



FINANTSINSPEKTSIOON

RESPONSIBLE LENDING REQUIREMENTS

The advisory guidelines have been established by decision no 1.1-7/ 62 of the management board of the Financial Supervision Authority.

1. Competence

1.1. In accordance with the Financial Supervision Authority Act (hereinafter: FSA) § 3, financial supervision is conducted in order to enhance the stability, reliability, transparency, and efficiency of the financial sector, to reduce systemic risks, and to promote prevention of the abuse of the financial sector for criminal purposes, with a view to protecting the interests of clients and investors by safeguarding their financial resources, thereby supporting the stability of the Estonian monetary system.

1.2. In accordance with FSA § 57 (1), the Supervision Authority has the right to issue advisory guidelines to explain legislation regulating the activities of the financial sector and to provide guidance to subjects of financial supervision.

2. Scope of regulation and objective

2.1. In accordance with § 83 (3) of the Credit Institutions Act (CIA) § 83 (3), upon granting loans, a credit institution is required to observe the main internal crediting principles of the credit institution, the principles of sound banking management, and responsible lending.

For observance of the principle of responsible lending, a credit institution is required to collect and store information on the size of the financial obligations of and performance of payment obligations by the clients and to use such data to calculate a reasonable loan load for the clients.

2.2. Pursuant to CIA § 89 (3¹), a credit institution is required to inform a client of the dangers related to the taking of loans.

2.3. The objective of the guidelines is to explain the requirements in CIA § 83 (3) and § 89 (3¹), which creates preconditions for an increase in transparency of the service and the guidelines help the client better understand the essence of the service and the standard of the relevant professional activity, which in turn create larger preconditions for avoiding any potential disputes in exercising rights and performing obligations in good faith under the framework of legal relationship.

3. Scope of application

3.1. The guidelines shall apply to credit institutions, branches of credit institutions that have the operating licence in Estonia, and cross-border service providers in Estonia (hereinafter: credit institution) upon conclusion of consumer credit and mortgage loan agreements.

3.2. The guidelines shall apply to the preconditions for granting a loan, such as the performance of loan analysis, calculation of a reasonable loan load, the making of a loan offer, submission of pre-contract information and warnings, etc.

3.3. Upon application of the guidelines, the requirements arising from the legislation, mainly the Law of Obligations Act, shall be taken into consideration. Upon any imperative requirements arising from the legislation, the provisions of the legislation shall be adhered to.

3.4. The guidelines are limited to the area of regulation of these guidelines and to the objective thereof, and they shall not apply to other general rights and obligations under the law of obligations and shall not impose any other restrictions on application of the principle of contractual freedom.

4. Definition and scope of responsible lending

4.1. The principle of responsible lending is an expression of socially responsible behaviour of a credit institution in the loan market.¹ For a credit institution, it means the submission of pre-contractual information and warnings to clients as well as the calculation of a reasonable loan load in order to help create the conditions necessary for the client to assess whether the assumed loan or credit relationship is appropriate to the personal borrowing interest and financial situation and to estimate any risks related to the borrowing.

4.2. In general, the loan and credit relationship between the lender and client is not fiduciary relationship (the parties do not have any duty of care and loyalty towards each other). In the case of consumer credit, a credit institution shall give a client sufficient explanations based on which the client can assess the appropriateness of an offered consumer credit contract to his or her needs and economic condition. If necessary, the credit institution shall explain to the client the pre-contractual information the submission of which is mandatory, the main conditions of the offered consumer credit contracts, and any potential specific impacts thereof, including the consequences of violation of the repayment obligation by the client. The existence of the explanation obligation or the granting of such an obligation shall not render a credit institution, with regard to the client, a mandatary or any other similar person enjoying a special position of trust to choose and decide on a loan or credit relationship that is most appropriate to the client.

4.3. For observance of the principle of responsible lending, a credit institution shall act as follows based on the legislation and these guidelines:

4.3.1. For observance of the principle of responsible lending, a credit institution is required to collect and store information on the size of the financial obligations of and performance of payment obligations by the clients and to use such data to calculate a reasonable loan load for the clients.

