EBA – Loan Origination and Monitoring

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Thanks to a long tradition in the development of applications for the credit sector, FERNBACH can provide 'FlexFinance', a component-based solution that covers the whole process chain of lending operations, including loan origination, life cycle management, account processing, financial accounting, bank management, regulatory reporting and business optimisation.

This solution can be implemented and operated either in full or in part. The major advantage is that customers start with a module that is tailored exactly to meet their requirements, enhancing and optimising the existing infrastructure.

Thus, significant added value is generated in the shortest time possible and at manageable cost without having to implement a large-scale project. At a later date and when a customer considers it appropriate, other modules can be integrated in succession.

In this way, FERNBACH helps its customers to meet the requirements of the new EBA guidelines on loan origination and monitoring.

Guidelines on loan origination and monitoring

The EBA guidelines on loan origination and monitoring (EBA/GL/2020/06) introduce requirements for the credit assessment of borrowers.

The objective of these guidelines is to ensure that high-quality loans are granted in order to reduce the likelihood of new loans becoming non-performing in the future.

To this end, the guidelines define detailed governance arrangements for the granting and monitoring of credit facilities throughout the credit life cycle.

The EBA guidelines on loan origination and monitoring are divided into a total of eight chapters.

Compliance and reporting obligations Section 1	Subject matter, scope and definitions Section 2
Implementation Section 3	Governance requirements Section 4
Loan origination procedures Section 5	Pricing Section 6
Collateral Section 7	Monitoring framework Section 8

The implementation of chapters 4 to 8 is closely related to IT systems:

- Clarifying the internal governance and control framework for the credit-granting and credit decision-making process, building on the requirements of the EBA Guidelines on internal governance (chapter 4);
- Determining requirements for the collection of information and data on borrowers, documentation and requirements for the credit assessment of borrowers (chapter 5);
- Setting out supervisory expectations for the risk-based pricing of loans (chapter 6);
- Providing guidance on the approaches to the valuation of immovable and movable property collateral at the point of credit granting, and the monitoring and review of the value of such collateral, based on the outcomes of the monitoring (chapter 7);
- Specifying the ongoing monitoring of credit risk and credit exposures, including regular credit reviews of borrowers (chapter 8).

The main guidelines define requirements for assessing borrowers' creditworthiness, together with the handling of information and data for the purposes of credit decision-making and the assessment of credit risks.

Regardless of the business model and an institution's approach to risk adjustment, FlexFinance provides applications, whose scope of services covers the central aspects of the guidelines, for the various phases in the life cycle of a loan.

Figure: FlexFinance applications for the various phases in the life cycle of a loan

Data requirements

In FlexFinance, all data required for loan origination and ongoing monitoring are available in digital form. In addition to the extended set of data defined in annex 2 of the guidelines, all information on an individual customer relationship is available. This includes a complete overview of the credit risk associated with the client in question and the economic units to which the client belongs.

In addition, observations on previous payment behaviour are specified, as well as expectations of future payment behaviour, findings from the implementation of measures to improve credit quality ("monitoring forbearance") and the risk appetite of credit risk positions with similar characteristics.

Due to this integrated view of information and its availability "on

demand", FlexFinance is able to meet the EBA's requirements for system landscapes.

Processes/workflows

FlexFinance supports the life cycle of a loan by providing configurable processes and workflows. Credit decision-making processes can be tracked: All elements involved in such a process are made transparent: the decision-maker, the time as well as the information base. Processes used to identify an impending deterioration in credit quality monitor key indicators and related threshold values. Watch lists, task lists, notifications and resubmissions support the organisation of business departments. The high degree of automation increases process efficiency.

Figure: Notifications, work assignments

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Credit decision-making

In the guidelines, the EBA defines specific criteria for the granting of credit to consumers as well as businesses.

The FlexFinance Decision Engine links processes/workflows with the criteria defined by the EBA. This supports an automated credit decision-making process that avoids delays, reduces operating costs and implements strict detailed legal requirements.

