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EUROPEAN BANKING FEDERATION'S RESPONSE TO EUROPEAN BANKING AUTHORITY'S CONSULTATION PAPER ON DRAFT GUIDELINES ON CREDITWORTHINESS ASSESSMENT EBA/CP/2014/42

GENERAL COMMENTS

The European Banking Federation (EBF) welcomes the opportunity to respond to the [European Banking Authority \(EBA\)'s consultation on draft guidelines for creditworthiness assessment](#).

The EBF supports the introduction of guidelines to ensure consistency in the implementation of the Mortgage Credit Directive¹ across the EU Member States.

Conducting systemic and thorough creditworthiness assessment is at the heart of banking activities and represents an important prerequisite for both credit institutions and customer, as regards the evaluation of the risk and of the impact of the credit must have on the customer budget. The EBF therefore welcomes the EU Institutions' decision in the context of the Mortgage Credit Directive (MCD) **to adopt a high-level principles-based approach to the assessment of creditworthiness to allow the National Competent Authorities to implement the Guidelines according to their national specificities.**

However, the EBF considers that the following key points should be particularly underlined:

- The creditworthiness assessment is already a general principle of the European banking system introduced by the Capital Requirements Directive (2006/48/EC) and Regulation (EU) no. 575/2013. **The Guidelines implementing the Mortgage Credit Directive should reference the existing regulations in order to avoid overlapping, opposite or duplicated provisions.**
- **The suitability assessment issue was analysed in depth by the European Parliament, the Council and the Commission when adopting the Mortgage Credit Directive (MCD).**

¹ 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 Text with EEA relevance, 28.2.2014, OJEU L 60/34-85.



The “suitability assessment” was considered not appropriate for products such as mortgage and consumer credit and was rejected. It is therefore vital to clarify that the Guidelines do not refer/request any “suitability assessment” to avoid some provisions in the Guidelines being mis-interpreted extensively and introducing “de facto” a suitability assessment (for example in 1.1 (Verification of the consumer’s income) and 4.1 (Assessment of the consumer’s ability to meet his/her obligations under the credit agreement)).

The text of the MCD was finalised in a way that avoids increased litigation between banks and borrowers (in the event of consumer default, the creditworthiness assessment will not be automatically considered wrong based on an ex-post evaluation). The Directive notably obliges intermediaries to assess creditworthiness and inform the consumers concerned (adequate explanations) while – at the same time – making consumers responsible for choosing the product, meaning that suitability assessment was not included in the MCD.

Given this, the European Banking Industry considers it extremely important to constrain the Guidelines to the decisions that were taken when approving the Directive, without broadening the provisions on creditworthiness or on arrears and foreclosures. Reopening issues already solved at a political level would not contribute to the stability of the legal framework in terms of certainty about the compliance obligations.

- The Guidelines should not be limited to responsible lending obligations but should include reference to responsible borrowing in alignment with the provisions of the MCD in Recital (58), Article 18.4 and Article 20.3 and 20.4 (in reference notably to Guidelines 3 and 4).
- It is imperative to preserve a right balance between gathering relevant information on the financial situation of the customer and the respect of data protection requirements.
- This creditworthiness assessment also involves the borrower to which it belongs to provide accurate and clear information about his/her personal and financial situation. It is also important to insist on the fact that **it should not be imposed to lenders to predict the financial situation of their customers. Indeed primarily failures concern the accidents of life (illness, divorce, job loss ...) generating an abrupt change in the financial situation of the customer.** In essence and in practice an assessment can only take into account what is known or planned at the time the lending is being made – retirement being one example.
- The MCD was approved less than one year ago and must be implemented by March 2016, meaning that all national-level procedures will have to be modified to comply with the new Directive. **The implications of the transposition of the Directive and the implementation of the Guidelines could be significant for firms’ MCD implementation programmes, and delivery timescales may be challenging** (taking into account that no additional time is provided to the industry, when the law/Guidelines will be adopted, to adapt their ICT systems, prepare the programming etc.). It is important to note that this additional time already requested by the industry is necessary to avoid reiterating the difficulties which occurred during the transposition and implementation of the Consumer Credit Directive in certain countries.

