



EUROPEAN CENTRAL BANK
EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK
of 26 August 2011
on responsible lending requirements for credit institutions
(CON/2011/67)

Introduction and legal basis

On 29 July 2011, the European Central Bank (ECB) received a request from Lietuvos bankas for an opinion on a draft resolution of the Board of Lietuvos bankas on responsible lending requirements (hereinafter the ‘draft resolution’). On 17 August 2011, the ECB received an amended version of the draft resolution from the consulting authority.

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 third and sixth indents of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions¹, as the draft resolution relates to Lietuvos bankas and rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. In addition, the ESCB contributes to the smooth conduct of policies relating to the prudential supervision of credit institutions and the stability of the financial system under Article 127(5) of the Treaty. 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 draft resolution

- 1.1 The main purpose of the draft resolution is to establish the responsible lending requirements that are applicable to credit institutions providing credit to natural persons. The draft resolution is intended to reduce the systemic risk within the credit institution sector, imbalances in the development of the real estate market, risks related to the rapid growth of credit portfolios and the concentration of excess risk, as well as to provide consumers with protection from accumulating excessive financial liability. Accordingly, the draft resolution should help to contribute to the overall stability of the financial system.
- 1.2 The responsible lending requirements established in the draft resolution include: (i) rules for the comprehensive assessment of the borrower’s ability to meet their financial liabilities in relation to the credit offered; (ii) maximum acceptable loan-to-value ratios for pledged assets; (iii) maximum debt-to-income ratios; (iv) maximum credit maturity, and (v) rules relating to the lending process and conditions, including the information, to be provided to the borrower.

¹ OJ L 189, 3.7.1998, p. 42.

- 1.3 The draft resolution is intended to enter into force on 1 October 2011, except for Chapter VI ('Borrower's assessment'), which is expected to enter into force on 1 February 2012.

2. General observations

- 2.1 The ECB welcomes the draft resolution, which is aimed at promoting responsible lending by credit institutions, enforcing market discipline, and increasing the transparency of credit institutions' activities to provide a higher level of consumer protection, especially in the area of credit for residential property. From a financial stability perspective, the ECB supports the measures that are aimed at ensuring responsible borrowing and lending, and restoring consumer confidence.
- 2.2 The ECB understands that Lietuvos bankas follows the current legislative initiatives at Union level related to the proposal for a directive of the European Parliament and of the Council on credit agreements relating to residential property². In this context, the ECB refers to its Opinion CON/2011/58³. The ECB understands the relevant national legislation will, if necessary, be aligned with the future Directive.

3. Specific observations

Criteria for assessing consumers' creditworthiness

- 3.1 The ECB welcomes the introduction of quantitative limits, notably on loan-to-value ratios⁴ insofar as such measures should contribute to strengthening credit institutions' lending practices, whilst also ensuring consistency in assessing consumers' creditworthiness. In this respect, the ECB notes the following. First, as regards the quantitative limits on loan-to-value ratios, the ECB recommends subjecting them to a thorough impact assessment study of their appropriateness⁵ and regularly reviewing them to take into account the implications of changes in macroeconomic and financial conditions. Second, further guidance may be required regarding the methods and criteria used to evaluate consumers' creditworthiness. Such guidance should include the clarification of the requirements set out in paragraph 7.3 of the draft resolution, according to which lending should be based on an assessment of 'rational' ratios.
- 3.2 The substantive scope of the recommendations in Chapter III should be clarified. Under the current wording, such recommendations refer exclusively to lending for residential purposes, i.e. they are narrower in scope than the draft resolution. Moreover, the reference periods for which the average credit repayment and interest contribution pursuant to paragraph 16 are calculated should be specified.

² COM(2011) 142 final.

³ ECB Opinion CON/2011/58. All ECB opinions are available on the ECB's website at www.ecb.europa.eu.

⁴ Paragraphs 9, 10, 12 and 13 of the draft resolution.

⁵ In the Financial Stability Review of June 2011, the ECB highlighted that "About a third of outstanding commercial property mortgages in the euro area are due to mature between 2011 and 2013[...]. Many of these mortgages [...] were often granted with high loan-to-value ratios (often 75-85%)".

Foreign currency lending

- 3.3 The ECB has noted⁶ that high levels of foreign currency loans to unhedged borrowers may create latent financial vulnerabilities in certain Member States. Such lending converts direct exchange rate exposure in the banking system into credit risk and exposes the economy to significant macrofinancial risks. Given the potentially negative side effects associated with foreign currency lending, the ECB emphasises the importance for policymakers taking appropriate measures to avoid an excessive accumulation within the banking system⁷.
- 3.4 The ECB welcomes the stricter limitations on the acceptable loan-to-value and debt-to-income ratios where the credit and income currencies are different, which would take into consideration potential foreign exchange risk. However, the ECB would welcome further details and an explanation of these proposals. For example, the information provided to the borrower should also include an explanation of the potential risks where the credit is denominated in a foreign currency. In addition, the regulatory framework could be amended to provide incentives to credit institutions to offer domestic currency loans to customers, for the same purposes as foreign currency loans.
- 3.5 More generally, it should be noted that the European Systemic Risk Board (ESRB), in considering options to reinforce the resilience of the Union financial system, has identified as one of the challenges the potential problems arising from foreign currency borrowing by households and small and medium-sized enterprises within the Union⁸. The outcome of the work undertaken by the ESRB in this regard will need to be adequately taken into consideration by the relevant national authorities.

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

Done at Frankfurt am Main, 26 August 2011.

[signed]

The President of the ECB

Jean-Claude TRICHET

⁶ ECB Opinion CON/2011/58, paragraph 2.2.

⁷ ECB Opinion CON/2010/62, paragraph 3.1.1.

⁸ ESRB press conference – 22 June 2011.