4.3.2. Shall submit information on the significant conditions of a loan agreement (CIA § 89 (3));

4.3.3. Shall inform of the dangers related to the taking of loans (CIA § 89 (3¹)).

5. Credit institution's degree of care upon application of the responsible lending requirement

5.1. Observance of the responsible lending requirements with due care cannot be regarded as a guarantee of a positive result with regard to the subsequent solvency of the client. Risks related to the granting and taking of loans are intrinsic and unavoidable to some extent; therefore, even the best demonstrated care might not lead to a positive result for the client, nor does any subsequent solvency of the client qualify by default as negligence by a credit institution.

5.2. Upon compliance with the responsible lending requirement, the activities of a credit institution cannot be qualified as a violation of the responsible lending principle in a specific loan relationship, if it concerns circumstances which are beyond the direct control of a credit institution and the related risks are intrinsic to the taking of loan, or if the credit institution could not and had not foreseen (e.g. subsequent solvency of the client is caused by the general aggravation of the economic environment, loss of/decrease in the client's earnings, decrease in

¹ Explanatory memorandum to the Credit Institutions Act and the draft Act on Amending the Financial Supervision Authority Act. In the computer network:
<http://web.riigikogu.ee/ems/saros-bin/mgetdoc?itemid=063110011&login=proof&password=&system=ems&server=ragne11>.

other income of the client, decrease in the market value of the collateral assets, additional financial liabilities later assumed by the client, the concealment of the actual borrowing interest and financial capacity by the client, etc.).

5.3. Upon application of the responsible lending principle, a credit institution has a right to assume that the client knows its borrowing objective and financial condition, and that the client submits to the credit institution correct information on its interest and financial condition.

6. Liability of the client

6.1. The taking of the loan shall be decided by a client who shall assess the appropriateness of the loan product and conditions, based on the supplied information and warnings, for his (her) personal borrowing interest and financial condition, and shall be liable for any consequences resulting from the conclusion of the loan agreement.

7. Scope of information to be collected and submitted

7.1. The content of information to be collected from and submitted to the client for compliance with the responsible lending requirements may depend on the amount of loan, peculiarity of the loan product, and the borrower. A credit institution may optionally adjust the recommendations of these guidelines if it is not contrary to the provisions of the legislation, and it is expedient, substantiated, and reasonable, taking into account the amount of loan, the peculiarity of the loan product, or any other circumstances that characterise the conclusion of a specific loan relationship.

7.2. The use of the options specified in clause 7.1 may not lead to a situation where, as a result thereof, a credit institution does not assess significant circumstances upon calculation of a reasonable loan burden or a client is deprived of information or warnings that might significantly influence the client's decision on the conclusion of a loan decision.

8. General requirements for a credit institution upon application of the responsible lending requirement

8.1. For observance of the requirement of responsible lending, it is necessary that the organisational structure of a credit institution, transparency of the area of liability as well as the knowledge and skills of managers and the activities based thereon comply with the provisions of the legislation.

8.2. A credit institution is required to ensure that loan administrators and other employees and representatives of the credit institution participating in the lending process (hereinafter: employees) would have the competence required for such activities at all times.

8.3. A credit institution shall establish internal rules to ensure that the employees directly related to the granting of the loan shall act in an environment where they are fully aware of the legislation regulating responsible lending and the requirements of these guidelines, and shall assess the efficiency of such internal rules and shall exercise internal control over compliance therewith.

8.4. According to the internal rules, a credit institution shall hedge and avoid any conflicts of interests where the bases for remuneration of managers and employees related to the granting of loans would encourage them to waive observance of the principles of responsible lending or make any concessions in that respect.

9. Requirements for calculation of a reasonable loan load

9.1. For better management of its risk, a credit institution shall calculate a reasonable loan load for a client before the conclusion of a loan agreement. The client shall assess the appropriateness of the loan product for his (her) interests and financial condition.

9.2. For the purposes of these guidelines, the calculation of a reasonable loan load is an activity during which the client's capacity to service an obligation arising from a specific loan contract in

a sustainable manner is determined. Upon calculation of a reasonable loan load, the credit institution shall take into account the circumstances related to the client and the information that the client has supplied to the credit institution and that is applicable in the period when a loan decision is being considered. The assessment of the sustainability of the client's solvency does not involve the foreseeing of the circumstances specified in clause 5.2 hereof unless the collected information clearly refers to a decrease in solvency, which poses a threat to the sustainable servicing of the loan.