RESPONSES TO THE QUESTIONS

Question 1: Do you agree with the proposed Guidelines? If not, outline why you disagree and how the Guidelines could be improved. Please respond separately for each of the seven Guidelines.

GUIDELINE 1: VERIFICATION OF THE CONSUMER'S INCOME

Guideline 1.1:

According to point 1.1 *the creditor should make reasonable enquiries and take reasonable steps to verify a consumer's prospect to meet his/her obligation under the credit agreement including the consumer's underlying income capacity, the consumer's income history and any variability over time.*

- The requirement regarding income history and any variability over time is problematic and we face difficulties to understand the rationality behind it. The income history seems to be relevant only when it comes to consumers with irregular income (freelancer etc). In general, relevant information is the income the consumer receives when applying for the mortgage credit and the estimation of the general income in the future.
- The obligation to verify income history is burdensome and, at worst, it can have a negative influence on the consumer. The proportionality principle should be emphasized (mentioned in point 1.2 but not in point 1.1). Salary slips and annual tax returns for example should be seen to confirm the declared income.
- In order to avoid any confusion, the Guidelines should also clearly state that this obligation applies only *before granting the credit*. Hence, this Guideline should not be interpreted as a requirement to monitor the consumer's income on a periodical basis in the context of credit-worthiness assessment. It is indeed imperative to consider this point in the context of the requirements of Article 18.6 of MCD², which requires a reassessment of the consumer's creditworthiness before a significant increase in the total amount of credit.
- In addition, it is also important to insist on the fact that it should not be imposed to lenders to predict the financial situation of their customers. Indeed primarily failures concern the accidents of life (illness, divorce, job loss ...) generating an abrupt change in its financial situation of the customer. In essence and in practice an assessment can only take into account what is known or planned at the time the lending is being made – retirement being one example.

Guideline 1.2:

According to point 1.2 *the information should be provided by sources that are independent of the consumer*. This duty is problematic if it excludes the possibility that the consumer provides the information to the creditor (for example a salary certificate).

² Article 18.6 of the MCD: 6. *Member States shall ensure that the consumer's creditworthiness is re-assessed on the basis of updated information before any significant increase in the total amount of credit is granted after the conclusion of the credit agreement unless such additional credit was envisaged and included in the original creditworthiness assessment.*



The MCD states clearly that the information used for creditworthiness assessment shall be obtained by the creditor from relevant internal or external sources, including the consumer (article 20). This requirement does take into account the fees evaluations or of the personal situation of the consumer.

The Guideline could indeed be interpreted as excluding the information based on the declaration of the client. (e.g declaration of honour of the consumer).

The Guidelines should not impose stricter requirements compared to the Directive.

Suggestion for amendment:

1.1 The creditor should use necessary, sufficient and proportionate information that can be evidenced and ***could also be*** ~~that is~~ provided by sources that are independent of the consumer.

Guideline 1.3:

Provided the creditor is obliged to take steps described in Article 1.1 it should be clarified further why there should be more stringent rules pertaining to self-employed customers. It might be difficult to assess that the income is seasonal.

It would be more appropriate to verify “*specific*” information instead of “*additional*” information.

The EBF is concerned about the introduction of notions aimed at guaranteeing the quality of the information provided by the consumer, specifically the independence of sources (1.2) and third party verification (1.3). We understand that the requirements for the creditor to refer to “*independent sources*” as well as “*third-party verification*” only mean that the creditor shall check the consumer’s statements about his income requiring different justificatory documents drawn up by third parties (such as pay slip or tax assessment for instance).

However we believe it should be clearly mentioned in the Guidelines.

GUIDELINE 2: DOCUMENTATION AND RETENTION OF INFORMATION

Guideline 2.1:

- According to point 2.1 “*the creditor should maintain complete documentation of the information that leads to mortgage approval, and maintain this documentation for at least the duration of the credit agreement*”.
- In addition, according to the wording, it is unclear whether the consumer could have access the documentation of the information that leads to mortgage approval. The information should only be available for the competent authorities.
- There should be clear rules at national level regarding the duration of retention, the type of archiving and the conditions of accessibility, which should be aligned with the existing national legal and tax rules.



