FAQ – Circular CSSF 22/824

Application of the Guidelines of the European Banking Authority on Loan Origination and Monitoring (EBA/GL/2020/06)

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Context

The present document refers to a first question and answer (Q&A) in relation to a specific aspect of the Circular CSSF 22/824 **Application of the Guidelines of the European Banking Authority on Loan Origination and Monitoring (EBA/GL/2020/06)** (hereafter "Circular"). The objective is to bring further clarity on the supervisory expectations of the competent authority.

This document will be updated when necessary and the CSSF reserves the right to adapt its approach to any matter covered by the Q&A at any time. You should regularly check the CSSF website in relation to any matter of importance to you to see if questions have been added and/or positions have been adapted.

Update information

29/03/2024	First publication

Question 1: Lombard loans being secured by diversified and liquid collateral, how should these loans be considered under the provisions of Circular CSSF 22/824?

Published on 29/03/2024.

Lombard loans are frequently used as a financial product in the context of private banking and wealth management activities. They are defined as loans collateralised by securities pledged for the benefit of the lending institution, which may enforce the pledge and sell the collateral in the case of a breach of the terms of the loan agreement by the borrower. The pledged securities must be sufficiently diversified and liquid.

In line with Part III of Chapter 5 of the Circular CSSF 12/552 (in particular, paragraph 33), institutions must apply all of the following requirements to Lombard loans:

1) Lombard loans acceptance must follow a credit decision-making process in line with section 4.4 of the EBA guidelines on loan origination.
2) The loan contract signed by the borrower must be sufficiently explicit and transparent on the characteristics of this type of loan, with margin calls that may be requested and sales of collateral securities by the institution as needed.
3) The pledged securities must be subject to prudent haircuts that comprehensively cover all risks and thus protect the lending institution from losses, even under severely adverse scenarios. The review of haircuts applied must be performed regularly.
4) The value and quality of the underlying collateral must be closely monitored (e.g. on a daily basis) and an early warning system must be in place to detect any deterioration of the collateral quality and value.
5) Effective procedures must be in place so that corrective measures, including margin calls and ultimately the liquidation of the collateral, are taken in a timely manner in order to shield the lending institution from losses if the collateral drops in value. The liquidation process of the pledged securities must thus be triggered in good time both from a legal and operational standpoint. In any case, liquidation should be triggered as soon as the debtor fails to meet the margin call obligations within the timeline set by the institution.
6) Financial collateral concentration at the level of the institution must be monitored, assessed (via stress testing), reported and mitigated.

In accordance with paragraph 97 of the EBA guidelines on loan origination, in the case of secured lending, collateral should be considered the institution’s second way out in case of default or material deterioration of the risk profile, and not the primary source of repayment, with the exception of when the loan agreement envisages that the repayment of the loan is based on the sale of the property pledged as collateral or liquid collateral provided.

The CSSF considers that Lombard loans at origination benefit from the exception as set forth in paragraph 97 of the EBA guidelines on loan origination, provided that they meet the criteria set out above.