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## AFME Consultation response

### EBA Consultation on Draft Guidelines on Loan Origination and Monitoring

September 2019

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#### About AFME:

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

#### General Comments:

AFME are pleased to have the opportunity to comment on the EBA's proposed Guidelines on loan origination and monitoring. **Please take note that we have set out general comments here and in relation to the consultation questions, as well as a detailed annex which raises issues on specific paragraphs in the guidelines and some amendments.**

We recognise these EBA guidelines are developed in the broader context of the addressing the build-up of banks' non-performing exposures. As set out in the EU Action plan on NPLs, regulatory requirements have emerged to tackle NPL-related risks, most notably, the design and introduction of prudential backstops as well as the EBA Guidelines on management and forbore exposures. Such measures and requirements are considered as sufficiently extensive and exhaustive to address the NPL issue. Therefore, we are concerned by the aim of these Guidelines and the relevancy of the requirements to tackle NPLs given our members' interest in avoiding undue complexity and intrusion on existing credit practices.

Moreover, the guidelines tackle issues which are to some extent already covered by existing adopted EBA guidelines. It is therefore crucial that these guidelines are appropriately and coherently implemented and integrated within the existing regulatory framework. This is all the more necessary given that the EU Commission is considering a legislative review of existing EU laws (namely the Consumer Credit Directive and Mortgage Credit Directive) to include provisions regarding loan origination criteria creditworthiness assessment and which will therefore cover loans that fall in the scope of these guidelines.

While these guidelines do not constitute a fundamental evolution of regulation, they will undoubtedly lead banks to significantly redevelop internal systems in order to justify, document, track, and explain practices – most of which are already applied by banks. Consequently, one of the main concerns arising from this consultation is the prescriptiveness which will in some cases lead to a major overhaul of banks' practices, which could in turn limit some business activities. Indeed, the guidelines indicate in many

instances things that banks “should” undertake “at least” or “as a minimum”. While the use of “should” infers flexibility, the requirements are in fact more prescriptive than our members felt appropriate. This is particularly relevant in terms of the level of application between banks (and how it will be applied by different supervisors) and within banks – 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. Guidelines which are too prescriptive may lead to standardized credit granting principles which would hamper competition and be detrimental to borrowers and the wider economy. The general framework should aim at avoiding excessive non-performing exposures, while maintaining access to credit for higher risk borrowers based on different banks’ risk appetites and portfolio diversification. If too prescriptive, the guidelines may also reduce employees’ skills and expertise in credit granting by favoring more automated decision making. This may also lead to credit exclusion for higher risk borrowers or more complex or specific projects.

Regarding proportionality, we understand that EBA is not looking to apply any proportionality principle on specific requirements related to consumers as all consumers should be treated equally as per consumer protection (which we agree with). In addition, we understand proportionality principle related to governance requirements is already covered in EBA GLs on Internal Governance and EBA sees no need to provide additional guidance on this aspect. On aspects related to creditworthiness assessment, we understand this is intended to be irrespective of the type of bank, and solely depend on size and type of credit facility and further flexibility is provided within the guidelines by using terms “where relevant” and/or “consider”.

However, while noting the above, it is important that the requirements of the guidelines are proportionate to the underlying credit risk represented by a certain exposure in order to ensure an efficient SME and private customer credit process. Proportional implementation should be governed by specific provisions for flexibility within the text to ensure a level playing field for all EU banks. There are several aspects of proportionality that therefore still need to be considered in the draft guidelines:

- Within a banking group, proportionality with regards to the size, nature, complexity and risk profile of the credit facility should be further clarified. In particular, depending on the type of credit facility and the type of financing, a one-size-fits-it-all approach is not appropriate. The Guidelines should leave room for better customisation of requirements and flexibility regarding the requirements to fulfil listed criteria, which are not intended to be applied mechanistically but should be considered examples.
- It is important to introduce in section 4 the concept of “materiality” at credit portfolio level for banks. Individual credit file decisions ensure individual credit file quality and compliance with risk strategy and credit policies. In addition to decisions on individual credit files, credit risk limits ensure risk diversification and prevent concentration on portfolios with shared risk characteristics. Credit risk limits are only meaningful for credit portfolios that are material in relation to the size of the institution and its overall credit risk, when smaller, non-material, diversified portfolios should not require specific RAF limits as stated in section 4.2.
- With regards to the adaptation of the Guidelines in respect of the size and various business models of banks in Europe, the consistent application of the guidelines by different competent authorities will be very important (e.g. in relation to the documentation requirements in section 5 and monitoring requirements in section 8 and some other requirements (such as data infrastructure).

Indeed, large financial institutions can have small entities where there is limited exposure and the application of these GLs in such entities should be proportional. Additionally, the proportionality of the guidelines in this respect should also consider the competitive landscape with respect to non-banks regarding documentation requirements, which could in turn impact on financial stability, consumer experience and financial inclusion.

- For banks supervised by the ECB on a consolidated basis, prescriptive wording may contradict local regulatory constraints for countries outside the scope of the SSM. Therefore, we encourage coordination between regulators and home/host authorities advocating for recognising local regulation in case of conflicting regulation.

With regard to the scope of the guidelines, in order 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.

Taking into account all of the above, if the final guidelines are published by end of the year, it will be extremely challenging to prepare for implementation in time, due to definition of IT specifications and operational planning (some of which is already allocated largely to implementation of other projects such as the IRB roadmap finalisation); and gap analysis of existing practices which institutions' will need to undertake and which can only be done once the final guidelines have been published. This is particularly impactful for cross-border banks, as there needs to be clarity about the local transposition/compliance. A more realistic deadline for implementation would be up to four years once **all** aspects of the IRB repair work are fully implemented as per the EBA's IRB progress report (n.b. the implementation date was postponed in part to recognise the heavy workload associated with it). This would also allow for other regulatory developments such as Basel III implementation, continued implementation of other NPL-related regulations, reviews of related level 1 texts listed below, changes in data infrastructure, and ESG/Climate factors, which are still nascent in regulatory development. Where necessary, further phasing in may still be required.

Finally, it should be noted that the guidelines refer to terms that are defined already in existing or upcoming regulations. We believe that the context of these GLs in relation and with reference to those regulations should be included to improve understanding, this includes:

- Definition of consumer: we understand that the applicable definition is that defined under Directive 2008/48/EC on consumer credits (CCD), which is currently under evaluation and it will be relevant to wait for evaluation results.
- Definition of professionals: in order to consider a client as "professional" we should refer to the criteria laid down under Annex II of Directive 2014/65/UE (MiFID II)
- Definition of Commercial Real Estate may be reviewed under the Mortgage Credit Directive
- Other definitions in areas such as risks of climate change, or ESG (see publications due in the EU Sustainable Action Plan which are at an early stage)
- Requirements in relation with the EBA Guidelines on institutions' stress-testing
- Requirements in relation with the EBA Guidelines on credit institutions' credit risk management practices and accounting for expected credit losses (e.g. factors to assess a significant increase in credit risk for a lending exposure)
- Requirements in relation with the EBA Guidelines on management of non-performing and forborne exposures (e.g. as the word "renegotiated" might imply a conceptual connection with

the definition of Forborne Exposures, and since paragraph 6 mentions both ‘throughout the life cycle’ and ‘monitoring performing exposures’), as well as the ECB Guidance on NPLs

- Requirements in relation with the EBA Guidelines on internal governance
- Requirements in Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing’
- Requirements in relation with Joint Guidelines under Articles 17 and 18(4) of Directive (EU) 2015/849 on simplified and enhanced customer due diligence and the factors credit and financial institutions should consider when assessing the money laundering and terrorist financing risk associated with individual business relationships and occasional transactions (The Risk Factors Guidelines)
- Requirements regarding EBA Guidelines on connected clients
- Application of BCBS 239 in terms of data collection
- Anacredit reporting
- ECB credit underwriting data collection
- ECB guidance on leveraged transactions

The above list includes level 1 and level 2 texts among other types of adopted supervisory guidance. In this regard, we urge the EBA to introduce references to those existing texts where possible, instead of rewriting the provisions and definitions, in order to keep only soft law requirements in the Guidelines. This would moreover enhance transparency and readability of regulation, for which complexity has increased over the years.

#### **Consultation questions:**

##### **1. What are the respondents’ views on the scope of application of the draft guidelines?**

Overall members consider the scope of the guidelines should be limited to only newly originated loans, and not cover existing loans originated before the application date. We believe the cost-benefit analysis decision in this respect is very unclear where it states that these guidelines apply to some existing loans (renegotiated and reviewed as in page 11), but it says they apply to ‘*all existing credit facilities*’ (page 77). The Guidelines should therefore apply exclusively to credit facilities granted after the application date. Decisions made under the previous regulatory context did not take into account all the aspects set out in these guidelines, and as such should not be subject to them. In particular, the regular credit review of a deal should not trigger any of the new requirements and this should be made explicitly clear within the guidelines. If the EBA does not amend the scope to apply only to newly originated loans, we would welcome clarification from the EBA on which sections in the Guidelines are applicable only to new or renegotiated facilities. This clarification should take appropriate account of the fact that monitoring the credit risk in the portfolio on newly introduced elements is not possible for existing facilities (please amend paragraph 8 accordingly). Complying with the requirements regarding the collection of information is operationally unachievable for the stock of operations and further consideration of this is specifically needed with regard to section 8 if the guidelines cover renegotiated loans.

Members also considered that the principles of proportionality could be better specified. The requirements are particularly disproportionate in relation to smaller entities/retail and the additional requirements set out in the guidelines will entail extra costs for them. It is noted that the guidelines adopt

a different scope of application depending on the areas of intervention, for instance, mandatory stress-tests (section 4.5, para.76 (k)) should be subjected to the principle of proportionality depending on the type or size of the portfolio. In addition, we would like the EBA to confirm that, (as per paragraph 14) for sections 5 until 8, proportionality can be applied to the size, nature and complexity of the credit facility and this then overrules requirements in those chapters stating "institutions should (at least)". Another example are the valuation requirements for property collateral (section 7), where it is difficult for banks to apply in full across all their entities. While they are implementable in highly developed European markets, it is not feasible for large institutions to apply them consistently globally because the terms under which the valuers are engaged can vary dependent on territory surveyors in a number of countries do not align with business models commonly seen in highly developed European markets.

Members considered **further clarification on the supervisory expectation in the application of the requirements would be necessary**, in particular, given not all the requirements set out in the Guidelines can be applied in a uniform way as loans have different characteristics.

With regard to the scope of definitions, clarity is sought on the definition of 'CRE', 'Green lending' 'professional', "movable property", "specific actions triggered", "natural person", "technology-enabled" innovation, and "ESG", as set out in the specific comments in the annex. More generally with respect to the definitions, requirements and descriptions used in the guidelines, we suggest that instead of redefining a concept/process the EBA include a reference to the applicable regulation and only reference requirements in excess of this (as is the case in paragraph 81). Special care should be taken where the referenced regulation has not entered into force yet. In such cases, these guidelines should respect the existing implementation timeline and avoid frontloading future requirements. Examples of this include:

- a) **AML** (section 4.3.1) is already regulated in '*Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing*'.
- b) **Governance and the roles of the lines of defence** are already described in '*EBA Guidelines on Internal Governance*'. We consider that only new or different requirements to those guidelines should be reflected in this document and existing provisions do not need to be restated but cross reference. This will aid gap analysis.
- c) Requirements regarding the **quality of data and infrastructure** that appear in several parts of the document (Pars. 54, 55, 226, 229, 232, 234, 236 et al.), should be checked against the already implemented following the '*BCBS 339 Principles for effective risk data aggregation and risk reporting*'
- d) Regarding section 4.4.3 "**Lending to affiliated parties**", it is worth noting that transactions with related parties are already covered by para. 113(d) of the EBA Guidelines on Internal governance, therefore, we suggest para. 67, 68 and 69 should be deleted. If those paragraphs are not deleted, the Guidelines should at least clearly specify that the notion of "affiliated party" is in line with the notion of "related party" as defined in CRD5.

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

AFME members considered the deadline for complying with the application of the guidelines to be very ambitious and should therefore be delayed/extended. In order to be able to implement the criteria in a satisfactory manner and with all possible guarantees, an extension of the period of entry into force, or a phase-in period is essential. This would also accommodate for a comprehensive impact assessment on primary business processes, sound decision making on required changes throughout multiple business lines, and the subsequent implementation into internal policies. As per the draft guide, many criteria will need to be included in the entities' concession models. This is particularly relevant if the scope of the guidelines is not only applicable to newly originated loans, but also to the existing stock.

Furthermore, it should be noted that although the guidelines include many common-sense requirements for loan origination and monitoring processes, changes can still be material and complex to implement in terms of practical application, with a knock-on effect on IRB modelling. It will also require the involvement of key personnel that are already heavily relied upon in other change projects related to the IRB repair work and the Basel III implementation process. A more realistic deadline could follow the implementation periods set for other comparable EBA guidelines (up to 4 years), once **all** aspects of the IRB repair work are fully implemented as per the EBA's IRB progress report. This would also allow for other regulatory developments such as, Basel III implementation, reviews of related level 1 texts listed below, changes in data infrastructure and ESG/Climate factors which are still nascent in regulatory development. Where necessary, further phasing in may still be required. Specifically, the data collection and management will need an IT infrastructure that may need to be designed from scratch in some areas to adequately meet the new requirements introduced by the guidelines. By delaying the implementation this would allow banks sufficient time to align their investment and operational structure to the new standards.

