ASSOFIN response to EBA consultation on draft guidelines on loan origination and monitoring

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Introductory observations

Assofin, the Italian voice of consumer credit and mortgage specialised providers, welcomes the opportunity to respond to the Consultation Paper on Draft Guidelines on loan origination and monitoring.

Assofin shares the EBA's view on the importance of the correct application of creditworthiness assessments. The Consumer Credit Directive (CCD) and the Mortgage Credit Directive (MCD) are the gold standard for regulation of consumer credit and mortgages in the European Union. Their provisions set out the obligation to assess the creditworthiness of consumers who wish to borrow on the basis of sufficient information. Assofin fully supports this obligation and view it as a prerequisite for successful and responsible lending.

However, as further outlined in our response, we believe the Guidelines do not provide for the relevant flexibility required, but setting out actions that lenders "should" undertake "as a minimum", without providing sufficient consideration and safeguards to enable an proportionate approach by lenders and supervisors.

Such flexibility is especially relevant in light of the proposed scope of the Guidelines, which encompasses a wide range of products of varying risk and complexity. Therefore, whilst we welcome the initiative, we believe that further steps should be considered by the EBA to ensure the proportionate and effective application of the Guidelines, and to respect the relevant measures. We believe the general lack of proportionality would ultimately lead to a less diverse and competitive lending landscape, since many smaller players who provide lending would be disproportionately burdened if required to comply with the provisions set out in the Guidelines.

The specific selection and use of data points should remain within the remit of lenders. Based on their core expertise and local market knowledge, they can ensure the suitability of processes and data taking into account the specificities of the product and transaction value alongside the context of local market and regulatory characteristics. It should also be ensured that the sources used to provide this information are relevant and proportionate for the situation in question.

The full and coherent application of the proportionality principle should also apply in relation to consumer lending-related activities and the creditworthiness assessment, while at the same time fully respecting consumer protection obligations as set out by the relevant legislation.

1 - What are the respondent views on the scope of application of the draft guidelines?

(1) In our opinion the EBA guidelines lay down a set of best practices related to the process of credit granting and monitoring which are probably appropriate for some segments of credit market but very inadequate for some other.

In particular, most of the requirements proposed are not adequate for large scale, small ticket and short term credit granted to consumers (e.g. consumer credit in general and in particular consumer credit originated at the point of sell or online) and small professionals.

Those types of products/business models heavily rely on automatized and more and more technology-based tools, currently duly supervised in respect of existing and already constraining regulation framework.

For those concerned institutions that have demonstrated an accurate control of risks, a strict application of the proposed guidelines requirements would represent not only a regression in risk management but also significant investments in HR and information systems, disproportionate to any potential benefit in the cost of risk.

Changing these models, which have demonstrated over the time their reliability, to strictly respect the proposed guidelines would cause high costs in terms of IT developments and business/HR organisations and would have an impact in terms of access to credit for borrowers and pricing.

Moreover, a rigid application of the requirements proposed in the guidelines to loans granted to consumers and small professionals would cause a greater financial exclusion and a severe fall in consumption and production in the Member States.

In this respect, it could be appropriate to define all the specific circumstances (e.g. specific type of clients, sectors, products, business model etc.) in relation to which the proposed guidelines should not be considered mandatory for supervisors or supervised entities.

(2) According to the guidelines, the proportionality principle is based on the size, nature and complexity of the granting institutions with regard to internal governance requirements (section 4), and on the type, size and complexity of the individual credit facilities, for the requirements on the creditworthiness assessment, pricing, valuation of immovable and movable property collaterals and credit risk monitoring, contained in the following sections (5, 6, 7, 8).

Furthermore, the proportionality principle should be considered also in those situations where the national legislation provides for specific technical forms of credit (for example in Italy, salary and pension backed loans and loans guaranteed by severance indemnity) and the proposed guidelines should not be considered mandatory for supervisors or supervised entities.

However, the EBA document doesn't define any further elements in order to enforce the proportionality principle, leaving institutions with a wide margin of discretion in its application.

