



Loan Origination & Monitoring

Summary Insights

December 2020



Building a better
working world

Building a better financial services industry

At EY Financial Services we train and nurture our inclusive teams to develop minds that can transform, shape and innovate financial services. Our professionals come together from different backgrounds and walks of life to apply their skills and insights to ask better questions. It's these better questions that lead to better answers, benefiting our clients, their customers and the wider community. Our minds are made to build a better financial services industry. It's how we play our part in building a better working world.

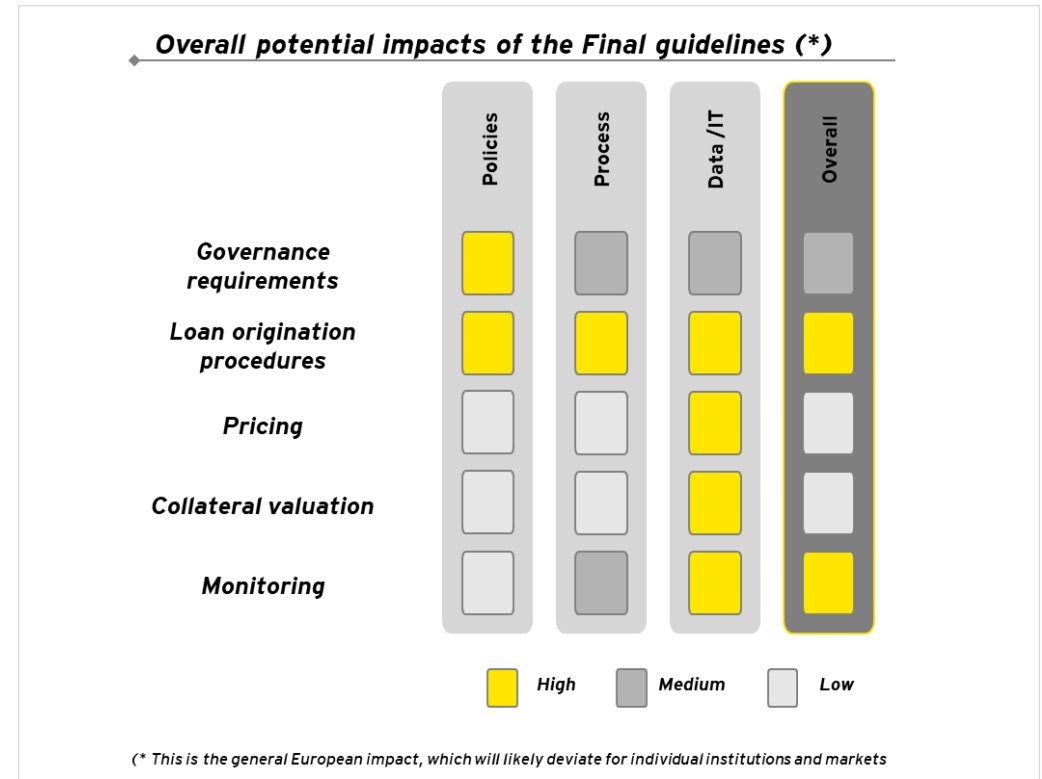
**Minds made for building
financial services**

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Context

EBA has published its final guidelines on Loan Origination & Monitoring...

- After consultation, on 26 May 2020, the EBA published its final guidelines on Loan origination and Monitoring as part of European Council action plan to reduce the level of NPLs in the EU
- These guidelines tackle the overarching scope of the end to end credit granting process with the following objectives:
 - Improve banks' practices and associated governance arrangements, processes and mechanisms in relation to credit granting
 - Ensure that banks have robust and prudent standards for credit risk-taking, management and monitoring, and that newly originated loans are of high credit quality
 - Ensure that banks' practices are aligned with consumer protection rules and respect fair treatment of consumers
 - Ensure that banks make reasonable enquiries and take steps to assess and verify the borrower's repayment capacity during the entire loan life cycle



