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Narodowy Bank Polski

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Andrzej Sławiński, Economic Institute

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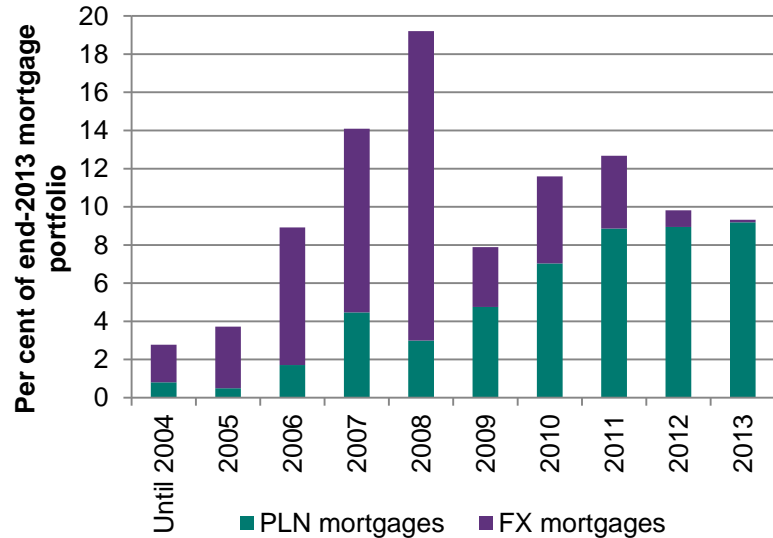
# **Financial reforms and foreign currency lending – the case of Poland**



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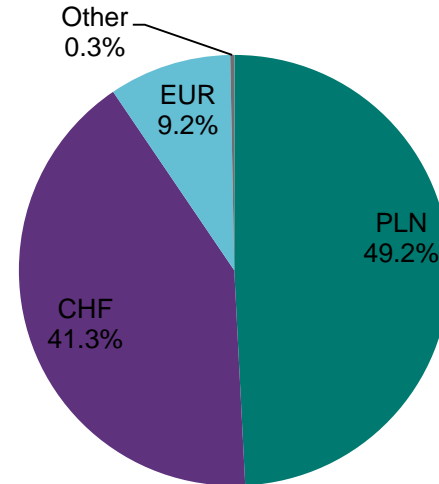
# Overview

# FX mortgage loans already a legacy issue...



Mortgage portfolio currency composition by year of granting

Source: PFSA



Mortgage portfolio currency composition, end-2013

Source: PFSA

## ...thanks to a number of policy actions...

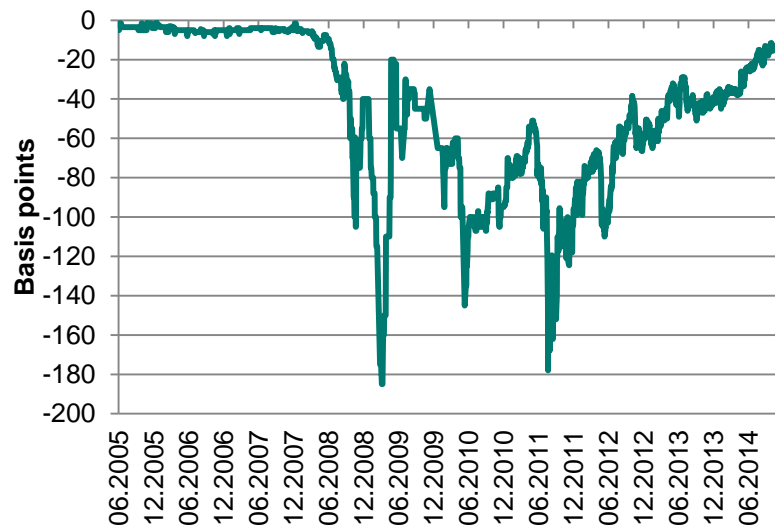
### ■ Recommendation S

- First issued in February 2006, updated in December 2008, January 2011 and June 2013.
- Mortgage loans.
- LTV limits, explicit DTI caps.