9.3. On the basis of the information primarily received from the client, but also from reliable sources without any active enquiries by the credit institution, and on the basis of information enquired from other sources upon a specific decision of the credit institution (without any direct or indirect obligation of the credit institution to make such a decision with regard to the client), the credit institution shall assess whether:

9.3.1. The client is able to repay the loan from its own earnings (taking into account the amount of the client's earnings);

9.3.2. On the basis of the circumstances that are known to the credit institution in the period when the loan decision is being considered, it may be assumed that the client's solvency will be sustainable in the foreseeable future;

9.3.3. The client's loan servicing capacity exists despite his (her) existing financial obligations.

9.4. Upon calculating a reasonable loan load, a credit institution shall take into account, *inter alia*, if possible:

9.4.1. Differences arising from different loan products;

9.4.2. The amount of the obligation related to credit (mainly the principal part of the credit and the interest repayment obligation) and the related risk for the client;

9.4.3. The client's financial situation upon submission of a loan application;

9.4.4. The client's previous behaviour upon performance of financial obligations;

9.4.5. The client's existing financial obligations;

9.4.6. Any changes in the client's financial situation of which the credit institution is aware.

9.5. For the purposes of these guidelines, the sustainable servicing of loan means the servicing of a loan:

9.5.1. From the earnings or savings of the client, without a need to collect the collateral or other assets of the client, except when the subsequent collection of the collateral is an intrinsic component of the product due to the nature of the loan product;

9.5.2. The client is able to perform other financial obligations assumed earlier by him or her;

9.5.3. Without a need to assume any additional financial obligations (loans) to service the existing loan.

9.6. The following acts and omissions shall not be deemed to be in compliance with the responsible lending requirement:

9.6.1. The credit institution does not establish any internal rules for calculating a reasonable loan load;

9.6.2. The credit institution does not maintain a loan file for the information and documents collected for calculation of a reasonable loan load;

9.6.3. The credit institution does not carry out the calculation of a reasonable loan load in each specific occasion before making a loan decision;

9.6.4. The credit institution does not apply sufficient measures to ensure the existence of sufficient information necessary for the calculation of a reasonable loan load of a client before the adoption of a loan decision;

9.6.5. Upon making a loan decision, the credit institution primarily or only takes into account the value of the assets established as a collateral, except when the subsequent collection of the collateral is an intrinsic component of the product due to the nature of the loan product;

9.6.6. The credit institution makes a positive loan decision although it is known or should have been known, as a result of the calculation of a reasonable loan load, that the client is unlikely to

be able to sustainably perform the contractual obligations and the credit institution did not warn the client of such a situation;

9.6.7. The credit institution advises to increase or refinance the existing financial obligations up to the level where the client is not able to sustainably perform the obligations;

9.6.8. The credit institution recommends a loan product to the client that involves a higher cost (mainly interest) than the client has initially wished and, as a result of the calculation of a reasonable loan load, it is known or should have been known that the client is unable to sustainably service the loan;

9.6.9. A credit institution accepts the loan application of a client although it is aware that the client has submitted incorrect information in the loan application or has concealed any data;

9.6.10. The credit institution induces the client to submit wrong information in the loan application;

9.6.11. The credit institution distorts, at its own initiative, the data in the loan application that underlies the calculation of a reasonable loan load.

10. Requirements for information submitted to clients and notification of threats related to the taking of loan

10.1. If a client has expressed a wish to conclude a loan agreement, at the pre-contract stage a credit institution shall notify the client of the content of the obligation and the contract to be concluded. The credit institution shall give the client explanations (while avoiding excessiveness) that help the client to make an informed loan decision.

10.2. In addition to the provisions of the Standard European Consumer Credit Information, for compliance with the requirement of responsible lending and the obligation of submission of warnings provided for by the legislation, it is important to make emphasised references to the following threats related to the taking of a loan:

10.2.1. Creation of expenses related to the amount of loan repayments and the contractual credit (mainly the principal amount and interest to be paid) - a credit institution shall pay special attention to loan agreements with a variable interest rate and warn the client against any potential risks related to a change in the interest rate;

10.2.2. The rates of penalties and fines for delay applicable upon violation of the payment obligation;

10.2.3. The conditions of the contract which may lead to negative consequences for a client which the client is unlikely able to foresee (incl. a possibility for demanding an additional collateral in the case of a decline in the real estate prices, any additional expenses in the case of a claim for a fine for delay, etc.);

10.2.4. The main consequences which arise from the violation of the obligations, including potential commencement of enforcement or bankruptcy proceedings and the sale of the pledged object, if it is a likely consequence;

10.2.5. The consequences of exercising the contractual right to cancel the agreement and the circumstances which serve as a basis for cancellation of the agreement by a credit institution;

10.2.6. The risk of a decrease in the client's solvency in the future which may result from a decrease in the client's earnings (e.g. the job loss, a decrease in earnings, etc.) or an increase in expenses.