Suggestion for amendment:

2.1 The creditor should maintain record of the relevant ~~complete documentation~~ information that ~~has led leads~~ to the conclusion of the credit agreement ~~mortgage approval~~, and maintain this documentation **available for competent authorities** for ~~at least~~ the duration of the credit agreement”.

Guideline 2.2:

According to point 2.2 “the creditor should ensure that a record with an adequate explanation of the steps taken to verify income is readily available for competent authorities. The record should at least document the income history collected for each applicant”.

- Legislative measures imposing too long income histories and / or income outlooks will be harmful for the consumer and the lender.
- The duty seems to be unclear. It should not be required that the banks are obliged to create separate records or IT-systems for this purpose only.

The following wording should be therefore considered: **“the record should at least include a statement of the source and the period of which the income history has been verified”**.

GUIDELINE 3: IDENTIFICATION AND PREVENTION OF MISREPRESENTED INFORMATION

Guideline 3.1:

The article does not reflect the information requirements in the MCD and would appear to impose additional disclosure requirements outside of the ESIS, the added value of which is not clear. Further clarifications are needed concerning “loan documentation” which should be aligned with the MCD requirements and not go further.

It should also be noted that the assessment of whether documentation is well presented or not, is very subjective.

GUIDELINE 4: ASSESSMENT OF THE CONSUMER’S ABILITY TO MEET HIS/HER OBLIGATIONS UNDER THE CREDIT AGREEMENT

Guideline 4.1:

According to article 4.1 “The creditor should assess the consumer’s ability to meet his/her obligations under the credit agreement without causing the consumer undue hardship and over-indebtedness, while taking into account data protection rules that may apply in the relevant jurisdiction”.

This requirement may be interpreted as creating a presumption of liability on the lender in case of failure from the borrower. In the current MCD the lender should only assess the “probability” for the customer to fulfil its obligations.



To ensure consistency with the MCD, the following wording should be deleted: ~~“without causing the consumer undue hardship and over-indebtedness”~~.

Furthermore, pursuant to this provision, banks must establish sound processes to assess the ability of consumers to meet their obligations under the credit agreement. Apart from credit risk monitoring (under the Supervisory Rules), it is not clear what banks can do if this monitoring identifies an increase in credit risk.

Guideline 4.2:

According to point 4.2 the creditor should *“review the processes at regular intervals”*.

This duty seems to be quite burdensome. Banks are already obliged to maintain instructions on credit granting processes. The processes must be revised to take into account changing circumstances (for example new legislation), not at regular intervals. The Guidelines should re-phrased.

Guideline 4.3:

Point 4.3 lists the factors that should be taken into account in the creditworthiness assessment. We are worried that this point could actually limit the factors that the creditor is allowed to take into account (taking into account the data protection legislation). Those factors for example do not take into account the “accident of life” (losing a job, illness, divorce etc.) which are important factors of over-indebtedness.

The reference to *“taxes and insurance”* does not seem appropriate. It is indeed very difficult to take into account all directly relevant taxes and insurances, since not all this information is known by the creditor / consumer at the time when the credit assessment has to be made. A more generic wording should be favored.

Suggestion for amendment:

*“The factors may include **without limitations/for example** other servicing obligations, their interest rates, and the outstanding principal on such debt; evidence of delinquency; as well as directly relevant **statutory payments** ~~taxes and insurance~~.*

Guideline 4.4:

Point 4.4 of the draft Guidelines states that *the creditor should take appropriate account of the adequacy of the consumer’s likely income and ability to continue to meet obligations under the credit agreement in retirement, if the loan term extends past normal retirement age.*

It is important to stress that it is very difficult to forecast or estimate the financial situation of a debtor in the time of his/her retirement as:

- the European pension systems are under revision (ageing society);
- the retirement age is continuously growing;
- the savings at retirement age is different from one borrower to another;

If a lender knows that a consumer will retire during the term of the mortgage, the impact of retiring on the consumer’s income needs to be understood.