We warmly suggest that the criteria set in Annex 1 and in Annex 2 regarding loans under the highest threshold of consumer credit (i.e. under 75.000 euro), granted to both consumers or professionals, should be applied as "nice to have" instead of "at least" requirements.

Furthermore, in several instances, the guidelines state the criteria listed are to be applied on a "at least" basis. The expression "at least" could imply that the information has always to be collected and does not allow for the application of the proportionality principle. This could generate uncertainty in credit granting activity, with the risk that competent Supervisor Authorities could consider entities to be non-compliant.

In relation to above, it would, therefore, be appropriate to clarify the real nature of the EBA guidelines. We warmly suggest it should be clarified that they are indications of good practices, with aim to improve over the time the credit granting and managing process, which means that a partial application (or non-application) of guidelines is not considered as a breach. If, on the contrary, these provisions are effectively imposed on institutions with mandatory effects, further disposals on the application of the proportionality principle are needed, in particular as regards the consumer credit granting and monitoring process.

(3) For the purpose of the latter, the guidelines seem to be appropriate in relation to significant-amount transactions, which justify the additional costs connected with further detailed creditworthiness analysis and wider information collection required. On the other hand, some of the required information may not be available at all for some borrowers or business models.

Therefore, it could be appropriate to 1) explicitly explain in the text which provisions should be considered a "must" or a "nice to have" practice; 2) introduce specific thresholds in terms of loan amount below which the EBA requirements are not applied "tout court".

(4) On the latter point, it could be envisaged a set of thresholds on the size of loans, with the aim to apply the EBA requirements on the basis of loans' characteristics .

Defining a set of thresholds, embodying the loan risk relevance, might help avoid a disproportionate implementation of the requirements and keep costs under control for those customer segments/products/business models where margins are tight.

(5) The EBA requirements (e.g. monitoring rules, valuation criteria on movable/immovable properties) should apply only to facilities originated after the implementation date of the guidelines.

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

(6) The EBA requirements significantly impact on the credit granting and managing process, which imply huge investments in all institutions' organisational procedures. In particular, the IT structure will need, in some cases, to be re-designed and, in other cases, adjusted to the new requirements introduced by the guidelines. Furthermore, a deep staff training is needed.

Institutions need enough time to align their investment and operational structure to the new standards: it depends on their starting point and the context in which they operate (for example, the context could be more or less favourable in terms of collection of the required information).

(7) Furthermore, it should be considered the impact of the new credit risk assessment framework on credit granting rating systems and, at what extent, they will need to be reviewed. In latter case, it will imply a great amount of time for the collection of supporting statistics and the acquirement of the necessary authorisations.

(8) Considering the complexity of the EBA requirements implementation, it's fundamental to modulate over time their entry into force, especially if they are mandatory. In any case, they should not be applied before **31 December 2021.**

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 4.3.3) and environmental factors and green lending (Section 4.3.4)?

(9) The main part of this consultation paper deals with the "traditional" way of creditworthiness assessment, while technology-enabled innovation for credit granting processes is underexposed. When this kind of data models are

adequately governed and back-tested, and these measures show that model outcomes are sufficiently robust and prudent, their use should be allowed.

(10) From our point of view section 4.3.3 (Technology-enabled innovation for credit granting) should be amended especially for consumer credit facilities and loans granted to small professionals since regulation should be technology neutral and not impose a higher compliance burden when using a specific technology.

(11) With regard to consumer credit and loans granted to small professionals, already existing technology-enabled procedures like scoring models are very diffused and they have proven very effective, so their use should be encouraged and not undermined by the strict application of the Guidelines.

(12) In our opinion paraghaph 47 should be deleted because is not relevant. Otherwise, the requirement under letter d should be changed at least, because of the lack of meaning of “traditional methods/tools”. The requirement should be replaced with a new one, concerning the need to compare – when a significant innovation change occurs - the performance of outputs of the possible new methods/tools with those previously used.

(13) Requirements included in paragraph 49 are very burdensome, implying a relevant responsibility for lenders regarding the use/destination of loans. They can probably be applied to large amount lending in the field of energy and environment, but they aren’t applicable to small ticket loans concerning the green financing, such as consumer credit to finance “green vehicles”, energy saving home equipment, etc.

