



OPINION OF THE EUROPEAN CENTRAL BANK

of 23 June 2014

on responsible lending requirements

(CON/2014/44)

Introduction and legal basis

On 28 May 2014, the European Central Bank (ECB) received a request from the Magyar Nemzeti Bank (MNB) for an opinion on a draft MNB decree setting the maximum payment-to-income and loan-to-value ratios permitted in respect of consumer credit transactions (hereinafter the ‘draft decree’).

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/EC¹, as the draft decree 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 decree

- 1.1 This subject matter is regulated under Hungarian law by Government Decree 361/2009² (hereinafter referred to as ‘Government Decree’). As a result of the integration of the Hungarian Financial Supervisory Authority into the MNB on 1 October 2013, the MNB became the authority responsible for setting macro-prudential policy and for micro-prudential supervision of the entire financial market. Having obtained the competence to regulate this subject matter, the MNB has drawn up new regulations based on the provisions of the Government Decree.
- 1.2 The draft decree aims to reduce (a) consumer indebtedness by preventing excessive credit growth, and subsequently (b) the potential systemic risk that may arise from foreign currency lending for real estate investments and consumer credit, thus contributing to the overall stability of the financial system. According to the explanatory memorandum, the draft decree would not excessively constrain lending, but could help prevent the build-up of non-performing loans in the future, while at the same time supporting sustainable growth. The draft decree will apply to all consumer credit agreements concluded in the territory of Hungary. Therefore, the scope of the draft

¹ 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).

² See Government Decree 361/2009 (XII. 30.) on the conditions of prudent retail lending and the examination of creditworthiness, published in *Magyar Közlöny* No. 196 of 2009. As the ECB was not consulted on this Government Decree, it did not have the opportunity to issue an opinion as regards its provisions.

decree covers all credit institutions, foreign branches and leasing companies operating in Hungary, and all consumers applying for credit. The new measures are expected to enter into force on 15 September 2014.

- 1.3 Building on the provisions of the Government Decree, the MNB has decided to update, clarify and adjust the existing rules relating to the maximum payment-to-income (PTI) and loan-to-value (LTV) ratios permitted. The draft decree sets out comprehensive rules for the assessment of a consumer's ability to service the loan requested, and sets caps on the LTV and PTI ratios in order to establish the creditworthiness of consumers and their capacity to withstand adverse shocks due to exchange and interest rate movements.
- 1.4 The main changes introduced by the draft decree can be summarised as follows.
 - (a) As regards the PTI ratio, the draft decree sets caps on this ratio aimed at limiting the level of consumer indebtedness. These caps will cover all types of loans (mortgages, consumer credit, financial leases). In contrast to the currently applicable provisions, the PTI ratio will be established taking into account the certified income, and all existing debts of the consumer. Accordingly, the ratio will be more favourable for consumers with higher incomes.
 - (b) The caps on the LTV ratio will only apply to residential mortgages and car loans.The rules capping the PTI and LTV ratios will be stricter for loans denominated in euro than for loans denominated in Hungarian forint, and much stricter for all loans denominated in currencies other than forint or euro.

2 General observations

- 2.1 The ECB has highlighted the risks associated with foreign currency lending on several occasions³. Such lending represents a major risk to financial stability in several Member States in central and eastern Europe, particularly in Hungary⁴ where the proportion of foreign currency loans is among the highest in the Union.
- 2.2 In recent years, several European countries have implemented macro-prudential policies aimed at mitigating risks related to foreign currency lending. In particular, they have adopted measures to increase the resilience of the financial system and prevent or mitigate the further build-up of risks related to housing markets and household indebtedness in a low interest rate environment⁵.
- 2.3 From a financial stability perspective, the ECB welcomes and supports the measures contained in the draft decree, as they are aimed at promoting responsible borrowing and lending, enforcing market discipline, and increasing the transparency of credit institutions' activities.

³ See the ECB's periodical Financial Stability Reviews available on its website at www.ecb.europa.eu.

⁴ See Opinions CON/2010/62, CON/2011/87, and CON/2012/27. All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

⁵ See Opinions CON/2011/58, CON/2011/74, CON/2012/102, and CON/2013/33.

