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EBF RESPONSE TO EBA CONSULTATION ON DRAFT GUIDELINES ON LOAN ORIGINATION AND MONITORING

General remarks

The EBF welcomes the possibility to express its views on the Draft Guidelines on loan origination and monitoring. Having a consistent and functioning framework for loan origination and monitoring is key to ensure a stable credit market and financial stability.

As a general remark, we note:

1. Firstly, the objective of these guidelines is to support the creation of a single rule book and to promote convergence and a level playing field. This is in line with the rule that guidelines of the European supervisory authorities are meant to support harmonized interpretation and application of EU law¹. They are not meant to amend it or to add new requirements. However, many of the requirements in the current version of the guidelines, go beyond existing legal texts and the harmonisation/clarification mandate of the guidelines. Any changes to existing legislative frameworks should be subject to the codecision process. Also, given the breadth of application and implications of these guidelines, the consultation period is considered as not proportionate, nor timely. Many of the underlying L1 texts (e.g. Consumer Credit Directive, Mortgage Credit Directive) are currently undergoing an evaluation exercise by the European Commission which can lead to a review of the text via codecision procedure. This means that within a short time frame, new legislation could regulate the very same topics covered by the guidelines. Some other topics addressed in the guidelines are currently under negotiation (e.g. sustainable taxonomy) and will be applicable after the proposed date for entry into force of the guidelines.
2. Although the text states that the proportionality principle is embedded in the draft document, this is very often not the case according to the current wording of the guidelines, which often lack also consideration of the materiality of risks. Indeed, the guidelines list the requirements that creditors should perform "at least" or "as a minimum". While the use of "should" infers flexibility, the requirements are de facto more prescriptive than that.

This is particularly relevant in terms of both the application of the guidelines among different banks (and how it will be applied by different supervisors) and also within banks – ie retail and non-retail, risk-sensitive and non-risk sensitive business – especially with regard to the lists of documentation and information that have to be sourced.

Although we understand this is not the intent of EBA, the current text of the guidelines de facto introduces standardised loan monitoring and origination practices regardless of the type,

¹ Recital 26 Regulation 1093/2010 establishing the European Banking Authority says: *In areas not covered by regulatory or implementing technical standards, the Authority should have the power to issue **guidelines and recommendations on the application** of Union law. In order to ensure transparency and to strengthen compliance by national supervisory authorities with those guidelines and recommendations, it should be possible for the Authority to publish the reasons for supervisory authorities' non-compliance with those guidelines and recommendations.*

Article 16 1093/2010/EU also says: 1. *The Authority shall, with a view to **establishing consistent, efficient and effective supervisory practices within the ESFS, and to ensuring the common, uniform and consistent application of Union law, issue guidelines and recommendations** addressed to competent authorities or financial institutions.* 2. *The Authority shall, where appropriate, conduct open public consultations regarding the guidelines and recommendations and analyse the related potential costs and benefits. **Such consultations and analyses shall be proportionate in relation to the scope, nature and impact of the guidelines or recommendations.***

characteristics and amount of credit. This is a major impediment to the principle of proportionality and materiality.

Banks apply very different processes between plain vanilla retail loans and sophisticated non-retail loans with significant exposure. The text of the guidelines does not duly reflect the differences among loans (e.g. non-retail process and retail small business regulated under the same rule). Overall, the document lacks acknowledging that appropriate risk-based approach for each exposure class can be performed. It should be clearly assessed and stated which requirements are appropriate for which exposure classes. It is of vital importance to systematically confirm for all topics of the consultation that the principle of proportionality can always be applied to the size, nature and complexity of the credit facility. This has to be mirrored also when the GL state that creditors "should (at least) consider". This principle of proportionality is enshrined in Articles 5 and 8 of the Consumer Credit Directive (Directive 2008/48 / EC). In this context, the criteria, factors, parameters and analysis listed in the paper should be considered only as indicative and not compulsory requirements. It should be clarified that EBA Guidelines are to be interpreted as a collection of best practices and recommendations on how to grant and monitor credits to support good and prudent risk management practices which contribute to preventing excessive amounts of non-performing loans.

The principle of proportionality to be applied to sections 5,6,7 and 8 is described differently in different sections of the guidelines. Likewise, para 15, mentions that Consumer protection aspects set out in these guidelines when dealing with the creditworthiness assessment of consumers should not be subject to the application of the principle of proportionality. However, creditworthiness assessment needs the application of proportionality principle both for practical needs, as well as for legal consistency (as it belongs to the sections where proportionality is to be applied). Likewise, it should be clearly stated that the lists provided in Annex 1, 2 and 3 should be taken as a reference to be considered proportionally to the type, size, nature, complexity and risk profile of the credit facility and not a prescriptive list to be complied with at all times for all types of lending.

3. The stated objective of the guidelines is defined as to 'ensure that newly originated loans are of high credit quality'. However, credit quality is a risk appetite theme and the guidelines shall not restrict portfolio diversity. The prescriptive nature of these guidelines under the current form and scope provide a very prescriptive list of actions that banks "should" undertake "at least" or "as a minimum" regarding banks' core business – i.e. providing financing to the economy and to consumers. Beside the key principle that business decisions shall not be provided by the regulator, this approach also brings huge consequences to the economy. Prescriptive guidelines can lead to standardized loan granting principles which hamper competition and are detrimental also for borrowers who cannot access credit, with huge consequences on the entire EU economy. Borrowers whose application has been rejected by a creditor shall still have the chance to apply with other creditors and see their request met. The general framework should aim at avoiding excessive non-performing exposures while maintaining access to credit to higher risk borrowers based on different risk appetite's and portfolio diversification. This can be achieved only if flexibility is granted with regard to credit worthiness assessment.