### ■ Recommendation T

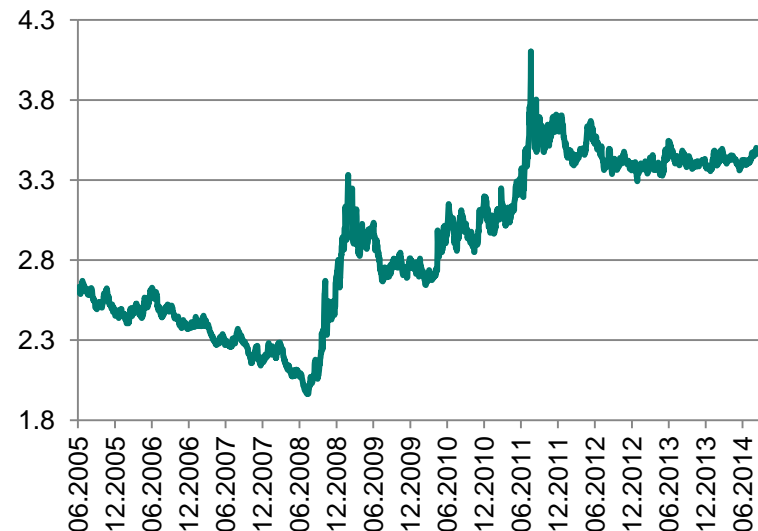
- First issued in February 2010.
- Household loans, both mortgage and consumer credit.
- Explicit DTI caps.

## ...supported by market developments...



EURPLN 5Y basis swap spread

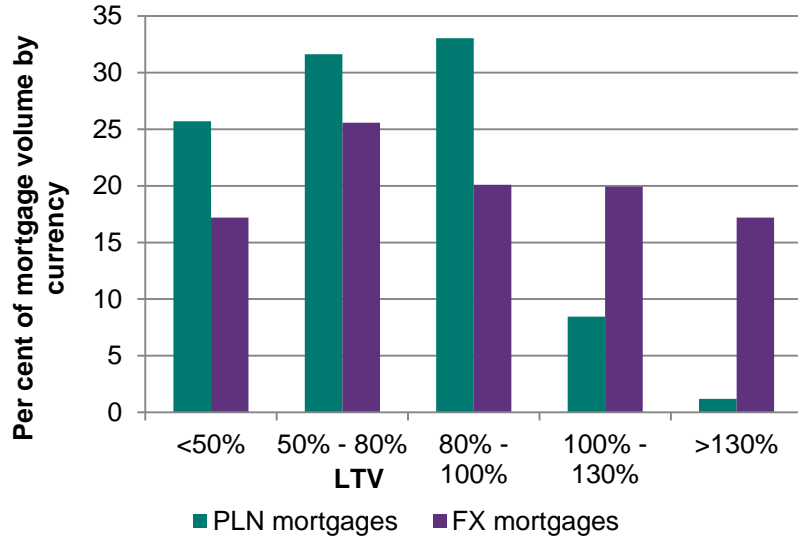
Source: Bloomberg



CHFPLN exchange rate

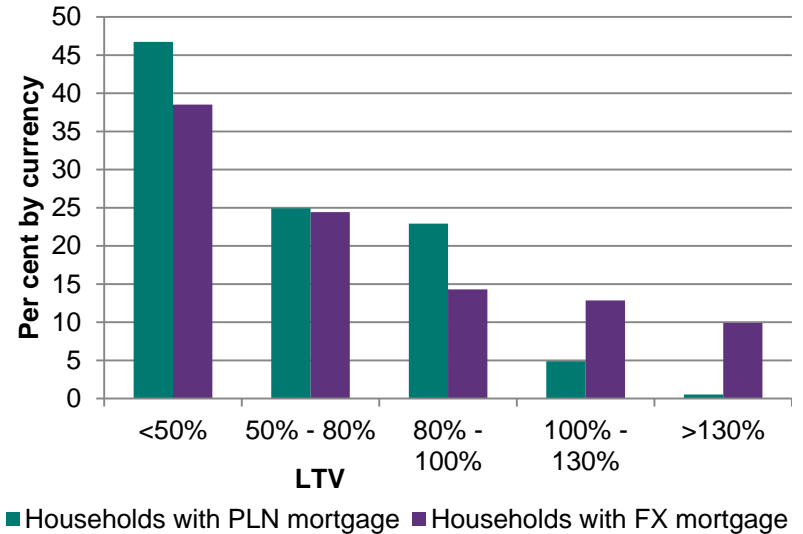
Source: Bloomberg

## ...but close monitoring still needed



Distribution of loan volumes by currency and LTV

Source: PFSA



Distribution of mortgage borrowers by currency and LTV

Source: PFSA

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# **Supervisory recommendations and changes in capital requirements**

## Issues regarding viable policy options

- Ban on capital controls (OECD and EU membership).
- Regulatory arbitrage (EU membership).
- Significant surpluses in bank capital and/or liquidity.  
→ Need to use instruments effective at customers' end.
  
- But:
  - Lack of experience and (incomplete) data → gradual approach (from qualitative recommendations regarding credit risk management to explicit limits/caps).
  - Trade-offs, e.g. limitation of credit risk vs limitation of credit supply (and regulatory arbitrage).



