**Small and medium-sized enterprises (SME) Loans Due Diligence Questionnaire** [November 2019 Version]

**–** *Name of**Participant MM/DD/YY*

This Due Diligence Questionnaire (DDQ) forms part of the eligibility process for Participants wishing to positon SME loan pools as collateral with the Bank of England. Answers will be used to inform the Bank’s discussions with Participants on site visits or annual review conference calls.

Due Diligence Questionnaire Guidance

* **Answers to questions should cover all asset types** being discussed as part of the review. If necessary, split your responses to each question into sections to ensure each asset type is adequately covered.
* **Participants should answer all applicable questions with a written response for each**. Whilst Participants may mention a supporting document there should always be an explicit answer to each question provided. This enables the Bank to track changes between reviews.
* **For subsequent reviews, the DDQ should be** **black lined versus the last submission.** This will ensure visits/conference calls focus on changes and minimise any repetition of previously discussed topics.

Supporting Documents

The following documents should be uploaded to the Portal alongside the questionnaire:

* **Lending policy** (including a log of recent changes).
* **A copy of, or specific details of, any affordability models** you may use as part of your underwriting process.
* **Arrears and forbearance policies**.
* **Two recent MI/Board/Risk committee packs covering the asset types being reviewed** (these should provide management information on the risk characteristics of the loan book, origination controls, risk register/limits etc). Please also submit the minutes for each of these meetings.
* **List of all internal audit reports issued since the last visit (or in the case of new participants in the last five years (or 2 internal audit cycles)).** This should include the titles and ratings for each one (focus should be on audits covering systems, processes and controls within underwriting, loan origination, securitisation (if relevant), portfolio monitoring and risk management). Once reviewed the Bank will then specify which reports it would like to be submitted.
* **Performance data:** Annualised loss (default) data over the past 7 years (or as many years as possible).
* **BoE data tape glossary –** This document should highlight any instances of non-compliance with mandatory fields or particular definitions versus the Bank’s published data tape requirements.
* Any other additional documentation requested by the Bank on a per Participant basis.

Declaration

By submitting this questionnaire, [Name of the participant] confirms that the questionnaire has been completed to the best of its knowledge and the responses have been reviewed prior to submission. [Name of participant] acknowledges that any information found to be incorrect or misleading may result in re-assessment of eligibility resulting in the proposed portfolio being rendered inadmissible as collateral.

**Name:**

**Date:**

1. BoE Collateral Plans
   1. Details of individuals at the Participant responsible for managing collateral positioned with the Bank. These should cover individuals responsible for the funding strategy, data reporting and the payment of legal bills.

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| --- | --- | --- | --- |
| **Name**  *(plus job description)* | **Email Address** | **Phone number** | **Address** |
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* 1. Details of the Participants expected use of BoE schemes over the next twelve months (drawing/repayment plans).
  2. What collateral changes are expected to facilitate this (i.e. top ups, new pools)? Include information on expected values and timings. How does this interact with projected amortisation of existing pools?
  3. What funding plans does the Participant have to repay drawings made in the Term Funding Scheme/Funding for Lending Scheme?

1. Strategy, Outlook and Competition

**Strategy**

* 1. Details of the Participant’s general business (including origins), overall business strategy and any recent or planned changes.
  2. What are the general characteristics of the SME business, please include a section on each of:
     1. Highlights of the Participants financial performance within the SME business over the last year including market share, profitability, gross and net lending growth rates;
     2. Details of the organisational and management structure of the SME lending business, including any anticipated changes and the tenure/experience of key management personnel;
     3. Strategic goals for the SME business including the Participant’s origination strategy (e.g. Who is the target market? What is the Participant’s unique selling point? Are originations broker led, price driven, service driven etc?);
     4. Key risks around the SME strategy with reference to the industry segments in which you operate. Specifically, how these views are incorporated in the origination, underwriting and risk management of SME loans;
     5. The Participant’s view of the current state and future outlook of the domestic banking sector in terms of trends and growth areas and how this may affect their business; and
     6. Details of any projects currently planned (including cost-cutting or headcount reductions which may affect the business).

