OPINION OF THE EUROPEAN CENTRAL BANK

of 16 December 2014

on the conversion of foreign exchange loans

(CON/2014/87)

Introduction and legal basis

On 17 November 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 laying down the rules applicable to the conversion of foreign exchange loan contracts (hereinafter the 'draft law').

The draft law was amended subsequent to the receipt by the ECB of the request for an opinion[1], but the ECB was not notified of these later amendments. The scope of the ECB's opinion is limited to the draft law as it was submitted by the consulting authority, without the later amendments. Furthermore, the draft law was adopted by the Hungarian Parliament on 25 November 2014.

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[2], as the draft 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 Background and purpose of the draft law

1.1 This draft law is one of a series of legislative measures[3] introduced by the Hungarian government in order to deal with foreign currency consumer loans. Unlike previous legislative measures of this nature, the draft law should not be considered as having been introduced in consequence of a particular ruling of the Hungarian Supreme Court[4].

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1 See amending proposal T/2055/3. This proposal, inter alia, changes some basic elements of the draft law, such as the rules applicable to the interest rate premium and the loan contracts of customers participating in the exchange rate cap scheme.

2 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).

3 Law XXXVIII of 2014 on measures to address the Supreme Court's decision on consumer loan contracts published in Magyar Közlöny 98/2014 on 18 July 2014, see Opinion CON/2014/59; Law XL of 2014 on the rules of settlement related to such contracts published in Magyar Közlöny 137/2014 on 6 October 2014, see Opinion CON/2014/72; and Law LXXVIII of 2014 concerning the general terms and conditions of consumer loan contracts published in Magyar Közlöny 168/2014 on 5. December 2014, see Opinion CON/2014/85. All ECB opinions are available on the ECB's website at www.ecb.europa.eu.

4 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.

1.2 Under the draft law, foreign exchange and foreign exchange-based loan contracts (hereinafter ‘FX loans’) will be converted into forint, effective as of 1 February 2015, at a specific exchange rate set by the Magyar Nemzeti Bank (MNB). The conversion applies to all consumer loan contracts, including financial lease contracts denominated or based in foreign currencies, which were concluded between 1 May 2004 and 19 July 2014.

1.3 The interest rate applicable to the converted loans will be linked to the three-month Budapest Interbank Offered Rate (BUBOR). The interest rate premium must be the same as the interest rate premium applied to the original FX loan, provided that this is not lower than 2 percentage points[5]**.** The draft law also introduces caps on the interest rate premium as follows: (a) the interest rate premium may not exceed 5.5 percentage points[6] in the case of residential mortgage loans; and (b) the interest rate premium may not exceed 7 percentage points[7] for home equity loans.

The interest rate premium caps are binding and, if a bank charges an administration fee, the interest rate premium is to be reduced accordingly. Furthermore, the final amount payable in interest may not exceed the interest payable on the original FX loan.

1.4 The draft law sets the length of the interest rate period in the case of loans with fixed interest rates, and the interest rate premium period in the case of loans with interest tied to a reference rate, as follows: (a) five years if the loan maturity is greater than 16 years; (b) four years if the loan maturity is between nine years and 16 years; and (c) three years if the loan maturity is between three years and nine years. Changes to the interest rate may be made only in line with the interest rate premium alteration indicators approved by the MNB. Financial institutions may raise the applicable fees once a year only, and by no more than the previous year’s annual rate of inflation as measured by the consumer price index and published by the Hungarian Central Statistical Office. The earliest date from which this increase can take place is 1 April 2016.

1.5 Financial institutions are obliged to notify their customers about the conversion at the same time as they are notified of the settlement. The draft law also sets out the conditions under which consumers may, within 30 days of receiving notification that conversion of their FX loans is to take place, opt out of such conversion. The financial institutions concerned will need to examine whether the relevant conditions are met within 30 days of receiving an opt-out request. For such a request to be met, one of the following conditions must be fulfilled: (a) the customer’s monthly income must be in the same foreign currency and must exceed the amount repayable; (b) monthly repayments must be no higher than 10% of the monthly income of the customer; (c) the mortgage loan must be due to expire on 31 December 2015 at the latest; or (d) despite the fixed interest rate premium, the interest rate calculated in accordance with the draft law is higher than the interest rate applicable to the original FX loan or the rate applicable prior to 19 July 2014.

