EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK
of 28 July 2014
on new general measures stemming from the Supreme Court's decision on consumer loan contracts
(CON/2014/59)

Introduction and legal basis

On 27 June 2014 the European Central Bank (ECB) received a request from the Hungarian Ministry of the National Economy (hereinafter the 'consulting authority') for an opinion on a draft law on certain measures relating to consumer loan contracts (hereinafter the 'draft law').

Several amending proposals to the draft law were submitted to the Hungarian Parliament, none of which was sent to the ECB[1]. Furthermore, the draft law was adopted by the Parliament on 4 July 2014[2]. Under these circumstances, the ECB has adopted its opinion based on the adopted law (hereinafter the 'law').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and the sixth indent of Article 2(1) of Council Decision 98/415/EC[3], as the law relates to rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1 Purpose of the law

1.1 Following a Court of Justice of the European Union preliminary ruling[4] and a Hungarian Constitutional Court decision[5] on this subject matter, the Hungarian Supreme Court delivered a uniform decision[6] (hereinafter the 'Supreme Court decision') outlining the basic conditions of certain uniform measures to be laid down by the Hungarian Parliament for consumer loan

1 See in particular amending proposals T/465/7 and T/465/9.

2 Law XXXVIII of 2014, published in Magyar Közlöny 98/2014 on 18 July 2014.

3 Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

4 Judgment of the Court of 30 April 2014 in Case C-26/13.

5 Decision 8/2014 of the Constitutional Court of 20 March 2014.

6 Uniform Decision 2/2014 of the Supreme Court of 16 June 2014. See also Decision 6/2013 of the Supreme Court of 16 December 2013.

contracts denominated in forint or in foreign currency entered into by private persons in Hungary. The Supreme Court decision states inter alia that the use of exchange rate margins (i.e. bid/ask spreads) in relation to loans granted in foreign exchange (hereinafter 'FX loans') is unfair and that financial institutions must apply the official exchange rate quoted by the Magyar Nemzeti Bank (MNB) when recalculating loan instalments. The Supreme Court also established that increases in the interest rates, charges and fees relating to consumer loan contracts unilaterally imposed by financial institutions will be considered unfair unless they comply with a set of cumulative principles (hereinafter the 'seven principles') laid down in the Supreme Court decision. Against this background, the law regulates certain elements of forint and FX loans and financial leasing contracts entered into by private persons, with retroactive effect. The measures introduced by the law are the first[7] in a series of measures to be adopted by the Parliament which aim to address the Supreme Court decision. The law also introduces additional requirements relating to the execution of the new measures stemming from the Supreme Court decision.

1.2 To these ends, the law:

- declares null and void the use of exchange rate margins by financial institutions to calculate loan advancement and loan instalments in FX loan contracts and financial leasing contracts entered into prior to the entry into force of the law, but not earlier than 1 May 2004. As a result, the law requires financial institutions to calculate the amounts to be repaid to consumers using the official exchange rate published by the MNB. This calculation has to be made dating back to the start of the contract but not earlier than 1 May 2004, within 90 days of the entry into force of the law. The financial institutions concerned are required to submit the methodology used for this calculation to the MNB for verification within 60 days of entry into force of the law.
- lays down the seven principles, and states that no unilateral amendment of the general terms and conditions of a loan contract or a financial leasing contract meets the seven principles, therefore making any such amendment unfair, and thus, void. A financial institution that has adopted such an amendment will have to prove that the amendment complies with the seven principles in civil legal proceedings initiated at the institution's discretion within 30 days following the entry into force of the law in the case of FX loans and 90 days in the case of forint loans. If such a procedure is not carried out, the unilateral amendment is considered to be unfair pursuant to the law, and thus null and void,
- lays down specific rules on how financial institutions can initiate such civil proceedings. These rules impose a short deadline for the financial institutions to prove that the

7 See the preamble to and Article 3(5) of the law.

contractual conditions applied by them comply with the seven principles. The burden of proof is on the financial institutions.

