar documents issued on behalf of the supplier in the transaction.“*
(Old version:
Where in the syndicated lending or project finance transactions, the payment streams pass through the agent or another designated entity, institutions should perform a due diligence of the agent or the designated entity. For cross-border lending and project finance transactions, the agent or the designated entity should be the sole issuer of any guarantees, letters of credit or similar documents issued on behalf of the supplier in the transaction.“)

10) The requirements stipulated in **part 5.2.5** should allow less strict approach for small limits loan granted to micro companies. These loans usually undergo automated processes where e.g. projections of the business plans or detailed financial statements are not required.

11) It should be allowed to use in granting processes an alternative than described assessment of the creditworthiness based on the technology-enabled innovation. We propose to clarify that it is possible to use models and automatic processes in a given area.

12) The same comments as to the question 1, GL does not reflect the natural split in granting process for professionals (retail granting process for non-consumer loans and non-retail granting process).

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

Generally, the same answer as already above - requirements stated in this part do not correspond to retail small business granting process. The rules are tailored-made for fully individual non-retail process and granting big exposures and subsequently the rules do not correspond at all to heavily automatized granting process for professionals and small business that is further digitalized (big and alternative data incorporation etc.)

The same comments as to the question 2, 8 and 9 + many indexes (ratios) stated in the Annexes are not used in the practice.

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

This whole section should be deleted (or alternatively only the Art. 186 can remain) since we do not consider the determining the pricing by these GL appropriate. Pricing is the result of the business strategy of each loan provider/bank and it follows his/its business objectives. To make a profit in short or medium term is the basic interest of any borrower and there is no need to specify the composition of the prices.

Further:

- The profitability can be defined on the transaction level, customer level or portfolio level so that the requirement stated in Art. 190 *„All of the transactions below costs should be reported and properly justified."* is completely inadequate.
- The Art 187 c. *("Operating and administrative costs resulting from cost allocation processes that involve all group entities"*) does not make sense since the operating and administrative costs do not include costs of all group entities (i.e. "*that involve all group entities"* should be deleted).

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

The document should be changed in the following way:

7.1. Requirements for valuation at the point of origination Art. 193 "*….. Surveyors (RICS) standards **and national standards of banking associations***."

7.1.2. Movable property collateral Art. 201 *"….. is assessed by an independent qualified **internal or external** valuer or ….."* (the text should be the same for movable as for immovable property collateral - Art.194)

Section 7 requires some clarifications. In our opinion certain valuation tools are omitted for real estate and movables (e.g. automated valuation for RE). In case of monitoring/revaluation the conditions are too strict and not in line with practice. The banks typically monitor RE annually, regardless of rating, LTV, limit etc. In our opinion it does not make sense to monitor RE based on certain other characteristic more often.

Some requirements are not feasible in practice – e.g. the duty to rotate internal valuer after every second valuation. In case there is regional allocation of internal valuers, it is not feasible to rotate such internal valuers and even if a rotation takes place, the assumption that new valuer is going to bring a better valuation quality will not be realized in practice in the expected extent.

The current wording of the requirements would lead to difficulties during the implementation due to expected complexity of necessary process add IT changes.

Detailed comments to specific points:

Point 191. In practice the bank does not need an accurate valuation of collateral at the point of origination if such collateral does not represent an object of financing. Typically, in case when there is a preliminary valuation in place, if granted loan is already fully secured etc.

Point 194. Omission of automated valuation tools for real estate; RE are with success valued (flats) based on advanced valuation models online. For certain RE asset class the automated valuation mechanism represents not only cheaper, but also more reliable method of valuation. The valuation made by valuers tends to be more subjective. AVT should therefore not be omitted from the scope of allowed valuation tools. Please see 4.3.3. where the usage of technology driven tools is enabled under given conditions (these shall apply accordingly for automated valuation tools as well).

Point 201. In practice the purchase price is used for valuation of movables. It is the most common valuation method used. It is not feasible to use for every movable object the valuation provided by valuers. Advanced models might be used for planes/special means of transport generally, which are rarely used. Statistical models are predominantly used for monitoring/revaluation. Exclusion of purchase price as an allowed valuation method would lead to opposite effect (not taking the movable collateral at all = lower collateralization, or decision not to value such collateral at all). Customers are not used to carry the load of expenses related to valuation, especially if they provide standard movable object with defined (purchase) price, which for new object represent the market price.

Point 207. In case we monitor CRE/RRE annually, the more frequent monitoring based on other proposed elements does not make sense. There would not be any additional risk benefit to carry on monitoring more frequently, if current level is already sufficient and more frequent monitoring does not make a sense (e.g. monthly, quarterly monitoring for RE, where prices fluctuate slowly/low volatility). Also, we do not agree with detailed list of elements, which shall be taken into consideration. It shall be upon the bank to prove to regulator, that their setup of monitoring framework is robust, transparent and in alignment with other regulatory requirements. The cost of implementation of all elements into the monitoring framework will be too high and unfounded.