Indeed, it should also be noted that gap analysis can only commence once the final guidelines are published and for banks that operate globally, they will also have to take account of local transposition, especially with regard to the use of data. The timeline should therefore account for both the gap analysis and the implementation to take place. One consideration could be a phased implementation, focusing on the least challenging aspects such as governance and non-retail, and allowing more time for application to retail loans and IT infrastructure which will take longer. It will nonetheless be different depending on the business model of the bank and it is difficult to be more precise at this stage.

### **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)?**

#### **Technology-enabled innovation for credit granting**

Members noted that as it is the first time that such a topic is included in guidelines, its implementation may need more time than that set out and should potentially be removed. This is particularly relevant given the European Commission aims to prioritise a legislative initiative on AI and a "Digital Leadership Package" in the next mandate, as well as address outsourcing rules and cyber risk in the forthcoming CRR3 legislative package. Moreover, the majority of requirements listed in this section are already addressed in other parts of the document (e.g. under the need to understand and manage risks, involvement of the management body etc.).

Members are not clear what exactly the “technology enabled innovation” includes – for instance does it cover all models, AI, systems, data sources, algorithms, optimizations and how does this relate to ‘traditional methods’? In fact, currently technology is present in any credit granting activity. Additionally, uncertainty is introduced around what is expected in regard to justifying the outcome of technology-enabled regulation which could be interpreted differently by supervisors. More clarity on how to explain the outcome of the technology enabled innovation and understand whether the comparison should be high level with the common benchmarks (e.g. Gini coefficient of the model compared to standard models), or if standard models need to be implemented as well (and for how long) would be welcomed. In this respect, the existing constraints over model risk management framework are already considered exhaustive, we therefore suggest avoiding additional layers of constraint at this stage which could limit or bias further development in such areas.

Moreover, the main part of this consultation paper deals with the “traditional” way of doing a creditworthiness assessment, while technology-enabled innovation for credit granting processes is lacking consideration. When these 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. We see innovation being implemented in different steps of the credit granting processes such as creditworthiness assessments. The loan origination in companies is more standardized in the smaller segments as well as more oriented to statistical criteria than to for individual analysis. The latter involves a client being assessed by a reactive scoring model (i.e. model that assesses the application based on the information and documentation generally provided by the client); while the former follows an evaluation process which provides pre-approved credit limits to clients in digital channels, assessed by a behavioural scoring model (i.e. model that assesses clients based on information automatically fed from internal or external database). However, the EBA guidelines do not recognise these differences and hardly refer to the size of the debtor.

### **Environmental factors and Green lending**

Overall members are supportive of the 2015 Paris agreement and action plan on sustainable growth and welcome initiatives to address climate risk. Nonetheless, we note that both regulatory initiatives and measures being taken internally by banks are at a very early stage of development. Indeed, while Members have launched projects to address challenges of climate risk, including proactive engagement with front line RMs and Wholesale credit risk managers, a comprehensive implementation of transition risk assessments will take several years to complete. Consequently, Members considered the guidelines in this area are premature in terms of methodology, and the timeline too restrictive given the stage firms are at in incorporating climate risk into risk processes, alongside other initiatives underway such as developing a Taxonomy and the EBA’s CRR2 mandate to incorporate ESG into SREP.

In order to maintain legislative coherence, the requirements set in the guidelines should only be considered and consulted on once the EU taxonomy determining sustainability of economic activities enters into force (currently Member States are proposing taxonomy apply from January 2023). In addition, the flexible nature of the taxonomy should be taken into account, for example an economic activity classified as environmentally sustainable could be “taken out” of the list in the future, creating uncertainty for financial operators. Moreover, many aspects of the firm will need to be involved in operationalising this section and this should be reflected in terms of setting the implementation deadline and allow room for forthcoming regulation that may set overall thresholds to monitor environmental

risks, data sources, etc. Delaying or phasing this section would also mean that timing of the ESG requirements for loan origination are aligned to ensure consistency between the guidelines to banks and how EBA will consider ESG in the SREP (due mid-2021) as part of their CRR2 mandate.

If this section is to be maintained in some form, members recommend that there is a clear distinction between green lending and the assessment of risks associated with climate change and the ESG factors intrinsic to the loan. The scope should be limited to lending to corporates, and the EBA should consider phasing in or postponing parts of the guidance e.g. factoring climate (risk) vs green lending (market), and other sustainable loans.

For example, it is clear that climate change and environmental protection in relation to real estate will play a significant role in the future, and it should be recognized that the integration into the credit systems or into the credit decision process will be a multi-stage process over a longer period of time. This is justifiable because many of these aspects (e.g. energy consumption, risk floods etc.) are already included in the market valuation assessment.

Another example that illustrates that retail banking activities should deserve a long phase-in period is related to energy-efficient mortgages. Banks have sometimes the information of the energy efficiency of a house when they provide some mortgage loans, this information may be included in paper documents provided by the borrower. However, this information is not, at this stage, collected and available in the IT systems. EU banks are at the preliminary stage of defining a common template to gather and report on the Energy Efficiency Certificates for mortgages, as the Energy efficiency Data Protocol and Portal (EeDaPP) initiative (set up with EU funds) is still on going.

Hence, providing reasonable requirements in a later regulatory product for institutions with risk-appetite for such lending, rather than introducing the requirements here, even with a longer implementing timeline, would enable the EBA to revisit the scope and necessity for such requirements at the appropriate time with more in depth consultation. If not postponed, the incorporation of environmental factors and sustainable lending must be performed gradually and proportionally, taking into consideration provisions and timelines of the ESG-related regulatory and initiatives including those related to CRR and CRD. We would also recommend removing requirements included in paragraphs 50-53 as these will be particularly challenging to implement without a more developed taxonomy framework in place (e.g. under §50 banks don't have 100% formal qualitative and quantitative targets today as industry view of green lending is still evolving rapidly). We note that ESMA has concluded in recent technical advice not to mandate ESG factors in ratings as this is already being done, although it will take time to develop.

As well as the above considerations, Members' ability to incorporate Climate Transition Risk into risk assessments is often constrained by the general lack of disclosure and inconsistencies in disclosure by corporate clients, particularly with respect to their carbon emissions and plans for curtailment and related investments over time. Moreover, while some jurisdictions are taking much more concrete steps towards controlling carbon emissions, others are not, which makes an analysis of global companies more complicated. In order to harmonise requirements across jurisdictions it would be welcome if the EBA supported data gathering and sourcing through existing mechanisms, such as Task Force on Climate Related Disclosure (TCFD). Here, 'comply or explain' approach could help to expand the adoption of the TCFD. As a member of Network for Greening the Financial System, the EBA is in a good position to



promote global efforts to address the key issues. Regulatory endorsement of initiatives by industry bodies to request data collectively for use in firms would assist industry efforts to overcome the data challenges.

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

Generally, the requirements for governance and for credit granting are too standardized and prescriptive and yet in places unclear. A better approach to these topics may be principles-based guidance focused what the EBA considers the best outcome. The EBA should also reflect on the existing well-functioning framework already implemented or in the process of being implemented.

**Digital innovation:** With regard to this, the proposed rules seem overly prescriptive which may hinder simple and fast accessibility on-line, that this distribution channel foresees. Flexibility of rules should be the key principle to follow when dealing with loan origination so that the legal framework remains technologically neutral.

**AML guidance:** Banks have AML/CFT procedure during on-boarding and on an ongoing basis for monitoring. However, these policies are procedures which are not specific to credit risk and there would be no clear benefit of embedding them into a credit process or monitoring framework. Given the specifications are in any case fairly minimal it might be useful to make more detailed specifications in AML-specific EBA Guidelines (such as EBA Risk Factor Guidelines from 2017). See also detailed annex comments.

**Data infrastructure:** it would be useful to have a clarification on the supervisory expectations, especially with respect to the monitoring throughout the life cycle of credit facilities, and for specific portfolios for which the information is not available. Clarity on the proportional application of the data collection requirements would also be welcome.

**Leveraged transactions:** The main challenge in this area is the lack of a consistent definition for Leverage Lending across regulatory regimes. The implementation of these guidelines would be improved if EBA and other regulators were to agree on a consistent global definition and ensure consistency with existing publications (e.g. ECB guidance on leveraged transactions).

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

This section of the guidelines should recognize and include the fact that robust credit decision-making frameworks can also consist of a robust framework of delegated credit responsibilities to duly authorized individuals, and that not all institutions will necessarily use 'credit committees' or 'credit decision-making bodies.' Among other aspects, we welcome the fact that the EBA Guidelines recognise the use of sole delegated credit authority. However, banks' actual practices in this respect do not seem to be reflected in references in Section 4.4 to 'credit committees' and 'credit decision-making bodies.' Specifically, the guidelines are not clear about individual credit decision making – for instance in §62 it states *“Where **members** of staff are delegated with a relevant authority level for credit decision purposes, there should be 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.”* Our members view is that the credit decision making does not strictly need to be through credit committees and delegated credit decision-making bodies, which is implied here. Credit decision making through individual delegated authority, where governed by appropriate set of standards, should be equally effective. Often banks apply the ‘four eyes’ principle or have a hierarchy of decision making which will go through various individuals for approval. In these instances the responsibility for making material credit decisions is not the sole responsibility of one individual, even if there is no committee structure to approve it. Similarly, section 4.4.1 states: *‘More specifically for the purposes of these guidelines institutions should ensure that any individual involved in credit decision-making such as members of staff and members of management body: a. should only have limited sole delegated credit authority for credit decisions for small and **non-complex credit facilities**. The specific criteria, exposure levels and associated aspects should be defined in the relevant delegation policy and be approved by the management body’*. Contrary to what this suggests, the use of sole delegated credit authority should not be dependent on the type of credit facility (e.g. ‘non-complex’) but rather for the bank to determine, otherwise the requirement of credit decision-making may limit proven and well-functioning lending activity.

With regard to section 4.2 we would also propose that the concept of materiality in relation to the financial institution’s overall credit portfolio is introduced. Individual credit file decisions ensure individual credit file quality and compliance with risk strategy and credit policies. In addition to decisions on individual credit files, credit risk limits ensure risk diversification and prevent concentration on portfolios with shared risk characteristics. Credit risk limits are only meaningful for material credit risk portfolios, when smaller, non-material, diversified portfolios should not require specific RAF limits. Applied to a large diversified generalist bank, the RAF does not cover every single credit portfolio of the bank with dedicated limits. Limits are set-up for material portfolios with shared risk characteristics, i.e. sectors (i) with common risk drivers affecting the clients of these sectors (ii) above a certain materiality threshold (iii) with specific risk sensitive indicators such as Watch List concentration or Doubtful concentration.

Additionally, the distinction between credit risk and operational risk in Section 4 is not clearly differentiated. For instance, it is not clear whether the guidelines require an internal control system for operational risk and whether credit risk is meant to be represented directly in the internal control system. This could risk mixing two major risk types. A clear separation between operational risk and credit risk would be welcome.

Moreover, we think that input of risk opinion in the remuneration policies as per section 4.3 is necessary and sufficient. However, excessive requirements as laid down in particular in §82 in the remuneration policies and practices could be disproportionate with the real risk taking. Remuneration policies and practices should be consistent with the overall credit risk appetite and should not create conflict of interest. Nonetheless, it is essential that performance management and reward of employees involved in credit activities should be based on several criteria and on indicators linked to their activities and the quality of their credit risk analysis rather than being based on the quality of credit exposures which are independent and disconnected from the employee him/herself, his/her individual performance and the way he or she conducts his/her activity.

Finally, regarding the measures related to managing conflicts of interest, it is considered highly complex to define the organizational control and monitoring structures, policies and procedures with the detailed

requirements that appear to be set in the guidelines and we suggest introducing a clarification on the supervisory expectation with respect to this issue.

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

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*” ( §76(c)) and an “*independent/second opinion to the creditworthiness assessment*” ( §76(g)) appears to require an ex-ante supervision of the risk management function within the credit process. This approach, which implies an active role performed by the risk control function during the lending phase, might be difficult to apply in practice for the following reasons:

- **the prior involvement of the risk control function is 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;
- **the need to have second opinion to the creditworthiness assessment might trigger inefficiencies in the process** related to the duplication of activities and skills in charge of different functions, entailing inter alia also additional staff costs.

In addition, we suggest the EBA clarifies whether an “independent or second opinion” or “an independent and second opinion” is needed. Proportionality and a more risk-based approach for such requirements should be sought. For certain types of activities (e.g. retail exposures, small corporates), an independent second opinion is deemed excessive given the materiality and the risk taking in such cases. When implementing ‘an independent/second opinion to the creditworthiness assessment and credit risk analysis’ is considered to be an additional pair of eyes to be involved in the credit process (next to the First Line and Second Line), then it could lead to an inefficient credit process and longer lead times. In practice, the approval bodies in the Signatory Approval Process can be viewed as independent and, additionally, the third line of defence will be involved afterwards and will have the opportunity to flag and give direction on correcting any flaws in the credit risk analysis going forward. Removal or rephrasing of §76(c), §76(g) and §76(n) is therefore advisable.

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

With regards to collection of information and documentation, the requirements of collection and especially verification of information provided by the borrower are highly prescriptive, extensive and intrusive and could slow down processes related to high-demand products (e.g. 0% credit payments). With respect to collecting an adequate set of information and documentation for the purpose of assessing borrowers/transactions, we underline that the guidelines should better state and accept the possibility for information packages differentiated by borrower type and/or asset class. Bearing in mind that not all required documentation is available for clients, we suggest a more granular differentiation for individual firms, small corporates, mid-sized companies, large firms (for example by introducing thresholds, also driven by loans' sizing and borrowers' risk profile), and to allow for a certain degree of flexibility. Ease of implementation will also partly depend on the regulators approach to assessing compliance. If

supervisors adopt a “comply or explain” approach to the documentation requirements, internal procedures and policies could become excessively complex as a result. Another issue lies in regulatory inconsistency - today interest free credits of less than 3 months and credits of less than EUR 200 are excluded from the requirements of the CCD, however, EBA guidelines would apply regardless of the amount or duration of the credit. We consider the EBA should align with the CCD in this respect.