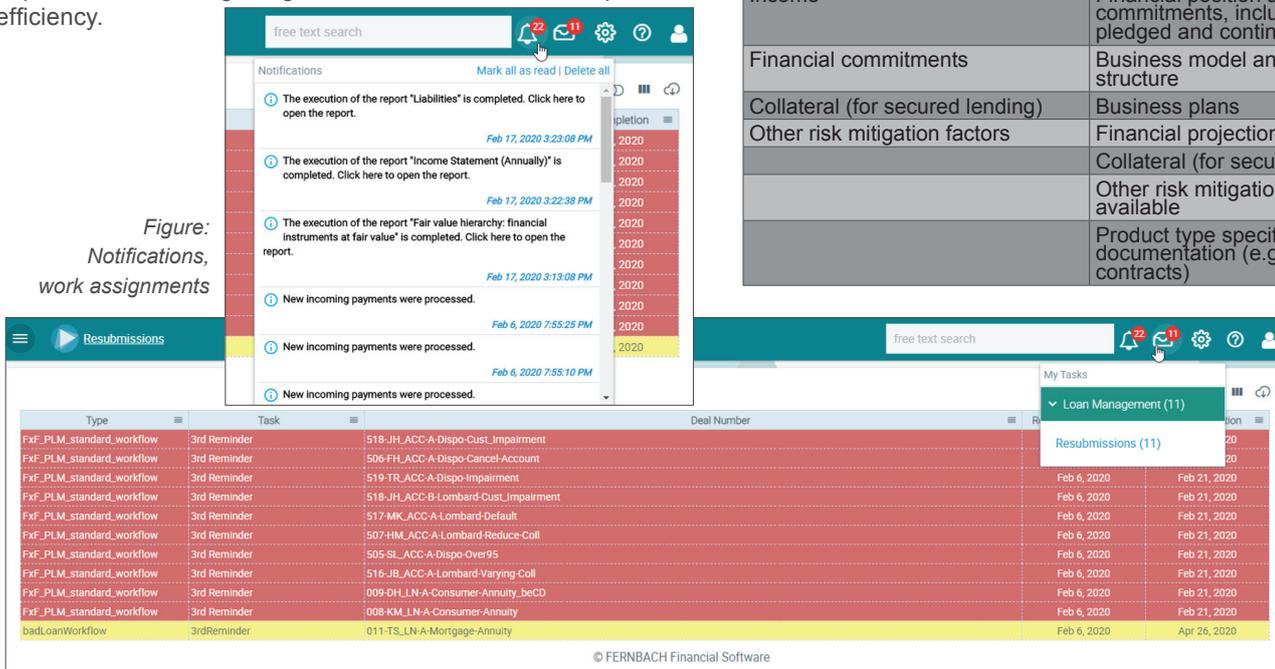| Lending to consumers	Lending to professionals
Purpose of the loan, where relevant for the type of product	Purpose of the loan, where relevant for the type of product
Employment	Income and cash flow
Income	Financial position and commitments, including assets pledged and contingent liabilities
Financial commitments	Business model and corporate structure
Collateral (for secured lending)	Business plans
Other risk mitigation factors	Financial projections
	Collateral (for secured lending)
	Other risk mitigation factors, where available
	Product type specific legal documentation (e.g. permits, contracts)

Table: EBA parameters for the lending decision

Using this set of tools, FlexFinance helps customers to implement the '3 lines of defence' approach called for by the EBA.

