Consultation paper on draft Guidelines on loan origination and monitoring

20 September 2019 | Public Hearing

Outline

1. Main features of the draft guidelines
2. Scope of application
3. Proportionality
4. Next steps
5. Discussion

Background and main features

Requested under the EU Council Action plan on tackling NPLs

Council invites "the EBA to issue detailed guidelines on banks' loan origination, monitoring and internal governance"

These guidelines could in particular address issues such as transparency and borrower affordability assessment and where relevant will leverage on existing national experiences

Prudential credit risk taking

Consumer protection and fair treatment of consumers

EBA Guidelines on management of non-performing and forborne exposures

EBA Guidelines on loan origination and monitoring

NPL stock

Inflows

Performing loans lifecycle

Financial stability and sustainable levels of NPLs

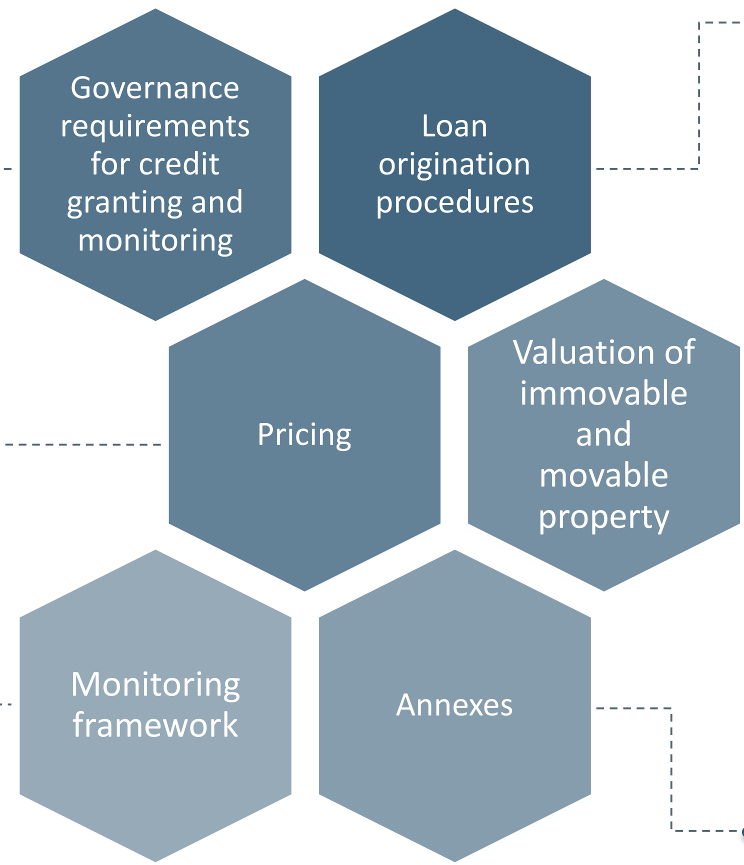
Addressing key policy areas and future proofing:

- ESG factors (environmental, social and governance)
- AML/CTF
- IT and data infrastructure
- FinTech

Legal basis: the draft guidelines build on the requirements under CRR/CRD, MCD and CCD

Content of the draft Guidelines

Application of internal governance requirements (EBA/GL/2017/11) in relation to credit granting process: Governance and culture; risk appetite, strategy and risk limits; policies and procedures; decision-making; risk management and control.



Requirements for borrower's creditworthiness assessment, and information collection and documentation for this purpose. Structure of the section is asset class specific, and incorporates of the consumer protection framework.

Supervisory expectations for risk-based pricing of loans introducing a minimum set of risk-based elements.

Requirements for valuation at the point of origination, revaluation and monitoring. Limitations for the use of statistical models and indexation.

Supervisory requirements for the ongoing monitoring of credit risk and credit exposures, including regular credit reviews of non-financial corporate borrowers.

Setting criteria for considerations and examples for benchmarking – criteria for credit granting and monitoring.