More proportionality should be introduced the general requirements listed in the chapter 5 (e.g. §135) to leave room for banks to better customise and manage different types of banking such as retail vs non-retail practices – and within these perimeters – different types of lending, obligors etc. In this respect the guidelines appear to lean towards less riskiness, whilst not recognising that taking risks is also part of a sound market lending. The guidelines should aim to strike an appropriate balance between a thorough credit assessment and risk taken, in line with risk appetite.

Specifically, in the collection of information and documentation for the purposes of creditworthiness assessment according to the size and complexity of the types of credit facilities covered, we would welcome confirmation that the list in Annex 2 of specific requirements for lending are only examples and not prescriptive. For the purpose of banks meeting supervisory expectations it is important to confirm that this list does not mean all items are relevant all the time for all types of lending (para.91 and 92). Considering the above we would suggest following amendment for 92:

*“For the purposes of the collection and verification of information, institutions and creditors should ~~at least~~ consider collecting **where appropriate** the information and data as set out in Annex 2. **This list is not prescriptive and should be complied with proportionally to the type, size, nature, complexity and risk profile of the credit facility. It should also be completed where relevant with additional information.**”*

Furthermore, not all of the information items mentioned in paragraph 91 and 93 will be relevant in all cases. Therefore, we suggest rephrasing (para 91 and 93) “*should collect and verify information*” to “*should take reasonable steps to collect and verify relevant information*” or “*For the purposes of the creditworthiness assessment of professionals, institutions should collect **where available** and verify information in relation to ~~at least~~ the following...*”.

Annex 2 (para 94) should make clear it is an exemplary list rather than a fixed one as this list offers quite a range of information sources, which will not necessarily be available for all corporates. Indeed, it is not clear what the consequences are in case a potential borrower cannot or is not prepared to provide certain information. We would propose the following modification for §94:

*“For the purposes of the collection and verification of information, institutions and creditors should ~~at least~~ consider collecting **where appropriate** the information and data as set out in Annex 2. **This list is not prescriptive and should be complied with proportionally to the type, size, nature, complexity and risk profile of the credit facility and size of the professional client. It should also be completed where relevant with additional information.**”*

At present, the bank usually reflects such lack of information in the rating and thus the pricing. If that approach is within the envisaged outcomes, the EBA guidelines should be clear, otherwise it is implied that no provision of information will result in no lending. Indeed, it should be clear that banks are obliged to use only information that is potentially available (for verification) at origination (i.e. borrowers

existing credit commitments). For business lending institutions it should be possible to assess creditworthiness based on other criteria (e.g. behavioural criteria) apart from classic financials and/or financial projections (for short term usage). As banks use various techniques to assess creditworthiness we think the parameters and metrics used for assessing the borrower's ability to repay should be either high level recommendations (not a concrete list of parameters but rather an approach such as ratios of income and the loan / loan installment should be used) or just a list of possible parameters.

Although it is stressed in several places that the guideline should apply to "newly granted loans" (e.g. §4, 10) or "significant increases" (e.g. §83), it is stated in several places that "changes to the contract or loan amount" should also be affected (§ 97). In any case, only the conclusion of the loan agreement and the significant increase in the loan amount are covered by the MCD and CCD (Art. 8(1) and (2) CCD; 18 (1) and (6) MCD. An extension beyond the existing (directive-compliant and statutory) scope of application is therefore not needed. Another impact of the requirements in Section 5 and criteria established in Annex 1 and 2 is that it implies manual process and will hinder innovation in credit granting as they are too prescriptive and do not allow companies to develop alternative procedures to determine the creditworthiness of a consumer or a professional. Specifically, the draft guidelines remove the possibility of developing alternative creditworthiness procedures that minimize the information required from borrowers and 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 - one proposal the EBA should also consider including is an additional section setting out less prescriptive requirements to firms applying alternative procedures, which could improve customer access to credit or the accuracy of the creditworthiness assessment that do not fall into the traditional approach to assessing creditworthiness.

For specialised lending, the guidelines should only include indicative provisions, as that type of lending is used for complex exposures with often bespoke characteristics. Clarification on how the general requirements (and to what extent) should cover lease exposures would also be welcome (see also Q9).

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

We reaffirm our comments in Q7 in relation to available information and documents (as required under §97) and better definition of the proportionality principle – the EBA should clarify (in §130 for instance) that the requirements under 5.2 do not represent an exhaustive and compulsory list that needs to be applied to each credit case, but can be applied proportionally by each institution in relation to their internal credit decision-making frameworks, and the relevance of those requirements to the specific credit cases. In particular, we suggest banks set their own thresholds for the applicability of the cash flow and sensitivity analysis on the corporate sector based on the bank's own risk appetite and profile, though such analysis should not be applicable for individuals. Furthermore, it should be noted that the definitions and expectations set in the guidelines will not be compatible with markets which are not as developed as the EU.

In respect of the creditworthiness assessment, the requirements for mortgage credit seems to be applied to consumer credit, which is disproportionate given these are completely different in duration and amounts. It is also unnecessary when one considers the level of digital innovation and the evolution of

trends towards vocal communication for these processes. Standardizing the creditworthiness assessment may also exclude atypical clients which have a trusted relationship with the regional entities.

The guidelines could also accommodate for loans and advances which are based mainly on the assessment of collateral and less on the creditworthiness of the counterparty (e.g. common collateralised lending /Lombard lending in private banking business). If such products are in scope, we propose a proportionate approach (as described in paragraph 14) that would allow the flexibility to “opt-out” of disproportionate requirements, i.e. to assess the borrower’s creditworthiness by taking into account future cash flows (required by paragraph 125).

Section 5.2 brings into scope ‘Commercial Real Estate Lending, Shipping Finance and Project and Infrastructure Finance’. It is unclear why separate requirements are proposed specifically for these industries – if these are required, then why not separate requirements for e.g. Aviation, Container, Reserve Based Lending, Asset Based Lending, Leveraged Finance? Such a selection appears random and puts additional burden on these specific groups. Furthermore, Project and Infrastructure Finance are grouped under one header, however Project Finance is much broader than Infrastructure Finance. While typically Infrastructure Finance transactions have the character of a Project Finance, the latter also includes transactions in e.g. Oil & Gas Midstream and Power & Utilities. It would make more sense in this case to remove Infrastructure Finance from this header and just call it “Project Finance”.

Regarding shipping, we believe the framework of analysis proposed by EBA should be flexible and adapted to each specific situation. In many cases, financing is provided on a fleet basis, with recourse to a large operator. In these cases, an individual analysis, on a vessel-by-vessel basis, such as the one suggested in §171 (a), will not be possible, as each vessel will be operated as part of a larger fleet and can have widely different types of earnings at any given time.

Regarding commercial real estate lending, we would suggest that a proper analysis may require other factors to be taken into account than those proposed. We believe that the criteria proposed by EBA should not be read on a prescriptive basis, but as general guidelines to be taken into account within the analysis performed by the bank (see also our comments on the definition of CRE in the annex).

We would like also to note that some of the criteria proposed in paragraphs 125, 126, 129 are not appropriate for non-recourse or limited-recourse transactions, further clarification on their definition of “consumers” and “professionals” is also needed for this section. For instance, for couples or joint accounts, it should suffice to fulfil the creditworthiness criteria on consolidated level. The same should apply for professionals who have a joint account. The category of “professionals” now appears to include small businesses to multinational corporations. The requirements should respect the principle of proportionality and the level of granularity should be commensurate to the risk profile of the counterparty or class of counterparties.

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

As already noted in questions 1 and 7, in view of the extensive requirements foreseen in the loan origination procedure, a more granular differentiation between activities is necessary. The scope of the asset classes, products and clients covered is very broad. The proportionality principle is key to section

5.2 and certain wording should be modified for clarity sake on their applicability (e.g. "at least" replaced by "where relevant" and "list not exhaustive"). Once again, the "one size fits all" approach should be reconsidered. For example, paragraphs 145 and 146 are detailed and often include events which would occur simultaneously, hence the necessity for proportionate application in accordance with each case. Generally, we also support keeping the asset classes mentioned in the CRR and to align with the (existing) guidance from the EBA and ECB where possible, rather than developing new definitions in these guidelines.

In respect of Leasing and Factoring business we consider the requirements very generic and not reflective of the specifics of the asset class. We therefore feel a clear need for these guidelines to provide, where relevant, more specific interpretations and, where possible, exemptions for these individual product types, as was also done in e.g. for the EBA guidelines on the application of the definition of default under Article 178 of Regulation (EU) No 575/2013 (EBA/GL/2016/07). With respect to the definition of CRE in paragraph 17, note the definition applied in the guidelines is in line with the new definition of ESRB/2019/3. However, we ask the EBA to exclude the subcategories of social housing, property owned by the end user, clarify buy-to-let in the definition (see Annex). We also propose closer coordination between definitions given in these guidelines and those in Art. 4 of CRR, for example for purchased receivables a definition only exists under IRB, but no definition of this exists under SA, so if they are included in the guidelines a clear and concise overarching definition would also be needed.

It should also be noted under §183 that price is not part of a credit decision or a credit risk management task but done by the front office/1st line of defence.

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

Overall, our view is that banks should consider their loan pricing in well-documented, comprehensive frameworks. Those frameworks should include a definition of their credit risk appetite and business strategies as stated out by the draft. The pricing should consider cost of funding and credit risk costs and risk adjusted performance measures, such as EVA, RORAC or RAROC. §188 states that it should be done in "a manner that is proportionate to the size, nature and complexity of the loan". We welcome this proportionality principle as a one-size-fits-it-all approach cannot be applied. We also suggest reinforcing this flexibility to ensure sound understanding and application. Nonetheless, it is concerning that the guidelines seem to require the entire cost base to be considered rather than marginal costs, this should be clarified. Furthermore, the current drafting does not fully reflect modern pricing methods (as outlined in the specific comments 187-190) and more simplistic methods in accordance with materiality of loans.

Members were also concerned by the granularity of requirements in this section, and the EBA should have a more flexible vision based on the different types of credit. While it is valuable to establish a binding industry standard for loan pricing, it is important that in taking into account the parameters listed in §187, there is no obligation to define minimum pricing thresholds for every single transaction depending on the level of risk and the EBA should make clear that this is not required. Instead more tailoring of requirements could be considered for consumer credit and classic activities e.g. the reference to this list of parameters for each loan is disproportionate. In addition, we consider that there is no valid ground to require the management to explain pricing validity in case of inspection. The guidelines should likewise recognize the fact that not all institutions would necessarily use the exact profitability measures enumerated in the draft guidelines. It should also be reflected that while capital and funding costs would

impact the profitability of a given loan to an institution and hence influence its initial willingness to lend, the actual pricing of the loan would be subject to wider considerations such as market competition.

Separately it should be noted that additional details to the existing comprehensive framework as foreseen in the guidelines could be technically difficult to integrate into systems. Consequently, more time should be specifically allowed for this in the implementation if the overall timeframe for implementation is not changed.

Finally, the guidelines should recognize and allow for the fact that institutions can and do find it expedient to put the pricing of a loan into a broader context. For example, the profitability of relationship loans would be reviewed at the client relationship level and not necessarily purely on a transactional level, whereas the profitability of an acquisition financing could be viewed more on a transaction level.

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

This topic has also been covered within EBA guidelines on NPL management and attention should therefore be paid to the coherence with those texts as well as the CRR. Indeed, there is a risk that the combination of Basel III requirements and these guidelines may lead lenders to not collateralize movable and immovable property because of the administrative burden or to remain competitive with other credit granting parties to whom these guidelines do not comply.

There is a need to provide a more precise definition for "movable property". It could also be useful to make clear whether the "collateral valuation" refers to the valuation of real estate or of the bank security. Additionally, the EBA should distinguish between "collateral" used for asset-based lending (Commercial Real Estate / Shipping / Aviation) and "security / general lien" (Leveraged Lending / Corporate Lending). For the former asset-based lending where an institution might get an "eligible collateral" offset/RWA relief should have a robust assessment policy/procedure versus the taking of security reflected through generic LGD setting. Indeed, the EBA should clarify this section such that it clearly differentiates between 'asset reliant financing' and 'non-asset reliant financing'. In our view, the current draft wording should refer to the former only. When the primary source of repayment is cash flows, and security is therefore granted only with great caution and as a last resort for repayment via enforcement of the security, the EBA should recognize that institutions do not usually consider it expedient to get valuations of those immovable or movable property and other security. However, as explained above, we do agree that valuations are required for 'asset reliant financing' credit decisions.

In the case of immovable property, we understand the CP is intended to align with Article 208 of CRR with regard to the use of advanced statistical models for valuation purposes at origination. This should be made clearer to avoid confusion e.g. stating where the use of statistical models is allowed for exposures up to EUR 3 million at origination and for monitoring purposes. Disallowing the use of statistical models altogether would not in our view contribute to making banks' standards more robust. Instead, it would result in additional costs, without direct benefits to the client and the bank. A strict restriction on the use of those models can hamper the development in this market and the overall progress of the valuation market. Furthermore, in those cases where national legislation allows for the use of other methods for valuation (e.g. model-based valuations), this should be allowed as national legislation supersedes the EBA guidelines.