In addition, the guidelines require the acquisition of a large amount of data and specific competencies to evaluate risks that can be very difficult for institutions to gather and assess on a large number of clients.

It is necessary to clarify the content and depth of the risk assessment as referred in paragraphs from 51 to 53, which require professional skills not typically present in the credit granting institutions. It would be more appropriate identifying possible priority criteria to define a more limited and focalized scope of application.

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

(14) The requirements regarding credit risk policies and procedures appear to be too prescriptive, formal and standardised whatever the type of loan (amount, duration, counterparty, complexity, distribution channel, etc).

(15) Moreover, the criteria listed for example in Annex 1 may not apply in certain situations. As such, the expression "at least" is in any case not appropriate.

(16) We warmly suggest harmonizing these guidelines with the "Reporting instructions on Credit Underwriting data collection" recently issued by ECB (April 2019), to avoid possible overlaps / mismatches on these topics, also better detailing the main definitions (for example, it would be very useful to include the definition of "new business volume origination").

(17) Regarding the implementation of automatic process of decision making, it is necessary to better specify which kind of analysis are required to perform the comparison between automatic and manual processes.

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

(18) As a general comment, we suggest EBA should review the part of the requirements introduced in the section regarding the credit decision making, in order not to limit the well-functioning lending activity. In particular:

(i) We deem extremely relevant to avoid the request of a limitation in the credit decision making in terms of time and number. In fact, if interpreted in the tighter way, it can represent a relevant obstacle for operations. In particular, we deem that the number of delegated credit decision is not correlated to an increase in terms of risks undertaken by the institutions.

(ii) The Paragraph 63, that would allow individual approval authorities only for small and non-complex transactions, would significantly increase the complexity of the lending process and highly decrease the level of efficiency of institutions.

Due to the peculiar characteristics of consumer credit activity (institutions granting many loans of small amount, whose maximum threshold is defined by law), it should be clarified that any individual involved in consumer credit decision-making such as members of staff and members of management

body is allowed to take credit decision within the range of amounts defined by law.

(iii) We deem that should be better clarified what does EBA intends with a "well-defined framework to control the process, establish minimum applicability and professional suitability for such delegated authority. Individual delegated authority holders should be adequately trained and hold relevant expertise and seniority in relation to the specific authority level delegated to them."

(iv) We deem that excluding the commercial network as approval authority would significantly increase the complexity of the lending process. For this reason we warmly suggest that commercial network should be included as approval authority, bordering such activity with specific and clear limits set by institutions' risk management.

(v) As to the remuneration schemes - as in the paragraph 63 – it is extremely important to highlight that they are associated to a large number of parameters - not only the volume, but also the level of lending quality. Variable remuneration of the staff involved in credit granting that is linked to performance objectives/targets should include credit quality metrics and be in line with credit risk appetite: it would be important to exemplify some measures of credit quality metrics. The link of variable remuneration of the staff involved in credit granting to the long-term quality of credit exposures appears more as a theoretical concept rather than a practical one, since the credit cycle in some products is long and dependent on the economic.

(19) Regarding the section 4.3.1 on the Anti-money laundering and counter-terrorist financing policies and procedures, we deem useful adding the following to the end of paragraph 41: "Conversely, also information collected for anti-money laundering purposes may be used for creditworthiness assessment. For example, institutions may take into consideration also credit risks referred to beneficial owners". It might be worth emphasizing the principle of the usability of the information acquired for AML-CTF purposes also for granting and monitoring credit procedures and vice versa.

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

(20) The requirement set out in the Guidelines for the Credit risk management and internal controls framework to provide an "independent risk opinion to the credit decision takers" (par 76c) and an "independent/second opinion to the creditworthiness assessment" (par. 76g) seems to require an ex-ante supervision of the risk management function within the credit process.

This approach, implying an active role performed by the risk control function during the lending phase, might be hardly applicable for reasons:

(i) the prior involvement of the risk control function appears not fully coherent with the separation of responsibilities between the ex-ante first line of defense (lending functions) vs the ex-post second line of controls (risk management) and, ultimately, with the regulatory principle of segregation of duty;

(ii) the need to have second opinion to the creditworthiness assessment might trigger process inefficiencies related to the duplication of activities and skills in charge of different functions, entailing inter alia also additional staff costs.

