EUROPEAN CENTRAL BANK

EUROSYSTEM

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OPINION OF THE EUROPEAN CENTRAL BANK

of 9 November 2017

on support to home loan borrowers in a difficult financial situation and support for the voluntary restructuring of home loans denominated or indexed in a foreign currency

(CON/2017/48)

Introduction and legal basis

On 21 August 2017 the European Central Bank (ECB) received a request from the Polish Parliament for an opinion on a draft law amending the law on support to home loan borrowers in a difficult financial situation and amending the law on corporate income tax (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 relates to rules applicable to financial institutions in so far 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 law of 9 October 2015 on support to home loan borrowers in a difficult financial situation[2] specifies the rules for granting and the conditions of use for repayable financial aid for natural persons in financial difficulties with a home loan (hereinafter 'financial aid'). Financial aid is provided through a State-owned bank, Bank Gospodarstwa Krajowego (BGK). The law covers any home loans that are secured by a mortgage arrangement, regardless of the currency in which they were granted.

1.2 The main purpose of the draft law is to (1) change the mechanism for providing financial support to those borrowers who find themselves in a difficult financial situation and are also required to repay instalments on a home loan that represents a significant burden on their household budgets and (2) introduce a new instrument to facilitate the voluntary restructuring of loans denominated in or indexed to a foreign currency.

1.3 The draft law extends the scope of the law on support to borrowers in a difficult financial situation by introducing rules for granting a loan (hereinafter the 'repayment loan') to pay back the remaining part of the home loan and by specifying the conditions of use for the repayment loan if the amount obtained from the sale of the property fails to cover the entire obligation. Furthermore, the draft law modifies the criteria for granting financial aid and defines criteria for granting repayment loans.

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 Published in Dziennik Ustaw (Dz. U.) of 2015, item 1925.

Under the draft law financial aid or repayment loans may be granted if (1) when applying for financial aid or a repayment loan at least one of the borrowers is an unemployed person; or (2) the proportion of the borrower's expenses allocated to paying monthly instalments of principal and interest on a home loan exceeds 50 % of the borrower's household income; or (3) the monthly household income minus any monthly costs related to the home loan is lower than Polish zlotys (PLN) 1268 for a single-person household or PLN 1028 per person for a multi-person household (these amounts are subject to adjustment every three years), which is twice the amount of the current thresholds[3].

1.4 The draft law extends the duration of financial aid from 18 to 36 months and increases the maximum amount of financial aid from PLN 1 500 to PLN 2 000 per month, up to a maximum of PLN 72 000 over 3 years. Also, the new support in the form of a repayment loan may not be higher than PLN 72 000. For home loans that should be repaid in foreign currency BGK will transfer the repayment loan in the currency in which the home loan is repaid, at the selling rate of exchange published by Narodowy Bank Polski (NBP) on the day preceding the transfer of the repayment loan.

1.5 The draft law introduces an appeal procedure against a creditor's decision to reject a borrower's application for support (financial aid and/or a repayment loan). If the borrower is found to comply with the criteria for granting financial aid or a repayment loan, the creditor must pay the financial aid which would have been paid during the appeal period, or 8.33 % of the total amount of the repayment loan, from its own funds.

1.6 The draft law facilitates the provision of financial support related to the voluntary restructuring of home loans denominated in or indexed to a currency other than the currency of the borrower's income, by specifying that such loans may be voluntarily converted into home loans denominated in the currency of borrower's income. This financial support aims to cover the difference between the carrying (balance sheet) amount of the pre-restructuring debt, calculated according to the average exchange rate published by NBP, and the carrying amount of the post-restructuring debt. Such support would be granted to the creditor, who would be responsible for offering the borrower adequate restructuring terms and obtaining the borrower's consent. The creditor may apply for funds intended for voluntary restructuring up to the amount of the quarterly contribution made by the creditor to the restructuring fund. Such funds may only be used by the creditor for any voluntary restructuring agreements concluded within six months of the end of the quarter in which the contribution was made. If the creditor fails to fulfil their responsibilities, or if the creditor and the borrower fail to reach agreement, the funds will not be granted to the creditor, instead they will be divided among all other creditors contributing to a restructuring fund established under the draft law for a given period and in proportion to the contributions made. Komisja Nadzoru Finansowego (KNF, The Financial Supervisory Authority) may issue recommendations for creditors, which set forth rules determining the sequence of voluntary restructuring of the pre-restructuring debt, taking

3 See Article 3(1)(3) of the Law on support to home loan borrowers in a difficult financial situation in connection with Article 8 Section 1 of the Law of 12 March 2004 on social assistance (Dz. U. of 2016, item 930) and Regulation of the Council of Ministers of 14 July 2015 on the verification of income criteria and the amount of social assistance (Dz. U. of 2015, item 1058).

into account the stability of the financial system and the efficient allocation of funds made available for this purpose.

1.7 Under the draft law financial support would be financed by a supporting fund and a restructuring fund, both of which would form part of a support fund for borrowers managed by BGK. The supporting fund would be used to make financial aid payments and disburse repayment loans, while the restructuring fund would be used to support the voluntary restructuring of foreign currency denominated or indexed home loans. The supporting fund will be financed by (i) quarterly contributions from creditors in proportion to the portfolio of home loans whose principal or interest have been outstanding for more than 90 days, (ii) reimbursement of financial aid or repayment loans by borrowers and (iii) income from the investment of funds from the supporting fund. Quarterly contributions made by creditors to the supporting fund may not exceed 1 % of the carrying amount of the portfolio of home loans referred to above. The restructuring fund will be financed by (i), quarterly contributions from creditors in proportion to the portfolio of home loans denominated or indexed in a foreign currency and (ii) income from the investment of funds from the restructuring fund. Quarterly contributions made by creditors to the restructuring fund may not exceed 0.5 % of the carrying amount of the portfolio of home loans denominated or indexed in a currency other than the currency of the borrower's income.