Governance requirements for credit granting and monitoring (Section 4)

0 Credit risk governance and culture

1 Credit risk appetite, strategy and credit risk limits

2 Credit risk policies and procedures

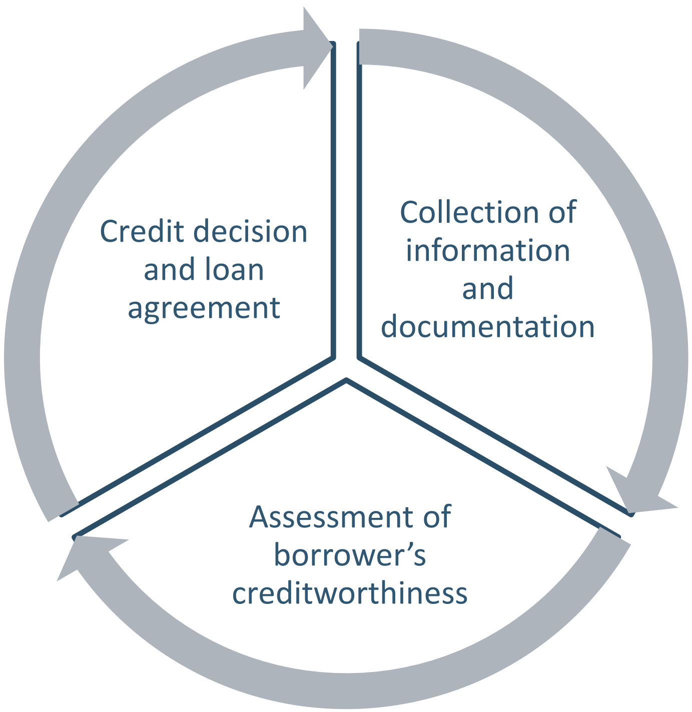
3 Credit decision-making

4 Credit risk management and internal risk control

5 Resources and skills

6 Remuneration

Loan origination procedures (Section 5)



Consumers	Professionals
Secured	General
Unsecured	Asset-specific

Collection of information and documentation

- General requirements for lending to consumers (under MCD and CCD) and professionals
- A set of minimum information to be collected such as on income for consumers, cash flow and business plan for NFCs, financial commitments etc.
- Supported by additional considerations in Annex 2

Assessment of borrower’s creditworthiness

- Requirements for lending to consumers under MCD (integration and repeal of EBA/GL/2015/11)
- Lending to consumers that is secured by other property (covering buy-to-let), and unsecured lending (e.g. CCD)
- General requirements for lending to NFC and CRE, shipping, and project and infrastructure finance specific
- Covering also sensitivity analyses
- Supported by additional considerations in Annex 3

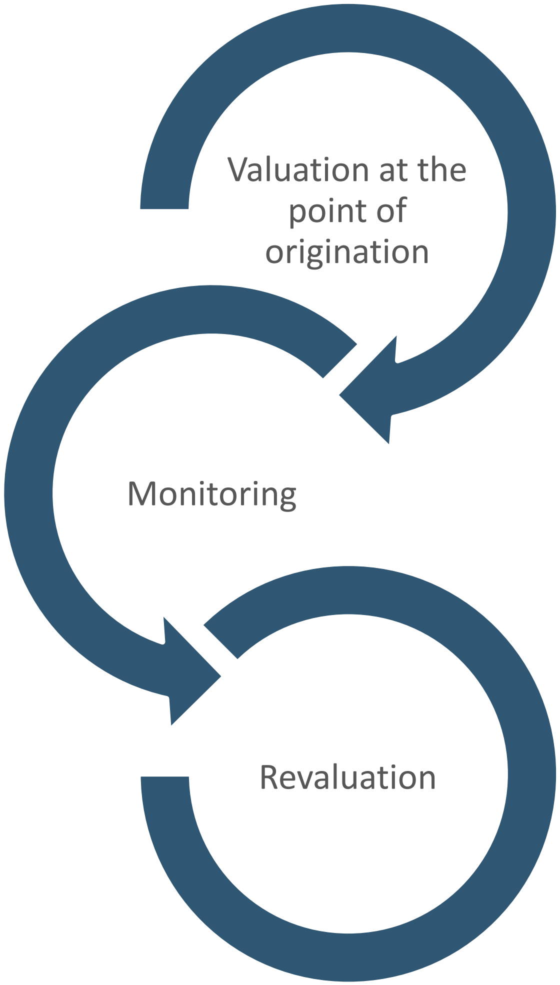
Pricing (Section 6)

