OPINION OF THE EUROPEAN CENTRAL BANK
of 10 April 2015
on the prohibition of the auction of primary residences
(CON/2015/14)

Introduction and legal basis

On 4 March 2015 the European Central Bank (ECB) received a request from the Greek Ministry of Economy, Infrastructure, Maritime Affairs and Tourism for an opinion on a draft law introducing provisions for suspending auctions of the primary residences of eligible debtors (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 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

The stated purpose of the draft law is to tackle the current humanitarian crisis in Greece by protecting eligible debtors from the auction of their primary residences. Guarantors of eligible debtors are also granted protection from the auction of their property. Under the draft law, for a period of two months from the publication of the law or from the service of a notification for execution, debtors may establish that they are eligible for protection. The ECB understands that the protection offered under the draft law is limited to the prohibition of auctions, without impeding the foreclosure process for the protected properties.

Under the draft law, the auction by banks of primary residences, the objective value, for taxation purposes, of which does not exceed EUR 300 000, is prohibited. This prohibition will apply until 31 December 2015. In order to be eligible for protection, debtors must fulfil, notably, the following criteria: (a) their net annual income must not exceed EUR 50 000; and (b) the total value of their movable and immovable assets must not exceed EUR 500 000, of which the total amount of deposits and other movable assets in Greece and abroad on 20 November 2013 must not exceed EUR 30 000 (periodical benefits from insurance and pension schemes are excluded). During the prohibition period beneficiary debtors with an annual household income of up to EUR 35 000 are obliged to pay to the creditor a monthly instalment equal to 10% of their net monthly income. If the annual family income exceeds the threshold of EUR 35 000 the debtors are obliged to pay to the creditor a monthly instalment equal to 10%

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).

up to the threshold of EUR 35 000 and 20% on the incremental income above that threshold. More vulnerable categories of debtors are granted protection under more favourable conditions.

The protection afforded by the draft law is subject to compliance by debtors with the duty to disclose their property and account transactions. Furthermore, if a debtor does not comply with the obligation to pay the envisaged instalments for six consecutive months, the protection will be suspended.

2. General observations

2.1 The ECB understands that the draft law aims at reintroducing the prohibition on auctions of the primary residences of eligible debtors following the expiration of the pre-existing framework of Law 4224/2013[2] at the end of 2014. The ECB notes that Law 4224/2013 was adopted in December 2013 as a temporary scheme offering protection to eligible households from auctions of primary residences. The ECB notes that, in comparison with Law 4224/2013, the draft law sets out significantly broader eligibility criteria in terms of the value of the protected property, the annual household income, the value of immovable and movable assets and the amount of deposits. Under Law 4224/2013, which already provided broad protection clearly going beyond the most vulnerable households, the protection from auctions was granted provided, inter alia, that: (i) the objective value, for taxation purposes, of the primary residence did not exceed EUR 200 000, whereas the draft law sets a threshold of EUR 300 000; (ii) the debtor's annual household income did not exceed EUR 35 000, whereas the draft law sets a threshold of EUR 50 000; (iii) the value of the debtors' movable and immovable property did not exceed EUR 270 000, whereas the draft law sets a threshold of EUR 500 000; and (iv) the total value of deposits and other movable assets in Greece and abroad on 20 November 2013 must not exceed EUR 15 000, whereas the draft law sets a threshold of EUR 30 000. Law 4224/2013 was adopted following the expiration of the broad-based moratorium on auctions of primary residences that was in force from September 2010 until the end of December 2013 (the 'broad-based moratorium').

2.2 The ECB notes that the broad-based moratorium has had an adverse impact on the payment culture in Greece and was also one of the major impediments to the effective working out and resolution of the very high amount of non-performing loans (NPLs) of Greek banks. If banks are deprived of efficient tools to work out NPLs in an effective manner this could result in unnecessarily high levels of NPLs and private sector debt, which in turn have an adverse impact on financial stability. At the same time, high levels of debt also negatively affect household expenditure plans, contributing to dampening of demand for new credit and overall economic activity.

2.3 Broad-based prohibitions on the auction of primary residences, which are not well-targeted at a relatively narrow group of vulnerable debtors in real need of protection, are not an appropriate means of tackling a high volume of distressed debt, as they create moral hazard and undermine future credit supply. It is likely that the prohibitions contained in the draft law will incentivize debtors

2 FEK A 228/31.12.2013.

that are not in real need of protection to stop meeting their obligations or reduce them significantly even if they have the means to meet them in full. Banks which anticipate the negative impact these prohibitions could have on the payment culture are likely to provide less credit and ask for higher interest rates, which would subsequently undermine growth and job creation. As indicated, measures like a prohibition on auctions should be carefully targeted at vulnerable households and accompanied by further effective safeguards to prevent strategic defaults and avoid a negative impact on future credit growth. In the absence of the above conditions, the soundness of credit institutions may be adversely affected, as impairments may remain sustained or even increase due to the lack of sufficient incentives for repayment, thereby posing risks to financial stability with possible adverse spill over effects on the economy.