However, it is impossible for banks to estimate the future income of the consumer, if the consumer retires, for example, in twenty years' time.

It is then to the Member States National Competent Authorities' to provide guidance, if needed, on how they would expect this to be implemented in their market.

GUIDELINES 5: ALLOWANCE FOR THE CONSUMER'S COMMITTED AND OTHER NON-DISCRETIONARY EXPENDITURES

Guideline 5.1:

This point requires creditors to assess and take into consideration the *"living expenses of the consumer"*.

Apart from other credit agreements signed by a consumer, it is impossible for banks to access a database holding details of the living expenses of that specific borrower and it should also be considered that mortgage credit usually has a duration of 20/30 years.

It is also important to insist on the fact that it should not be imposed to lenders to predict the financial situation of their customers. Indeed primarily failures concern the accidents of life (illness, divorce, job loss ...) generating an abrupt change in the financial situation of the customer.

Again it is to the Member States National Competent Authorities' to provide guidance, if needed, on how they would expect that to be implemented in their market. This could range from a detailed review of a customer total income and expenditure through to the use of robust market survey data.

GUIDELINE 6: ALLOWANCE FOR POTENTIAL FUTURE NEGATIVE SCENARIOS

Guideline 6.1:

The point 6.1 lists the prudent allowances for negative scenarios in the future to be used in the creditworthiness assessment.

Even though the list includes only examples, it is impossible for the banks to take into account all the factors mentioned in the list. It should be up to the National Competent authorities to define those criteria.

Therefore the word *"quantifiable"* should be added and the rest of the article should be deleted as it may cause severe interpretation problems. In addition, the issue of reduced income in retirement is already dealt with under Article 4.4.

Suggestion for amendment:

6.1 When assessing the consumer's ability to meet obligations under the credit agreement, the creditor should make prudent allowances for potential **quantifiable** negative scenarios in the future, ~~including for example, a reduced income in retirement; an increase in benchmark interest rates in the case of variable rate mortgages; negative amortisation; balloon payments, or deferred payments of principal or interest.~~



GUIDELINE 7: IDENTIFICATION OF GROUPS OF LOANS WITH HIGHER RISK PROFILES

Guideline 7.1:

According to article 7.1 *“The creditor should identify groups of loans with a higher risk profile, and should take this into account when assessing consumers’ creditworthiness”*.

The EBF believes this article is unclear, notably on the definition of groups of mortgage loans which could be considered as “high risk” (does it refer to foreign currency mortgage loans? Variable interest rate mortgage loans?) The MCD already defines specific rules for these cases and the EBA principles would be overlapping. It is important to consider that the risk of a mortgage credit portfolio depends on the credit risk of the borrowers concerned: how can banks consider the high-risk mortgage portfolio before assessing borrowers’ creditworthiness, if this risk depends on the borrowers’ creditworthiness?

The Creditworthiness Assessment is one element of the overall credit risk considerations when assessing a credit application. The “risk profile” of the lending will also be affected by factors such as LTV and concentration risks which are an integral part of managing the credit risk of a portfolio. The wording of this Guideline has similarities to sections 6 and 7 of the FSB Principles for Sound Residential Mortgage Underwriting Practices (which was referenced in drawing up the EBA Guidelines). The FSB comments are more aligned to Prudential Risk Management and it is not clear how 7.1 fits into a conduct requirements document.

It is the EBF understanding that for the EBA, groups with higher risk might be for example first Time buyer, people close to retirement, etc.

In the EBF’s view this definition should be at the discretion of financial institutions, function of the risk profile they implement.

Guideline 7.1 appears to have a prudential risk basis, and with the conduct requirements around a creditworthiness assessment being adequately covered within Guidelines 1 to 6, this guideline should be removed.

Question 2: Are there any additional requirements that you would suggest adding to the Guidelines? If so, outline the reason(s) for each proposed additional requirement.

No additional requirements are considered necessary.

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