Additionally, there should be an alternative to use automated property valuation (and other forms of valuation, e.g. book value for professional lending) at the point of origination instead of an independent qualified valuer. Best practices / Conditions for such assessment should be included within the guidelines. It should be possible to reevaluate properties based on external data (e.g. based on indexation) apart from external valuer and / or the advanced statistical models.

Finally, the requirements for monitoring and revaluation (section 7.2 in particular §207 and §208) are very granular in terms of elements to take into account. Regarding requirements to rotate valuers (§214), though we deem necessary such rotation, we suggest not harmonizing the maximum numbers of valuations with the same valuer, in order to render the various practices of different business lines, this could also prove difficult in the case of specialized collateral where there is a scarcity of qualified valuers. Therefore, we suggest deleting this paragraph.

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

The requirements expect the use of a monitoring system which is to a large extent automated and works without undue delay, with little reliance on manual process. However, the guidelines state the importance of monitoring qualitative factors. We note that such qualitative information is inherently more difficult to automate, and its collection will give rise to data protection issues. The guidelines should therefore clarify that the ambition for automation is more aimed at the monitoring of credit and financial metrics rather than qualitative information.

Throughout this section there is an excess of required indicators, which will not always correspond with the available information nor with all the necessary factors in the analysis. The EBA should therefore clarify that the requirements under section 8.6 are not an exhaustive and compulsory list that will need to be applied to each credit case, but can be applied proportionally by each institution in relation to their internal credit decision-making and monitoring frameworks, and the relevance of those requirements to the specific credit cases. Taking into account the proportionality principle, it should be enough to use behavioral models (e.g. EWS model) to identify deterioration of the financial situation of the company. In any case, in order to guide conversations with supervisors and consistent standards of supervisory application we suggest in all mentioned information requirements and processes, a general disclaimer stating:

- Information should be gathered if it does not represent an undue cost and effort;
- Information and processes should be adapted to the materiality of the portfolios, the local specificities, and the local regulation should the portfolio be in a jurisdiction outside the European Union;
- Lists of indicators or information are just indicative, and entities are allowed to adapt it to the relevant indicators to their portfolios (which could be more, less, or simply different to the ones suggested).

In terms of other general considerations, members noted the EBA could more clearly specify whether and in which situation the Warning on Monitoring should be performed at portfolio level or at loan level. The consultation paper does not differentiate monitoring activities according to the credit process applied i.e. Standardized or Individual or taking Retail vs. Corporate. There is also no differentiation between an

automatic or manual identification, as well as the clear separation of customer types. The requirements stated do not consider sufficiently the very different characteristics of the activities and the risk connected to the different client groups. It is not clear, for example, if the watch list requirements are also applicable to retail individuals' exposures. Members consider that the governance requirements for early warning tools should also be reviewed.

Given that the retail portfolios of consumer loans and mortgages consist of committed exposures, Early Warning Indicators are based on delinquency days rather than the indicators defined under section 8.6.

Regarding requirements of covenant monitoring, these should be proportionate to the nature of loans, types of counterparties and risk taken, especially in terms of IT system considerations. While it is important to monitor covenants where applicable for specific types of loan, the practice should take into account the bank's overall credit monitoring framework and its accuracy to monitor loan risk and prevent default. To this purpose, covenants provide further security and possibility to monitor the loan and could be considered as one means but not the panacea. For instance, a covenant breach does not always lead to default, yet a default could occur even if no covenant is breached. Therefore, the borrower's adherence to covenants cannot be considered as an early warning tool, in particular, delivery of covenant compliance certificate is more an ex-post consideration of the loan situation, rather than an early warning indicator. We suggest the EBA reconsider the drafting of 8.4 with this in mind.

Regarding the section on stress-testing, we do not consider it relevant or practical to conduct stress-testing on individual exposures to assess risk. The practice is to consider, where relevant, scenarios on concentrated exposures at portfolio level as this is proven to be a more effective way to assess risk in a stress situation.

While members agree with the need to continuously monitor and assess the quality of credit exposures and financial situation of borrowers so that to ensure the resulting changes in credit risk, they note that the monitoring should not be carried out with respect to the initial recognition of the lending exposure. While it is a principle applied for accounting purposes (as in IFRS9) it is not appropriate for the monitoring framework whose aim is to assess/monitor the exposure evolution by comparing the current exposure with the most recent information to allow banks to undertake the necessary actions more promptly.

Finally, it should be recognized that the data infrastructure changes for a large global institution will take significantly longer to implement than the proposed timelines, especially with regard to this section and as such we request that it allows for development of an appropriate data infrastructure (up to four years).

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## Annex 1

### Comments by Paragraph to the EBA Consultation on Draft Guidelines on Loan Origination and Monitoring

#### Section 2: Subject matter, scope and definitions

**Paragraph 6:** We believe that referring to “credit granting process” is too general. It is worth specifying whether, for example, if the identification of potential customers in a campaign for credit granting, or fraud detection processes would fall within scope. Bearing in mind that not all required documentation is available for clients, the additional requirements set in the guidelines in terms of processes and monitoring – both with regard to documentation and analysis - would imply additional costs for the micro-entities which would be required to present new analysis and documents, such as the cash flow and the sensitivity analysis, that are currently not elaborated on internally. Consequently, it would result in an overall restriction on lending as well as increase reputational risk for financial institutions. In addition, the data may be of poor quality because financial statements are not audited. The most predictive data on small enterprises should be used.

**Paragraph 7:** It should be made clear that derivatives and Securities Financing Transactions (SFT) are out of scope. We would suggest the following amendment:

*“Debt securities, **derivatives and Securities Financing Transactions (SFT)** are excluded from the scope of application of these guidelines. “*

**Paragraph 9:** Are non-bank financial institutions in scope of the guidelines i.e. not part of the exempted counterparty list?

**Paragraph 10:** Can the EBA confirm whether the scope of “loans and advances” includes lending, trade finance and export finance products? The guidelines could also accommodate for loans and advances which are based mainly on the assessment of collateral and less on the creditworthiness of the counterparty (e.g. common collateralised lending /Lombard lending in private banking business). If such products are in scope, we propose a proportionate approach (as described in paragraph 14) that would allow the flexibility to “opt-out” of disproportionate requirements, i.e. to assess the borrower’s creditworthiness by taking into account future cash flows (required by paragraph 125). Furthermore, complying with the requirements regarding the collection is operationally not achievable for the stock of operations that were originated before these guidelines and should be made clear. We would as a result suggest the following amendments:

*“Section 5 **and Annex 2** apply**ies** to loans and advances that are originated after the application date of these guidelines. ~~Section 5 and Annex 2 also applies to loan agreements where terms are renegotiated or which require specific actions triggered by the regular credit review of the borrower after the application date, even if they have been originated before the application date.~~”*

**Paragraph 13:** Confirmation sought that compliance with the guidelines at the consolidated level and individual level would be sufficient to demonstrate compliance at the sub-consolidated level.

We consider that the application of the guidelines in third countries would affect the level playing field with respect to non-European banking entities therefore, the reference to article 109 of Directive 2013/36/EU should be removed.

With respect to the following sentence: *“When implementing requirements... should consider type, size, and complexity of the credit facilities...”* members understand that all requirements as mentioned by EBA could be relevant in credit granting processes and will therefore always consider whether or not additional information or substantiation is needed, however, the requirements are not always relevant for all types of clients nor when taking the complexity of the deal/financing into account. We would therefore like the EBA to confirm that for sections 5-8 that the proportionality principle can always be applied to the size nature and complexity of the credit facility, also in cases where the GLs state that banks should *‘at least...’*. Where proportionality cannot be applied for paragraphs with wording like “institutions should (at least)”, the impact on institutions and their clients will be substantial. The EBA should amend the wordings “Should at least” and “should” in the following articles: 129, 134, 135, 136, 139, 143-146, 154, 169.

In addition to applying to the specifics of the credit facilities (type, size, nature, complexity and risk profile of the credit facility), the principle of proportionality should be considered in conjunction with the risk profile of the borrower. Consequently, we would also propose the following amendment:

*“13. Second, when implementing the requirements for the creditworthiness assessment, loan pricing, collateral valuation and credit risk monitoring, competent authorities and institutions instead of size and complexity of institutions, should consider the type, size, nature, ~~and~~ complexity and risk profile of the credit facilities being originated or monitored, in conjunction with the risk profile of the borrower, because this is the main driver that could give rise to disproportionate application of the guidelines.”*

**Paragraph 14:** While it is positive that the size criterion is not the only one taken into account, the guidelines differ from the ECB guidance, in which the cooperative model is explicitly recognized, in this respect it would be helpful for the EBA to align with existing ECB guidance. In addition, the independence criterion is envisaged in a way that goes further than the notion of conflict of interest in the texts tackling governance. With regards to the nature of the credit facility, we assume that this also enables the application of the proportionality rule based on different product types (e.g. for collateralized lending assess creditworthiness based on collateral, rather than cash flows as suggested by paragraph 125). Furthermore, as well as applying to the specifics of the credit facilities (type, size, nature, complexity and risk profile of the credit facility), the principle of proportionality should be considered in conjunction with the risk profile of the borrower. To reflect this and allow for a streamlined interpretation of the principle of proportionality and avoid any, we would suggest rephrasing the end of section 2, §14 as follows:

*“14. Institutions should apply section 4 of these guidelines in line with the proportionality principle described in Title I of EBA Guidelines on internal governance. Institutions should apply sections 5, 6, 7 and 8 and related Annexes 1, 2 and 3 of these guidelines in a manner that is ~~comprehensive and~~ proportionate [NB: if proportionate, then cannot be comprehensive] to the type, size, nature, ~~and~~ complexity and risk profile of the credit facility, in conjunction with the risk profile of the borrower.”*

**Paragraph 16:** this provides definitions contained in various directives. The definition of the loan for residential property contained in Para. 17 restricts the further definition from Directive 2014/17 EU to

the case group of the loan secured by a residential property. The loan not secured by a mortgage for the acquisition of a property would therefore not be covered by the guideline (in contrast to the WIKR). The EBA should clearly state whether loans for the acquisition of real estate that are not secured by mortgages are excluded from the Guidelines.

**Paragraph 17:**

**Definition of CRE:**

Although we understand that the EBA used the latest definition from the ESRB, this definition creates issues in terms of risk profile analysis (impacting thus the creditworthiness assessment).

First of all, it would be useful if the EBA could clarify in the definition whether the scope of CRE loans is limited to 'asset reliant (usually mortgage secured) loans to SPVs for the purpose of acquiring or developing real estate assets' or extends to 'corporate (usually unsecured) loans to property companies such as REITs'.

Moreover, the definition of CRE / RRE remains an issue for

- social housing;
- property owned by end-users;
- buy-to-let housing.

As for social housing, it does not fall within the regular assessment of CRE, because other criteria / specificities are applicable. For instance, for some countries, social housing has a special status in law which conditions its risk nature. This type of lending is often guaranteed by local administrations, risks are mutualised through guarantee scheme, the sector is particularly scrutinised by the government. For instance, "Action Logement", which is a social landlord, was rated Aa2 by Moody's on September 2019 (which is the same rating that the French government, given the assumption of implicit government support).

Besides this, property used for conducting own business (and therefore not being income producing real estate) should be out of scope for CRE. From a credit risk perspective, the criteria for evaluating RE professionals (pure CRE counterparties) are very different from the ones to be used for evaluating the granting of lines collateralized by RE assets to companies operating in other businesses.

We would also welcome clarity on rental / buy-to-let property which appears to be captured under both Commercial real estate (CRE) and Residential real estate (RRE) definitions. We also note that national differences in structures and legislation related to regional reporting requirements and tenant-owned housing companies / associations and social housing makes the EBA definition problematic. Therefore, the local specificities should be recognised in the definitions, especially when national competent authorities have not disputed such definitions.

Last but not least, given the divergent definitions through time, does the scope for CRE / RRE apply for both new and existing loans?

**Definition of 'Green lending':** Ideally, we recommend the EBA to refrain from proposing any definitions (as these will come from the EU classification system of sustainable economic activities, 'taxonomy') and focus solely on proceedings. If it is maintained, then the high-level definition will need further clarification (e.g. "lending dependent on climate and/or environmental criteria", "requires 'positive climate-and/or environmental effects"). If the EBA goes ahead with a definition, we would propose a refinement of the definition of 'sustainable lending' which is referred to as dependent on green/environmental reasons for granting finance ('sustainable' lending as this encompasses a wider range of activities that go beyond pure 'green'). The EBA should also consider the definition put forward by the LMA, as well as take into account the need for consistency across jurisdictions.

## **Section 4: Governance requirements for credit granting and monitoring**

### 4.1.1 Responsibilities of the management body

**Paragraph 21:** "management body" should be re-defined as "management body and relevant delegated decision-making bodies", so that it is not interpreted as only the Management Board but also other relevant governance bodies of the bank. For cross-border banks, there is always a level of delegated authority, depending on the underlying risk and business allocation.

### 4.1.2 Credit risk culture

**Paragraph 25:** This sets high expectations in relation to the monitoring of credit culture, the use of mitigating actions where deficiencies are noted, and tailoring of policies and procedures to mitigate against potential cultural deficiencies. We acknowledge the importance of culture within the context of governance, however, it should be made explicit in the guidelines that the ambition level should fit the relatively limited extent (as compared to for example financial risks) to which cultural risks can be objectively identified, measured and effectively mitigated in practise.

### 4.2 Credit risk appetite, strategy and credit risk limits

**Paragraph 26:** The requirement to determine the 'desired portfolio' is highly theoretical, potentially reliant on factors not in an institution's control (e.g. market conditions, competition), and time consuming with little added value and we would propose to delete. If not deleted in full, we consider it is excessive to include geographical location in the risk appetite and would delete the reference to this, or at least make clear it should only be required 'for material portfolios where appropriate'. We also consider the reference to specify the 'desired diversification and concentration' excessive. The general concept 'risk appetite' can be interpreted in different ways.