Point 208. Similar reasoning is valid for this provision as well. LTV concept is not fully usable for more complex transaction with cross-collaterization as well. Based on our experience it cannot be applied in practise and LTV should be replaced with level of collateralization (sum of allocated value from all collateral on given loan/loan risk value). LTV concept can be only used for simple retail mortgage transaction and even here a detailed definition of calculation in case the loans are secured by more collateral (cross-collateralization) does not exist.

Point 214. Rotation of internal valuers is not feasible from these reasons:

- Rarely there is more than one internal valuer in place for given region, where he is allowed to carry on valuation (local substitutability).
- Insisting on rotation of internal valuers after two valuation shall bury the concept of having internal valuation in place, because of additional cost for external valuations.
- Internal valuation is usually under supervision (4eye principle).
- In practise it is impossible to gain the same valuation from two valuers due to subjectivity of their opinion about market price of given asset. It leads to issue of mitigating situation, where the price distinction is in certain range. In practice it will not be allowed to propagate negative change in RE valuation, only because the newly appointed internal valuer has a slightly different opinion (if any crucial valuation entry is not changing into negative territory – e.g. rent is still same or higher).
- Management of internal valuers remains the same and it will not tend to fluctuate in RE valuation for same object only because new valuers carry on valuation. In reality the insisting on rotation might harm the bank, because newly appointed valuer lacking the in-depth knowledge of given region is going to provide worse, or same output as the regional expert.
- We advise to either exclude the internal valuers from provision, or mitigate the strictness (e.g. not necessary if bank might proof there is a proper risk management supervision upon the work of internal valuers, or it shall be used only when it is applicable /there is more than 1 valuer for given region and type of RE asset in place).

Point 220. The selection criteria for valuer (monitoring/re-evaluation) are hardly feasible in practice. Due to range of movables it will not be achievable to fulfil the minimum requirement for all criterions (value, life span, condition, depreciation, maintenance, inspection, certification). There are maximum requirements and could be applied for planes/ships, but not for a standard machinery. Please explain, how the bank will setup the selection criteria for such different movable objects as are drilling equipment, IT equipment, standard cars etc.? Unless the RE, for movables the range of valuer´s qualification is so broad, that bank is hardly able to find the valuer with proper qualification at all. This provision is out of the market standards and cannot be in proposed extent fulfilled in reality, even if bank makes the maximum to comply.

There should be the same treatment concerning the possibility to use appropriate advanced statistical models both for immovable property collateral (para 194) and movable property collateral (para 201-202, 205-206). Although the statistical models for immovable property collateral valuation is more difficult to develop, such models can be successfully developed for a predefined homogenous part of residential property portfolio. It is assumed that the implementation of such model-based-valuation would involve adequate oversight including ongoing monitoring, back testing and calibration, adequate coverage definition, penetration thresholds and verification of both model inputs and property risks.

There should be added a principle that a statistical model is allowed to use in case of credits with the favourable risk profile and for proportionate share of real estate valuations (e.g. 20%), that is based on outputs of valuations processed by using drive-by valuation approach or full visit. This model can be applied on immovable property collateral that is of similar design, specifications and characteristics to the ones already valued by a valuer.

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

The same comments as to the question 1, GL does not reflect the natural split in granting process for professionals (retail granting process for non-consumer loans and non-retail granting process).

With respect to the principles of proportionality outlined in para 14, the guidelines on Credit review of professionals are excessive for portfolio-managed exposures given the characteristics of these clients and exposures (simple products, small exposures). The risk management approach to theses exposures rather respects the approach outlined for consumers.

Annex 1, Annex 2, Annex 3

In regards to the annexes, we assume that the proportionality principle should be clearly stated even for "basic" requirements - for example "where relevant, institution should consider the following criteria/information" as the criteria/information may materially differ according to products/client segment/jurisdiction especially in case of professionals (mainly for the individually managed exposures and for the portfolio-managed exposures).

Concrete comments to set of documents mentioned in Annex 2 „Information collection and verification": *point 6. Evidence of income (pay slips, current bank account statements, audited or professionally verified accounts)*

Following sources of income evidence are missing:

a) Official state databases

In some countries across European Union state/government authorities provide the source of the verified data reflecting client's income. This kind of databases can be interrogated automatically with/without client consent. As example can be mentioned Romania, Bulgaria and Slovakia. For example, in Slovakia - there is special database with verified incomes/sources of the income (meaning employer verification) Social Security Database (provided by CRIF) – data in this database are confirmed and this source of income verification is moreover considered as relevant by NBS *(Národná banka Slovenska – central bank of the Slovak Republic).*

b) Other documents

Mentioned documents are not covering all types of incomes – what is for example missing: specific template of document created by bank which is than confirmed by employer, tax return, confirmation of pension/state allowance.

c) Statistical sources

We believe that our response is sufficiently clear and our views are helpful.