

Reg. No: 57-093/093/21-7

Zagreb, 14 June 2021

TO ALL CREDIT INSTITUTIONS

Attention of: Management Board

Subject: Application of the Guidelines on loan origination and monitoring (EBA/GL/2020/06)

Dear Sir/Madam,

We would hereby like to remind you that the European Banking Authority (hereinafter: the EBA) on 29 June 2020 issued the Guidelines on loan origination and monitoring (EBA/GL/2020/06; hereinafter: the Guidelines).

In accordance with Article 4, paragraph (1), item (3) of the Credit Institutions Act¹, the Croatian National Bank shall make every effort to comply with those guidelines and recommendations issued by the European Banking Authority in accordance with Article 16 of Regulation (EU) No 1093/2010 (OJ L 24.11.2010). To this end, on 26 August 2020, the CNB submitted to the EBA a notification expressing its intention to fully comply with the Guidelines. In this regard, credit institutions are expected to apply the Guidelines as good practice, while respecting the expectations contained in this Circular.

We would like to inform you about the detected specifics of which we have notified the EBA in the notification on the application of the Guidelines and which we do not consider to constitute material differences that might affect the efforts of credit institutions to bring their policies and procedures into compliance with the provisions of the Guidelines.

Please first note that the Guidelines cover the entire credit cycle and aim to strengthen credit-granting standards and portfolio oversight and thus directly influence the level of non-performing loans in the future, while ensuring that practices are aligned with the provisions on consumer protection. For the purposes of the Guidelines, the term "loan" means loans and advances and all debt instruments that an institution may hold and that are not securities. This term also includes "loans" within the meaning of the ECB BSI Regulation² and advances that are not classified as "loans" within the meaning of the ECB BSI Regulation.

¹ Official Gazette 159/2013, 19/2015, 102/2015, 15/2018, 70/2019, 47/2020 and 146/2020.

² Regulation (EU) No 1071/2013 of the European Central Bank of 24 September 2013 concerning the balance sheet of the monetary financial institutions sector (recast) (ECB/2013/33).

Creditworthiness assessment, which the EBA recognises as the core of all credit-granting processes, is the focus of Section 5. Let us note that Sections 5 and 6 apply in relation to loans to consumers, micro and small enterprises, and medium-sized and large enterprises and they do not apply to loans and advances to credit institutions, investment firms, financial institutions, insurance and reinsurance undertakings, central banks and sovereigns, including central governments, regional and local authorities, and public sector entities. Sections 5 and 6 also do not apply to forborne and non-performing loans.

The proportionality of the Guidelines is reflected in distinct general requirements for lending to consumers, micro and small enterprises and medium-sized and large enterprises as well as class-/product-specific requirements for specific types of loans and collateral. It is noteworthy that, with effect from the date of application of the Guidelines, appealed are the Guidelines on creditworthiness assessment (EBA/GL/2015/11), which the Croatian National Bank has transposed into the Decision on the additional criteria for the assessment of consumer creditworthiness and on the procedure of collection of arrears and voluntary foreclosure³, and which we believe, in the part related to consumer creditworthiness assessment (Article 3), does not depart from the provisions of Section 5.2.2 of the Guidelines. We note that the Guidelines do not go beyond the scope of the Mortgage Credit Directive⁴ (hereinafter: the MCD) and the Consumer Credit Directive⁵ (hereinafter: the CCD), subject to national laws transposing these directives (paragraph 102 and paragraph 114 of the Guidelines). In this regard, let us note that the Act on Consumer Housing Loans⁶ (hereinafter: the ACHL) does not make use of the discretion under Article 3(3)(b) of the MCD, and does not apply to credit agreements which provide that the immovable property cannot at any time be occupied as a house, apartment or another place of residence by the consumer or a family member of the consumer and is to be occupied as a house, apartment or another place of residence on the basis of a rental agreement. This implies that, together with the criteria set out in Section 5.2.1, credit institutions in the RC are expected to apply as additional criteria the criteria for consumer housing loans set out in Section 5.2.2 of the Guidelines. In comparison, under the provisions of paragraph 109 of the Guidelines, such loans are exempted from the criteria for consumer housing loans and are subject to the additional criteria set out in Section 5.2.3 of the Guidelines.

Furthermore, the provisions of Section 5.2.4 Unsecured lending to consumers, in the RC apply to a somewhat broader set of loans than under the CCD. More specifically, Article 2(2)(c) of the CCD lays down that the CCD applies to credit agreements involving a total amount of credit more than EUR 200 or less than EUR 75 000, while under the provisions of Article 3, paragraph (1), item (a) of the Consumer Credit Act⁷, the Act applies to all credit agreements involving a total amount of credit from HRK 1 500 to HRK 1 000 000 00.

Under the provisions of the Guidelines, in cases of foreign currency loans, credit institutions should also factor into the assessment of the borrower's capacity to meet the obligations potential

³ Official Gazette 107/2017.