**Paragraph 27:** This paragraph is not clear in general and in particular the following sentence: "*When defining the credit risk appetite, institutions should ensure that both top-down (e.g. setting high-level targets) and bottom-up perspectives (e.g. operationalisation of these high-level targets). These perspectives should be also supported by an adequate budgeting process*". Is it correct that references to 'budgeting' here should be read as an adequate credit risk limit framework?

**Paragraph 28 and 30:** The EBA should allow institutions to manage credit risk metrics/limits (paragraph 28) and concentration (paragraph 30) at a level which is deemed fit for that portfolio by the institution.

We propose to amend para 28 as follows: “*The credit risk appetite and strategy should include, **where appropriate applicable for material portfolios, appropriate**-specific credit risk metrics and limits, which should be a combination of backward-looking and forward-looking indicators. Such indicators should include **for the material portfolios** key aspects of the credit facilities including **where relevant** their geographical coverage, business lines, asset classes, sectors, client segments, currency, credit risk mitigation instruments and products. These indicators should be tailored to the business model, **the materiality of the portfolios**, and the complexity of the institution.*”

We propose to amend para 30 as follows: “*For the purposes of managing concentration risk, institutions should set quantitative internal credit risk limits for their aggregate credit risk, as well as for **material** portfolios with shared credit risk characteristics, sub-portfolios and individual borrowers. In the case of group entities and connected clients, the limits should account also for the consolidated and sub-consolidated position and the position of the individual entities of the consolidated and sub-consolidated levels.*”

#### 4.3 Credit risk policies and procedures

**Paragraph 34:** it should not be necessary to establish specific and more granular policies for example for different sectors, unless required because their frequencies of default significantly deviate from the average. Another reason for establishing and identifying specific lending policies could be when the nature of the risk is different from the standard, for example for invoice finance.

**Paragraph 35(b)+ Annex 1:** these require further clarification as quite a few items are not explicitly defined (e.g. max loan amounts or maximum maturities, minimum requirements for acceptable covenants as well as acceptable level of various financial covenants). With respect to the following sentence: ‘Credit granting criteria should at least consider items referred to in Annex 1’, the words ‘at least’ can lead to issues in practice, as per type of lending product and per industry some of these criteria are relevant, while others are not.

We suggest amending as follows: “*credit granting criteria; while specifying these criteria, institutions should ~~at least consider~~ **where appropriate** items referred to in Annex 1 (list non exhaustive);*”

**Paragraph 36:** In the retail space there is no additional need to check an individual facility against credit risk appetite. Normally, the policies imply cascading down the risk appetite, and an operation within these policies does not require an individual check. We therefore suggest the following amendment:

“**Paragraph 36.** *The credit granting criteria referred to in paragraph 35(b) should enable institutions to operationalise the credit risk appetite in consistence with the credit risk strategy and should provide input **for evaluating the impact of the credit facility** in request on the institution’s credit risk profile and credit risk capacity.*”

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

**Paragraph 40 (b):** This requires that “at the level of the individual relationship, identify, assess and manage the ML/TF risk associated with that relationship and any third party that might be associated with the credit facility, and the purpose of the credit.”, yet there is no concrete definition of who exactly is regarded as such a “third party”. This should at least make clear that it does not cover credit guarantors. Indeed, if not, it is unclear if the EBA intends with this to introduce CDD for any type of credit risk guarantor. We do not consider there to be any reason to do so as there is no money laundering risk associated with the mere acceptance of a loan collateral, nor is there cash flow at this point. In addition, there are also physical securities. Moreover, the requirement to extend the KYC obligation to any guarantor would have a significant negative impact in practice and would complicate the lending business in many areas (e.g. syndicated loans). In practice, it is hardly feasible to conduct a timely and complete due diligence of such guarantors and would give rise to a number of further questions such as: Is there a need for an independent risk score for collateral providers?; What should happen if the bank cannot update the CDD information on a collateral provider?; Should the bank then be forced to terminate the relationship with the collateral provider and give up the collateral, as is the case with customers whose data cannot be updated?.

This same paragraph also requires the verification of the origin of the funds used by the customer to repay the credit seems to relate to any credit relationship, which suggests that the origin of funds must be checked for any credit relationship. If this is the case, it would appear to go in excess of the AMLD IV and V where only certain customer groups subject to increased due diligence are under an obligation to clarify the origin of the assets used in the business relationship with the bank or transaction. It should therefore be clarified that in the context of checking funds it applies to customers with increased risk and is consistent with the AMLD directives.

#### 4.3.2 Leveraged transactions

**Paragraph 44:** This paragraph states that banks should define their risk appetite for Leveraged Transactions extensively (type of transactions, acceptable leverage levels, including at sector level). We believe that a too large definition of framework conditions works counterproductive. Banks are well capable of assessing their risk appetite at client level within the overall agreed Risk Appetite Exposure limit. Alignment with the ECB guidance on leveraged transactions would be welcomed.

#### 4.3.3 Technology-enabled innovation for credit granting

**Paragraph 47:** This section should clarify what is meant by ‘technology-enabled innovation’ as it could refer to cloud or machine learning. Additionally, can the EBA clarify if this does not include features such digital facility offer letter, e-sign etc.

**Paragraph 47 (b):** Regarding the management for potential bias, any credit decision-making will always have a certain bias to some variables e.g. institutions should specify within the credit risk policies and procedures their credit granting criteria which would include for instance customer acceptance criteria in the case of lending to customers or specific targeting of geographic markets and economic sectors in the case of professionals (Annex 1).

**Paragraph 47 (d):** This requirement is onerous on the use of technology in credit granting and could even hinder the application of innovative technology to credit granting, since it would oblige financial



institutions to maintain multiple methods/tools only when using innovative technology. The comparison will be impracticable, as for financial institutions it is impossible to know if a credit that would have been granted with a traditional method, but not granted using innovative technology, would have defaulted or not. Instead of requiring a comparison of the performance of technology-enabled innovation with traditional methods, the guidance should focus on ensuring that institutions use the best methodology available for the institution in each case, according to institution's preferences. Therefore, we propose the following wording is incorporated: "*to ensure that the best methodology available for the institution is used*".

If comparison is to be made, then it should be clarified that this comparison or decision (if amended) should be performed only at the development process. It wouldn't make sense to be comparing results on an ongoing basis between methodologies. The wording should be refined in order to be consistent with the real needs of model monitoring.

In addition, such a comparison may include as required both quantitative and/or qualitative criteria (e.g. institutions should be able to decide to use a particular technology to learn with a portfolio, even when its performance could not be done significantly better).

We would finally like to qualify the concept of "traditional tools". Some AI algorithms have been developed many decades ago (e.g. neural networks were developed in 1943). This section also gives rise the question of how long the traditional model has to be used alongside the machine learning model.

**Paragraphs 47. (c)(f) and (g):** Members would welcome further clarity on the requirement to explain the outcomes of technology-enabled regulation and the supervisory expectations linked to this. Different interpretations of what is considered a satisfactory explanation by supervisors should be avoided as this might lead to varying speeds of adopting innovation in different jurisdictions.

Additionally, it would be helpful if terms like auditability, traceability, robustness and resilience would be clarified in respect to technology enabled innovation. Especially, because even when technology-enabled machine output is could be less auditable and traceable, this could be mitigated by several 'interpretation' algorithms.

The use of technologies such as Artificial Intelligence clearly represent an opportunity for the financial sector in the credit granting process. Having better risk analysis capabilities will allow firms on the one hand to reduce the number of false positives, thereby improving the stability of the financial system and avoiding situations where the client is unable to meet its financial obligations. On the other hand, it will give more people to access financing, reduce the number of false negatives in which, for example, the system could deny credit due imprecise analysis of the available information, or because it does not take into account variables that the new AI systems have the capacity to analyse.

With respect to supervisory expectations in this section, some of the most promising techniques available for areas such as detecting Money-Laundering present challenges when it comes to explaining the results. It is always possible to give a technical explanation about how the model works that would be appropriate for technical audience. Unlike simpler models such as linear regression though, there is no equation on which to rely in order to obtain the results. Besides technical explanations, firms use alternative techniques that focus on describing the result of the models and that may make more sense for a less

technical audience. Finally, an explanation could also be based on providing full transparency about the process followed to obtain results (e.g. input variables used, main assumptions made, testing procedures, alerts in case of unexpected outcomes...). All these different approaches should be considered valid to fulfil the requirement for an explanation.

#### 4.3.4 Environmental factors and green lending

**Paragraph 48:** We propose the following bolded addition to the latter sentence: “Institutions should adopt a holistic approach and incorporate ESG considerations in their credit risk policies and procedures **for corporate lending using a risk-based approach**”. This emphasizes that banks should focus on most material ESG risk cases and industries and spend very little effort, if at all, on the benign cases. This is particularly important in lending to SMEs where banks often have very large numbers of customer companies operating at industries which have small ESG risks.

**Paragraph 49 (b):** Members considered this would be difficult to apply, in particular with respect to the evaluation of a properly use of the “green credit facilities” after the origination. While a bank can perform general plausibility checks (i.e. verify that a sum of money has been disbursed for a dedicated purpose), it cannot evaluate in detail the environmental or “green” benefit of a project. This evaluation should be carried out by an independent party such as a specialized non-financial rating agency active in this field. Furthermore, we think it is important not to cause unnecessary administrative burden by these regulations for growth of sustainable loan origination. The requirements should also work in a situation where a bank originates large number of sustainable loans (e.g. hundreds or thousands) in a year (compared to small numbers nowadays), and we point out that documentation and monitoring work repeats in each loan’s case.

**Paragraph 49 b i:** We propose streamlining the requirements by deletion of the following: “collecting information about the climate related and environmental business objectives of the borrowers;”. The original requirement 49 b ii covers this point. The aspects in the 49 b (i) are typically discussed with a potential sustainable lending customer company. We see however no value in documenting evidence of compliance with such information collection requirement into a bank’s IT system.

**Paragraph 49 b iii and iv:** we propose combining these two clauses in order to streamline the text.

**Paragraph 49 b iv:** It is important not to cause unnecessary monitoring work by this clause. We propose the following additional bolded clarification wording: “*monitoring on a regular basis **(once a year unless special circumstances require more regular monitoring)** that the proceeds are allocated properly (which may consist in requesting borrowers to provide updated information on the use of the proceeds until the relevant credit facility is repaid).*”

**Paragraph 51:** Could the EBA clarify if this paragraph supposed to be applicable to **all** borrowers of the institutions or only the ones with a green lending/project? As noted, it takes time to gain insight in both transition and physical risk on a qualitative and quantitative basis. Institutions and borrowers need a time path of years (also recommended by the TCFD) to get the right information and insight on these subjects.

**Paragraph 52:** this refers to ‘transition risks’, which have already been defined by other authorities or official working groups (TEG), we would to avoid introducing here until this has been agreed.

**Paragraph 53:** propose to delete.

#### 4.3.5 Data infrastructure

**Paragraph 56:** the EBA should provide more clarification around the expectation that ‘institutions should consider using the relevant data fields from the EBA’s NPL transaction templates.’ The clarification should address the proportionality of its application in relation to an institution’s existing credit data collection and management framework, the specific expectations as to the data fields in the template to be prioritized, and the timeframe over which the expectation could be met by institutions. Consequently, the templates should remain optional.

#### 4.4 Credit decision-making

**Paragraph 57:** we suggest the rewording “including when applicable structures of credit committees...”. Also, we would welcome more clarity on the definition of “delegated credit decision making bodies” as per our comments to Q6.

**Paragraph 59:** On limiting the number of delegated approvals, additional clarification should be provided on the intended purpose and application. As long as delegation is clearly defined and monitored, this should be a sufficient start up without the need to actually limit the number of such delegations, which may have negative operational consequences. Time limits would also discourage people empowerment and accountability. Instead, we would suggest that delegated authority is granted until it is revoked. Banks should be free to set delegated authorities based on the most relevant factors and the list should not be prescriptive.

**Paragraph 60:** It is common industry practice that the first Line of Defence has a delegated authority for certain types of exposures, such as in the case of loans secured by retail residential property. In such cases, credit risk management is not always involved in the decision-making process but is involved in setting the boundaries of the delegated authority. Members would like to continue to have the possibility to delegate authority.

**Paragraph 62:** Members would like clarification on what is intended under this sentence: “Individual delegated authority should be governed by a set of standards to support consistent risk-based decision making. Where members of staff are delegated with a relevant authority level for credit decision purposes, there should be 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.*” Our members view is that the credit decision making does not strictly need to be through credit committees and delegated credit decision-making bodies. Credit decision making through individual delegated authority, where governed by appropriate set of standards, should be equally effective.

#### 4.4.1 Independence in credit decision-making

**Paragraph 63:** this paragraph would mean individual authorisation approval only for small and non-complex transactions, which would significantly increase the complexity of the lending process. This is contrary to the banks' ambition that aims to guarantee a more efficient service to banks' customers.

Therefore, we suggest rewording the paragraph 63a as follows: *"could use sole delegated credit authority for credit decisions for facilities in accordance with the risk taken for the bank"*

**Paragraph 63 (c):** for the purpose of the remuneration scheme, it should be noted that these are associated to a large number of parameters - not only the volume, but also the level of lending quality. We deem that excluding the Network as approval authority (within specific limits in terms of amount, policy, etc.) would significantly increase the complexity of the lending process.

#### 4.4.2 Exception and escalation procedures

**Paragraph 65:** Instead of asking for tracking exceptions and deviations from credit policies, we propose to ask that each transaction should be compared to the applicable lending standards/documentation standards of the specific asset class.