One element of this approach sets out a strategy for taking and managing credit risks when they are incurred.
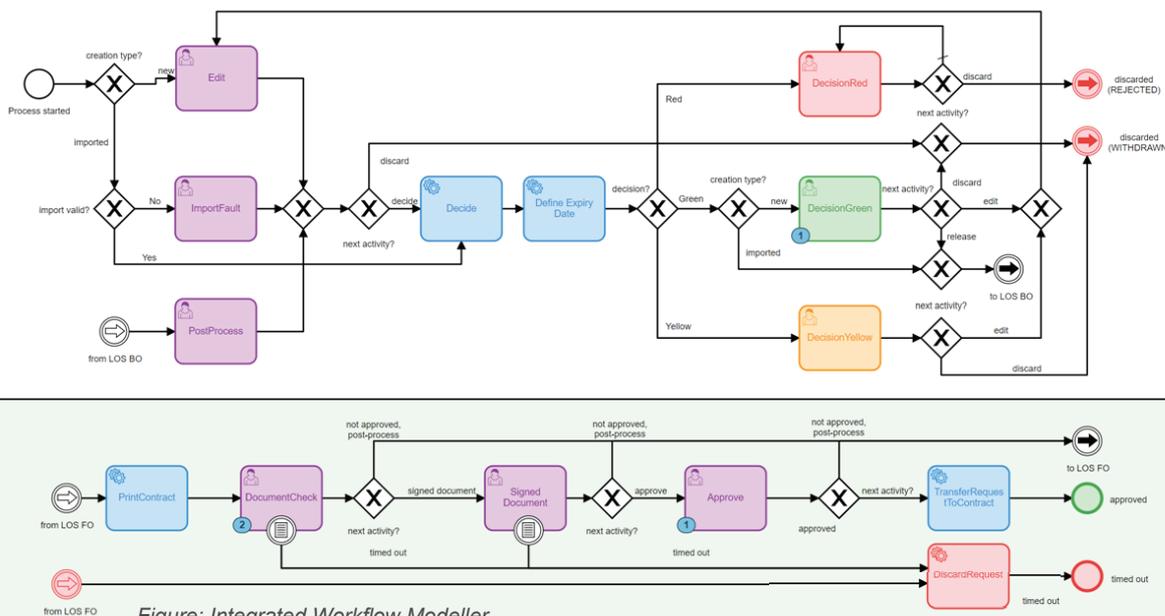

Figure: Integrated Workflow Modeller

A second element deals with controlling the processes involved in assuming and managing credit risks and for implementing risk management and compliance measures.

A third element focusses on regular monitoring activities regarding the stability and effectiveness of the credit risk monitoring framework and reviews the activities of the other elements.

Moreover, FlexFinance provides the expected probability of default for credit decision-making processes which is based on historical default information on loans with comparable risk characteristics and takes into account probability-weighted macroeconomic scenarios.

Credit monitoring

FlexFinance supports the monitoring of credit risk positions from different perspectives. On the one hand, the risk appetite of the various segments is monitored using default probabilities and expected credit losses.

A scenario workbench supports the simulation of the expected credit losses in different macroeconomic scenarios. Expected credit losses are available for consideration at both segment and individual loan levels.
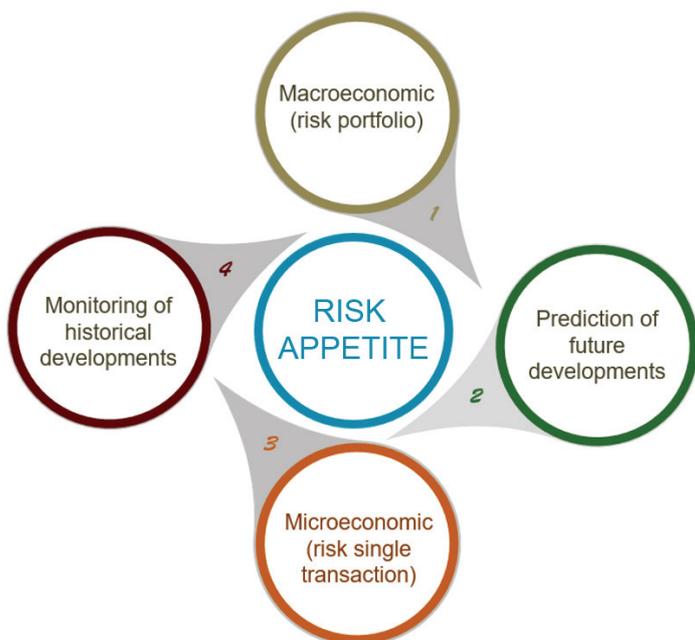

Figure: Forecast of risk appetite as a function of macroeconomic and microeconomic parameters

