# Responsible lending in times of crisis

## Meeting report[1]

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The European Banking Authority (EBA) published the final guidelines on loan origination and monitoring in May 2020.[2] These guidelines aim to improve the lending standards and asset quality of lenders after June 2021, and bring together the prudential standards for lenders, borrower protection, anti-money laundering and sustainability.

These new guidelines were discussed during the CEPS-ECRI webinar by stakeholders involved in their preparation and affected by them. To what extent do they strike the right balance between economic growth, financial stability and consumer protection? Is the guidance on the creditworthiness assessment fit for purpose? What is the likely impact on both lenders and borrowers? What more is required to promote responsible lending?

## Panel Discussion

- Oleg Shmeljov (Presentation), *Senior Policy Expert, Unit on Reporting, Loans Management and Transparency, European Banking Authority (EBA)*
- Panajotis Papazoglou (Presentation), *Head of Solutions, Schufa*
- Françoise Palle-Guillabert (Presentation), *CEO, Association Française des Sociétés Financières (ASF)*
- Olivier Jerusalmy, *Senior Research & Advocacy Officer, Finance Watch*

*Moderated by* Willem Pieter de Groen, Research Fellow & Head of Unit, CEPS

[1] This meeting report is not a transcript of the discussion, but an interpretation of it by the authors.
[2] https://eba.europa.eu/regulation-and-policy/credit-risk/guidelines-on-loan-origination-and-monitoring

## Introduction

The EBA's guidelines on loan origination and monitoring form part of the EU NPL Action Plan of July 2017,[3] which aims to address the large amounts of non-performing loans (NPLs) resulting from the 2007-09 global financial crisis and the 2010-12 eurozone debt crisis. At one point in the aftermath of these crises there were as much as €1.2 trillion worth of NPLs or 6.5% of loans issued in the EU-28 (June 2015). This high level of NPLs increased the risk for the European banking sector and for financial stability more widely. NPLs not only deter the bank profitability and capital position, but also reduce the banks' capacity to lend. In turn, this jeopardises the future for the over-indebted households or businesses. The improved economic conditions and the Action Plan contributed to the gradual reduction in outstanding NPLs in the past couple of years. The amount of NPLs more than halved between December 2014 and December 2019, to 2.7%.

## Covid-19

The main objective of the EBA guidelines is to ensure that consumer credit and mortgage loans are at the point of origination of high credit quality, which, with another big economic crisis inevitable, is paramount. While the guidelines are unlikely to be in time to avoid large increases in NPLs in the short term, they could contribute to the mid- to longer-term recovery from the Covid-19 crisis through more responsible lending.

Covid-19 has had a big impact on the European lending market, especially consumer lending. The increased uncertainty about the income in the near future has led to a sharp drop in credit demand and to a lesser extent, supply. For example, during the lockdown in France, newly issued consumer credits decreased by 68%, while car loans fell by as much as 90% just in April.

Lenders are playing an important role during this crisis. Many businesses depend on credit for their survival, and the lenders have the difficult task of determining who receives credit and against what conditions. They have to assess whether the households and businesses in need can afford the credit product and what conditions should be connected to the credit (maturity, rates, collateral, and so on). In these circumstances, lenders are responsible for continuing to lend to households and businesses that are creditworthy in the longer term, but also for refusing those that are not. With the huge uncertainty about the development of the Covid-19 crisis and the potential recovery, it is currently very difficult to make these assessments in practice.

## EBA guidelines on loan origination and monitoring

The EBA guidelines on loan origination and monitoring aim to guarantee responsible lending in the future. Indeed, the guidelines form the forward-looking part of the Action Plan and address new credit, instead of the outstanding credit and NPLs that are addressed by most of the other initiatives. The guidelines cover the loan origination and monitoring, but not potential redress. The guidelines further follow a comprehensive approach, including internal governance issues, creditworthiness assessment, pricing, collateral valuation, a monitoring framework and procedures. Moreover, the guidelines introduce various new elements in the loan origination, including the assessment of ESG risks, automated models, artificial intelligence (AI) and new technologies.

[3] https://www.consilium.europa.eu/en/press/press-releases/2017/07/11/conclusions-non-performing-loans/

The EBA aims to take the guidelines into the lenders'[4] core practices, beyond prudential treatment and risk management, to influence business decisions and ensure that a creditworthiness assessment and an assessment of the credit risks from the perspective of the lender are taken into account at the point of loan origination. In this way they bridge prudential requirements and consumer protection.

## Credit information

High-quality credit information on the borrower is essential for the creditworthiness assessment and monitoring. The NPLs in the past were often associated with too limited, inaccurate and/or incomplete information. The guidelines demand enhanced data comprehensiveness, which involves including positive and negative data of the borrower in the credit-decision process. This should improve the accuracy of the lenders' assessment as to whether the borrower is likely to default. It is expected that recent developments and new technologies such as automated models will contribute to enhancing the credit information. For instance, the second Payment Service Directive (PSD2), open banking and the increased use of new technologies such as AI make it much easier to collect and assess high-quality income information in an automated manner.

The single customer view, as defined by the EBA, focused on how customers' assets and liabilities held at a single lender could be expanded to all lenders. This information is often already collected and provided by credit reporting agencies (CRAs), which can facilitate the access to all lenders for their credit worthiness assessment. In this way the CRAs contribute, with their central collection of information, to the level playing field between lenders and to easing the verification and validation of the data.

The reliance on large amounts of personal information raises concerns regarding data privacy. Households might provide data for a potential lender to do a credit worthiness assessment, but that does not mean that they agree with the data being shared with the CRAs and other lenders. Moreover, is all the collected information really necessary to perform creditworthiness assessments? And for how long must it be stored in order to help with a sound assessment and allow for a second chance? There are dividing views on these issues, with the CRAs and lenders arguing for a more holistic data collection of the income, assets and liabilities and for longer data retention periods than the consumer representatives. Studies show that one person who had defaults seven years ago will have five times the probability of default than somebody without any disruption to payments.

## Implementation

The EBA guidelines are non-binding but are nevertheless likely to be imposed by most of the national supervisors. According to some experts this could create problems in certain countries where the guidelines are not fully aligned with the national implementation of the Consumer Credit Directive (CCD), as well as in countries where the credit information collected is insufficient (in some countries, CRAs only collect negative data, for example). Moreover, some of the industry representatives fear that the implementation of the guidelines in 2021 will work procyclical, as they might contribute to tightening of the lending conditions in the midst of an economic crisis.

[4] Banks and other lenders subject to the Mortgage Consumer Directive (MCD) and Consumer Credit Directive (CCD) are in scope of the guidelines.

# European Credit Research Institute

The European Credit Research Institute (ECRI) is an independent, non-profit research institute that develops its expertise from an interdisciplinary team and networks of academic cooperation partners. It was founded in 1999 by a consortium of European banking and financial institutions. ECRI's operations and staff are managed by the Centre for European Policy Studies. ECRI provides in-depth analysis and insight into the structure, evolution and regulation of retail financial services markets in Europe. Through its research activities, publications and conferences, ECRI keeps its members up-to-date on a variety of topics in the area of retail financial services at the European level, such as consumer credit and housing loans, credit reporting, consumer protection and electronic payments. ECRI also provides a venue for its members to participate in the EU level policy discussion.

For further information, visit the website: www.ecri.eu.

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