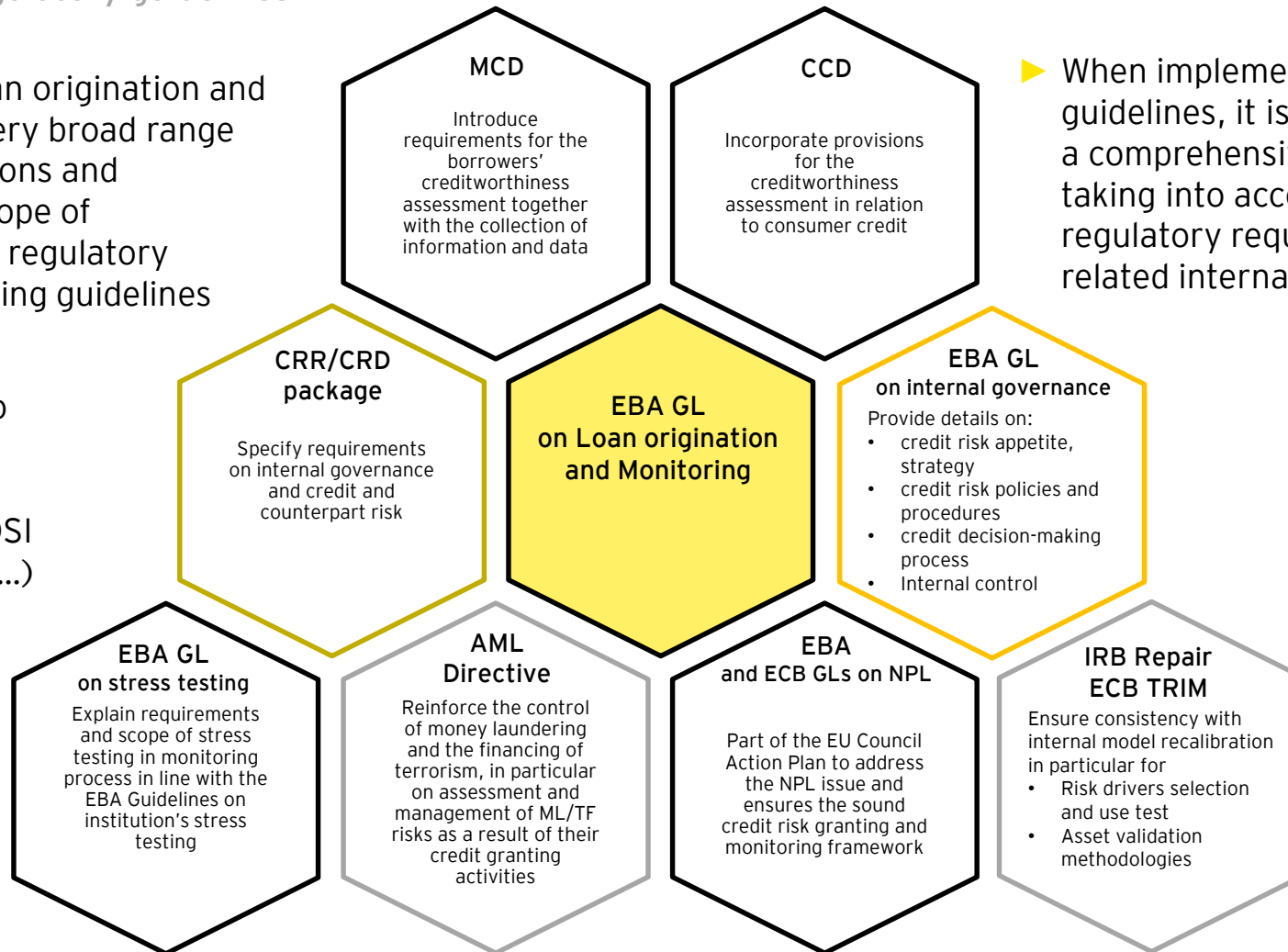
Context

... which interact with several regulatory frameworks and existing guidelines...

Overview of related regulatory guidelines

▶ EBA guidelines on loan origination and monitoring cover a very broad range of topics and regulations and specify/extend the scope of application of several regulatory frameworks and existing guidelines

▶ These guidelines also interact with several supervisory recommendations (OSI missions, deep dives...)



▶ When implementing those guidelines, it is important to build a comprehensive framework taking into account other regulatory requirements and related internal projects.