**Outlook and Competition**

* 1. What are the Participant’s growth targets for total SME assets? Please provide a split across different SME products where relevant (such as industry or borrower type)?
  2. How does the Participant intend to meet these growth targets?
  3. In the event these growth targets are not being met, what options does the Participant have at its disposal to facilitate increased growth?
  4. What are the biggest current and future threats to growth?
  5. Who are the Participant’s main competitors in the SMEmarket?
  6. In the last 12 months has the Participant entered into any new SME product areas? Please give details regardless of whether or not the Participant intends to include them in pools positioned with the Bank of England.
  7. In the next 12 months, is the Participant planning to enter any new SME product areas? Please give details regardless of whether or not the Participant intends to include them in pools positioned with the Bank of England.
  8. Detail the Participants approach to pricing SME loans. Including any methodology and the governance process for approval.
  9. How do you expect that climate change might affect your firm and the wider market?

1. Underwriting and Origination

**Distribution**

* 1. Details of the Participant’s marketing strategy and the distribution of its lending products (for instance, by branch network, authorised intermediaries, relationship managers and/or telephone sales), including;
     1. What is the split of originations through different origination channels, and how has this changed over the past five years?
     2. Details of the degree of discretion that relationship managers have in determining risk appetites and loan decisions.
     3. Please provide a description of the procedure used by a relationship manager when first assessing potential lending.
     4. Which intermediary networks are used?
     5. Details of how the intermediary panel is managed, including;
        1. What is the process for admission to the intermediary panel?
        2. What monitoring is done as to the quality of loan applications arriving from individual intermediaries?
        3. What monitoring is done with respect to the performance of loans deriving from a particular intermediary?
        4. How many brokers have been removed from the intermediary panel in the past three years, and for what reasons?

**Underwriting Approach**

* 1. Full details of underwriting policies and procedures in place at the time of origination for the proposed loans to be submitted to the Bank, including;
     1. Details of underwriting staffing, including; location, headcount, training policies, average experience/tenure.
     2. What are the mandate levels for underwriters?
     3. How is the performance of underwriters managed?
     4. What training is provided for new underwriters and how is their performance tracked and monitored through time?
     5. What checks are carried out to ensure consistency of underwriting across the business and with lending policy? Please detail any quality assurance checks completed by the first line including: sample sizes, frequency and the governance process for reporting on findings.
  2. Outline the underwriting process from an application being received to a decline or offer being released. This should detail the different teams involved, systems or scorecards used and how data is captured during the different stages of the process.
     1. How manual or automated is the underwriting process? At which stages are automated processes used? What proportions of loans receive no manual review?
     2. Are there any differences on account of the origination channel?
     3. What is the average time to offer from a completed application being submitted? Does the Participant have any targets which performance is monitored against?
     4. Please provide information on the accept/decline rates at the following underwriting stages (where applicable): Decision In Principal, Underwriting, Senior mandate referral/Credit Committee.
     5. What models and scorecards are used in making credit decisions (including credit scoring models)? How often are these reviewed? Please detail changes made over the last year and the rationale for them. Outline the governance process followed to agree these.
     6. Full details of the Participants record management approach for underwriting documentation.
     7. Full details of any insurance products taken out by the Participant in relation to SME originations (e.g. title insurance). Who provides these policies? Would these policies pass to the Bank of England in the event of the Participant defaulting?

**Lending Policy**

* 1. Outline the governance process followed to make changes to the SME lending policy. Please outline any changes made over the last 12 months.
  2. Outline the Participants approach to exceptions to lending policies, including:
     1. Are exceptions to lending policy allowed?
     2. What is the sign off process for exceptions and how is the decision rationale recorded or flagged in systems?
     3. What proportion of the Participant’s book is an exception (percentage by number/loan balance)? What proportion of originations over the last 12 months were exceptions? Is there a limit to the value of exceptions permitted?
     4. What are exceptions permitted for?
  3. Please outline any track record requirements borrowers are required to pass (i.e. minimum business history)
  4. Please outline the customer due diligence process or checks undertaken on borrowers prior to a lending decision including anti-fraud, anti-money-laundering and know your customer.

**Affordability Model**

* 1. Full details of affordability assessment policies in place at the time of origination for proposed loan pools (incorporating changes over the period to date), including;
     1. How is affordability assessed? What are the affordability pass/fail thresholds?
     2. What expenditure items are taken into account when assessing affordability and how are these evidenced? How much value is given to each item?
        1. If statistical expenditure data is used, what is the source? How often is this updated?
        2. If an internal source, on what basis have these figures been calculated? If external, to what extent have you amended or excluded any underlying expenditure categories?
     3. What is the stressed interest rate used in the affordability assessment and how is this agreed/updated?
  2. What evidence is acceptable to verify income?