7 - What are the respondent's views on the requirements for collection of information and documentation for the purposes of creditworthiness assessment (section 5.1)?

We believe that most of the requirements in section 5 and criteria established in annex 1 and 2 will have a hinder innovation in credit granting as they are too prescriptive and do not allow companies to develop alternative procedures in order to determine the creditworthiness of a consumer or a small professional. Thus, it seems that the creditworthiness assessment will always require financial institutions to collect specific information and documentation and have details on income, cashflow or financial commitments, for instance.

This dismisses the possibility of developing alternative creditworthiness procedures that minimize the information required from borrowers or do not take into consideration specific individual pieces of information, even though such procedures could prove to be more accurate than traditional ones.

Therefore, although we understand the rationale behind this section - seeking harmonization of credit granting practices across Europe and the accrued knowledge on the credit granting business – we suggest the EBA should include an additional section, setting less prescriptive requirements to institutions applying alternative procedures, which could improve customer access to credit or improve the accuracy of the creditworthiness assessment, but which do not fit this prescriptive approach.

(21) The guidelines should make clear that pieces of information listed in Annex 2 should be collected and verified if they are relevant for the type of product only, according to the proportionality principle. It means that they should be needed only in case of non-standard requests. Moreover, the guidelines should exclude those situations in which the national legislation provides for specific forms of

financing (i.e. in Italy salary and pension backed loans and loans guaranteed by severance indemnity).

(22) Some of the pieces of information required are not available for institutions granting consumer credit and loans to small professionals and, moreover, they don't add any value to the creditworthiness assessment especially when granting small ticket loans and loans granted on the point of sale or online.

(23) In order to check consumer's financial commitments it should be mandatory to interrogate and contribute credit bureaus, which are often private companies and, moreover, are not available in all European countries. This should cause a further increase of costs, in many cases disproportionate to any potential benefits in the cost of risk.

(24) Therefore we would suggest EBA to open for the possibility, for consumer credit and small professionals granting activity, to focus institutions' assessment on statistic tools (such as rating and scorecards) used in order to evaluate in a predictive way the ability of the borrowers to meet their obligations, limiting the obligation to collect and verify information investigating credit bureaus only to the cases when the loan required is over a defined threshold.

We underline that, with reference to the proportionality principle, the Guidelines should better state the possibility for info packages differentiated driven by loans' sizing and borrowers' risk profile and accept a certain degree of flexibility.

(25) For the purposes of the creditworthiness assessment of consumers, we welcome the requirements included in paragraph 91, a), which provide that lenders collect information on the loan purpose, "where relevant for the type of product". As a matter of fact, for some consumer credit classes (e.g. revolving credit card, personal loans, overdraft, etc.) loan purpose is not required, if the granted amount is not significantly above the average.

8 - What are the respondent's views on the requirements for assessment of borrower's creditworthiness (section 5.2)?

(26) We note that the borrower's creditworthiness assessment process seems excessively complex and disproportionated compared to credit facilities size in consumer credit activity.

(27) In general, while sharing EBA requirements for assessment creditworthiness, we reaffirm considerations previously summarized with reference to available information and documents and needed better definition of the proportionality principle.

(28) In general, we consider credit granting criteria set out in Annex 1 too much detailed and standardised and often not adequate to reduce the cost of risk in consumer credit activity. Our suggestion is to simplify, not asking for fixing ex ante limits on all parameters listed in Annex 1.

(29) It should be clarified that the financial metrics (ratios) listed in paragraph 99 for the purposes of the creditworthiness assessment for lending to consumers must not be always used, regardless of the characteristics and amount of financial transaction.

(30) The requirement set in paragraph 101 to carry out sensitivity analyses reflecting potential negative scenarios in the future should be eliminated or re-defined as a “best effort” requirement.

(31) In addition, it is necessary to specify how institutions have to document the use of these metrics for credit decision purposes and, to what extent, they have to be implemented in their rating system.

