OPINION OF THE EUROPEAN CENTRAL BANK

of 5 August 2015

on a draft law on specific terms of restructuring of home loans denominated in foreign currency

(CON/2015/26)

Introduction and legal basis

On 23 July 2015 the European Central Bank (ECB) received a request from the Polish Parliament for an opinion on a draft law setting specific terms for the restructuring of housing loans denominated in a foreign currency and amending certain other Acts (hereinafter the 'draft 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[1], as the draft law contains 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 law

1.1 The purpose of the draft law is to facilitate the restructuring of home loans denominated in a foreign currency (hereinafter 'foreign currency home loans') that were granted before the date of entry into force of the draft law. In particular, banks will be required, on the request of an eligible borrower, to restructure foreign currency home loans, in accordance with the terms set out in the draft law, until 30 June 2020.

1.2 Under the draft law, borrowers who are consumers will be eligible to request a restructuring of their foreign currency home loans, provided that: a) the property is used by the borrowers to satisfy their own housing needs; b) the borrowers own no other residential unit nor single family house; c) the usable area of the property does not exceed 75 square metres in respect of a residential unit or 100 square meters in respect of a single family house (unless at the date of filing a restructuring request the borrower is raising three or more children, in which case no square meter limit applies); and d) the loan to value (LTV) ratio of the foreign currency home loan is above 80%.

1.3 The draft law provides that the restructuring request may be filed at different points of time depending on the LTV ratio. It may be filed as soon as the draft law comes into force where the value of the LTV ratio is above 120%, no sooner than one year after the draft law comes into force where the LTV ratio is above 100% but equal to or lower than 120%, and no sooner than two years after the draft law comes into force where the LTV ratio is above 80% but equal to or lower than 100%.

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).

1.4 The draft law provides that, once the borrower exercises the right to restructure a home loan, the borrower's new obligation towards the bank will be the total of the following three components:

(i) First, the principal amount of the home loan, denominated in zloty (PLN), which would have remained payable on the date of filing the restructuring request had the borrower concluded, with the same bank, a home loan denominated in PLN with identical loan payment terms on the date he or she concluded the foreign currency home loan which is being restructured;

(ii) Second, the difference between: a) the remaining principal amount of the foreign currency home loan which is being restructured, converted into PLN at the buying exchange rate for the relevant currency published by Narodowy Bank Polski (NBP) on the day preceding the borrower's restructuring request; and b) the amount represented by the first component in point i) above. If, based on such calculation, the resulting amount has a positive value, the bank will be required to redeem half of the amount. The non-redeemed half will form the second component of the borrower's new obligation to the bank;

(iii) Finally, the difference between two further amounts. First, the amount equal to the total principal and interest payments which the borrower would have made up to the date of filing the restructuring request, had the borrower concluded, with the same bank, a home loan denominated in PLN with identical loan payment terms on the date he or she concluded the foreign currency home loan which is being restructured. In calculating this amount, an interest rate based on the Warsaw Interbank Offered Rate base rate on the relevant dates will be applied, in line with the specific time period for the Euro Interbank Offered Rate/London Interbank Offered Rate base rate applied in the contract for the foreign currency home loan. It will be assumed that the bank's margin would have been equal to that set in the relevant contract concluded by the borrower. If the contract provides for changes to the interest rate at the discretion of the bank's management, the interest rate will be applied according to the terms stipulated in the relevant contract. Second, the amount representing, in PLN, the total principal and interest payments which the borrower has made under the foreign currency home loan up to the date of filing the restructuring request. The conversion to PLN will be based on the buying exchange rate for the relevant currency on the day preceding each respective payment date, as published by NBP (unless the borrower was obliged to make payments based on the buying exchange rate set by the bank, in which case that exchange rate shall be used). The difference between the two amounts described in this paragraph forms the third component of the borrower's new obligation to the bank.

The amount represented by the first component will substitute for the borrower's obligation under the original, now-restructured foreign currency home loan. The loan will be performed according to the contractual terms of the original foreign currency home loan and bear the same interest rate as that described in section ii) above.