2.4 Moreover, this insufficiently targeted prohibition on auctions is also likely to be perceived as unfair from a social perspective. The tackling of the humanitarian crisis, the stated purpose of the draft law, is something for which the ECB, like the Institutions, certainly has understanding. The development of a social safety net would be a preferable solution for tackling this issue as it would be more effective and not trigger the abovementioned adverse effects. Prohibitions on auctions, well-targeted at vulnerable households, could, under certain conditions limiting such adverse effects, be introduced in order to accompany the development of the social safety net. Like the Institutions, the ECB stands ready to offer constructive advice with a view to achieving these objectives. Also, as indicated in Section 3, other reforms, when successfully completed, will contribute towards providing more solid ground in the relations between creditors and debtors.

3. Impact of the draft law on effective debt resolution processes and financial stability

3.1 As indicated, the ECB notes that the draft law grants protection from the auction of primary residences to a very wide group of debtors who have a net annual income of up to EUR 50 000 and a total value of movable and immovable assets not exceeding EUR 500 000. Thus, in practical terms, the draft law materially reinstates the broad-based moratorium. The very broad scope of eligible debtors, which goes beyond the protection of vulnerable and low-income debtors, may create moral hazard and could lead to strategic defaults, further undermining the payment culture and future credit growth, as explained above.

3.2 The repeated extension of broad-based prohibitions on auctions for primary residences does not constitute a sustainable solution for addressing the high level of NPLs in the Greek financial sector. First, it minimises incentives for debtors to cooperate with creditors in restructuring NPLs through efficient processes that take into account the debtor's capacity to repay. Second, the draft law could undermine the effectiveness of recent reforms that have been implemented in Greece with a view to enhancing corporate and personal debt resolution frameworks. Such recent reforms include notably the establishment of a Government Council for the Management of Private Debt, the adoption of a code of conduct to regulate banks' engagement with debtors, the establishment of an out-of-court debt restructuring framework to facilitate the early rehabilitation of viable firms that are suffering with debt, and the adoption of definitions of a cooperative borrower and reasonable living expenses for use in debt workouts.

3.3 The effective workout and resolution of NPLs is of the utmost importance for the economic recovery and has to be addressed by a comprehensive strategy and implementation plan that requires the coordinated efforts of various stakeholders[3]. Building further on the recent reforms aimed at enhancing corporate and personal debt resolution frameworks, as explained above, and the commitments underpinning the Master Financial Assistance Facility Agreement (MFFA) between the European Financial Stability Facility and the Hellenic Republic[4], this strategy should focus on policies that can further contribute to sustainable debt resolution. These policies include, inter alia, the modernisation of the personal and corporate insolvency framework, the further improvement of the functioning of the judicial system, the introduction of debt counselling services and information campaigns, and the development of a social safety net for vulnerable home owners as a permanent solution.

3.4 The ECB suggests that the Greek authorities carry out a thorough impact analysis of the possible effects of the draft law including the solvency and liquidity position of affected creditors, as the measures included in the draft law could put a significant strain on them and the stability of the Greek financial sector as a whole[5].

3.5 The ECB notes that, in principle, the draft law does not seem consistent with the commitments of the Hellenic Republic underpinning the MFFA. As discussions on the path forward for the Hellenic Republic are currently underway between the Eurogroup and the Greek government with the support of the Institutions, a final evaluation of the draft law is expected to take place within this process. The Institutions will contribute to this evaluation.

Done at Frankfurt am Main, 10 April 2015.

[signed]

The President of the ECB

Mario DRAGHI

3 See paragraph 2.4 of ECB opinion CON/2013/33 on mortgagor protection. All ECB opinions are published on the ECB's website www.ecb.europa.eu.

4 The Eurogroup agreement of 20 February 2015 includes the following commitment: 'The Greek authorities commit to refrain from any rollback of measures and unilateral changes to the policies and structural reforms that would negatively impact fiscal targets, economic recovery or financial stability, as assessed by the institutions.'

5 See paragraphs 1.2 and 3.3 of ECB opinion CON/2014/59 on new general measures stemming from the Supreme Court's decision on consumer loancontracts.