**Valuations**

* 1. Full details of valuation policies in place at the time of origination for proposed loan pools (incorporating changes over the period to date), including;
     1. What applications were subject to full valuations, automatic valuation models (AVM’s), indexed valuations and ‘drive by’ valuations?
     2. Who carries out property valuations (including AVM’s, indexed valuations and ‘drive by’ valuations)?
     3. Are there any restrictions (such as property type / LTV) to using AVM’s, indexed valuations or ‘drive by’ valuations?
     4. How are AVM confidence intervals taken into account when assessing the valuation?
     5. How is the valuation panel managed for fraud?
  2. Details of indexation used for monitoring current LTV levels within the book including index(es) used and frequency of update.
  3. How often does security go through a full re-valuation during the term of the loan?
  4. Are climate related risks taken into consideration as part of your valuations? If yes, how?

1. Risk Management, Monitoring and Controls
   1. Full details on the structure of the risk management division within the organisation, including number of people, previous SME experience and tenure.
   2. Outline the Participants risk management framework and how this applies to the SME business.
   3. Describe the risk function’s activities:
      1. Does the Participant have risk resources devoted to SME credit risk? Is this split per product line or shared with other areas (such as personal loans)?
      2. How is the quality of SME originations monitored within the risk function?
      3. Define the Participant’s credit risk appetite. Outline how this was determined, approved and embedded within the organisation. How does the Participant ensure it is adhered to?
      4. Detail the analytical approach to evaluating credit risk in different SME sectors/industries.
      5. What kind of stress testing does the Participant carry out on its lending book? What levels of loss provisioning does it have and how does it come up with these?
      6. Does the risk function have oversight/ownership of the firm’s lending criteria and policies?
      7. Does the risk function have full control over the specification, development and maintenance of the credit models/scorecards/affordability models?
      8. What is the role of the risk function in live underwriting decision-making?
      9. How does the risk function set, monitor and enforce risk policies on broker, valuation, and application fraud?
      10. Describe the process by which observed problems with underwriting or servicing observed by Risk Management are fed back to the relevant front or back office in terms of changing criteria, procedures. Give examples of where this has occurred in recent years.
   4. What are the main committees responsible for risk management of SME lending and how do they interact? For each group, please provide detail on;
      1. Membership of the group
      2. Terms of reference of the group, including areas of responsibility (e.g. setting lending policy, monitoring MI)
   5. Provide a summary of the MI and risk limits used to monitor the SME book. How are book triggers/limits agreed? Outline any changes to limits made over the last year.
   6. How does the Participant consider concentration risk within the SME book? Including large exposures, geographic and employer concentration.
   7. Detail any developments to the risk function over the last year. What is planned for the next twelve months?
   8. Details of any discussions or actions taken by regulators against the relevant risk management or credit rating systems in the past five years.
   9. How is your firm incorporating the risks from climate change within your risk management framework?
2. Servicing, Arrears and Foreclosures
   1. Details of servicing staff, including location, headcount numbers, training policies and average tenure/experience levels;
   2. Details of servicing operations and policies, including;
      1. Please provide a breakdown of the percentage of accounts paid by direct debit, standing order or other payment methods.
      2. Are all first payments made within 30 days of the advancement of funds, or is there scope for borrowers to roll partial payments into month two or other arrangements such as payment holidays for initial payments?
      3. Details on the frequency of credit reviews and covenant compliance testing. Including details of the parties responsible for carrying out these reviews and what management oversight and reporting is conducted.
      4. What proactive credit management is done of borrowers before accounts are in arrears?
   3. Details of the collections process, including;
      1. What are the key milestones for an account as it passes through the collections process?
      2. Are accounts with different risk characteristics subject to different collections strategies?
      3. Outline the level of automation within the servicing process. How are arrears cases tracked? How does this link to the core SME system?
   4. Details of forbearance policies in place and forbearance options that are available to borrowers;
      1. Provide management information showing the current and historic levels of forbearance arrangements in place and the effectiveness of forbearance arrangements;
      2. Are accounts with forbearance options still counted as in arrears? Does this include where forbearance was applied prior to an account missing any payments?
      3. Outline the governance process used to agree forbearance.
   5. Details of contingency plans in place to deal with increases in arrears and collections. What flexibility does your current arrears strategy provide for any unforeseen changes and how would you approach altering staffing levels?
   6. Please detail how the performance of the overall book provided is expected to compare to the performance of the pools being positioned.
   7. Outline the actions taken when covenant breaches are identified. What further actions are taken when borrowers are unable to correct a breach?
   8. Detail the penalty interest rate charged when a loan is in arrears/default.
   9. Description of any anticipated events which may impact the ability to administer the portfolio of SME loans on behalf of the Bank, including any changes in the costs of servicing or compliance with laws and/or regulations;
   10. Details of any outsourcing arrangements that may impact the SME business. This should include information on the day to day management of the outsourced relationship, summary of any service level agreements which have been agreed, details on any mandates for decision making held by the outsource entity, linkages with the Participants core SME systems and information on contract termination;