In order to facilitate payment of the second and third components, the bank will be required to grant a new loan to the borrower for the remaining period of the original foreign currency home loan. Article 8 of the draft law refers to a 'non-mortgage loan redeemed by the bank' and the ECB therefore understands that the new loan will be uncollateralised. The interest rate on the new loan may not exceed NBP's current reference rate.

1.5 Finally, the draft law amends personal income tax law to provide relevant tax exemptions for the borrower as regards the amount of the debt subject to write-off. The draft law also amends corporate income tax law to treat the non-mortgage backed debt written off by the bank as a tax deductible expense.

2. General observations

2.1 Prior to the global financial crisis, borrowing in foreign currencies by households and non-financial corporations was popular in several Member States[2]. As previously noted by the ECB[3], the lower interest rates applicable to foreign currency loans compared to loans in the domestic currency, as well as the expectation of domestic currency appreciation, increased the demand for such loans. Most of the foreign currency loans in Poland are housing loans denominated in Swiss francs (CHF). Foreign currency housing loans constituted approximately 47% of all outstanding housing loans and 29% of all outstanding loans to households in June 2015[4].

2.2 Acknowledging that Directive 2014/17/EU of the European Parliament and of the Council[5] does not apply to credit agreements existing before 21 March 2016, as previously noted by the ECB[6], the retroactive effect of the draft 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.

2.3 It is for the Polish authorities to assess whether the retroactive character of the draft law complies with Polish legal and constitutional principles.

2.4 The ECB notes that the draft law draws on previous proposal presented by the Polish Financial Supervision Authority (KNF), with the notable difference that the KNF's proposal anticipated that the restructuring of foreign currency loans would be voluntary for both banks and borrowers.

3. Specific observations

3.1 *Eligibility criteria*

3.1.1 The rationale behind the eligibility criteria for participation in the restructuring scheme raises some doubts. In particular, the ECB notes that these criteria are not directly linked to the borrower's actual income position. Given that not all households with a lower income and/or a fragile financial situation due to exchange rate fluctuations will be eligible, it is unclear to what extent the measures proposed in the draft law would substantially reduce overall loan default risks, or provide debt relief for low income households holding foreign currency home loans.

3.1.2 The ECB also notes that the proposed eligibility criteria, in particular, the fact that they do not refer

---

2 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).

3 See Opinion CON/2014/59, para. 2.2. All ECB opinions are available on the ECB website at www.ecb.europa.eu.

4 See NBP Monetary and financial statistics report at http://www.nbp.pl/en/statystyka/czasowe_dwn/nalez_zobow_banki_en.zip.

5 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).

6 See Opinion CON/2014/59, para. 3.2.

to a given household's available income, could raise issues of equal treatment.

3.1.3 Finally, the ECB notes that the criterion linked to the LTV ratio may be difficult to assess given fluctuations in the exchange rate.

3.2 *Effects on the banking sector*

3.2.1 The ECB notes that the implementation of the draft law is expected to entail financial costs for the banking sector. This, in turn, may negatively affect profits and the future lending capacity of certain credit institutions. In particular, by introducing a restructuring right that will be exercisable over several years, the draft law might create a challenge for the Capital Adequacy Assessment Processes (ICAAP) of the affected institutions, potentially leading to increased write-down requirements. As a result, and given that foreign banking groups are dominant investors in banks that hold almost 60% of banking assets in Poland, it cannot be excluded that the measures affecting foreign currency loans in Poland might also have cross-border effects on the consolidated profits of international banking groups. However, given the cost estimates presented in the explanatory memorandum to the draft law, and the relatively small size of the majority of Polish banking subsidiaries, as compared to their parent banking groups, such spill-over effects should be limited.

3.2.2 As regards the proposed burden-sharing mechanism described in points (ii) and (iii) of paragraph 1.4 above, the ECB notes that the new loans granted to borrowers who take advantage of the right to restructure will not be priced at market rates. The proposed establishment of NBP's current reference interest rate as the maximum interest rate for such new loans is substantially below the usual pricing of uncollateralised, long-term non-mortgage loans. This could have a further negative effect on the future profitability of the affected banks.