#### 4.4.3 Lending to affiliated parties

**Paragraph 69:** Reference to affiliated parties' definition should be made to the definition in CRD5. We note there are no additional mentions to loans between affiliated parties in the GLs other than the observation in paragraph 89 there's a reference to the concept of "group of connected clients", which we believe is related to lending facilities to an affiliate belonging to an economic group for which the provision of collateral is done by the group of "connected clients". The EBA should therefore include the necessary amendments to adapt the content of section 5 so that lending to affiliated parties is also taken into account.

#### 4.5 Credit risk management and internal control frameworks

**Paragraph 70:** clearer differentiation between OpRisk and Credit Risk is necessary. The terms "comprehensive credit risk management" and "internal control frameworks" are used which goes beyond credit risk and also includes non-financial risks (OpRisk, compliance, etc.).

**Paragraph 72:** propose amended wording: *These functions should be fully integrated into the institutions' overall risk management and risk **control functions frameworks*** to avoid confusing first and second line of control (para. 72). It is not clear if this is a typical framework or is it an "internal control framework" which means a control system.

**Paragraph 75(b):** With regard to the importance of the 3LoD concept in terms of compliance measures - from our point of view, risk management and compliance are mixed here, and it should be made clear that risk management and compliance are different control functions with their own areas of responsibility.

**Paragraph 76:** Generally, this paragraph places certain redundant or excessive requirements on the Risk function, if applied without regards to the materiality of the exposures under consideration. Large

institutions, for instance, already have control groups in place to review past credit decisions, but such reviews can only be done on a sample basis and with justification (e.g. materiality, or complexity).

**Paragraph 76 (b):** This is inconsistent with paragraph 70 which refers to ‘internal control frameworks’ in accordance with the published EBA Guidelines on internal governance and means all risk types are required for the control system. Para. 76b, on the other hand, refers only to credit risk (e.g. credit risk appetite), although the term “internal control frameworks” is also used here. Consequently, the EBA should clarify what is meant by an “internal control framework” and how the distinction between OpRisk and Credit Risk is made.

**Paragraph 76 (c):** This is inconsistent with paragraph 70 which refers to ‘internal control frameworks’ in accordance with the published EBA Guidelines on internal governance and means all risk types are required for the control system. Para. 76(b), on the other hand, refers only to credit risk (e.g. credit risk appetite), although the term “internal control frameworks” is also used here. Consequently, the EBA should clarify what is meant by an “internal control framework” and how the distinction between OpRisk and Credit Risk is made.

We would also suggest not to impose an independent review and to add “where applicable” at the end of the paragraph.

**Paragraph 76 (e):** we do not understand this requirement and suggest deleting it. If maintained, we suggest not imposing an independent review and to add “where applicable” at the end of the paragraph.

**Paragraph 76 (g):** The requirement to have a second opinion should not be compulsory. Firms mainly rely on credit bureaus information to compare with independent opinions. However, these are not available in all jurisdictions, nor for all cases. Having a second opinion also incurs a cost. The requirement should be based on the risk taken by the institution. We suggest rewording the paragraph as follows: *“providing second opinion to the creditworthiness assessment and credit analysis in accordance with the risk taken by the institution”*.

**Paragraph 76 (l):** The requirement to perform regular individual credit reviews (rather than a portfolio monitoring approach) should be risk-based, such as for consumers and other retail.

**Paragraph 76 (n):** we suggest adding at the beginning of the sentence: *“in accordance with the risk taken by the institution”*.

#### 4.7 Remuneration

**Paragraph 81:** The term ‘credit administration’ should be removed as it’s ambiguous and appears to include miscellaneous credit risk resources not included in ‘credit granting and credit risk management’. In addition, we would propose changing the term ‘prudent’ to ‘adequate’ as ‘prudent’ seems to refer to a conservative policy and we understand that it should be a policy appropriate to the circumstances.

**Paragraph 82:** This section requires in point a) that *variable remuneration of the staff involved in credit granting should be linked, among others, to the long-term*. We believe the words ‘long-term’ should be removed as it a very ambiguous term. The reason is that this could be understood as that variable

remuneration should be deferred for a long term. This way, the evolution of the portfolio could be known and if the performance of the credit portfolio is poor, deferred remuneration could be penalised. All those involved in granting, managing and monitoring loans would be treated as material risk-takers with deferral periods that could even exceed 5 years. Point 'a' could therefore be further clarified as follows: "a. variable remuneration of the staff involved in credit granting should be linked, among others, to the ~~long-term~~ quality of **the analysis of** credit exposures **and** the balance between profitability and risk;"

Point (b) should also be amended as follows: "*variable remuneration of the staff involved in credit granting that is linked to performance objectives/targets should include **metrics** on the ~~credit~~ quality **of credit analysis** ~~metrics~~ and be in line with credit risk appetite;*"

## 5.1 Collection of information and documentation

### 5.1.1 General requirements

**Paragraph 83:** EBA should define/specify the "significant increase in the loan amount" mentioned in accordance with national rules where appropriate (rule in German legislation - § 7 ImmoKWPLV (increase in the net loan amount by more than 10 percent)).

**Paragraph 85:** The GDPR and other legal constraints limit the possibility to have massive credit data bases. Therefore, borrower own declaration is key to have a comprehensive view of its credit commitments of which some elements may be verified by the lender, some may not.

**Paragraphs 85 and 100:** propose to consider only generally customer view and not to specify "single", in order to cover the different categories of borrowers (e.g. several borrowers as a unit) in accordance with existing practice. The EBA should therefore clarify whether 'view of all the borrower's credit commitments (single customer view)' refers to all commitments or only those towards the lender. If it refers to the former, then due to national requirements on data protection (amongst others) it might be extremely difficult if not impossible to comply with this requirement from a practical and GDPR perspective.

**Paragraph 86:** While we support the need to have an adequate set of information and documentation to be collected for the assessment of borrowers/transactions, it should be underlined that the Guidelines need to better state and allow the possibility for information packages to be tailored by borrower type and/or asset class. Bearing in mind that not all required documentation is available for clients, we suggest a more proportional and risk-based approach to be implemented by the institutions.

We would propose the following amendment (also in alignment with §14):

*"Information and data should be accurate, timely and relevant to the asset class and specific product, and proportionate given the purpose, **type**, size, complexity, and potential risk associated with the loan **in conjunction with the risk profile of the borrower.**"*

Furthermore, asking for the mandatory availability of business plans and projections from all clients is in clear contrast with the evidence that smaller, less structured counterparties do not usually have managerial ability to develop such detailed documents. Therefore, we suggest the EBA is open to the

possibility, in such cases, to focus banks' assessment on most recent historical performances and few key budgeted figures (where available to understand the future sustainability of the counterparty).

**Paragraph 88:** In the context of the initial credit decision, the employer side of dependent employees must also be examined. If a technically supported portfolio approach is chosen for subsequent checks (e.g. renewals), in which the analysis of borrowers is based on valid statistical data, EBA should also continue to make this portfolio approach an option for analysis, in order to be more proportionate. Additionally, it should be noted that bank secrecy limits the possibility to conduct enquiries among third parties to verify the information and data collected. Inconsistencies are an alert too further investigate within the allowed legal framework.

#### 5.1.2 Specific requirements for lending to consumers

As mentioned before, it is important to confirm that the lists referred to in this section does not mean all items are relevant all the time for all types of lending (para.91 and 92). Please refer to our response to Q7 in this paper for more details and suggested amendments.

**Paragraph 91a:** Annex 2 Lending to consumers no. 4 and Lending to professionals no. 2 can be interpreted in such a way that lenders are to be obliged to obtain proof of the borrower's appropriate use of the loan funds. The current market standard is to only oblige the borrower to use the loan funds exclusively for the purpose specified in the loan agreement, the lender is not obliged to verify this. The standard agreements issued by the Loan Market Association, for example, are formulated accordingly. An obligation to provide evidence would go far beyond the current market standard and would presumably mean a significant additional effort. The EBA should clarify that no concrete obligation to provide evidence is required, or at least provide concrete information on how to carry out the verification of evidence.

In addition, regarding lending to consumers, the guidelines are not clear on whether lending facilities with a business purpose are included. We agree that a single customer view should prevail, regardless of whether credit facilities are for personal or business purpose. We have also observed that performance of self-employed tends to be different from individuals and that some of the predictive variables of risk may be the same than the ones described for Small Enterprises (often with different weights).

#### 5.1.3 Specific requirements for lending to professionals

As in the previous section, please refer to our response to Q7 in this paper for more details and suggested amendments.

**Paragraph 93:** The minimum requirements set out here for granting loans to companies cannot be met by smaller companies. EBA should clarify whether it would be compatible with the principle of proportionality set out in Para. 12 to nevertheless affirm the creditworthiness of the entrepreneur even in the lack of certain information. As an example, par 93.f refers to financial projections. Financial projections are not always received/included for each and every credit assessment e.g. when a bank lends to a large corporate, then often credit assessment is done based on historical financials (next to other credit risk assessment criteria). This comment also applies to par 127.a. In line with our comments on proportionality this should be amended as follows:

93. For the purposes of the creditworthiness assessment of professionals, institutions should collect *where available* and verify information in relation to ~~at least~~ the following:

**Paragraph 94:** the words ‘at least’ could lead to conflicts as not all information is necessary and available in each individual case.

#### 5.2.1 General requirements for lending to consumers

**Paragraphs 96-99:** We consider that the assessment is too prescriptive. The CCD doesn’t set out specific metrics to assess creditworthiness. We consider that it is not relevant to treat all credit-granting in the same way. The EBA should take into account the type of credit and the amount. A strict application of the listed metrics and parameter would challenge current concerned institutions scoring models. These models work well in limiting risks and indebtedness. In addition, the use of metrics proposed would finally become factor of exclusion as they could become standards for indebtedness ratios while economic conditions of consumer could be very different in the EU. We suggest removing the paragraph 99 or to clarify what is considered as “where appropriate”.

**Paragraph 99a-d:** It is not clear whether the ratios mentioned here are mandatory. If they are then we would note that the relationship between the rate performance at the financing and / or liability level of the borrower does not show any additional insights that would support a credit decision compared to the individual budget calculation and thus the determination of the borrower's ability to service its debt. Similarly, the relationship between credit and debt to income is already sufficiently reflected in the budget calculation, as well as in the future-oriented analysis with a view to possible ability to service capital in the event of a change in the economic framework, such as deviating interest rates at the time of interest prolongation or a retirement of the borrower. A further consideration / calculation of key figures would therefore only increase the costs of the credit decision and whilst failing to provide any further insight into the credit decision. Therefore, we suggest the following amendment: “Where applicable, these metrics and parameters could include one of the following”.

**Paragraph 101:** the supervisor’s expectations should be clarified regarding the sensitivity analysis and banks should be free to select the most appropriate stress test to assess serviceability. Some firms already apply default models at the level of portfolios, to take decisions e.g. based on risk appetite policies. It is not necessary to do it at individual level for retail customers. The requirement to develop related sensitivity analysis may not be possible, especially in cases where smaller clients do not provide the bank with their own forward-looking projections and where listed companies are not allowed to provide lenders with detailed financial projections. The requirements must be driven by the proportionality principle, as for limited proposals and retail SME customers the requirements are not proportionate to the risk. In any case, consumer credit is generally short-term lending for which the potential negative scenario is not relevant so we would drop the application to this here and in paragraph 102.

#### 5.2.2 Lending to consumers relating to residential immovable property

**Paragraph 106:** This section requires entity to maintain up-to-date records. In order to avoid misunderstanding, we believe the paragraph should clarify that it should be up to date when necessary.



**Paragraph 107:** This paragraph is difficult to apply for countries where there is not a legal retirement age.

**Paragraph 110:** This paragraph should not leave room to a differentiated approach to the creditworthiness analysis for foreign currency loans if the exposures are not deemed material with regards to the risk taking.

### 5.2.3 Other secured lending to consumers

**Paragraph 112:** We propose that the extensive information requirements for the financing of income-generating real estate in section 5.2.3 are deleted as it can be assumed that a consumer usually does not have this information available and that this alone does not allow the bank to carry out the examination required in this section. Collecting the information on architects, developers and other companies involved within the framework of a construction financing decision will increase the decision costs on the one hand and on the other does aid the credit decision to evaluate the creditworthiness of the individual borrower. Banks are not qualified to assess the quality of all the stakeholders involved in the development of the property. In addition, there's a risk with the introduction of this paragraph that in the event of the failure of such real-estate projects, an attempt could be made to transfer the resulting economic risks to the bank by constructing claims for damages under civil law. Point (c) also appears more as a theoretical concept rather than a practical one, since the certification of the costs associated with the development is not easy to obtain and overall the consideration of such risks could lead to an increase in the price of real estate for customers. If this provision is not deleted it should at least allow for an exception in practice for the way in which the income from the property to be financed if it is of no significance for the creditworthiness and the lending decision, when the borrower is in a position to meet the loan obligations even without the expected rental income.

**Paragraph 118:** We propose to rephrase to "institutions should take reasonable efforts to consider living expenses (...)".

### 5.2.5 General requirements for lending to professionals

**Paragraph 121:** see comments in paragraph 101.

**Paragraph 122:** Risk appetite, policies and limits are generally at portfolio level (apart from concentration limits) rather than at single transaction approval (for which IT constraints could represent a major weakness). Therefore, suggest this is amended to make the focus on portfolio monitoring.