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

(32) We draw the attention on the requirements included in the paragraph 180, which seem to impose on lenders a responsibility for the possible misrepresentation of information provided by the borrower.

We propose a better coordination of this paragraph with the requirements laid down in Chapter 6 of MCD and in Article 8 of CCD.

In addition, in accordance with the aim of the CCD, the guidelines should confirm the relevance of "responsible borrowing” principle in order to avoid that, if over indebtedness of the borrower occurs, courts shouldn’t assign automatically a responsibility to the lender.

(33) About the definition of “disposable income”, we deem not clear the reference to the “expenses” of the borrower. Most part of these expenses is not known by lenders and the requirement should consider that borrower’s information is under the GRDP. We propose that the guidelines take into account only the expenses which could be known by lenders at the moment of the creditworthiness assessment.

(34) Once again, loan origination procedures set in Section 5 should be applied with reference to the proportionality principle, i.e. excluding consumer credit and loans to small professionals activity because of its large scale, small ticket and short term loans characteristics.

10 - What are the respondent's views on the requirements for loan pricing (Section 6)?

(35) The implementation of the pricing framework, as referred to in paragraphs 189 and 190, requires a depth revision of the institutions' industrial accounting methods. That said, the application of these requirements will require an adequate timeframe which is not compatible with the aim of ensuring the guidelines compliance by 30 June 2020.

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

(36) The approach proposed from Paragraph 207 to 213 would completely modify the current perimeter identification applied to collaterals subject to revaluation and the frequency of the update. Many institutions have just modified their evaluation processes on the basis of the recent NPEs guidance.

The EBA guidelines should take into account that new potential changes would require high IT budget allocation and a greater amount of time for their implementation, not complied with the EBA proposed deadlines (June 30th, 2020).

(37) Specifically, performing full appraisals for revaluation purposes as set out in paragraph 213 instead of the current desktop (mainly) or drive-by (negligible) ones, would significantly increase the appraisals' annual cost, as well as delivery time could be delayed. Additionally, mainly in case of NPE, the debtor/asset owner wouldn't permit an internal visit of the Real Estate asset. Furthermore, statistical model-based revaluation (Paragraph 209 and 216) used by institutions generally update the real estate assets value every 6 months and revaluation appraisals are always performed by external valuers.

(38) Referring to the requirements for the valuation at the point of origination (par. 7.1) and for monitoring and revaluation process (par. 7.2), we observe that the guidelines should include a detailed definition of movable property collateral (e.g. It's not clear if they include registered assets or pledges on goods too).

(39) Moreover, the last period of paragraph 199 - "Valuation should be carried out (internal valuation) or ordered (external valuation) by the institution, unless it is subject to a request from the borrower under certain circumstances" – seems to allow borrowers to choice the valuers, also if the responsibility for the real estate

evaluation belongs to the lenders. This point deserves a clarification to avoid possible interest conflicts.

(40) Regarding the requirement included in the paragraph 214, we propose to clarify that the turnover of valuers is required for the valuation of the same immovable property only.

(41) In paragraph 223 “Institutions should ensure that the fee or the salary for the valuer is not linked to the result of the valuation”: the payment of valuers follow different approaches. This includes models where market price of the property is taken as indicator for the complexity and the needed effort for the valuation. This requirement should be deleted as it excludes customary pricing models that show no risk for the appraiser´s neutrality – also due to sufficient quality assurance.

12 - What are the respondent’s views on the requirements on monitoring framework (Section 8)?

(42) The ongoing monitoring introduced by EBA guidelines appears too complex and elaborate. This framework represents a burden that is not justified in relation to the average size of the consumer credit (and mortgages) granting institutions' portfolio (see the considerations provide in question 1).

(43) In any case, the monitoring activity shouldn’t lead to additional reporting requests for entities towards the Supervisory Authorities, by determining the increase of the administrative obligations and costs for institutions.

(44) As a general consideration we would suggest EBA should better specify whether and in which situation the warning on monitoring should be performed at portfolio level or at loan level. In particular, we deem important to clarify the supervisory expectations related to the watch list (paragraph 266).