- Pricing section sets high-level requirements when institutions price loans and presents no asset-specific specific requirements
- Institutions should look at a set of criteria such as cost of capital, cost of funding operating and admin costs, credit risk and other real costs
- Risk-adjusted performance indicators for pricing and profitability including cross-subsidisation, e.g. EVA, RORAC, RAROC
- Documentation and regular monitoring

The draft guidelines do not prescribe any specific pricing strategies, as these remain business decisions of the institutions

Valuation of immovable and movable property (Section 7)

- Draft Guidelines set requirements in line with the CRR Art. 208(3)
- Focus on policies, procedures and processes → no standards set for the actual methodologies
- Draft guidelines specify also the use of advanced statistical models at various points of lifecycle of a collateral – all within the legal boundaries of the CRR
- All valuation should lead to a transparent and comprehensive valuation report covering all relevant information on the process and findings
- Requirements for the quality and competency of all valuers and on external valuers
- Requirements for mitigation of conflict of interest for the valuers



Monitoring framework (Section 8)

1. Institutions should have prudent and granular framework in place to monitor all their exposures
   - Strong link to the overall IT and data infrastructure, and information collected at the point of origination
   - Granular framework to identify associated credit risk with the borrower, market risk, country risk, impairments, write-offs etc. via key risk indicators
   - Feedback loop to inform the setting/review of credit risk appetite, policies and limits
2. As part of monitoring, institutions are expected to perform credit review of professionals to identify any changes in the risk profile of the borrowers since the origination stage
   - Update of financial information and data, update on scoring/rating, where necessary
3. Tools and framework for monitoring
   - Stress testing
   - EWIs (with an adequate escalation process)
   - Watch-list

Scope of application

	Type of debt instrument	Scope in relation to application date (proposal: 30 June 2020)
Section 4 Governance	All credit facilities (excluding debt securities)	Credit facilities granted before and after the date of application
Section 5 Loan origination	Loans and advances	New loans originated after the application date and existing loans where terms are renegotiated after the application date
Section 6 Pricing	Loans and advances	New loans originated after the application date and existing loans where terms are renegotiated after the application date
Section 7 Valuation	All credit facilities (excluding debt securities)	Initial valuation of new collateral after the application date and monitoring and revaluation of existing collateral after the application date
Section 8 Monitoring	All credit facilities (excluding debt securities)	Credit facilities granted before and after the date of application

- In terms of the type of borrower, the scope of application covers professional clients and consumers for all sections of the guidelines (i.e. Sections 5, 6 and 7). Sections 4 and 8 cover all counterparties.
- While all sections address credit institutions, Section 5 covers credit institutions and creditors under MCD and CCD.

Proportionality

Proportionality is strongly embedded into the guidelines and explained in the 'Background and rationale'. The draft Guidelines incorporate three types of proportionality:

Proportionality in relation to the size and complexity of an institution	• Applies to the internal governance requirements (Section 4) • Proportionality criteria are explained in the EBA Guidelines on internal governance (direct reference to Title I of EBA/GL/2017/11)
Proportionality in relation to size and complexity of a credit facility	• Applies to all other requirements (Sections 5-8)
No proportionality	• Consumer protection aspects set out in these guidelines when dealing with the creditworthiness assessment of consumers should not be subject to the application of the principle of proportionality • Consumer protection framework should be applied regardless of the size and complexity of the institutions or of the loan

Tentative timeline

Public hearing
20 September 2019

End of consultation
30 September 2019

Finalisation and publication of the final report on the Guidelines
December 2019

Application date of the Guidelines
30 June 2020

Annex

Valuation of immovable and movable property (Section 7)

Immovable property collateral

	Initial valuation	Re-valuation		Monitoring
		Art. 208(3) applies*	Art. 208(3) does not apply**	
Valuer	✓	✓***	✓	✓
Advanced statistical models	.	.	✓	✓
Other statistical models including indexation	.	.	✓	✓

**This is whenever the price of the immovable property may have declined materially or for big loans of EUR 3 million or 5% of the own funds of the institution*

***This is when there is no "suspected" material decline of the value of the immovable property and the loan is not exceeding EUR 3 million or less than 5% of the own funds of an institution*

****A statistical model cannot be used as sole means of undertaking the review of the property valuation.*

Note: all options are possible for movable property collateral

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