Context

... implementation will prove challenging across various topics









Overview of key challenges

	Potential impacts		
	Policies	Process	Data / IT
Governance requirement of credit granting and monitoring <ul style="list-style-type: none"> ▶ Ensure that the management framework of credit granting defines management team responsibility and is aligned with their Risk Appetite framework ▶ Clearly define powers and limitations of each decision maker and set time limits for powers if relevant ▶ Include environmental, social and governmental (ESG) factors in Governance, incl processes and policies 	High	Medium	Medium
Loan origination procedures <ul style="list-style-type: none"> ▶ During granting process, the bank should collect a more extensive series of information in comparison to the current situation. This information must be properly documented and maintained accessible for all the duration. ▶ The creditworthiness assessment must be based on tangible and objective criteria. Guidelines specify a set of criteria to be considered, differentiated by typology of customer/product type, appropriately defined within the GL (KRI i.e. DSCR, LTV...). ▶ Additional "Limit values" must be set within the Policies and articulated with Risk Appetite framework ▶ Institutions should assess the sustainability of the borrower's financial position, by carrying out sensitivity analyses considering market or idiosyncratic events (e.g. increase in the cost of funding, decline in revenues or margins, adverse movements of assets prices etc.) 	High	High	High
Pricing <ul style="list-style-type: none"> ▶ Ensure that pricing policies reflect risk appetite, the institution's strategy and linked to the product's characteristics, clients types and their associated risks. The following elements to consider: <ul style="list-style-type: none"> ▶ Cost of capital on loans granted ▶ Cost of funding ▶ Operating and administrative costs ▶ Credit risk costs; where necessary, using expected loss models ▶ Consider profitability measures such as EVA, RORAC and RAROC 	Medium	Medium	High
Valuation of immovable and movable property <ul style="list-style-type: none"> ▶ Specify the process for collateral valuation (movable and immovable) and re evaluation ▶ Specify rules for valuers, considering potential conflict of interests and use of external valuation ▶ Institutions should ensure adequate rotation of valuers for collateral valuation 	Medium	Medium	High
Monitoring framework <ul style="list-style-type: none"> ▶ Build an effective monitoring framework, including early warning signals, supported by an adequate data infrastructure ▶ Build and infrastructure enabling data trail concerning the exposure, client and security through the whole lifetime of the exposure 	Medium	Medium	High

High
 Medium
 Low
 5

Context

Data and reporting requirements represent an important challenge to address

	<i>GL LOM references</i>	<i>Highlights</i>	<i>Readiness</i>	<i>Indicative gaps observed*</i>
 Key Metrics	Annex 2	All useful credit information's for debtor assessment process		Limited information for the areas: <ul style="list-style-type: none"> • Real Estate • Shipping finance • Project and infrastructure
 KRIs	Annex 1 & 3	Relevant metrics/parameters for the purpose of understanding the debtor's ability to repay in the origination phase and during credit life		Lack of metrics <ul style="list-style-type: none"> • Interest Coverage Ratio for RRE • Loan to Cost (LTC) and Rental Yield (RY) for CRE • "Normalization" of the definition of DSCR compared to EBA / ECB expectations • Development Permits on "building"
 EWIs	Chapter 8.5 -Use of EWIs in credit monitoring	Early warning indicators to be implemented in order to prevent and anticipate potential deterioration of the debtor's credit quality		<ul style="list-style-type: none"> • Lack of EWI framework • Difficulty in intercepting the debtor: <ul style="list-style-type: none"> • Legal actions in progress (independent of the Customer/Bank relationship) • Sector and/or geographical crisis
 EBA Transaction template	Chapter 4.3.7 - Data Infrastructure	Best practices in financial due diligence (FDD) and valuation of an NPL portfolio		Lack of information <ul style="list-style-type: none"> • Collateral cadastral data (e.g. number rooms, measurements, etc.) • Swap, Leasing and Enforcement • Balance sheet data (e.g. fixed and current assets/liabilities, etc..)

(* Non exhaustive)

Key Success Factors

Understand your starting position, and quickly move towards defining the to-be vision and necessary domain support

1 **Baseline:** Mobilisation of accelerated gap and impact assessment across existing credit processes, decisioning and monitoring activities

2 **Assess, Anticipate & Understand Dependencies:** Assess the GL implications on other Regulatory programmes e.g. BCBS 239 and other credit risk initiatives.
Assess data requirements and ensure appropriate stakeholder engagement / buy-in from other domains

3 **Plan:** Develop H-L implementation roadmap that is outcome orientated and themed according to business line/ownership (don't design by GL Chapter)