Under the current form, the guidelines practically provide standardized rules for credit worthiness assessment (that also cover different types of loans with different risk levels). This may lead to lack of appropriate assessment and credit exclusion for higher risk borrowers, limiting banks' capacity to finance innovation and entrepreneurship. It also increases pro-cyclicality by preventing risk diversification and mitigation. Therefore, it must be clarified that the information requirements and processes:

- are just indicative, leaving room to the entities to adapt it to the relevant indicators to their portfolios (which could be more, less, or simply different to the ones suggested)
- should be adapted to the materiality of the portfolios, the exposures, the clients, the local specificities, and the local regulation should the portfolio be in a jurisdiction outside the European Union
- should be gathered if they don't represent an undue cost;

Under the competition perspective, the introduction of very strict requirements for the provision of lending to the financial sector alone (which is the current interpretation of 'creditor' under CCD), risks to distort competition vis – à – vis alternative providers that are entering the credit market.

4. Provisions of the guidelines, even after the due application of the proportionality principle and adjustments in the scope, still significantly impact existing credit granting and managing process, requiring huge investments and upgrades of organisational procedures and systems (including IT infrastructure, staff training, MIS etc.). The proposed application date at 30 June 2020 is unrealistic and not consistent with other rules that are necessary for the very same application of the guidelines (e.g. taxonomy rules).
5. The scope of the guidelines shall also be clarified. To ensure legal certainty and adjustment, they should apply only to new originated loans, not covering existing loans granted before the application date or regular credit review of a deal
6. In addition, due to the current evolutions towards more automated credit underwriting processes, a lot of the requirements and controls mentioned in the Guidelines cannot be implemented. As long as the credit quality of loans granted via automated processes does not significantly deteriorate due to missing controls, we don't see any value making such controls mandatory given that controls imposed in automated processes cover the main risks.
7. These guidelines include definitions, requirements and descriptions which are regulated in existing or upcoming standards. Definitions must respect existing legislation. For these cases we suggest:
 - Instead of redefining the process/concept or rewording the requirement, include a reference to the applicable regulation.
 - Once the reference is included, outline only if there are additional requirements arising from these specific guidelines. A good example of this practice is found in paragraph 81 (Remuneration), that states: " In addition to the requirements on institutions' remuneration policies set out in Articles 74 – 75 and 92 of Directive 2013/36/EU and EBA Guidelines on remuneration policies [...], institutions' remuneration policies and practices should be in line with the approach... "
 - Special care has to be taken if the referenced regulation has not entered into force yet. In those cases, these guidelines should respect the existing implementation timeline and avoid frontloading the future requirements.

There are several definitions which are not aligned with the applicable legislation or current practices. For example the definitions of ESG related terms should be aligned with other regulatory initiatives under the EU Action Plan for sustainable finance.

- a) The definitions of transition risk (par. 52) and 'physical risk' (par. 53) in the context of environmental risks, are being discussed in other standards and papers. We recommend waiting completion of the mandate given to EBA in the CRR and seek alignment with the EU classification system of sustainable economic activities and other relevant initiatives.
 - b) AML requirements (section 4.3.1) is already regulated in the Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing'. Therefore, the guidelines should only provide a reference to the existing legislation without duplicating requirements or fragmenting them across different legal acts
 - c) Governance and the roles of the lines of defence are already described in 'EBA Guidelines on Internal Governance'. We reckon that only new or different requirements to those guidelines should be reflected in this document. New requirements shall also be justified.
 - d) Requirements regarding the quality of data and infrastructure that appear in several parts of the document (Para. 54, 55, 226, 229, 232, 234, 236 et al.) should be checked against those already implemented following the 'BCBS 339 Principles for effective risk data aggregation and risk reporting'.
 - e) New terms such as "professional borrowers" should be avoided for clarity. New definitions may increase inconsistency in reporting.
8. Given all the above, we recommend EBA to consider instead developing more forward looking, principle-based yet prudent guidelines to meet the transition challenge. By the same token, this means that in our view this is not the moment to design data requirements for potential future data driven supervision on loan origination or monitoring.
- In some cases the guidelines don't match with the current practise and developments that occurred in recent years (e.g. existing machine learning models, automated property valuation at the point of origination). Full application of the proposed requirements (e.g. comparison of technology

enabled innovation with traditional models) would need significant investments and / or may lead to reducing effectiveness and/or customer satisfaction. To its extreme, it may even drive some entities out of some business areas due to unreasonable cost, eventually limiting the supply of credit to the economy.

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About the EBF

The European Banking Federation is the voice of the European banking sector, bringing together 32 national banking associations in Europe that together represent a significant majority of all banking assets in Europe, with 3,500 banks - large and small, wholesale and retail, local and international - while employing approximately two million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that reliably handle more than 400 million payment transactions per day. Launched in 1960, the EBF is committed to a single market for financial services in the European Union and to supporting policies that foster economic growth.

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