- 2.4 In September 2011, the European Systemic Risk Board (ESRB) issued a Recommendation⁶ to Member States with a view to increasing the effectiveness of macro-prudential policies directed at addressing the risks to financial stability associated with excessive foreign currency lending. The Union-wide application of this Recommendation is necessary to reduce incentives to engage in regulatory arbitrage, and make it more costly.⁷ The ECB has already advised the Hungarian authorities in its 2014 Convergence Report⁸ that ‘financial sector policies should be geared towards ensuring that the financial sector makes a sound contribution to economic growth, while at the same time preventing excessive credit growth in the future. In order to minimise the potential risks to financial stability associated with a high proportion of foreign currency loans, it is necessary for Hungary to fully apply the recommendation of the ESRB on lending in foreign currencies, with which it was considered to be largely compliant in the follow-up report published by the ESRB in November 2013’.
- 2.5 The ECB also recommends that the MNB take note of the recently adopted Directive 2014/17/EU of the European Parliament and the Council⁹, which aims to promote responsible lending and borrowing and ensure that borrowers are offered affordable loans, thus reducing the need for recourse to foreclosure of properties. National implementation of Directive 2014/17/EU must be completed by 21 March 2016; hence, there is no legal requirement to bring the draft decree in line with its provisions at the present time. Directive 2014/17/EU sets out provisions applicable to the assessment of the creditworthiness of consumers¹⁰, requirements as regards property valuations¹¹ and foreign currency loans¹², and allows Member States to introduce further regulation of foreign currency loans, provided that it does not have retrospective effect. The MNB is invited to consider whether the provisions of the draft decree concerning the LTV ratio fully address the future requirements of Directive 2014/17/EU.
- 2.6 The draft decree overlaps with the provisions of the Government Decree. As the ECB has previously pointed out¹³, and as the explanatory memorandum also states, the draft decree cannot repeal the Government Decree. Since the regulation of the PTI and the LTV ratios now fall within the competence of the Governor of the MNB, the ECB would once again draw the Hungarian authorities’ attention to the need to avoid duplication of relevant legislation by repealing the Government decree in accordance with the procedural rules applicable to Hungarian legislation.

⁶ Recommendation of the European Systemic Risk Board of 21 September 2011 on lending in foreign currencies, ESRB/2011/1 (OJ C 342, 22.11.2011, p. 1).

⁷ See Opinion CON/2011/58.

⁸ See the ECB’s June 2014 Convergence Report, in particular Chapter 5.5 on the examination of the state of Hungary’s economic convergence.

⁹ Directive 2014/17/EU of the European Parliament and 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).

¹⁰ See Article 18 of Directive 2014/17/EU.

¹¹ See Article 19 of Directive 2014/17/EU.

¹² See Article 23 of Directive 2014/17/EU.

¹³ See paragraph 2 of Opinion CON/2014/15.

3. Specific observations

- 3.1 The ECB welcomes the stricter caps on LTV and PTI ratios where the credit and income currencies are different, which take into account potential foreign exchange risk. However, the regulatory framework could be further amended to provide incentives for credit institutions to offer domestic currency loans to customers for the same purposes as foreign currency loans. High levels of foreign currency loans to unhedged borrowers may constitute a significant vulnerability in Member States, as such lending transforms the direct exposure of the banking system to exchange rate risk into credit risk and exposes the economy to significant macro-financial risks. Furthermore, a high level of foreign currency debt may restrict the room for monetary policy manoeuvre and its effectiveness. As a general principle, to contain foreign currency lending, policy makers are encouraged to create an overall operating environment for economic agents that encourages prudent and well-informed decision-making by lenders and borrowers.
- 3.2 The ECB welcomes the introduction of quantitative limits, in particular the caps on the PTI ratio, as it should contribute to strengthening credit institutions' lending practices, whilst also ensuring consistency in assessing consumers' creditworthiness. The ECB agrees with the observations of the MNB, as set out in the explanatory memorandum, as regards the need for constant monitoring and updating of the LTV and PTI ratios, and recommends subjecting these ratios to a thorough impact assessment study of their appropriateness and regularly reviewing them to take into account the implications of changes in macroeconomic and financial conditions.

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

Done at Frankfurt am Main, 23 June 2014.

[signed]

The President of the ECB

Mario DRAGHI