



EUROPEAN CENTRAL BANK

EUROSYSTEM

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ECB-PUBLIC

## OPINION OF THE EUROPEAN CENTRAL BANK

of 24 March 2017

on foreign exchange-linked loans

(CON/2017/9)

### Introduction and legal basis

On 8 February 2017 the European Central Bank (ECB) received a request from the Polish Parliament for an opinion on a draft law amending the Civil Code to resolve issues relating to foreign exchange-linked loans (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<sup>1</sup>, 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. Purpose of the draft law**

- 1.1 Under the Polish Civil Code, provisions of a contract entered into with a consumer that have not been individually agreed are not binding if they set down the consumer's rights and obligations in a way which is contrary to good practice and are clearly against their interests (prohibited contractual clauses)<sup>2</sup>. This does not apply to provisions laying down the main obligations of the parties, including price or remuneration, as long as they are clearly worded. The Civil Code further provides that, in the event of doubt, certain specified clauses are deemed to be prohibited. The purpose of the draft law is to amend the Civil Code by supplementing this list of prohibited contractual clauses with clauses which (1) denominate in foreign currency a loan which is then disbursed in Polish zloty (PLN) and (2) index to, or revalue in line with, a foreign currency a loan which is denominated and disbursed in PLN.
- 1.2 The amendment proposed by the draft law is also to apply retroactively. However, according to the explanatory memorandum, the draft law has no effect on the content of the legal relationships between banks and borrowers as the new clauses proposed to be included in the abovementioned list were never valid. Furthermore, the draft law merely aims to accelerate resolution of the court proceedings between banks and borrowers relating to foreign exchange-linked loans.

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<sup>1</sup> 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).

<sup>2</sup> See Article 3851 of the Polish Civil Code.

## 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<sup>3</sup>. As previously noted by the ECB<sup>4</sup>, 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. The ECB understands that most of the foreign currency loans in Poland are housing loans denominated in Swiss francs and that foreign currency housing loans constituted approximately 40 % of all outstanding housing loans and 24 % of all outstanding loans to households in January 2017<sup>5</sup>.
- 2.2 The ECB has previously been consulted by the Polish Parliament and issued opinions on three draft legislative proposals, which were subsequently not adopted, dealing with the restructuring of foreign currency loans<sup>6</sup>.
- 2.3 The ECB notes that the draft law has both prospective and retroactive elements, which raise different issues. The ECB will therefore address these prospective and retroactive elements separately.

## 3. Prospective elements of the draft law

- 3.1 The ECB has pointed out on several occasions the risks associated with foreign currency loans<sup>7</sup>, and referred to the analysis of such risks by the European Systemic Risk Board (ESRB) and the ESRB recommendations for addressing them in Recommendation ESRB/2011/1<sup>8</sup>. The ECB also notes that the Polish Financial Supervision Authority took account of the ESRB recommendations and issued Recommendation S<sup>9</sup> pursuant to which banks are recommended to ensure that future mortgage loans to retail borrowers are granted in the currency of the borrower's income.
- 3.2 Against this background, to contain foreign currency lending and, as suggested by the ECB in the past<sup>10</sup>, policymakers are strongly encouraged to create an overall environment for economic agents which encourages prudent and well-informed decision-making. This involves the pursuit of sound and stability-oriented macroeconomic policies and policies to strengthen financial literacy and appropriate financial regulation and supervision. If this proves insufficient, additional policies to prevent an excessive build-up of foreign currency debt could be considered.

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3 For further information on lending in foreign currencies in the Union, see the Annex to the 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).

4 See for example, paragraph 2.1 of Opinion CON/2016/50. All ECB opinions are available on the ECB's website at [www.ecb.europa.eu](http://www.ecb.europa.eu).

5 See the Narodowy Bank Polski report on monetary and financial statistics, available at [www.nbp.pl](http://www.nbp.pl).

6 Opinions CON/2015/26, CON/2016/39 and CON/2016/50.

7 See the ECB Financial Stability Review of June 2010 and, for example, Opinion CON/2014/76.

8 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).

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 website of the Polish Financial Supervision Authority at [www.knf.gov.pl](http://www.knf.gov.pl).

10 See paragraph 3.1.2 of Opinion CON/2010/62.

- 3.3 Therefore, as also noted before<sup>11</sup>, the ECB in principle welcomes measures promoting responsible lending by banks, enforcing market discipline and increasing the transparency of bank's activities to provide a higher level of consumer protection, especially in the area of loans relating to residential property. Such specific measures which have been welcomed or suggested by the ECB in the past include limitations on the acceptable loan-to-value and debt-to-income ratios where the credit and income currencies are different, a requirement for the potential risks to be explained to the borrower where the credit is denominated in a foreign currency and incentives to banks to offer domestic currency loans to customers, for the same purposes as foreign currency loans<sup>12</sup>. More generally and also as previously noted by the ECB, there is a need to ensure that strict and prudent regulatory 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<sup>13</sup>.
- 3.4 Finally, as noted by the ECB in previous opinions<sup>14</sup>, if the draft law has a cross-border effect in the sense that it would effectively prevent borrowing in foreign currency, it may raise issues of compliance with Article 63 of the Treaty on free movement of capital and payments<sup>15</sup>. The ECB has also noted in this respect that the free movement of capital and payments is without prejudice to, inter alia, 'measures which are justified on grounds of public policy or public security', as laid down in Article 65(1)(b) of the Treaty. However, as in the case of exceptions based on the principle of general good, the exemption in Article 65(1)(b) of the Treaty is narrowly interpreted by the Court of Justice of the European Union, with the implication that any such measure would, for example, need to meet the proportionality test. Under this test, restrictions are justified only if no less restrictive measure would suffice to reach the desired end. The ECB notes that the assessment of whether the measures affecting financial institutions under the draft law are in breach of the free movement of capital and payments, the freedom of establishment or other Union rules is entrusted to the Union institutions ensuring the application and observance of the Treaties.