⁴ Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010.

⁵ Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC.

⁶ Official Gazette 101/2017.

⁷ Official Gazette 75/2009, 112/2012, 143/2013, 147/2013, 9/2015, 78/2015, 102/2015 and 52/2016.

negative scenarios of the exchange rate between the currency of the borrower's income and the currency of the loan. In accordance with the provisions of Article 5, paragraph (4) of the Decision on the classification of exposures into risk categories and the method of determining credit losses⁸ (hereinafter: the Decision on classification), an internal system of monitoring, analysing and assessing whether the foreign exchange position of individual debtors or peer groups of debtors is matched and whether their cash flows can be adjusted to the potential changes in the level of their liabilities towards a credit institution and overall liabilities due to the effect of exchange rate changes shall be established for all exposures with a currency clause and foreign exchange placements which include off-balance sheet liabilities denominated in a foreign currency that exceed HRK 50 000 (to a single natural person) and HRK 500 000 (to a single legal person), respectively. Credit institutions are expected to continue to apply these provisions of the Decision on classification, meaning that the obligation to assess whether the foreign exchange position is matched does not apply to placements below the threshold (including also loans that are the subject of the Guidelines). However, and in accordance with the provisions of the Guidelines, credit institutions should continue to conduct such assessments where this is required under their credit risk policies and procedures.

Sections 4 and 8 apply to the overall credit risk assumed by institutions (regardless of when loans were granted), excluding debt securities, derivatives and securities financing transactions. Section 4 specifies the content of the credit risk policies and procedures, a credit decision-making framework and the method of defining the allocation of responsibilities and powers, functions, business lines and units originating the credit risk. Section 4 provides a framework for the use of technology-enabled innovations and automated models in creditworthiness assessment and credit decision-making. Where credit institutions make use of such innovations and models, they are expected to meet the relevant obligations.

The Guidelines apply from 30 June 2021 to all loans that are originated after that date, while they also apply to loans that already exist on that date if their terms and conditions have been changed after 30 June 2022, provided that the changes follow a specific credit decision approval, and if their implementation requires a new loan agreement or an addendum to the existing agreement.

In Section 7 the EBA provides the guidelines for immovable and movable property collateral in the following key segments: valuation at the point of origination, subsequent monitoring and revaluation. Let us note that the Real Estate Valuation Act⁹ and the Real Estate Valuation Manual¹⁰ require for immovable property a valuation report made by a valuer, while the provisions of Article 68 of the Manual state that the report must contain the results of an on-site visit. In this regard, we are of the opinion that the term "on-site visit" implies a field visit and a property visit. Furthermore, in accordance with the provisions of Article 4, paragraphs (1) and (2) of the Decision on the minimum content of residential real estate records¹¹, with respect to granted consumer housing loans, credit institutions are required to maintain unique records of residential real estate that, among other things, for real estate serving as collateral and located within the territory of the Republic of Croatia, must contain data on the value of the real estate collateral, more precisely the value of the residential real estate indicated in the valuation report (item (12), first

⁸ Official Gazette 114/2017 and 110/2018.

⁹ Official Gazette 78/2015.

¹⁰ Official Gazette 105/2015.

¹¹ Official Gazette 109/2018.

indent). Further to all of the above and within the meaning of item 210 of the Guidelines, we are of the opinion that initial valuation made by a valuer of the immovable property serving as collateral and located within the territory of the Republic of Croatia cannot be made without a property visit, that is, it cannot be made only by means of supporting advanced statistical models.

Also, credit institutions are expected to comply with the Guidelines in respect of any activity associated with initial valuation, monitoring, revaluation or review of immovable property and movable property collateral conducted after 30 June 2021. Let us draw attention to the provisions of Article 18 of the Decision on classification, that define the conditions for recognition of movable and immovable property as appropriate instruments of collateral, and which credit institutions are obligated to meet if they use such instruments in the process of classification of exposures into risk categories and assessment of future cash flows based on the collections from immovable or movable property.

The EBA has recognised that difficulties may arise in addressing data gaps. For this reason, the Guidelines allow a transition period of three years, up until 30 June 2024, for the application of Section 8 of the Guidelines, which focuses on oversight and monitoring. We believe that this period is sufficient for quality adjustment of credit institutions, in particular their data infrastructure.

The English version of the EBA Final report on the Guidelines is available at the following link:
https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Guidelines/2020/Guidelines%20on%20loan%20origination%20and%20monitoring/884283/EBA%20GL%202020%2006%20Final%20Report%20on%20GL%20on%20loan%20origination%20and%20monitoring.pdf

The Croatian version of the Guidelines is available at the following link:
https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Guidelines/2020/Guidelines%20on%20loan%20origination%20and%20monitoring/Translations/886683/Final%20Report%20on%20GL%20on%20loan%20origination%20and%20monitoring_COR_HR.pdf

Kind regards,

Martina Drvar

Vicegovernor