5 Changed to 1 percentage point by amending proposal T/2055/3.

6 Changed to 4.5 percentage points by amending proposal T/2055/3.

7 Changed to 6.5 percentage points by amending proposal T/2055/3.

1.6 The draft law also provides that consumers who do not favour these conditions may repay their loans and terminate their contracts in order to take out more favourable loans for refinancing purposes.

1.7 On 10 November 2014, the MNB offered euro liquidity totalling EUR 7.83 billion to commercial banks through tenders. This was done on the basis that this conversion would occur and in anticipation of that the envisaged repayment of foreign currency liabilities would result in an increased demand for foreign exchange liquidity by financial institutions which, if settled on the foreign exchange market, could trigger disturbances. According to the MNB, this measure will counteract pressures on the exchange rate for forint by providing financial institutions with euro liquidity from its own foreign exchange reserves, thereby facilitating the rapid and efficient conversion of FX loans. According to an MNB statement issued on 10 November 2014, the total hedging need of commercial banks in relation to the FX loans conversion would be around EUR 8 billion[8]. Subsequently, the tenders referred to above covered almost the entire estimated demand for foreign exchange liquidity.

2 General observations

The appropriate time to consult the ECB

The draft law was adopted by the Hungarian Parliament on 25 November 2014[9], shortly after the ECB was consulted and before the ECB could adopt its opinion. As a consequence, the Parliament could not take the ECB's views into account before adopting the draft law.

The consulting authority did not indicate to the ECB that the opinion was urgent or that the draft law was to be adopted by the Hungarian Parliament under an urgency procedure. Moreover, due to amendments made to the draft law between the date of the consultation request and the date of adoption, which were not communicated to the ECB, the law as adopted differs substantially from the draft law submitted to the ECB.

The Hungarian authorities have again failed to comply properly with their duty to consult the ECB. The adoption of the draft law, as amended, does not relieve the authorities of their duty to give due consideration to this opinion, in particular with regard to the application and interpretation of the draft law as adopted, as well as any future amendments thereto.

The ECB would like to emphasise that, even in cases of particular urgency, or where the legislative process has reached an advanced stage, the national authorities are not relieved of their duty to consult the ECB. This should occur 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

8 See www.mnb.hu.

9 See Law LXXVII of 2014, published in Magyar Közlöny 168/2014 on 5 December 2014.

Decision 98/415/EC. The ECB would therefore appreciate it if, in future, the consulting authority would honour its obligation to consult the ECB in accordance with Decision 98/415/EC.

3. Specific observations

3.1 From a financial stability perspective, the conversion of FX loans should greatly reduce or even eliminate currency mismatches in households' balance sheets, which is expected to contribute to reducing the credit risk of banks in the longer term. The ECB appreciates that the method for calculating the exchange rate to be used for the conversion of the loans in question was set with the intention of avoiding an additional significant burden on the banking sector. The ECB, moreover, takes note of the measures taken by the MNB, in agreement with the banks, in order to ensure an orderly conversion of FX loans.

3.2 On the other hand, the interest rate premium cap could have a negative effect on the future profitability of banks, thereby adding to the significant strains already faced by the banking sector. These strains have resulted, inter alia, from the measures relating to the settlement of FX loans[10]. It should also be noted that the conversion will lead to a once-off increase in operational costs for banks in Hungary.

3.3 As regards the longer-term effects on financial stability, the ECB continues to be of the opinion that, when introducing measures in relation to settling and converting FX loans, due consideration should always be given to fair burden sharing between consumers, the financial institutions, the Hungarian Government and all authorities responsible for ensuring the stability of the financial system in Hungary. This consideration should also include foreign banking groups, whose entities manage around half of all banking assets in Hungary. As a result, the measures affecting FX loans may also have significant cross-border spill-over effects on the consolidated profits and capital positions of banking groups. In this regard, the ECB wishes to remind the Hungarian authorities that, during the past few years, losses stemming from previous government measures, including the bank levy, the financial transaction tax and the early repayment scheme for FX loans, were offset by capital injections from foreign parent undertakings to ensure the stable functioning of their subsidiaries. While this behaviour confirmed the parent banks' longstanding commitment to the financial sector in Hungary, the possibility of longer-term negative effects on the Hungarian economy and financial markets, as a result of the legislative package referred to in paragraph 1.1 on top of the abovementioned measures, cannot be excluded at this stage.

10 For more details on these measures see Opinions CON/2014/59, CON/2014/72 and CON/2014/76.

This would, in turn, also adversely impact the overall macroeconomic and financial stability in Hungary.

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

Done at Frankfurt am Main, 16 December 2014.

[signed]

The President of the ECB

Mario DRAGHI