1.8 Under the provisions of the draft law, quarterly contributions to the supporting and restructuring funds will be set by the Council of the support fund for borrowers on the basis of the opinion of the Polish Financial Stability Committee[4], acting in its macroprudential function. In exceptional cases, the Council may, at the request of a creditor, consent to the contributions being paid in instalments. The Council may, with the consent of the Minister competent for financial institutions, temporarily suspend a creditor's obligation to contribute to the supporting fund if the supporting fund has sufficient funds. Following the consultation of the Financial Stability Committee, acting in its macroprudential function, the Minister competent for financial institutions may suspend contributions to the supporting and restructuring funds in order to ensure the stability of the financial sector.

1.9 Under the draft law persons receiving financial support must start to repay the funds received, at the latest, in the month following the month that marks two years since either the last tranche of financial aid was paid out or the disbursement date of the repayment loan. The funds are to be repaid in 144 equal, interest-free, monthly instalments. If the borrower repays 100 instalments without any delay the remaining 44 instalments will be cancelled.

4 The Financial Stability Committee was established by the Law of 7 November 2008 (Dz. U. of 2008 No 209, item 1317). The functioning of the Financial Stability Committee, which is the competent authority for macro-prudential supervision and crisis management, is currently governed by the Law of 5 August 2015 on the macro-prudential oversight of the financial system and crisis management in the financial system (Dz. U. of 2015, item 1513).

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[5]. As previously noted by the ECB[6], the lower interest rates applicable to foreign currency loans compared to loans in domestic currencies, as well as the expectation that domestic currencies might appreciate, increased the demand for such loans. The ECB understands that most of the foreign currency loans in Poland are home loans denominated in Swiss francs and that foreign currency home loans constituted approximately 36.4 % of all outstanding home loans and 21 % of all outstanding loans to households in July 2017[7].

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[8]. However, the ECB notes that the draft law contains provisions applying not only to foreign currency loans, but also to home loans regardless of the currency in which they were granted.

3. Specific observations

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

3.1 The ECB has pointed out on several occasions the risks associated with foreign currency loans[9], and referred to the analysis of such risks by the European Systemic Risk Board (ESRB) and the ESRB's recommendations for addressing them in Recommendation ESRB/2011/1. The ECB also notes that KNF took into account the ESRB's recommendations when issuing its Recommendation S[10] 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 The ECB would repeat its past comments regarding the risks associated with foreign currency loans[11]. Nevertheless, 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 regarded as representing a particular risk from a financial stability perspective.

3.3 The ECB notes that the draft law may have a considerable impact on the profitability of the Polish banking sector, particularly when the quarterly contributions to both funds are set at their maximum level. In such a case, contributions could reduce the profits of the banking sector by up to 20 % of the current total pre-tax operating profits. Although the resulting financial impact appears manageable at the aggregate level, it could reduce the Polish banking sector's capacity to provide

5 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).

6 See for example, paragraph 2.1 of Opinion CON/2017/9. All ECB opinions are available on the ECB's website at www.ecb.europa.eu.

7 See Narodowy Bank Polski's report on monetary and financial statistics, available at www.nbp.pl.

8 See Opinions CON/2015/26, CON/2016/39 and CON/2016/50.

9 See, for example, the ECB's June 2010 Financial Stability Review, available on the ECB's website at www.ecb.europa.eu, and paragraph 3.3 of Opinion CON/2016/50.

10 Recommendation S on good practices with regard to management of credit exposures that finance property and are mortgage secured, available on the KNF's website at www.knf.gov.pl.

11 See paragraphs 3.3.1 and 3.3.2 of Opinion CON/2015/26 and paragraph 3.3.1 of Opinion CON/2016/39.

credit. The impact may also be unevenly distributed across the sector, with banks holding large portfolios of foreign currency loans being particularly affected. Against this background, the ECB notes that the draft law includes neither a limit on the size of the restructuring and the supporting fund, nor a time limit on the contributions. Thus, the financial impact of the draft law is likely to be of a recurring nature, subject only to the discretion of the Council of the support fund for borrowers and, ultimately, of the Minister of Finance. This marks a material change from the previous scheme, which was initially set at PLN 600 million with a possibility for further increases if needed and for which the cut-off date for borrowers' application submissions was 31 December 2018.

3.4 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. These effects may be aggravated if, in parallel, the Polish authorities implement further measures related to foreign currency lending that are currently under discussion.

3.5 The ECB also notes the considerable expansion of the perimeter of households eligible for financial support under the draft law. The draft law doubles the amount of the maximum per capita income threshold, below which a household is eligible to receive financial support. This may enable some households, which are not in financial distress, to take advantage of both the zero interest rate applicable to the repayments of the financial aid and the debt write-off mechanism provided for in the law. This may lead to moral hazard and put an undue financial burden on the supporting fund.

3.6 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 as regards whether the proposed measures could have negative effects on credit institutions 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 any cross-border effects on the consolidated profits of international banking groups. The Polish authorities are also invited to assess the risks that the draft law might introduce moral hazard and weaken the repayment discipline of eligible borrowers.

Legal certainty

3.7 The ECB notes that the draft law does not make it fully clear what constitutes a failure to reach an agreement for which the creditor can be made responsible, even though the failure to conclude voluntary restructuring agreements within the six-month period, following the date of the quarterly contribution payment, means that the creditor will not be entitled to receive financial support from the restructuring fund and recoup his quarterly contribution to the fund.

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

Done at Frankfurt am Main, 9 November 2017.

[signed]

The President of the ECB
Mario DRAGHI