



EUROPEAN CENTRAL BANK

EUROSYSTEM

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ECB-PUBLIC

OPINION OF THE EUROPEAN CENTRAL BANK

of 29 July 2016

on specific rules for restructuring loans indexed or denominated in foreign currency

(CON/2016/39)

Introduction and legal basis

On 15 June 2016 the European Central Bank (ECB) received a request from the Polish Parliament for an opinion on a draft law establishing specific rules for the restructuring of loans denominated or indexed to a currency other than the Polish zloty. An updated version of the draft law (hereinafter the 'draft law') was received on 11 July 2016.

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 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 loans denominated or indexed in a foreign currency (hereinafter 'foreign currency loans') that were granted after 1 January 2000 for a period exceeding 60 months, even if such loans have been repaid in full or terminated and settled. The draft law also prohibits granting of any future loans involving settlement in a foreign currency.
- 1.2 Under the draft law, all borrowers that are consumers or other natural persons are entitled to request the restructuring of their loans. Restructuring is subject to the following rules:
 - (i) Any contractual obligation of the borrower denominated in a foreign currency or indexed to a foreign currency is deemed to be null and void;
 - (ii) The principal amount of the loan is the amount in Polish zloty (PLN) actually paid to the borrower. Based on the explanatory memorandum, the ECB understands that the exchange rate used to convert the principal amount will be the exchange rate applicable on the date the amount is paid to the borrower;
 - (iii) The interest rate on the loan, which will for each interest period comprise the base rate and the margin, is determined based on the following rules: (a) the margin is equal to the level set in the loan agreement but must not be higher than 4 %, (b) the base rate for each interest period is equal to the reference rate of Narodowy Bank Polski (NBP) in

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).

force on the first day of a given period, and (c) the interest rate must not exceed 30 % of the margin set out in the loan agreement for the entire settlement period (before and after the restructuring); and

- (iv) The amount of any fees, commissions, insurance premiums and other costs which the borrower is obliged to pay and which are denominated in or indexed to a foreign currency is set based on the exchange rate applicable on the date of their payment to the lender.
- 1.3 The draft law provides that any loan repayments made prior to the date on which the borrower notifies the lender of his/her intention to restructure the loan will be credited towards the repayment of the loan following its restructuring. If the borrower has made repayments in a foreign currency, the amount repaid will be calculated based on the exchange rate used by the bank on the date of payment. If the loan was repaid in Swiss francs (CHF), the lender's purchase rate on that date will be used for the purposes of the calculation.
- 1.4 According to the draft law, if the total amount of repayments made prior to the date on which the borrower notifies the lender of his/her intention to restructure the loan is lower than the total amount of repayments due following the restructuring, the difference between these amounts will increase the borrower's debt. Conversely, if the total amount of repayments is higher, the difference between the amounts will reduce the borrower's debt.
- 1.5 Furthermore, if, following the restructuring, the repayment instalments would be at least 10 % higher than the first loan instalment, the borrower may extend the loan repayment term by the period necessary for the loan instalments to no longer exceed the pre-restructuring loan instalments by more than 10 %. Any such extension is for a maximum period of 10 years.
- 1.6 The draft law also provides that the lender may not amend any other term of the loan agreement in connection with the restructuring.
- 1.7 As regards the application procedure, the draft law provides that the borrower may notify the lender of its intention to restructure his/her loan within two years of the entry into force of the draft law. Following such notice, the lender will have 30 days to notify the borrower of the following: (i) the total amount of loan instalments due in the period between the date on which the loan was granted up to the notification date, (ii) the total amount of loan instalments paid by the borrower, (iii) the level of the borrower's debt following the restructuring, (iv) the interest rate on the loan following the restructuring and (v) the loan repayment schedule following the restructuring for the next 12 months. The borrower may apply to have his/her loan restructured within two months of receiving the above information from the lender. If the borrower contests the correctness of the information provided by the lender, he/she may within one month request that the Financial Ombudsman, through mediation, determines the rules for the loan restructuring. Where no agreement can be reached following such mediation, the borrower may request that the court determines the rules for the loan restructuring.
- 1.8 With regard to any loans that have been repaid in full, the draft law provides that, if the lender's calculation of the loan following the restructuring indicates that the borrower has overpaid an amount, the lender must return any overpayment to the borrower within 30 days of the borrower's request.

