



OPINION OF THE EUROPEAN CENTRAL BANK

of 20 September 2011

on lending to natural persons

(CON/2011/74)

Introduction and legal basis

On 5 September 2011, the European Central Bank (ECB) received a request from Banca Națională a României (BNR) for an opinion on a draft regulation on lending to natural persons (hereinafter the ‘draft regulation’).

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 of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions¹, as the draft regulation 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 draft regulation

- 1.1 The main purpose of the draft regulation is to update lending requirements applying to credit institutions that provide loans to natural persons, with a view to financial stability. The draft regulation covers loans for real estate investments and consumer credit. It is part of the prudential measures limiting risks related to the indebtedness of natural persons. It is intended to reduce systemic risk within the banking sector, as well as to protect consumers against excessive financial liability. Accordingly, the draft regulation aims to contribute to the overall stability of the financial system.
- 1.2 The requirements for lending to natural persons provided for in the draft regulation include:
 - (a) rules to assess a borrower’s ability to meet its financial obligations;
 - (b) maximum acceptable loan-to-value ratios for real estate;
 - (c) minimum guarantee-to-loan ratios for consumer credit denominated or indexed in a foreign currency;
 - (d) maximum credit maturity for consumer credit;
 - and (e) rules relating to the lending process and conditions, including information to be provided to borrowers (such as booklets with warnings on the possibility and consequences of an increase of the credit cost if exchange rate risk materialises) and clear information in the credit agreement or

¹ OJ L 189, 3.7.1998, p. 42.

reimbursement schedule on the possibility of an increase of the amounts to be repaid should exchange rate risk or interest rate risk materialise. The definitions of loans for real estate investment purposes and consumer credits are also provided, so that the amended framework will cover all credit provided to natural persons.

2. General observations

- 2.1 BNR has informed the ECB that Romania intends to establish by 31 October 2011 measures to balance the currency structure of loans granted to natural persons in the context of the financial assistance programmes concluded with the International Monetary Fund and the European Commission. In view thereof, the consulting authority invokes reasons of extreme urgency and asks the ECB to deliver its opinion by 20 September 2011. The ECB would like to draw the consulting authority's attention to the fact that according to the second sentence of Article 4 of Decision 98/415/EC, the ECB must be consulted 'at an appropriate stage' in the legislative process. This implies that the consultation should take place at a point in the legislative process that affords the ECB sufficient time to examine the draft legislative provisions and to adopt its opinion in the required language versions and which also enables the relevant national authority to take the ECB's opinion into consideration before these provisions are adopted.
- 2.2 The ECB welcomes the draft regulation, 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 real estate investment. From a financial stability perspective, the ECB supports the measures that are aimed at ensuring responsible borrowing and lending, and restoring consumer confidence.
- 2.3 The ECB understands that BNR 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

3.1 Criteria for assessing consumers' creditworthiness

The ECB welcomes the introduction of quantitative limits⁴ insofar as such measures should contribute to strengthening credit institutions' lending practices, while also ensuring consistency in assessing consumers' creditworthiness. As regards the quantitative limits referred to above, the

² COM(2011) 142 final.

³ All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

⁴ Article 11 and Article 13(1) of the draft regulation.

ECB recommends subjecting them to a thorough impact assessment study of their appropriateness⁵, regularly reviewing them to take into account the implications of changes in macroeconomic and financial conditions and complementing them, if necessary, with other measures (for instance, the provision of maximum debt-to-income ratios).

3.2 *Foreign currency lending*

3.2.1 High levels of foreign currency loans to unhedged borrowers may create latent financial vulnerabilities in certain Member States⁶. Such lending converts direct exchange rate exposure in the banking system into credit risk and exposes the economy to significant macro-financial 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. Generally, there is a need to ensure that strict and prudent regulatory and administrative measures are in place for lending to unhedged domestic borrowers in a foreign currency. In addition, banks should always hold sufficient capital to reflect the specific risks associated with foreign currency lending, in particular as regards the transformation of exchange rate risk into credit risk.

3.2.2 The ECB welcomes the stricter limitations on the acceptable loan-to-value ratios where the credit and income currencies are different, which would take into consideration potential foreign exchange risk. 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.

3.2.3 More generally, 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 account by the relevant national authorities.

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

Done at Frankfurt am Main, 20 September 2011.

[signed]

The Vice-President of the ECB

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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%)'.

⁶ See paragraph 2.2 of Opinion CON/2011/58.

⁷ Paragraph 3.1.1 of Opinion CON/2010/62.

⁸ ESRB press conference of 22 June 2011.