Interest Only Loans (if applicable)

* 1. Outline the Participants interest only servicing strategy.
     1. How frequently does the participant contact borrowers in the lead up to maturity?
     2. What was the response rate from the most recent exercise?
     3. What proportions of borrowers do not have a repayment plan in place?
     4. What is the participants approach to tackling the risks associated with borrowers with no plan in place? What forbearance options are used to address this?
     5. How is the performance of Interest only loans past maturity monitored and how long does the Participant allow before initiating repossession?
     6. On average, what proportion of interest only loans fail to repay the bullet payment by the scheduled maturity date? On average how long do these borrowers take to make the make such a payment?

1. IT Systems and Reporting

**IT Systems and Processing**

* 1. Provide an overview diagram showing the IT systems (including interfaces) used to capture the end to end process for SME loans. For each system summarise its function. Please flag any that are now legacy systems or in the process of being replaced.
     1. The diagram should include processing timelines, details of the software used, the flow of data between systems and key processing controls (e.g. verifications reconciliations, exception reports, checks around data amendments and overwrites).
  2. For business and IT staff, please summarise what controls are in place around system access / roles, user administration and to maintain segregation of duties across IT systems?
  3. How is data input into systems checked (e.g. at loan origination)?
  4. Do all product switches remain in the pool? How are these reported in the data tapes? (i.e. does the static data, including origination date, change?)

**BoE Data Reporting**

* 1. Outline the controls in place to ensure compliance with the Bank’s eligibility criteria will be achieved on an ongoing basis.
  2. How will the portfolio of SME loans to be used as collateral in the SMF be readily identifiable and separable from the rest of your portfolio?
  3. How are the cash flows from positioned collateral identified and reconciled in your systems? Is there a specific collection account receiving cash flows from SME loans used as collateral? Could they be easily segregated from other cash flows received?
  4. Please provide a diagram showing the process for compiling the Loan Data tapes including:
* Timeline of the process from start to finish – how long does it take in total?
* Indications of all IT systems involved.
* Description of the key controls in place stating whether they are manual or automated (e.g. data validation and plausibility).
* Outline the controls around data amendments / overwrites. What audit trail is in place to monitor this?

**Resources/Support**

* 1. Outline a brief description of the IT Department including staff numbers, location and skills profile?
  2. Explain the support arrangements for the IT systems used in the SME business, including any outsourced / offshored IT.

**Standby / resilience**

* 1. Outline the provision of any disaster management system. What plans does the Participant have in place to deal with unexpected events? How often are they tested?

**Managing Change**

* 1. Please provide information about any planned major changes to the IT systems used for loans reporting and processing in the next 2 years.
  2. Please give an overview of the IT Change Management process including governance, planning, process implementation and deployment and the key staff involved.