**Paragraph 126 (b):** The meaning of the requirements and the analysis of legal capacity for non-consumers is unclear. For example, legal advice on capacity or all corporate resolutions, powers of attorney and signature samples must be obtained when granting credit. Para. 126 is formulated as a minimum requirement ("at least"). Are minimum thresholds feasible here, so that the collection of such documents, for example, would only have to take place for a certain credit volume? The EBA should specify the provision on the analysis of legal capacity.

**Paragraph 127:** This states: *'For the purposes of the analysis of the financial position within the creditworthiness assessment as specified above, institutions should consider at least the following: a. current*

and projected financial position, including income, cash flow and source of repayment capacity to meet contractual obligations, including under possible adverse events'. The guidelines should recognize (and provide for) the fact that specific considerations will vary for specific credit cases, and that each consideration enumerated in the guidelines need not be relevant and hence applicable to each specific credit case.

Please can the EBA also clarify the relation between paragraph 127 and 132. Both start with: "*For the purposes of the analysis of the financial position within the creditworthiness assessment as specified above, institutions should consider at least the following:*"

**Paragraph 129:** It must be clear that the proportionality principle is applicable and that the requested assessment is only applicable in case the cross-border activities have substance. Furthermore, with regard to the requirements for analysing the legal environment and the extent to which the importer or exporter complies with the local legal requirements and the transfer of funds can take place, it is unclear how far-reaching these obligations are (e.g. proof through legal certificates). EBA should specify the requirements for the analysis of the legal environment in a proportionate manner.

**Paragraph 130:** refer to general comments to Question 3 regarding ESG factors and Sustainable Finance.

Analysis of the borrower's financial position

**Paragraph 131:** (see also paragraph 101). Projections are not always provided by the client, especially not in case of smaller (retail) clients, but also in case the client is active in a very stable environment (evidenced by its financial track-record). In some cases, banks won't always make their own projections but may instead challenge those provided by the client based on knowledge of the business, sector etc. We also suggest a more proportionate approach and propose the following amendment: institutions should consider **if applicable** the following...

**Paragraph 132:** propose to make applicability of the proportionality principle clearer as follows: "*For the purposes of the analysis of the financial position within the creditworthiness assessment as specified above, institutions should consider ~~at least~~ where appropriate the following (list non exhaustive)*"

**Paragraph 132 (a):** Whilst debt servicing will be considered, this may not always be in the form of free cashflow availability - circumstances may dictate that other measures may be used (e.g. earnings/repayment cover).

**Paragraph 134:** The proportionality principle should be applicable and clarified: "*Institutions should perform where appropriate an assessment of the cash conversion cycle of the borrower to measure the time duration for the business to convert the investment in inventory and other resource inputs into cash through the sale of its specific goods and services.*" Besides this, it should be noted the relevance of assessing the cash conversion cycle depends on the sector the client is active in.

**Paragraph 135:** members would welcome more guidance to clarify the use of metrics stated in this paragraph. In particular, the use of metrics should be dependent on type of lending and characteristics of the transaction under assessment. The EBA could consider aligning the use of metrics with the metrics used by rating agency for credit assessment to support consistency in the industry Furthermore, Credit

sanctioners will utilise a number of ratios when reviewing a particular request, but these will be case dependent and may or may not include all of those listed in this paragraph. The use of the words 'at least' suggest that every facility request must have those listed values calculated/reviewed - this is not always the case. We would therefore ask to clarify proportionality as follows: "*Institutions, where relevant, use ~~at least~~ where appropriate the following financial metrics (list non exhaustive) for the purposes of the creditworthiness assessment, and, where relevant, assess them against the metrics and limits as set out in their credit risk appetite, credit risk policies, and limits in accordance with Sections 4.2 and 4.3:*"

**Paragraph 135 (a) and (c):** The DSCR (Debt service coverage ratio) should not be mandatory beyond its partial warning function when considered within a purely corporate context. This is because difficulties in the calculation may arise, both with reference to cash flow available for debt service (cause, as said, business plans are not always provided) and to amortization profile of third parties debt. The same applies to the interest coverage ratio.

**Paragraph 135 (b):** An 'EBITDA' number in and of itself is usually not used as a financial metric. Typically, ratios including EBITDA (like Debt/EBITDA) are used as financial metrics. Metrics to be used in the analysis cannot be defined in detail. It depends on the sector. When analysing for example insurers or banks metrics such as DEBT/EBITDA is not the relevant ratio.

**Paragraph 136:** It is not clear why working capital should show a cash positive position on a regular basis. In our opinion this paragraph is not relevant, does not reflect common practice and should be deleted.

Specificities for assessment of the financial position of SMEs

**Paragraph 138 and 139:** The proportionality principle should be applicable.

**Paragraph 141:** Regarding the Specificities for assessment of the financial position of SMEs, we consider this section should give more detail on the pro-forma requirement. We understand it is necessary to collect enough information for a valuable assessment of credit risk. However, it should not be a formal process as the legislation does not require this information to those types of firms. Therefore, this information should not then be so strictly required from the financial institutions.

**Paragraph 144:** We would propose the following amendment in alignment with our comments on proportionality in §14:

*"Information and data should be accurate, timely and relevant to the asset class and specific product, and proportionate given the purpose, type, size, complexity, and potential risk associated with the loan in conjunction with the risk profile of the borrower."*

Sensitivity analysis in creditworthiness assessment

**Paragraphs 145 and 146:** The list of idiosyncratic and market events is too prescriptive as sensitivities should normally be driven by idiosyncrasies of the borrower and its industry. It should be made clear that sensitivity analysis is not expected to be performed on each individual event but rather on the events which are most relevant to the specific credit risk. It should be noted that in a sensitivity analysis as part

of a credit application, usually, Downside Cases that are considered relevant for the specific credit risks of the transaction are included. In general, we suggest remaining proportionate and suggest introducing the following amendment: “Institutions should take into account where applicable...”.

Paragraph 149: clarify proportionality as follows: “*Institutions should assess **where appropriate to the risk profile of the credit facility** the feasibility of the business plan and associated financial projections in line with the specificities of the sector in which the borrower operates.*”

**Paragraphs 150:** the dependency to key-person is applicable only to specific financing (e.g. LBO) but not considered as applicable for all Corporates. We suggest adding in the beginning of the paragraph “if applicable”.

#### Assessment of guarantees and collateral

**Paragraph 156:** According to this paragraph guarantees and letters of credit for cross-border syndicated loans and project financing should only be issued via the agent or a designated entity. It may be the case that neither the agent nor another participating bank has individual capacity to issue the guarantees, the text should therefore allow for more than one, i.e. refer to ‘designated *entities*. *Additionally*, the guidelines should recognize and allow for the fact that in the European market, facility agents are generally established and regulated banks and institutions, and hence the requirement for due diligence of the agent for each specific lending proposal would be duplicative. We recommend a more proportionate approach to due diligence requirements, and that this is only required when the third-party agent is not a supervised entity.

It remains unclear whether this paragraph will prevent the usual issuance of guarantees via ancillary lines under syndicated loans. From the borrower’s point of view in particular, this would restrict the current financing practice. This provision should be deleted or clarified. Regarding issuance of guarantees and LCs, the guidelines should recognize and allow for the fact that these are issued by a lender under a given credit agreement.

**Paragraphs 157 – 170:** Commercial Real Estate see definition issues under para 17. EBA should clarify, also with reference to point 165 (sentence “when the project converts into CRE loan”); (ii) point 166 (b) appears too detailed (subcontractors?).

**Paragraph 158:** The guidance should recognize and clarify that the reference to the ‘borrower’s experience’ will include ‘Sponsor’s experience’ where financing is granted to an SPV rather than to a corporate, in which case it is relevant and appropriate that the assessment should be made of the Sponsor’s experience and track record with the type, size, and location of the CRE (and not the borrower’s experience as the borrower would only be an SPV that would have been set up only for that project).

**Paragraph 161:** The EBA should consider introducing some additional flexibility with regards to the requirements concerning assessment of commercial real estate lending and shipping finance (also relevant for paras 171 and 173). Once institutions are comfortable with the quality of the main counterparties (customer, builder, and contractor), they should be allowed to rely on their experience

and track record and consequently should not need to assess the quality of the architects, engineers, and subcontractors.

**Paragraph 166:** This is a specific example of the general point that the rules should not be too prescriptive. Under point a, in the development stage the requirement is that a location specific review of supply and demand in the local market be undertaken by a reputable estate agent. A bank may rely on a valuer to undertake this, expecting them to liaise with estate agents as necessary – in this case the bank would not instruct an estate agent. Point b refers to background information for contractors and subcontractors. Whilst this may be done for the main contractor, it may not be done for all sub-contractors.

**Paragraph 169:** This requirement could result in smaller transactions becoming uneconomic – banks often set a threshold to determine whether these processes are mandatory, or borrowers are allowed to self-certify the features and progress of the project. The wording should be adapted to make the requirements more risk based, allowing for a sensible application of the proportionality principle.

#### 5.2.7 Shipping finance

**Paragraph 171. (b):** In relation to *Shipping finance* “vessel's current age-to-expected useful life”: the issue is to know who is assessing the useful life of the vessel, and whether should it be an internal /external consultant. In addition, what is the useful life changes over time (ships can have different usage after end of lease)?

**Paragraph 171. (d):** With regard to the requirement for “vessel valuations with or without haircut (if those are included as a repayment source) to reflect selling costs, the time value of money and uncertainties regarding the liquidity and marketability of the asset”, it should be noted external views are necessary to avoid discrepancies between banks.

**Paragraph 172:** Regarding the assessment of future market this is very open to interpretation and an external view should be allowed.

**Paragraph 173. (b):** It is almost impossible to get full visibility of all parties involved in the construction and may not be relevant if replacement options are available.

**Paragraph 173. (c):** We believe an external view should be allowed for to fulfil this.

#### 5.2.8 Project and infrastructure finance

**Paragraph 175:** (Project and infrastructure) This section requires taking into account any applicable regulatory or legal restriction. Using current applicable regulation is not a guaranty of future performance of the asset.

**Paragraph 176:** wording should be amended as follows: “To the extent possible, institutions should ensure that all the **material** assets of the project, and present and future cash flows and/or accounts are pledged to the institution providing the lending or to the agent/underwriter in the case of a syndicated transaction/a club deal. In case where a special purpose vehicle is established for the project, **to the extent possible** the shares of that special purpose company ...”.

**Paragraph 177(a):** This is usually covered by the lenders' technical advisor report.

**Paragraph 177. (b)** It is almost impossible to get full visibility of all parties involved in the construction, and it may not be the relevant if replacement options are available, so there should be room for a proportionate implementation. In addition; usual Project Finance structures rely on strong Engineering, Procurement and Construction (EPC) contractual arrangements which mitigate this risk. Wording could maybe simply say "the background information, **major parties** taking part in the project".

**Paragraph 177 (c):** Experts will not certify cash flows projections since each party (sponsors, banks ...) shall make their own assessment of the robustness of the projects. As such, it is the responsibility of each lender to be satisfied with the cash flow analysis of the project, based on the relevant assumptions (in house/external as the case may be).

### 5.3 Credit decision and loan agreement

**Paragraph 183:** It will be burdensome to document every decision in detail. If the key issues are weighed correctly in the presentation, then repetition is redundant. We suggest rewording as follows: "Credit decision should be clear and well documented".

**Paragraph 184:** for some institutions it should be noted that an individual credit decision does not mention the maximum period for its validity. Validity periods are described in the general policy on Delegated Authorities and Approval Rules.

**Paragraph 185:** this paragraph requires that the loan should only be paid out once all the approval conditions and all the conditions laid down in the loan decision or agreement have been fulfilled. It is unclear whether the responsible competent person can approve a disbursement in individual cases despite the absence of a payment condition. The EBA should keep the option of a special approval for payment in individual cases open despite the absence of a payment requirement by a competent person.

### 6. Pricing

**Paragraph 187(a):** while we agree the relationship of the revenues of a portfolio to its equity binding should be considered, it should be noted that this can be done by different methods e.g. Cost of Capital, measurement of RWA-efficiency, Return on Equity, etc. Therefore, this formulation should be more open to other concepts than Cost of Capital.

**Paragraph 187(c):** Although managers responsible for a loan portfolio should always consider the operating and administrative costs of their portfolio in their overall decision making, it is not clear whether loan pricing should completely reflect those costs as stated in the draft. This should be clarified to avoid negative consequences. It should also be made clear that the costs referenced under points **c** and **e** are marginal costs only. More allowance for modern pricing methods, such as partial cost methods or market price methods, behavioral pricing and pricing differentiation etc. should be allowed. Indeed, it is not feasible to break down allocated costs to every single credit product and it should be made clear that this is not required.

**Paragraph 187(e):** As per the comment above, it is not clear if other costs need be fully reflected.

**Paragraph 188:** This should make clear that the risk-adjusted performance measures are suggestions. Many banks use return on regulatory capital, which are risk-sensitive and represent a principal binding constraint on capital adequacy. There are more simplistic ways to price loans especially for retail, this paragraph would prevent more simplistic methods from being used. We suggest adding at the end of the paragraph: "In particular, more simplistic methods could be used."

**Paragraph 189:** The requirements of this paragraph in relation to the underlying cost allocation framework should be removed. As stated above regarding paragraph 187, marginal costs should determine pricing – the underlying cost allocation framework is relevant only in so far as it enables calculation of marginal costs. Fundamentally, members considered the requirement to document the cost allocation framework within the bank to ensure that the expected return by type of loan and by business line reflects the risk assumed very intrusive and not within the scope of EBA's mandate. Likewise, it is not clear the extent the documentation should be connected to the pricing framework and this should be made proportionate.

