

Reaction of the Dutch Ministry of Finance on the EBA Consultation Paper 'Draft Guidelines on loan origination and monitoring' (19 June 2019)

Question 1: What are the respondents' views on the scope of application of the draft guidelines?

The scope of section 5 concerning loan originating procedures must be limited to consumer loans. This section is about the requirements for lending and is based on the CCD and MCD. Lending to professionals does not fall under the scope of the CCD and MCD, and therefore the scope of section 5 must be limited to consumer lending. The requirements in the CCD and MCD are prescribed to protect the consumer. This is also the case for the creditworthiness assessment.

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

In annex 2 is mentioned which information must be collected. This list of information is very detailed and we strongly prefer to delete this annex. We think that credit institutions themselves can better determine which information is needed to assess the creditworthiness of consumers. In the Netherlands the living expenses for an average consumer by a certain income is calculated by the National Institute for Family Information (Nibud). The maximum amount of the loan in relation to income (LTI) is based on this information. The rules for the LTI are very detailed, but it is still the responsibility of the creditor to determine which information is needed to assess the borrower's income.

Concerning professionals there is no legal basis for the guidelines concerning the creditworthiness assessment for professionals. Furthermore, the creditor can better determine which information is necessary to assess the creditworthiness of the professional. It is the responsibility of the creditor to properly assess the creditworthiness.

Question 8: What are the respondent's views on the requirements for assessment of borrower's creditworthiness (Section 5.2)?

Paragraph 5.2.1. (general requirements for lending to consumers) line 97:

Written is that the relevant information collected in accordance with section 5.1 to carry out the assessment of the borrower's creditworthiness should be used by creditors before concluding a loan agreement or before amending the existing loan agreement or loan amount. Article 18 (6) of directive 2014/17/EU (Mortgage Credit Directive) and article 8 (2) directive 2008/48/EC (Consumer Credit Directive) stipulates that only by a significant increase in the total amount of the credit new information must be collected to carry out the assessment of the borrower's creditworthiness. So paragraph 5.2.1. is not in line with the MCD and CCD.

Paragraph 5.2.1. (general requirements for lending to consumers) line 101:

In line 101 it is stated that the creditors should carry out sensitivity analyses reflecting potential negative scenarios in the future including a reduction of income. We think that the creditworthiness assessment must be based on the borrower's actual income and financial situation at the moment

before concluding the loan agreement. We think that it is not useful to assess the borrower's ability to meet the obligations under the loan agreement if the borrower's income significantly decreases or the borrower no longer has an income. It is not possible to take into account any unexpected event in the future. The other negative potential scenarios in the future (an increase in interest rates in the case of variable rate loan agreements, negative amortization, balloon payments, deferred payments of principal or interest) are scenarios that are directly related to the product. It is useful that it is assessed if the borrower can meet these situations (based on his financial situation before concluding the agreement).

Although it is important that a creditor can accurately account for potential risks regarding the repayment capacity of their outstanding loans, running a sensitivity analysis for all individual customers might create a large administrative burden. Running a sensitivity analysis for an entire portfolio of outstanding loans might be more helpful in this regard, because it measures the aggregate potential risk.

Paragraph 5.2.2. (lending to consumers relating to residential immovable property) line 107:

In line 107 it is stated that creditors should take appropriate account of the adequacy of the borrower's likely income and ability to continue to meet obligations under the loan agreement in retirement when the loan term extends past the borrower's expected retirement age. In the Netherlands mortgage loans are typically provided with a loan term of 30 years. In our opinion it is not feasible to appropriately take into account the adequacy of the borrower's likely income in retirement such far ahead. In the Netherlands creditors assess the borrower's likely income only when the expected retirement age is within 10 years of loan origination.

Paragraph 5.2.4. (unsecured lending to consumers) line 121:

See our comment regarding line 101 about assessing the borrower's ability to meet obligations under the loan agreement and the sensitivity analyses reflecting a reduction of income in the future. This is an uncertain event. A change in taxation is also an uncertain event. The other scenarios are related to the product. We prefer to limit the sensitivity analyses of scenarios to the scenarios related to the financial product (e.g. an increase in interest rates in the case of variable rate loan agreements).

Paragraph 5.2.5, 5.2.6, 5.2.7, 5.2.8. (lending to professionals):

The guidelines in paragraph 5.2.5, 5.2.6, 5.2.7 and 5.2.8. apply to professionals. The CCD and the MCD are only applicable on consumer loans so there is no basis for rules concerning loans for professionals. Also article 74 (1) of directive 2013/36/EU provides no legal basis for the detailed guidelines mentioned in paragraph 5.2.5, 5.2.6, 5.2.7 and 5.2.8 and the guidelines for creditworthiness assessment of professionals. The creditworthiness assessment is primarily designed to prevent the consumer from ending up in a problematic repayment situation. In the second place, the effect of the creditworthiness assessment is that the credit risk for the financial institution reduces.