On the other hand, payment behaviour is monitored at microeconomic level. FlexFinance provides a comprehensive strategy for managing problematic loans which includes the following functions:
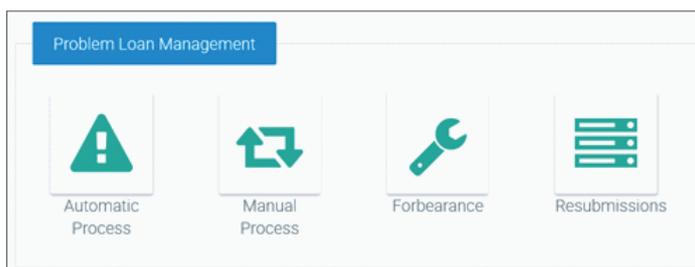
• Workflow-supported processing of problem loans

Figure: Various apps for Problem Loan Management

• Flexible reminder system based on both quantitative and qualitative key criteria

• Support of forbearance measures and flag for the forborne exposures

Figure: List of Forborne Exposures

• Flag for the non-performing exposures

An "early warning application", based on artificial intelligence, analyses and forecasts future payment behaviour. Thanks to the early detection of a deterioration in credit quality, this application is able to start workflows to initiate necessary countermeasures and thus avoid possible credit losses. In this context, loan officers receive an answer to their most important question:

'The loan is now 25 days overdue. What is the probability that the loan will default soon?'

Collateral

Collateral can be allocated to several loan commitments and/or drawings. Workflows and resubmissions can be used for initial valuation and for updating the valuation of collateral.

The valuation of collateral is linked to an internal or external assessor. A master record can be stored for assessors which contains information regarding the status of their independence, range of services, possible conflicts of interest and other information.

In accordance with the EBA guidelines, requests for valuation are triggered periodically or when there is a reduction in credit quality. As soon as a borrower's credit quality deteriorates significantly, a new valuation of collateral can be triggered and the time to liquidation can be updated.

Users can also define in the workflow the time when an assessor has to be replaced, e.g. for every third evaluation.

Forbearance and non-performing exposure (NPE)

FlexFinance supports the restructuring of non-performing loans in the Loan Management System. Among other things, the expectations regarding the recovery of the total claim are maintained and the necessary examination of the advantages of the measure or its significance is supported.

On the basis of this information, a loan is initially marked as a forborne exposure or a non-performing exposure.

The recovery periods defined by the EBA are also included in periodic monitoring.

Parameters such as the credit status (performing/non-performing) at the time when a forbearance measure is implemented, a customer's payment behaviour since the implementation of the measure and the significance of the measure are assessed.

Pricing

FlexFinance supports the modelling and implementation of a pricing approach based on behaviour when specific risk costs are calculated, taking into account the cost of capital, financing costs, expected (lifelong) credit losses as well as operating and administrative costs.
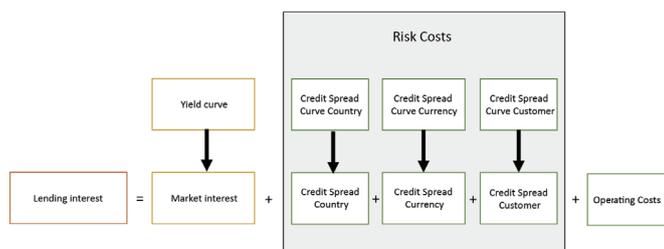

Figure: Consideration of behaviour-based risk costs during pricing in FlexFinance

The FlexFinance solution from FERNBACH will allow you to easily prepare for the challenges posed by the EBA guidelines. Depending on the business model in question, the EBA requirements for loan origination and monitoring can be implemented in automated processes – either in full or in part in addition to the existing lending applications (e.g. in the context of non-performing loans.)

About FERNBACH

FERNBACH is a group of medium-sized companies operating worldwide in software solutions and consulting. For the past thirty years, FERNBACH has enjoyed considerable success in the financial technology sector. A broad customer base, ranging from international financial institutions to regional private banks, relies on FERNBACH's solutions.

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