- 1.9 With regard to any loans that have been terminated, within 30 days of the borrower's request, the lender must notify the borrower of the information set out in paragraph 1.7 as well as of the loan repayment arrears outstanding on the date the loan was terminated. If requested by the borrower, the loan is restructured and the previous termination of the loan agreement becomes null and void. The restructured principal amount of the loan is increased by 1 % of the arrears.
- 1.10 The draft law also provides that if the lender has caused the borrower to suffer a loss, he/she must remedy such loss or reinstate the state of affairs that existed on the date the loan agreement was entered into.
- 1.11 Under the draft law, the borrower is entitled to refer any doubts concerning mutual settlements and terms of the restructuring for verification, determination and assessment by a civil court. The draft law prescribes that the court's decision must not include restructuring terms which are worse than those included in the information provided by the lender.
- 1.12 In addition, the draft law provides that the loan restructuring entitles the borrower to apply for the removal of the current mortgage securing the loan and its replacement by a new mortgage over the same real estate for the amount of the restructured loan plus 20 %.
- 1.13 The draft law amends the provisions of the Banking Act of 29 August 2007 by inserting, among other things, a provision pursuant to which borrowers that are consumers are entitled to discharge all of their debt arising from a loan secured by a mortgage over real estate by transferring the ownership of the real estate to the lender who is bound to purchase it.
- 1.14 Finally, the draft law provides that any bank enforcement titles concerning claims arising under loans denominated in or indexed to foreign currencies become void.
- 1.15 The draft law is to enter into force after one month following the date of its publication.

2. General observations

- 2.1 The ECB notes that it has previously been consulted by the Polish Parliament and commented on a draft proposal, which was not adopted subsequently, dealing with the restructuring of foreign currency home loans². The ECB also understands that various other proposals dealing with the conversion of foreign currency loans are currently being discussed by the Polish authorities. The current opinion relates only to the draft law submitted to the ECB on 15 June 2016.
- 2.2 Prior to the global financial crisis, borrowing in foreign currencies by households and non-financial corporations was popular in several Member States³. As previously noted by the ECB⁴, 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 CHF. Foreign

² See Opinion CON/2015/26. All ECB opinions are available on the ECB's website at www.ecb.europa.eu.

³ 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).

⁴ See paragraph 2.2 of Opinion CON/2014/59, paragraph 2.1 of Opinion CON/2015/26 and paragraph 2.1 of Opinion CON/2015/32.

currency housing loans constituted approximately 43 % of all outstanding housing loans and 26 % of all outstanding loans to households in May 2016⁵.

3. Specific observations

3.1 *Retroactivity*

3.1.1 Acknowledging that Directive 2014/17/EU of the European Parliament and of the Council⁶ does not apply to credit agreements existing before 21 March 2016, as previously noted by the ECB⁷, 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.

3.1.2 As previously noted by the ECB⁸, introducing measures with retroactive effect could in principle undermine legal certainty and might not be in line with the principle of legitimate expectations. It is however for the Polish authorities to assess whether the retroactive character of the draft law complies with the applicable principles under Polish law, including the Polish Constitution.

3.2 *Eligibility criteria*

The ECB notes that the draft law does not prescribe any eligibility criteria for borrowers applying for loan restructuring other than specifying that borrowers must be consumers or other natural persons. As noted previously⁹, this raises concerns with regard to the purpose of the draft law. In particular, the application of certain targeted eligibility criteria such as, for example, linking the right to convert to the borrower's actual income position or to the loan-to-value (LTV) ratio may be appropriate.

3.3. *Effects on the banking sector, financial stability and Polish economy.*

3.3.1 The ECB reiterates its comments regarding risks associated with foreign currency loans made in a previous opinion¹⁰. In particular, 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.

3.3.2 The ECB notes that the implementation of the draft law is expected to entail financial costs for the banking sector. Whilst the explanatory memorandum does not present a comprehensive assessment of the impact of the draft law, the ECB is of the view that the conversion of foreign currency loans at the exchange rate prevailing on the loan origination date, as anticipated by the draft law, may have a significant impact on the financial stability of the Polish banking sector, which could result in substantial losses and reduced capital buffers. Banks need to take into account the

⁵ See NBP Monetary and financial statistics report at http://www.nbp.pl/en/statystyka/czasowe_dwn/nalez_zobow_banki_en.zip.