3.2.3 From a banking supervisory perspective, the ECB notes that the restructuring of the foreign currency loans as proposed by the draft law does not eliminate all risks relating to such loans, in particular interest rate risks.

3.2.4 It should also be noted that the restructuring will lead to a one-off increase in operational costs for the affected credit institutions in Poland, in particular, due to revaluation, unwinding of existing hedges and refinancing. In that context, the KNF is recommended to consider how it could address potential negative effect on the sound capital base of the credit institutions concerned resulting from the application of the draft law.

3.3 *Effects on financial stability*

3.3.1 The ECB has pointed out on several occasions the risks associated with foreign currency loans[7]. In particular, they represent a major risk to financial stability in several Member States, where the share of foreign currency loans is relatively high. The ECB points in this respect to the analysis of such risks made by the European Systemic Risk Board (ESRB) and to the ESRB recommendations for addressing such risks, made in Recommendation ESRB/2011/1 of 21 September 2011 on lending in foreign currencies[8].

---

7 See in particular the ECB Financial Stability Review of June 2010 and, in respect of the foreign currency loans in Hungary, Opinions CON/2011/87, CON/2012/27, CON/2014/59, CON/2014/72 and CON/2014/76.

8 Recommendation ESRB/2011/1 of 21 September 2011 on lending in foreign currencies (OJ C 342, 22.11.2011, p.1).

3.3.2 However, in the case of Poland, such risks do not, at present, appear to be of a systemic nature for the financial system and are not seen as representing a particular risk from a financial stability perspective. First, the share of such foreign currency housing loans in the total housing loan portfolio is diminishing and currently amounts to around 47%. Second, following the adoption and revision by the KNF of Recommendation S[9], the supervisory guidelines related to the granting of housing loans have tightened significantly, mainly from January 2014. This measure includes, inter alia, a maximum loan maturity (35 years, with a recommended maximum maturity of 25 years), the requirement to grant the loan in the currency of the borrower's income (in force as of July 2014) and a maximum level for the LTV ratio for newly granted housing loans (95% in 2014, with the general target value of 80% from 2017). The revised Recommendation S has contributed to maintaining the positive trend in the currency structure of new mortgage lending in Poland and, in the longer-term, should result in a more balanced growth of housing loans. Finally, the current macroeconomic situation in Poland is characterised by sustained strong economic growth, increasing real disposable income of households and an ongoing decline in unemployment, reducing the default risks associated with home loans.

3.3.3 From a financial stability perspective, and subject to the comments on the appropriateness of the eligibility criteria set out in paragraph 3.1, the conversion of foreign currency loans should reduce part of the currency mismatches in households' balance sheets. This is expected to provide relief for distressed foreign currency borrowers and contribute to reducing the credit risk of banks in the longer-term.

3.3.4 As regards the longer-term effects on financial stability, the ECB remains of the opinion that, when introducing measures in relation to settling and converting foreign currency loans, due consideration should always be given to fair burden sharing among all stakeholders, thus also avoiding moral hazard in the future[10]. This consideration should also include foreign banking groups, whose Polish subsidiaries currently hold close to 60% of all banking assets in Poland.

3.4 *Effects on the Polish economy*

3.4.1 The draft law might also have some negative effects if it leads to a deterioration of foreign investor sentiment due to a perceived increase in legal uncertainty and country risk. Consequently, the ECB suggests that the Polish authorities carry out a thorough analysis of the possible effects on the economy of introducing measures having retroactive effect.

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

Done at Frankfurt am Main, 5 August 2015.

[signed]

The President of the ECB
Mario DRAGHI

---

9 Recommendation S on good practices with regard to management of credit exposures that finance property and are mortgage-secured, last revised in June 2013. Available on the KNF website at www.knf.gov.pl.

10 See CON/2014/59, para. 3.4 and CON/2014/87, para. 3.3.