#### 4. Retroactive elements of the draft law

##### *Legal aspects of retroactivity*

- 4.1 As previously noted by the ECB<sup>16</sup>, introducing measures with retroactive effect undermines legal certainty and is not in line with the principle of legitimate expectations.
- 4.2 In addition, although Directive 2014/17/EU of the European Parliament and of the Council<sup>17</sup> does

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<sup>11</sup> See paragraph 3.1 of Opinion CON/2011/87.

<sup>12</sup> See, for example, paragraph 3.2.2 of Opinion CON/2011/74.

<sup>13</sup> See paragraph 3.1.3 of Opinion CON/2010/62.

<sup>14</sup> See, for example, paragraph 3.2 of CON/2011/87.

<sup>15</sup> See *Westdeutsche Landesbank Girozentrale v Friedrich Stefan and Republik Österreich*, C-464/98, ECLI:EU:C:2001:9.

<sup>16</sup> See, for example, paragraph 3.2 of Opinion CON/2016/50.

<sup>17</sup> 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).

not apply to credit agreements existing before 21 March 2016, as previously noted by the ECB<sup>18</sup>, 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 provision allows Member States to further regulate foreign currency loans on condition that such regulation is not applied with retroactive effect. In that sense the provision reflects one of the key general principles of Union law, namely the principle of legal certainty<sup>19</sup> which also embraces the principle that the retroactivity of laws must be limited<sup>20</sup>.

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

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

- 4.4 As noted in previous ECB opinions<sup>21</sup>, in the case of Poland, risks associated with foreign currency loans 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. The ECB notes that this was also acknowledged in the recent Resolution of the Polish Financial Stability Committee on the recommendation on the restructuring of the FX housing loans portfolio<sup>22</sup>.
- 4.5 The ECB notes that implementation of the draft law may entail significant financial costs for the banking sector. Whilst the explanatory memorandum does not provide any estimates, the ECB notes that, in its opinion on the draft law<sup>23</sup>, Narodowy Bank Polski assesses that the potential cost of the entry into force of the draft law would exceed the estimated costs associated with the entry into force of the proposal presented by the President of Poland on 15 January 2016 and of another proposal on foreign currency loans on which the ECB was consulted and issued an opinion<sup>24</sup>.
- 4.6 As the ECB has noted previously<sup>25</sup>, introducing measures with retroactive effect may also have some negative impact on the Polish economy if it leads to deterioration in foreign investor sentiment due to a perceived increase in legal uncertainty and country risk.
- 4.7 Consequently, the ECB encourages the Polish authorities to carry out a thorough analysis to better quantify the financial stability implications of the draft law, in particular whether the envisaged retroactive measures could have negative effects on banks taken individually, the banking sector as a whole and the overall economy in Poland. In particular, due consideration should be given to the capital adequacy of the affected institutions and cross-border effects on the consolidated profits of international banking groups.

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18 See, for example, paragraph 3.1 of Opinion CON/2016/50.

19 See, for example, the judgment of the Court of Justice of the European Union in *Gottfried Heinrich*, Case C-345/06, ECLI:EU:C:2009:140.

20 See, for example, the judgment of the Court of Justice of the European Union in *Ditta Angelo Tomadini Snc v Amministrazione delle finanze dello Stato*, Case 84/78, ECLI:EU:C:1979:129.

21 See, for example, Opinion CON/2016/50.

22 See Resolution No 14/2017 of the Financial Stability Committee of 13 January 2017 on the recommendation on the restructuring of the FX housing loans portfolio, available at [www.nbp.pl](http://www.nbp.pl).

23 Available on the Polish Parliament's website at <http://orka.sejm.gov.pl>.

24 Opinion CON/2016/39.

25 See paragraph 3.4.1 of Opinion CON/2015/26, paragraph 3.3.3 of Opinion CON/2016/39 and paragraph 3.5 of Opinion CON/2016/50.

4.8 With regard to any potential negative effects of the proposed measures, the ECB remains of the opinion that due consideration should also be given to fair burden sharing among all stakeholders, thus also avoiding moral hazard in the future. The ECB also expects that the draft law should be balanced with regard to the impact on local and foreign-owned banks.

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

Done at Frankfurt am Main, 24 March 2017.

*[signed]*

*The President of the ECB*

Mario DRAGHI