⁶ 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).

⁷ See paragraph 3.2 of Opinion CON/2014/59, paragraph 2.2 of Opinion CON/2015/26 and paragraph 3.2.1 of Opinion CON/2015/32.

⁸ See paragraph 3.2.2 of Opinion CON/2015/32.

⁹ See paragraph 3.3 of Opinion CON/2015/32.

¹⁰ See paragraphs 3.3.1 and 3.3.2 of Opinion CON/2015/26.

direct costs of conversion as well as any costs relating to the closing of currency positions due to the unwinding of existing hedges and refinancing. This would reduce the resilience of the financial sector to adverse shock and may have a further negative impact on the Polish economy, in particular due to the possibility of a strong depreciation of the PLN¹¹.

- 3.3.3 The draft law may also have some negative effects on the Polish economy if it leads to a deterioration in foreign investor sentiment due to a perceived increase in legal uncertainty and country risk.
- 3.3.4 In addition, the ECB notes that the proposed interest rate for the restructured loans, which is to be composed of NBP's current reference interest rate and a restricted margin, is substantially below the usual pricing of collateralised, long-term non-mortgage loans, and could therefore have a further negative impact on the future profitability of the affected banks.
- 3.3.5 Whilst the conversion of foreign currency loans should reduce part of the currency mismatches in households' balance sheets, which could provide relief for distressed foreign currency borrowers and contribute to reducing the credit risk of banks in the longer term, the potential overall negative impact of the draft law on the financial stability of the Polish banking sector and the future lending capacity of certain institutions may be significant, thus resulting in overall negative effects on the Polish economy.
- 3.3.6 Consequently, the ECB suggests that the Polish authorities carry out a thorough analysis as to whether the envisaged retroactive measures could have negative effects on the banking sector and the overall economy in Poland, in particular on the sound capital base and the internal capital adequacy assessment processes of the affected institutions, including cross-border effects on the consolidated profits of international banking groups, potentially leading to increased write-down requirements. With regard to any potential negative effects of such measures, the ECB remains of the opinion that, when introducing provisions 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 future¹².
- 3.3.7 From a banking supervisory perspective, as previously noted by the ECB¹³, 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.

3.8 *Miscellaneous*

- 3.8.1 The ECB notes that the draft law contains provisions that are unclear, or may be interpreted very broadly and therefore give rise to legal uncertainty. For example, it is difficult to reconcile how the interest rate on the loan would comprise a base rate equal to the NBP reference rate and margin equal to the level set in the loan agreement (not higher than 4 %) with the specification that the interest rate must not exceed 30 % of the margin set out in the loan agreement for the entire settlement period (before and after the restructuring). Also, in the provision which requires the

11 Risks associated with blanket currency conversion of foreign exchange loans at the exchange rate prevailing on the loan origination have been discussed and analysed by the National Bank of Poland in the Financial Stability Review July 2015. See <http://www.nbp.pl/en/systemfinansowy/fsr201507.pdf>, Box 2 on p. 39-41.

12 See paragraph 3.4 of CON/2014/59 and paragraph 3.3 of CON/2014/87.

13 See paragraph 3.2.3 of CON/2015/26.

lender to remedy 'any loss' incurred by the borrower it is not clear what is meant by a loss on the part of the borrower and what kind of liabilities might arise for lenders as a result of this provision.

3.8.2 The ECB also notes that the draft law prescribes that if the borrower refers his/her doubts concerning mutual settlements and the terms of the restructuring for verification, determination and assessment by a civil court, the court's decision must not include restructuring terms which are worse than those included in the information provided by the lender. It might be useful to clarify more precisely what is intended by this provision.

3.8.3 Finally, the ECB notes that a temporary relief programme funded by the banks has recently been set up in Poland to assist borrowers in a difficult financial situation in meeting their foreign currency loan obligations. The Polish authorities might consider analysing the impact of this programme before introducing other measures dealing with foreign currency loans.

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

Done at Frankfurt am Main, 29 July 2016.

[signed]

The President of the ECB

Mario DRAGHI