

Press release of the Financial Stability Committee on implementation of the recommendation on FX housing loans portfolio restructuring

On 10 August 2016, the Financial Stability Committee established the Working Group on the Risk of FX Housing Loans. The task of the Working Group was to prepare a draft recommendation of the Committee on solutions which would lead to a restructuring of the FX housing loans portfolio based on a voluntary agreement between banks and their clients and which would outline the desired design of such restructuring. It was established that preservation of the stability of the financial system shall be the unconditional priority when embarking on any institutional measures regarding FX housing loans.

On the basis of comprehensive analyses and proposals presented by the Working Group, on 13 January 2017 the Financial Stability Committee adopted the resolution on the recommendation regarding restructuring of the FX housing loans portfolio.

The Committee assessed that in economic terms, the FX housing loans portfolio does not generate significant risk to the stability of the financial system. Financial standing of the overwhelming majority of households that took out loans in foreign currency is good and their resilience to further exchange rate shocks remains high. This is attributed to high initial income buffers, high growth in nominal wages since loan origination and low level of interest rates in foreign currencies. As a result, FX housing loans exhibit good repayment rate and the NPL ratio is only slightly higher when compared to Polish zloty loans.

The Committee assessed negatively the solutions aimed at statutory conversion of FX housing loans at an exchange rate significantly deviating from the current market rate. The statutory conversion of housing loans could lead to very substantial losses in certain banks, in consequence posing a threat to their solvency. Mass and concentrated in time currency conversion would also result in pressure on the zloty's weakening, which, in an extreme case, could endanger the financial and macroeconomic stability of Poland. Moreover, statutory interference in already established agreements would also entail a multi-faceted legal risk.

Given the above, the Committee concluded that the systemic risk generated by the FX housing loans portfolio owing to the potential effects of statutory solutions involving mandatory conversion of loans into zloty cannot be disregarded.

With a view to the identified conditions and risk factors, the Committee found that restructuring of FX housing loans is justified solely on the basis of a voluntary agreement between the banks and borrowers, particularly in the case of borrowers who have found themselves in financial distress.

The Recommendation of the Committee on the restructuring of the FX housing loans portfolio consists of nine partial recommendations addressed to the individual institutions

represented in the Committee. Their aim is, among others, to create economic incentives providing for an acceleration of voluntary restructuring of FX housing loans.

The recommendations addressed to the minister competent for financial institutions envisage the following:

- Increasing the risk weight under pillar 1 for exposures secured by mortgages on immovable property the purchase of which was financed by FX loans. Compliance with the recommendation requires the issuance of a regulation raising to 150% the risk weight used for estimating the capital requirement for credit risk. As a result of raising the risk weight, banks using a standardized approach would have to hold more regulatory capital in order to maintain existing capital adequacy ratios.
- Raising the minimum value of the LGD parameter under pillar 1 for exposures secured by mortgages on immovable property the purchase of which was financed by FX loans. In order to obtain an effect equivalent to raising the risk weights, in the case of banks using the IRB approach for determining the capital requirement for credit risk it will be necessary to increase the minimum value of the LGD parameter. Fulfilment of this recommendation requires legislative changes to provide a legal basis for the issuance of relevant regulation.
- Changes in the operating design of the Borrowers' Support Fund. Resources accumulated in the Fund have so far been used to a limited extent. The Committee recommended the introduction of changes in the model of its operation which would, on the one hand, unblock the existing mechanism used for supporting borrowers facing a difficult situation and, on the other hand, allow to allocate Fund's resources to support the process of voluntary restructuring of the FX housing loans portfolio.
- Imposing the systemic risk buffer. The Committee recommended that the systemic risk buffer at a level of 3% should be imposed on banks (the maximum level for which the opinion of the European Commission is not required). The introduction of the buffer should strengthen the impact of other recommended instruments and ensure banks' higher resilience to shocks, including those arising from the external environment.
- Development of adequate solutions, in justified cases, neutralising potential excessive tax burdens which may result from the voluntary restructuring of FX housing loans. The success of the restructuring process depends heavily on the interest and will of borrowers and creditors to conclude voluntary agreements. Any prospective solutions should take into account legitimate social aspects and impact on public finance.

The recommendations addressed to the Polish Financial Supervision Authority envisage the following:

- Modification of the Supervisory Review and Evaluation Process (BION). The BION methodology should be extended so as to enable the imposition of additional capital

requirements related to risk factors associated with the portfolio of FX housing loans, which has not been included so far (operating risk, market risk and risk of collective default of borrowers).

- Supplementing currently used additional pillar 2 capital requirements (so-called capital surcharges). The intention of the recommendation is to include other risk types in the calculation of capital surcharges, following the adequate modification of the BION methodology. Determining new level of surcharges will be possible after conclusion of the supervisory review and fulfilling relevant procedures provided under the European regulations, mainly after consultations within colleges of supervisors.
- Issuing the supervisory recommendation on good practices relating to restructuring of the FX housing loans portfolios. The Committee pointed out that this recommendation should, among others, focus on the necessity to identify all risk types and costs associated with the FX housing loans portfolio and require banks to prepare plans for restructuring process.