10.3. A credit institution is required to advise the client to thoroughly consider all the aforementioned circumstances and submit the above explanations to the client.

10.4. A client institution is required to provide the client with the possibility to submit questions on the conditions of the agreement. A credit institution shall explain to the client as to how the client may receive additional information and explanations should the client have any further problems in understanding significant circumstances related to the loan agreement.

10.5. The fact that the client does not want to receive the information and explanations specified in clause 10.2 hereof shall not release the credit institution from the obligation to offer such

information and explanations. A credit institution may not influence the client to waive his (her) right to thorough explanations.

10.6. The following acts and omissions shall not be deemed to be in compliance with the responsible lending requirement:

10.6.1. The credit institution shall not submit to the client the information specified in clause 10.2 hereof;

10.6.2. The credit institution does not establish internal rules for communication to the client of the pre-contract information and information concerning the threats related to the taking of loan;

10.6.3. In the explanations, the credit institution does not refer to the contractual conditions that may lead to negative consequences for the client;

10.6.4. Before conclusion of a loan agreement, a representative of the credit institution gives the client promises (e.g. concerning the possibility to amend the agreement in the future, etc.) although there is no certainty concerning their fulfilment or which the credit institution does not later enable to the client;

10.6.5. The credit institution does not warn the client against any potential consequences related to violation of the contractual obligations by the client and delay in performance of payment obligations;

10.6.6. The credit institution does not advise the client to carefully consider the information and explanations submitted to the client and ask any additional questions if necessary;

10.6.7. The credit institution influences the client to conclude a loan agreement within an unreasonably short time period without the client being able to assess the information received during the pre-contract negotiations;

10.6.8. A credit institution submits incorrect information and explanations to a client although the credit institution knows or should know that that the submitted information and/or explanations are incorrect.

11. Requirements for collection of information

11.1. A credit institution shall collect information, which serves as a basis for making a loan decision, from a client who is required to submit to the lender all the relevant information necessary for making the loan decision and, if possible, also from sources other than the borrower. From the latter source, the credit institution shall collect information per judgement and decision, and, should such a decision not be made, it does not imply any direct or indirect obligation of the credit institution to actively collect information concerning the client from any sources other than the client.

11.2. If possible, in addition to the information received from a client, a credit institution shall also assess the data received from official registers and other sources, e.g. land register, online credit information, and independent real estate appraisers.

11.3. Upon requesting a property appraisal report when giving a mortgage loan, a credit institution is required to analyse a document concerning the professional property (collateral) appraisal submitted by a client to the credit institution, which itself and the content of which correspond to the applicable appraisal standards and methods. The credit institution shall inform the client beforehand of more than one service provider who in the opinion of the credit institution shall prepare the documents specified in the previous sentence. Such a service provider shall be deemed to be a mandatary of the credit institution for fulfilment of the duty to prepare the aforementioned document only if the credit institution, client, and such service provider have so expressly agreed upon.

11.4. A credit institution shall ask the client to supply to the lender, whether orally or by filling out a relevant questionnaire, all correct and relevant information in relation to the client's loan application.

11.5. A credit institution shall apply necessary measures to assess all the information submitted by the client, taking into account the restrictions arising from the personal data protection regulation.

12. Final provisions

12.1. The guidelines shall enter into force as of 1st July 2011. Clause 12.3 of the guidelines shall enter into force as of its adoption.

12.2. The advisory guidelines of the Financial Supervision Authority “Requirements for pre-contract information to be disclosed for housing loan” shall be declared invalid as of 1st July 2011.

12.3. By submission to a client of the information specified in the Standard European Consumer Credit Information, the requirements of the advisory guidelines of the Financial Supervision Authority “Requirements for pre-contract information to be disclosed for housing loan” shall be deemed to be fulfilled by a credit institution.