- under certain conditions, disapplies the statute of limitations, and suspends court proceedings in pending cases, as well as the execution of foreclosures related to consumer credit contracts.

2 General observations

2.1 *The appropriate time to consult the ECB*

The draft law was adopted on 4 July 2014, shortly after the ECB was consulted, and before it could adopt its opinion. As a consequence, it was not possible for the Hungarian Parliament to take the ECB's views into account before legislating. Moreover, the law differs substantially from the draft law as a result of several amendments submitted to the Parliament in the interim, none of which was sent to the ECB in draft form. Under these circumstances, this opinion is based on the law.

The Hungarian authorities have therefore failed to comply with their duty to consult the ECB. The adoption of the law in no way relieves the authorities of their duty to consider this opinion, since this duty is important for the application and interpretation of the law and any possible future amendments.

In this respect, the ECB emphasises that even in cases of particular urgency or where the legislation has reached an advanced stage, the national authorities are not relieved of their duty to consult the ECB at an appropriate stage in the legislative process that allows sufficient time for: (a) the ECB to examine the draft legislative provisions and adopt its opinion in all required language versions; and (b) the national authorities to take into account the ECB's views in accordance with Decision 98/415/EC. The ECB would therefore appreciate the consulting authority honouring its consultation obligation in line with Decision 98/415/EC in future.

2.2 *Overview of the measures introduced by the Parliament*

The ECB has assessed the situation in the Hungarian financial market in relation to FX-denominated loans in several opinions[8]. Prior to the global financial crisis, borrowing in foreign currencies by households and non-financial corporations was popular in several Member States[9], as lower interest rates applied to FX loans compared to interest rates applied to loans in the domestic currency, as well as the expectation of domestic currency appreciation, supported the demand for FX loans. In Hungary, FX loans were denominated in euro, Swiss francs and Japanese yen.

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8 See Opinions CON/2010/62, CON/2011/87 and CON/2012/27.

9 For further information on lending in foreign currencies in the Union see the Annex to Recommendation ESRB/2011/1 of 21 September 2011 on lending in foreign currencies (OJ C 342, 22.11.2011, p.1).

To address risks borne by the banking system associated with the negative effects stemming from the depreciation of the forint on private sector balance sheets, the Hungarian authorities implemented a series of measures from 2010. In March 2010 the authorities introduced lower maximum loan-to-value ratios for mortgages and car loans in foreign currencies, and in June 2010 they introduced more stringent debt-to-income ratios for FX loans. Moreover, a prohibition on foreign currency-denominated mortgage lending effective from August 2010 was introduced. In July 2011 the Hungarian authorities repealed the prohibition, and announced very strict conditions for granting FX loans with essentially the same effect. In addition, two government initiatives aiming to reduce the increased burden of FX loans on households due to the depreciated forint were introduced in the same year. These were the early repayment scheme and the exchange rate cap scheme.

In the first quarter of 2014, FX loans to households accounted for more than 54% of the total loans granted in Hungary, and their total value was just below 13% of the country's annual gross domestic product.

3. Specific observations

3.1 As mentioned above, the Supreme Court laid down the seven principles (clarity, itemised listing, objectivity, factuality and proportionality, transparency, the right of termination and symmetry), and laid down that, if these are met, the unilateral amendment of the general terms and conditions of a consumer loan contract is not to be considered unfair. For the sake of consistency and legal soundness, it could have been made clearer in Article 5 of the law that a decision as to whether a particular condition imposed by unilateral amendment of the general terms and conditions applied by a financial institution is fair or not has to be assessed exclusively on the basis of the seven principles[10]. If possible, guidance should be given to the affected parties on the application of the seven principles, since pursuant to the law the question of fairness would have to be decided in a civil procedure if a financial institution decided to prove the fairness of the general terms and conditions it has applied.