1. Audit, Regulation and Ratings
   1. Provide a summary of the internal audit function (including experience and tenure). Is the function outsourced? Is co-sourcing utilised?
   2. How is the audit plan decided?
   3. How are actions tracked and monitored? How are actions closed? What steps are taken when actions are not remediated appropriately?
   4. Details of any action taken by regulators against the SME business or any of its employees in the past five years;
   5. Information about any disputes or issues raised by the *external auditors* that would affect the SME lending business or any transaction under the SMF;
   6. Details of any contingent liabilities, including those which the *external auditors* agreed not to disclose in the latest financial statements, that could impact the SME lending business;
   7. Description of any changes to accounting policies or other accounting changes proposed or contemplated which could impact the SME lending business or any transaction under the SMF.
2. Legal
   1. Details of the number of legal templates which are used in the loan agreements and how these have changed over time.
   2. Please provide details regarding whether the templates used are standardised or have the possibility of being customised for each borrower. If applicable, please outline the process for agreeing amendments and the frequency in which they have been agreed over the last five years.
   3. Description of any pending, threatened or anticipated litigation that, if decided adversely, would impact the SME lending business.
   4. Schedule 6 of the Bank of England’s Loans Assignment Annex and Schedule 4 of the Bank of England’s Loans Declaration of Trust Annex[[1]](#footnote-1) both include representations and warranties to be made in respect of each loan in the proposed portfolio.
      1. For new pools, please confirm that the Participant is able to satisfy these representations and warranties.
      2. For pools currently pre-positioned with the Bank but unencumbered (i.e. not securing any drawings), please confirm the Participant is currently able to satisfy these representations and warranties.
   5. Please confirm that you have a record of and have retained a copy of each set of standard loan documentation (including terms and conditions) and for each type of loan in the portfolio.
3. Buy to Let - Applicable for participants with pools containing Buy-to-Let loans
   1. How does the Participant consider the risks created by amateur versus professional landlords? Does the Participant offer loans to specialist BTL markets such as HMOs? Do the lending criteria differ between these segments?
   2. Does the Participant underwrite loans to limited companies? Are these included BoE collateral pools? Are these cases underwritten any differently to standard BTL cases? Is a guarantee sought from an individual?
   3. Please outline the rationale for the minimum ICR requirements. What evidence or research was used to justify this?
   4. Does the participant offer 5 year (or longer) fixed rate BTL mortgages? How are these assessed from an affordability perspective?
4. SME Lending Policy Summary

Participants should provide concise information on each lending criterion listed below. Information should relate to the Participant’s current live lending policy. Examples have been included purely to provide guidance on formatting.

|  |  |  |
| --- | --- | --- |
| **Lending Criteria** | **Example** | **2018** |
| **Eligibly SME industries** | Professional BTL  Retail  Office Space  Nursing Homes |  |
| **Max loan size** | £1m |  |
| **Max Term** | 25 years |  |
| **Max LTV** | 70% |  |
| **Maximum leverage** | Sustainable EBITDA  2x unsecured  8x secured |  |
| **Minimum Debt Service Coverage Ratio** | 1.3x (net cash flow)  1.4x EBITDA |  |
| **Minimum stressed interest coverage ratio (ICR)** | 145% - Standard BTL  165% - HMO |  |
| **Stress Rate** | Higher of 5.5% or product rate  For 5+ year Fixed Rate: 4.5% or product rate |  |
| **SVR** | 4.5% |  |
| **Affordability Approach**  (Incl. the proportion of the ICR that can be made up of earned vs rental income) | Assessed purely from rental income. No element of earned income included. |  |
| **Minimum business track record** | Employed: 6 months  Self-employed: 12 months |  |
| **CCJs** | No more than two single CCJs to a max of £200 within the last 18 months |  |
| **Defaults** | None allowed |  |
| **Missed Mortgage/ Rent Payments** | None allowed in the last 2 years |  |
| **Repossession/ Bankruptcy** | None allowed in the last 2 years |  |
| **Max no. of properties with participant**  (Include max exposure value if relevant) | Max 4 properties across all lenders  Max £3mn exposure |  |
| **Max no. of properties in whole portfolio** | Max 10 properties across all lenders |  |
| **Valuation Type** | Full valuations required except for further advances <60% LTV then an AVM is allowable subject to property rules (e.g. no non-standard construction types) |  |
| **Interest Only**  *(Additional criteria)* | Minimum £50k single income/£75k joint income  Max 70% LTV  Min £250,000 equity required |  |
| **IO Repayment Vehicles** | - Sale of Mortgaged Property (subject to min equity of £250k) - Unit Trusts - Investment Bonds - Endowment Policies - Stocks and Shares ISA - Cash ISA - Cash Deposits - Sale of UK property - Company and/or Private Pension |  |

1. Both available on the Bank’s website under the ‘Apply to participate in the Sterling Monetary Framework’ heading - [hhttps://www.bankofengland.co.uk/markets/the-sterling-monetary-framework](https://www.bankofengland.co.uk/markets/the-sterling-monetary-framework) [↑](#footnote-ref-1)