Article 74 of directive 2013/36/EU states that a financial institution must have effective processes to identify, manage, monitor and report the risks they are or might be exposed to and have a sound and effective risk management. EBA shall issue guidelines on this processes (article 74 (2)). EBA could

prescribe that there must be a sound creditworthiness assessment for professionals (that is the process) but it is not the role of EBA to describe what should be included in the creditworthiness assessment and which information the credit institution must collect.

The creditworthiness assessment is based on the CCD and MCD. So we strongly prefer to delete paragraph 5.2.5, 5.2.6, 5.2.7 and 5.2.8.

Question 9: What are the respondents' view on the scope of the asset classes and products covered in loan origination procedures (Section 5)?

Concerning the scope we do not agree that the guidelines are also applicable on professionals because the CCD and MCD are only applicable on consumers. It is not the role of EBA to expand the scope concerning the loan origination procedure. This is something that must be decided by the European Commission and the member states (a review of the directives is a good moment to discuss this point further). Furthermore, we do not agree with the scope of the products (commercial real estate, real estate development, shipping finance, project and infrastructure finance). These products do not fall under the scope of the CCD and MCD.

Question 11: What are the respondents view on the requirements for valuation of immovable and movable property collateral (Section 7)?

The Dutch government endorses that at the point of loan origination, when an immovable property collateral secures a credit facility, it is essential to guarantee a high quality valuation of the immovable property. This is, regardless of the valuation method, important from a consumer, creditor and prudential perspective.

Traditionally, a qualified valuer values immovable property. However, in the past years, the market for automated valuation models (AVMs) has developed rapidly in the Netherlands. As a result, the accuracy and reliability of AVMs increased significantly in the past years. For consumers the main advantage of AVMs is the considerably lower costs compared to traditional valuation, and the speed and easiness at which AVMs can be conducted. Also creditors benefit from a quick and cost-efficient valuation, especially when re-valuating and monitoring immovable property. Moreover, an independent valuation is ensured when using AVMs. This addresses the possible bias of traditional valuations; earlier this year the Dutch central bank (DNB) concluded that there is a clear indication of systematic overvaluation in the Netherlands.¹ At the same time, we recognize that also by using AVMs there is a risk that the immovable property is valued either too high or too low, possibly leading to overleveraging on consumer level and creating shortcomings in the risk management on creditor level. This might particularly happen when valuations by AVMs are used whilst immovable property is in a poor condition or the accuracy of the model is insufficient. The availability of a solid data infrastructure and high quality data, which is the case in the Netherlands, is key for the accuracy and reliability of AVMs.

As of 2016, the Dutch government allowed valuation by AVMs at loan origination under very specific

¹ <https://www.dnb.nl/en/news/news-and-archive/DNBulletin2019/dnb382679.jsp>

requirements addressing the before mentioned risks. The use of AVMs is permitted when the loan-to-value (LTV) is below 90 percent, whilst the maximum LTV is 100 percent when a traditional taxation is used. Furthermore, when an AVM is used they have to meet internationally recognized standards, thereby ensuring that valuations are impartial and objective. These standards include the ones mentioned in recital 26 of the Mortgage Credit Directive (MCD), the International Valuation Standards Committee, the European Group of Valuers and the Royal Institution of Chartered Surveyors, but are (as in the MCD) not limited to the before mentioned. Finally, when an AVM is insufficiently reliable in an individual case (e.g. the confidence level of an individual valuation does not meet the criteria) the valuation should not be used.

In the Netherlands, we have observed that in particular consumers who refinance their mortgage, usually carrying (very) low LTVs, make use of AVMs. For those consumers the lower costs and faster procedure is a vast advantage. The number of mortgage refinancing consumers who use AVMs has increased significantly over the past years. This increase in volumes strengthened the development of AVMs and their accuracy in the past years.

To conclude, we understand that the use of AVMs can have possible shortcomings but there are also benefits. In the Netherlands, we have seen a very rapid and encouraging development in the usage and quality of AVMs, offering advantages to both consumers and creditors. Thus, in our view, the use of AVMs should be possible under very strict requirements, especially in cases where the LTV is (very) low. Restricting the usage of AVMs would hamper the further development of AVMs in the future, and affect customers and creditors currently benefitting from the earlier mentioned advantages.

Question 12: What are the respondents' views on the proposed requirements on monitoring framework (Section 8)?

Line 241 prescribes that the credit institution should monitor all outstanding amounts under their credit facilities and perform regular reviews on borrowers' payment performance. Furthermore, line 241 states that institutions should monitor whether the borrower is in line with the conditions set at the point of credit granting, such as adherence to credit metrics, covenants. In our view, for consumers a periodic review on borrowers' payment performance should be sufficient. Only if there is a reason (risk based) the credit institution can decide to check whether the borrower is still compliant with the conditions set at the point of granting. In our view it is too burdensome to prescribe that the credit institution must check all the borrowers' on this point (consumers with mortgages credits, consumer credit and all professional creditors). It is important to realize what is the consequence for the borrower if the borrower does not fulfill the initial requirements for credit granting anymore, but still adheres to the repayment schedule.