**Paragraph 190:** The guideline states that: "All of the transactions below costs should be reported and properly justified." It is not clear from this requirement, whether this implies that there should be centralised reporting of all transactions below costs. In general, business units are responsible for individual pricing decisions. A centralised reporting on transactions level would not add significant value when business units are charged with appropriate funding- and capital costs and the performance is measured by appropriate risk adjusted performance measures. We therefore suggest including a more general statement that business units should monitor the (risk adjusted) profitability of its transactions taking into account funding, capital and other relevant costs. It should also clarify that the reporting is meant to be internal to the institutions, as institutions would not report this information externally. Moreover, institutions may or may not to decide to base their pricing purely on cost-plus-methods, therefore we do not agree that every single transaction should be justified against cost but rather against the pricing framework documented by the bank on a portfolio not individual basis.

**Paragraph 192:** This refers that reference value should be the market value. On occasions other bases may be used e.g. closed values on trading properties and set lending parameters against that.

## 7. Valuation of immovable and movable property

### 7.1 Requirements for valuation at the point of origination

**Paragraph 194:** The EBA should clarify that the wording refers only to 'asset reliant' CRE financing. The EBA should recognize the fact that institutions would not find it necessary or expedient to obtain independent property valuations for properties that are not pledged against the loans extended to real estate borrowers. The guidelines should clarify that such valuations need not be considered necessary for property that is not pledged (hence, there is a need for clarification or removal of the word "irrespective" in item 194. It is not clear whether the EBA requires an individual valuation of all collateral irrespective whether it is used in the LGD models for capital relief. In our view, the strict requirements for valuation in this section should not be needed to the same extent in case the collateral is not taken into account in LGD models.

**Paragraph 195:** Refers to prescriptive procedures for use of drive by etc. This is too granular as some flexibility should be allowed subject to credit sanctioner's discretion.

**Paragraph 196:** requires re-assessment of the enforceability of the collateral in the case of significant deterioration in the repayment capacity of the borrower. Enforceability is a legal test at the time of when an initial charge over the collateral is taken and should only need to be reviewed when some legal change (either generic through e.g. case law or within the company such as a takeover/merger/etc) creates the need for re-assessment. There should be no requirement to link re-assessment of enforceability with the credit quality of the borrower.

**Paragraph 197:** The implementation of a panel of accepted external appraisers should be seen as a recommendable option for immovable property to ensure the quality of the valuation and the valuers but not as mandatory precondition for eligibility. Paragraph 199 should be adjusted to accommodate the situations where the legal framework allows the borrower to deliver an independent valuation report and where the lender relies on audited financial statements (accounting values). In both paragraphs, the required quality could be ensured in different alternative ways.

**Paragraph 198:** An indemnity insurance is not market practice in every country and is not needed to ensure valuation quality. A mandatory insurance would increase costs that would be passed over to clients if not incurred by big valuation companies who could afford some extra expenses. Insurances premiums for small appraisal firms or individual experts would be deemed higher leading to a competitive disadvantage.

**Paragraph 200 (c):** It is unclear how the future use of the property should be collected and verified.

#### 7.1.2 Movable property collateral

**Paragraph 201 - 206:** When banks do not have a pledge over certain assets, it is not practically feasible to receive an assessment for these assets from an independent qualified valuer. The proportionally principle should explicitly apply to Section 7. In particular, **the systematic valuation of movable property by appraisers is deemed neither feasible nor necessary given the volume and the additional associated cost generated**, with limited benefits for most of the cases. Regarding moveable property collateral, the book value of collateral items can serve as the primary source of information and the EBA should make clear that this would satisfy the requirement in the final guidelines. Financial data is – by nature – highly reliable, as the processes that generate them are bound by numerous assurance measures, including independent external audits. Independent valuations by an external valuer should therefore only be required for exposures in excess of a materiality threshold where relevant. For instance, for collateral values in excess of EUR 15 million. Where advanced statistical models have proven to produce reliable valuations, the use of such models should be allowed. Moreover, it cannot be concluded that any other method (i.e. valuer or advanced statistical model) will result in more accurate valuations. To further underline this, we would like to emphasize the scope of section 7.1.2. Where the requirements are relevant for the explicitly mentioned examples of moveably collateral (e.g. vessels, aircrafts, etc.), they are less so for others (in particular less standardized / comparable types such as other means of transportation or inventories with low individual values. Can the EBA clarify the scope be regarded?



**Paragraph 203:** A panel of independent valuers is impracticable, if even possible, for many types of collateral due to lack of availability of qualified valuers and the heterogeneous nature of the collateral.

## 7.2 Requirements for monitoring and revaluation

### 7.2.1 Immovable property collateral

**Paragraph 207 to 213:** the approach to valuation would completely modify the current perimeter identification applied to collateral subject to revaluation and the frequency of the update. Due to the significant gap between the current and new proposed approach, further potential changes would require high IT budget allocation and banks would not expect to meet the EBA proposed deadlines for the new guidelines.

**Paragraph 207:** This refers to IFRS9 Stage 1 or Stage 2 as a way of measuring credit quality/monitoring – which is not used in this way. For point b clarification is needed on this paragraph, belief is it relates to impaired status of loans and ‘forced sale’ values. The requirements are also very detailed, and we would question the relevance for all cases of some breakdown drivers. Therefore, we suggest introducing more proportionate requirements with the following rewording: “These policies and procedures should account for one or several of the following elements”.

**Paragraph 208:** (Interval of frequency of monitoring) the dependency of the interval is not given with the LTV-ratio, but with the classification of property. The proposed parameter to be used to structure the frequencies of monitoring are not necessarily the best. Market volatility and risk of deterioration regarding industry, technical infrastructure and location as well as respective market price developments are deemed more suitable. The institutions do have enough experience and market knowledge to judge on the best parameter reflecting the risk structure of their portfolio. Hence, parameter for determining different monitoring frequencies should not be predetermined by the EBA.

**Paragraph 211:** This is unclear as it could be understood that banks can use a statistical valuation (from market benchmarks for instance) guarantee only in addition to an expert valuation. It is also not clear if this rule implies that a valuer should be involved for an opinion in first assessment or in periodic back-testing of an advanced statistical model in order for it to be considered eligible for using in the re-valuation of immovable property collateral. In case it is intended that an advanced statistical model should be checked by a valuer in a regular re-valuation process, a potential conflict of interest would exist, if the valuer were allowed to change the fair value calculated by the statistical model.

**Paragraph 213:** 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. Moreover, desktop or drive-by valuations will - except for special circumstances - be adequate for updating the actual value of the real estate. In case of NPE, the debtor/asset owner wouldn’t permit an internal visit of the Real Estate asset.

**Paragraph 214:** the provision regarding the rotation of valuers will be difficult to implement. The requirement for appraiser rotation already applies to non-performing loans via the EBA NPL Guidelines and banks’ processes have just been updated to accommodate for this new rule. The expansion to all exposures will cause yet more changes just as processes have been updated. The required quality could

be ensured in different ways. The EBA's intention has been understood as requirements to ensure independence and quality of the appraisers/appraisals. Processes for mandating external appraisers need to consider these demands. A rotation process is costly but cannot ensure compliance to the requirements, nor is it practical in the case of some specialist type of collateral. On the contrary, in some cases the mandate of another appraiser would not be reasonable to ensure quality, if possible, at all (for some real estate types in specific locations there are no other suitable appraisers available). Moreover, selection of appraisers via a panel could raise conflicts with competition regulations (also relevant to paras 197, 203 and 214). Specifically, with respect to syndicated loans, when a bank participates in this it does neither have control over appointment of independent valuers, nor over rotation after two years of subsequent assessment by such valuer.

**Paragraph 223:** The payment of valuers follows 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. We therefore suggest deleting this paragraph.

### 7.3 Requirements for valuers

**Paragraph 224:** this requires the continuous assessments of the performance of valuers. The added value of the continuous assessment requirement is unclear. Also, it is unclear how banks could apply this requirement in practice as it does not make the expectations clear in terms of method and volume. Institutions should be allowed to rely on other mitigating measures to ensure quality and independence of the appraisal such as (external) validation institutes or codes of conducts of national association of external valuers. It should also clarify what role technology such as AVMs can play in monitoring.

## 8. Monitoring framework

### 8.1 General requirements for credit risk monitoring framework

**Paragraph 225:** The requirement of no relation between the appraiser and the buyer or seller of the property could be made part of the contracts between Bank and appraisers but not realistically ensured.

**Paragraph 229:** The requirements are considered too granular and would raise questions in terms of data protection.

**Paragraph 229(e):** Without the roll-out of a unique and unambiguous data model and data dictionary, institutions cannot be held accountable that their credit risk monitoring framework allows for the use of peer group analysis. In addition, not all data as indicated in this chapter can be used for comparison across other institutions: one example is the number of exceptions to credit policies as credit policies of different institutions might be more or less strict.

In addition, we would like the EBA to clarify for Chapter 8 which paragraphs set a requirement on exposure or borrower level (i.e need to be considered at origination and for individual monitoring) and which paragraphs are referring to a portfolio and reporting perspective. (Many of the requirements in

these GL are registered in the credit decision, but – due to different registration systems, or different information needs – this information has so far not been made available for portfolio reporting centrally.)

## 8.2 Monitoring of credit exposures and borrowers

**Paragraph 233:** The terminology “high risk” is misleading as there is a notion of “high risk items” in CRR as per Article 128. Also, to avoid any misunderstanding and reflect proportionality, we suggest deleting the first part of the paragraph “Through these key risks indicators” and to add at the beginning “In a manner which is proportionate with the risk taken”.

**Paragraph 234:** Members raised concern with the request to have a single customer view on risk data that banks have on their clients. Due to national requirements on data protection among others it would be extremely difficult to have this on retail clients, this paragraph should therefore be deleted. E.g. for retail customers in the French retail market, there is a CNIL (French National Data Protection Commission) regulation makes this provision impracticable.

**Paragraph 238:** The framework required that institutions should monitor information related to qualitative factors. However, for Small Enterprises these factors rarely predict risk, probably because of the large number of firms that a relationship manager and/or risk analyst would need to track.

**Paragraph 243:** This references 60dpd which isn't linked to any norm. We therefore suggest including only 30 and 90dpd, allowing for discretion on other time horizons. More generally, we suggest including a proportionate stance per the following rewording of the paragraph: “[...] including any of the following elements where appropriate: product, [...]”

## 8.3 Credit review of professionals

**Paragraph 245:** We would propose the following amendment in alignment with our comments on proportionality in §14:

- *245. The review process and frequency should be specific and proportionate to the type **and risk profile** of the borrower and the type, size, and complexity **and risk profile** of the credit facility, and should be specified in relevant policies and procedures. Institutions should carry out more frequent reviews if they identify a deterioration in the credit and asset quality. The overall credit risk monitoring framework and data infrastructure should allow institutions to verify that the regular credit reviews have been performed in accordance with the credit risk policies and procedures, and for the identification of any outliers/exceptions to be flagged for follow up.*

**Paragraph 249:** Define ‘continuously assess’.

## 8.5 Stress testing in monitoring process

**Paragraph 255:** The practice is not to stress-test on individual exposures but to consider where relevant, scenarios on concentrated exposures at portfolio level, which is proven to be a more effective way to assess risk in a stress situation.

**Paragraph 258:** See comment on paragraph 255. We also suggest deleting the last sentence “Sensitivity analysis in relation to the original business plan.” as once the creditworthiness assessment is made and the bank has entered into such financing, the risk management is based on how to prevent default, further updates are not deemed useful. Moreover, there seems to be a confusion between stress-testing based on existing portfolios and sensitivity analysis.

#### 8.6 Use of early warning indicators in credit monitoring

**Paragraph 263:** With respect to the key risk indicators we deem that the list proposed by the EBA does not allow for a timely detection of increased credit risk in their aggregate portfolio. For example, a significant drop in turnover would have a temporary lag that would not ensure promptness.

Furthermore, Section 8.6 appears to discuss EWIs for portfolio monitoring; however, paragraph 263 appears to imply EWIs to be set for individual exposures; while obviously banks need to monitor borrowers, setting and managing EWIs for individual borrowers is not practicable.

We suggest the following rewording: “As part of their on-going monitoring of credit risk institutions should consider *one or several* of the following indicators [...]”

**Paragraph 263 (e):** There shouldn’t be any concrete thresholds such as the 10% actual earnings versus forecast.

#### 8.7 Watch list

**Paragraph 266:** Members would welcome clarity on the supervisory expectations related to the watch list. While the first part is on monitoring and reporting (therefore mainly at portfolio level), the second part asks for operational actions/assessment in the context of “in the monitoring of watch list” (not in the monitoring of watch list clients).

#### **Annexes and other comment:**

**Annex 2 (page 71):** Members questioned the need to provide some of the evidence required (e.g. reports of deficiencies from Port State Control) in relation to shipping finance documentation, or market reports for future trips, which are in many cases not available. Furthermore, not all the information listed in Annex 2 is relevant to all types of credit facilities (e.g. age debtor statements will not be relevant in all scenarios. Such requirements should be considered on a case-by-case basis.

The reporting requirements (which the ECB expects to find during its on-site inspections) are in some instances excessive e.g. the commercial real estate elements. They are close to those that professionals (such as a real estate company) have at their disposal to manage their activity: what is requested are the vacancy housing rate, the turnover rate of the tenants, the return rate according to seniority and the location of the apartments, etc. While banks already use these criteria in principle when granting the loan and have an audit trail on the fundamental indicators of the current and potential client’s financial situation, they would not extend as far as the audit details requested by EBA.

**Annex 3:** Break this out by asset class as the three mentioned are quite different; e.g. for leveraged finance liquidity would be cash position/undrawn RCF, interest cover and DSCR.