The recommendation addressed to the Bank Guarantee Fund entails the following:

- Taking into account the risk associated with FX housing loans when determining a level of contributions to the banks' guarantee fund. In the method used for determining contributions to the banks' guarantee fund, both the value of guaranteed deposits and the risk profile of individual banks is taken into account. According to the Committee, it is reasonable that the ratio of the value of the FX housing loans portfolio to Tier 1 capital is also included in the banks' risk profile assessment. As a result, the distribution of contributions between banks would change so that banks with FX loans portfolios would pay higher contributions.

The institutions to which the recommendations were addressed immediately embarked on implementing them, however the pace of implementation depends, among others, on the necessity to comply with the relevant procedures defined in the European law, requirements of the legislative process associated with the issuance of regulations, the obligation to introduce certain changes at a statutory level and the related required *vacatio legis* as well as supervisory procedures. The relevant EU institutions were informed in advance about the scope of the adopted recommendations, both after the commencement of the Working Group's proceedings and shortly after the publication of the Committee's resolution, what should facilitate and speed up further proceedings.

The progress on implementation of particular recommendations presents as follows:

- The Ministry of Finance finished work on the regulation introducing higher risk weights related to exposures secured by mortgages on immovable property. The regulation was published on the 1st of June. In accordance with Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms, a 6-month *vacatio legis* is required. As a result the regulation will enter into force on the 1st of December.

- The Ministry of Finance has also started a legislative procedure with respect to the regulation on the systemic risk buffer. The regulation is expected to enter into force on 1 January 2018.
- The Ministry of Finance has drafted the Act amending the Act on supporting borrowers in financial distress. The draft Act provides for separation of two subfunds from the Borrowers' Support Fund. One subfund will take over the tasks performed by the Fund so far, however the scope of the support will be extended. The resources collected in the second subfund will be used to cover the costs of voluntary restructuring of loans, conversion of loans into zloty in particular, which should eliminate the exchange rate risk on the part of borrowers. The amount of contributions paid by banks to the second subfund will depend on the value of their FX housing loans portfolio. The new mechanism for contributing to and using the fund should stimulate the process of voluntary restructuring on the part of the creditors by incentivising them to lower the contribution calculation base and obtain highest possible assistance from the Fund.

With a view to the financial stability, the increase in the scale of the Fund's operations and the change in its functioning renders more appropriate and advantageous solution than other concepts put forward in the public debate, which would impose a considerable burden on banks and would not result in material risk reduction. The date of entry into force of the amended act depends on course of the legislative process in the parliament. Nevertheless, the Ministry of Finance expects that the new solutions could enter into force on 1 January 2018.

- The Ministry of Finance is working on the amendment to the *Banking Act* incorporating appropriate delegation for the Minister of Finance to raise the LGD parameter for banks applying advanced methods for estimating the capital requirements. The date of entry into force of the amended act depends on course of the legislative process in the parliament.
- The Ministry of Finance is analysing the needs and feasibility of introducing changes to the tax legislation, neutralising potential excessive burdens which may result from restructuring of FX housing loans, in particular in the context of the changes to operating design of the Borrowers' Support Fund.
- In April 2017 the Polish Financial Supervision Authority (PFSA) updated the BION methodology. Supervisory review and evaluation of banks on the basis of the amended BION methodology will be carried out according to the BION schedule and – in the case of commercial banks – should be concluded in November 2017.
- The PFSA carried out a review and supplemented the methodology of pillar 2 capital surcharges for banks due to the risk associated with FX housing loans. A supplement to the methodology for estimating capital surcharges related to FX portfolios has been prepared. Banks will receive individual decisions on an adequate level of regulatory

capital and capital ratios on the basis of the single methodology. It can be expected that the new capital surcharges will be announced in the fourth quarter of 2017.

- In parallel, work on the supervisory recommendation on good practices related to restructuring of loans is being carried out. The recommendation should be ready at the end of 2017. Due to the close interconnectedness of the supervisory recommendation and the act changing operating design of the Borrowers' Support Fund, the exact date of its introduction depends on work progress on the aforementioned act.
- The Bank Guarantee Fund fulfilled the Committee's recommendation addressed to it. On 31 January 2017, the PFSA approved the methodology for determining the level of contribution to the banks' guarantee fund, which takes into account the FSC recommendation. Contributions to the banks' guarantee fund due for the first and second quarters of 2017 were calculated using this methodology.

In the shared opinion of all members of the Financial Stability Committee, the declarations on legislative actions reduce borrowers' readiness to enter into voluntary negotiations with banks. On the other hand, uncertainty with respect to the cost of potential legislative solutions prevents banks, as of now, from offering restructuring of FX loans. Voluntary restructuring with the use of resources of the Borrowers' Support Fund, in contrast to legislative solutions, allows to factor in the diverse financial standing of borrowers and enables for a more effective use of creditors' funds.

The Committee will continue to monitor the progress on the implementation of the recommendation by its addressees, i.e. the Ministry of Finance and the Polish Financial Supervision Authority. As a result of the actions taken, a legal and regulatory framework will be created that favours the gradual restructuring of the FX housing loans portfolio in a way that does not pose a threat to the stability of the Polish financial system. This process should substantially relieve borrowers' burden and render the proposals of legislative solutions devoid of purpose, thus reducing the systemic risk they might generate.

Members of the Committee unanimously emphasized the will of the relevant authorities (the Ministry of Finance and the Polish Financial Supervision Authority) to quickly and efficiently implement the recommendation. At the same time, in accordance with its statutory mandate, Narodowy Bank Polski will be monitoring the process of voluntary restructuring with a view to its impact on the financial market.