Nederlandse Vereniging van Banken

POSITION PAPER

EBA Consultation Guidelines on Loan Origination & Monitoring
Response of the Dutch Banking Association
27 September 2019

NVB response in addition to EBF response
The Dutch Banking Association has contributed to, and agrees with, the consultation response by the European Banking Federation. Our response should be read as an addition to the EBF response. In our response we aim to provide our key comments on the proposed Guidelines.

Main concern: lack of acknowledgement of technological development
We understand the EBA Guidelines as being a collection of good practices and recommendations on how to grant and monitor credits. Many of the requirements or the concepts behind them are therefore already embedded in banks' policies and operating standards. We agree that good and prudent risk management practices contribute to preventing excessive amounts of non-performing loans.

This being said, we have two strong concerns with the proposed Guidelines. The first concern is the misalignment of some of the proposed Guidelines with other (national / non-prudential) regulation and suitable market practices. This underlines the second concern, which is the limited consideration of technological developments and future innovation in the draft Guidelines.

Innovation in loan origination and added value of models
Within the Dutch loan origination practices, there is a strong focus on innovation which is made possible by a continuous further development of data sources and models. In particular, lenders strive to further improve the acceptance models with a dual objective: On the one hand we receive more objective information (source based) enabling better quality assessments, while at the same time we improve customer interests and convenience.

We consider that the main part of this consultation paper deals with the "traditional" way of doing the creditworthiness assessment, while technology-enabled innovation in credit granting processes tends to be underexposed. We are of the opinion that when 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.

In particular, we would like to emphasize the added value of models within:

- Creditworthiness assessments: These are generally more standardized for smaller loan exposures (e.g. SME, consumer finance), as well as more based on statistical and behavioural criteria than individually assessed by dedicated persons. The latter involves a client being assessed by a reactive scoring model (i.e. a 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, based on a behavioural scoring model (i.e. a model that assesses clients based on information automatically fed from internal or external databases). However, the EBA Guidelines do not establish these differences.

Furthermore, the current practice for credit granting within the Dutch mortgage market is largely anchored in Dutch legislation.[1] The legislation includes rules for the maximum LTV and the determination of LTI. In addition, the information base for technology-enabled credit granting will differ from the traditional way of doing the creditworthiness assessment (as described in section 5). In summary, we consider that the EBA Guidelines should allow for other ways in which creditworthiness can be robustly determined.

- Collateral valuation: The Guidelines limit the use of advanced statistical models at origination. We consider that for both advanced statistical models as well as independent valuers there will inevitably be a margin of error.[2] For the latter, there is always a certain extent of subjective judgement in the outcome of the assessment. On the other hand, and in comparison to the former, there is the advantage of viewing the subject property. However, advanced statistical models – when considering sufficient and proven accuracy – have the advantage of providing an objective outcome based on comparables (e.g. sales prices of houses built in the same style, of similar size and in the same area).

  In addition, we note that the Mortgage Credit Directive (MCD) currently allows for the possibility that the valuation is based on a model, as it has given the responsibility to Member States to ensure that reliable valuation standards are in place. It further specifies that "in order to be considered reliable, valuation standards should take into account internationally recognised valuation standards, in particular those developed by the International Valuation Standards Committee, the European Group of Valuers' Associations or the Royal Institution of Chartered Surveyors." As is also mentioned by the EBA in the draft impact assessment, the RICS's standards allow for the valuation to be based on advanced statistical models.

Therefore we would like EBA to include in these Guidelines that for those cases where national legislation[3] allows for the use of other methods for valuation at origination (e.g. model-based valuations), this should be allowed (as national legislation supersedes EBA guidelines and because this is also in line with the MCD).

Application of the principle of proportionality
Overall, the proposed Guidelines contain extensive and detailed requirements for lending processes and the data needed for these processes. We strongly advocate a flexible approach to guidelines for loan origination and monitoring. In the coming years important changes are to be expected in technology, society and economy. This will include important developments in Sustainability (ESG). It is therefore key to apply a risk-based approach for each type of credit and client.

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[1] BGFO WFT, art. 115: Decree on Conduct of Business Supervision of Financial Undertakings under the Wft (Besluit Gedragstoezicht financiële ondernemingen Wft) elaborates the provisions of part 4 of the Financial Supervision Act (Wet op het financieel toezicht / Wft), namely the part on the conduct of business supervision of financial undertakings

[2] In Dutch legislation, the use of a model-based valuation is therefore not allowed for LTVs > 90%

[3] BGFO WFT, art. 115

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Please find hereby a few concerns in this respect:

- It is of vital importance to systematically maintain for all topics of sections 5 to 8 (including the annexes 1 to 3) the principle of proportionality. Therefore we ask EBA to confirm that for these sections (and annexes)[4] proportionality can always be applied to the size, nature and complexity of the credit facility.
- The Guidelines apply the Commercial Real Estate definition of the ESRB, which include social housing and property owned by the end user. However, the relevant risk drivers for these type of exposures significantly differ from the project type of Commercial Real Estate business, and these differences should be taken into account.
- The definition of 'professional' encompasses any business client – from SMEs to larger corporations. The requirements for professionals as well as indicators to be taken into consideration as described in the annexes should take account of the size and complexity of the business in question.
- We agree with EBA that section 5 (Loan Origination Procedures) and 6 (Pricing) are not relevant for exposures to exempted counterparties given the difference in creditworthiness assessment. Promotional loans support public policy and as such obey to criteria and decision conditions other than those typical of a commercial decision. Therefore, the exemption should be extended to exposures which are guaranteed by sovereigns, local or regional governments and public sector entities in order to capture promotional loans.
- During the lifetime of the loan, several reasons might lead to amendments in the loan agreement. Not every change or action has a financial impact. For those cases where there is no or minimal weight on affordability or debt capacity, a new creditworthiness assessment would be a disproportionate measure in the existing process. In some cases a new creditworthiness assessment might discourage (residential mortgage) clients to make amendments that will reduce the risks for the clients and the bank. Therefore, we propose to rephrase article 97 accordingly.`

Scope to be limited to new loans

A last overarching comment that we would like to make is on the applicable scope for the Guidelines. We are concerned that limitations might occur in the legal enforcement for existing agreements. Therefore we strongly recommend that the Guidelines will apply only to newly originated loans. Renegotiations of terms for loans granted before the application date, or changes from specific actions triggered by regular credit reviews should be out of scope. If this cannot be accepted, we consider that the renegotiated loan agreements should only be subject to the full new scope of loan origination requirements when there is a significant impact on borrower's affordability assessment from the changes in the agreement.

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[4] Section 5: Loan Origination Procedures, Section 6: Pricing, Section 7: Property Valuation, Section 8: Monitoring Framework