3.2 Acknowledging that Directive 2014/17/EU of the European Parliament and of the Council[11] does not apply to credit agreements existing before 21 March 2016[12], the retroactive effect of the law does not seem to be in line with the general aim and principle of Article 23(5) of Directive 2014/17/EU. This Directive allows Member States to further regulate foreign currency loans, on the condition that such regulation is not applied with retroactive effect.

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10 These criteria are laid down in Article 4(1)(a)-(g) of the law.

11 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 (OJ L 60, 28.2.2014, p. 34).

12 See Article 43(1) of the Directive.

3.3 Noting that point 6 of the explanatory memorandum to the draft law acknowledges the significance of the potential economic impact of the new measures, the ECB suggests that the Hungarian authorities carry out a thorough analysis of the possible effects of the measures having retroactive effect, as such measures could put a significant strain on the banking sector, potentially adversely affecting the stability of the Hungarian financial sector as a whole, and possibly resulting in adverse spillover effects on the economy. Preliminary estimates by affected banks suggest that the potential one-off impact of the measures could be more significant than the losses that the banking system incurred in 2011 as a result of the early repayment scheme. While the banking sector's current capital position is stronger than before the implementation of the early repayment scheme, the potentially significant costs of the new measures may in some cases require material capital injections from the owners of the financial institutions to restore regulatory capital ratios and lending capacity to levels prevailing before the law was adopted[13]. The ECB reiterates[14] that in this context it is of the utmost importance that a meaningful dialogue takes place between the Hungarian authorities and all the relevant stakeholders, including authorities in other Member States. Consultation with such stakeholders might shed light on macro-prudential issues which are not apparent at national level. Furthermore, an exchange of views with the MNB, which is the authority responsible for macro-prudential issues, could help to coordinate effective action without impacting financial stability. In addition, the Hungarian authorities should ensure a proper and timely consultation of competent European authorities, including the European Commission, the European Banking Authority, the European Systemic Risk Board and the ECB on any further measures as anticipated in Article 3(5) of the law.

3.4 To this end, when laying down further measures applicable to the method of repayment or write down of the amounts to be repaid to customers as a result of the law, and the method for potentially converting FX loans, the ECB suggests that due consideration should be given to the interests of the general public, including financial institutions and borrowers, as well as the authorities responsible for ensuring the stability of the financial system in Hungary. In particular, further measures to be applied to the planned conversion of FX loans should also take into account the need to preserve financial stability, ensure an appropriate burden sharing among all stakeholders and avoid moral hazard in the future.

3.5 With regard to the high percentage of the entities operating in the Hungarian banking sector owned by foreign banking groups, and depending on the nature of the further measures applicable to the method of repayment or write down of the amounts to be repaid to customers, cross-border spillover effects on banking groups' consolidated profits and capital positions may

13 The MNB estimates that the one-off cost of the measures could be between EUR 2.3 billion and 2.9 billion for the banking sector. This estimate compares with the EUR 1 billion loss faced by the Hungarian banking system as a result of the early repayment scheme.

14 See paragraph 3.7 of Opinion CON/2012/27.

occur. In the past few years, losses stemming from other government measures, including the bank levy, the financial transaction tax and the early repayment scheme for FX loans, were offset by capital injections by foreign parent banks to ensure the stable functioning of their subsidiaries, highlighting their long-term commitment to the financial sector. Moreover, the MNB, as the competent banking supervisor, may wish to consider how it would address a capital shortfall in a Hungarian credit institution resulting from application of the law.

3.6 In addition to the possible significant adverse financial impact on the banking system, the possibility of negative effects on the Hungarian economy and financial markets cannot be excluded. This should also be taken into consideration in establishing the further measures on the conditions of the financial settlement between credit institutions and their customers and on the conversion of FX loans into forint so that these measures do not jeopardise macro-economic and financial stability in Hungary.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 28 July 2014.

[signed]

The President of the ECB

Mario DRAGHI