## The timeline

Recommendation	S	S (updated)	T	S (updated)	S (updated)
Issuance date	02.2006	12.2008	02.2010	01.2011	06.2013
Implementation date	07.2006	04.2009-07.2009	08.2010-12.2010	07.2011-12.2011	01.2014-07.2014
Main provisions	<p>More conservative assessment of creditworthiness in case of FX mortgage loans.</p> <p>The obligation for banks to establish their own LTV limits.</p>	<p>Earlier measures confirmed.</p> <p>Borrowers to be allowed to repay FX loans in foreign currency (an attempt to limit bid-ask spreads).</p>	<p>Explicit DTI caps for all exposures towards private individuals (50% or 65%, depending on borrowers' income).</p> <p>Additional buffer for DTI for FX loans.</p>	<p>“Soft” LTV limits for mortgage loans.</p> <p>Lower DTI cap for FX mortgage loans (42%).</p>	<p>Explicit LTV caps for mortgage loans (80% or 90%, depending on the collateral).</p> <p>Lifting explicit DTI caps for mortgage borrowers, DTI limits set by banks.</p>

## Recommendation S (2006)

- Qualitative recommendation of a more conservative assessment of borrowers' creditworthiness in the case of FX loans.
- Borrowers' creditworthiness assessed under the assumption that the loan amount is 20% higher and the interest rate is not lower than for a similar loan in złoty.
- Obligation to carry out regular stress-tests:
  - under the assumption of 30% PLN depreciation within a 12 month horizon.
  - under the assumption of 400 bps interest rate increase within a 12 month horizon.
- Obligation for banks to establish their own LTV limits (with no absolute numerical cap in the Recommendation).

## Recommendation T – DTI limit, February 2010

- Loan segment targeted: exposures towards private individuals, excluding those financing business activity or farming.
- 50% DTI cap in the case of borrowers with income below the average salary in the national economy and a 65% cap for borrowers with higher incomes.
- During the process of establishing the DTI caps for FX loans banks should take into account an additional buffer, calculated on the assumption that foreign currency exchange rate would increase by 10% or 20%, depending on loan maturity.
- The choice of the DTI caps was discretionary. At first, a uniform limit of 50% was considered. In the consultation process, banks proposed an additional 80% limit for high income borrowers, but this proposal was not accepted by the PFSA.

## The amendment to Recommendation S – “soft” LTV limit, DTI limit for FX real estate loans, January 2011

- Loan segment targeted: loans with real estate as a collateral and loans with other collateral, which finance the purchase of real estate.
- A 42% cap on DTI ratios for FX real estate loans taken by private persons, excluding loans, which finance business activity or farming (in effect, the cap applied to FX housing loans).
- A “soft” LTV limit: 80% for real estate loans with maturity above 5 years and 90% for other loans (possibility for banks to set higher limits based on appropriate analysis).
- A higher DTI cap, corresponding to the 65% limit applied in Recommendation T to high-income borrowers, was not applied here, despite the fact that most borrowers applying for FX real estate loans had incomes significantly above the national average.
- The choice of the LTV limits was discretionary, although the 80% threshold is commonly used to identify transactions in the real estate market that are overly financed with debt.

## The amendment to Recommendation S – “strict” LTV limits, June 2013

- Loan segment targeted: loans with real estate as a collateral (irrespective of currency)
- LTV limits for residential real estate mortgage loans:
  - 90% - if part of the loan exceeding the 80% limit is insured or backed by high quality collateral (funds on bank account, government or NBP paper),
  - 80% in other cases.
- Transition period: the limits will be gradually reduced from the initial level of 95% which came into force beginning 2014 to the target levels in 2017 (a decrease by 5 pp. every year).
- LTV limits for commercial real estate mortgage loans:
  - 80% - if part of the loan exceeding the 75% limit is insured or backed by high quality collateral,
  - 75% in other cases.
- The existing caps on DTI ratios were removed. DTI limits are to be established by banks themselves. Banks should pay particular attention to loans for which:
  - DTI ratios exceed 40% (for borrowers with incomes below the average salary in the region),
  - 50% (for borrowers with higher incomes).

## Application and enforcement

- The DTI and LTV limits introduced in recommendations issued by the Polish Financial Supervision Authority (PFSA).
  - The PFSA supervises the financial services industry in Poland, including banks and other credit institutions, insurance firms, pension funds and investment companies.
  - A representative of the central bank in the PFSA.
- Formally, recommendations are “soft” measures – in the legal sense not binding for banks.
  - According to the Banking Act, recommendations should be applied accordingly to branches of foreign credit institutions.
- In practice implemented and followed by the banking sector.
- The PFSA can also check compliance with the recommendations as part of the regular supervisory process (including on-site visits).

## Changes in capital requirements

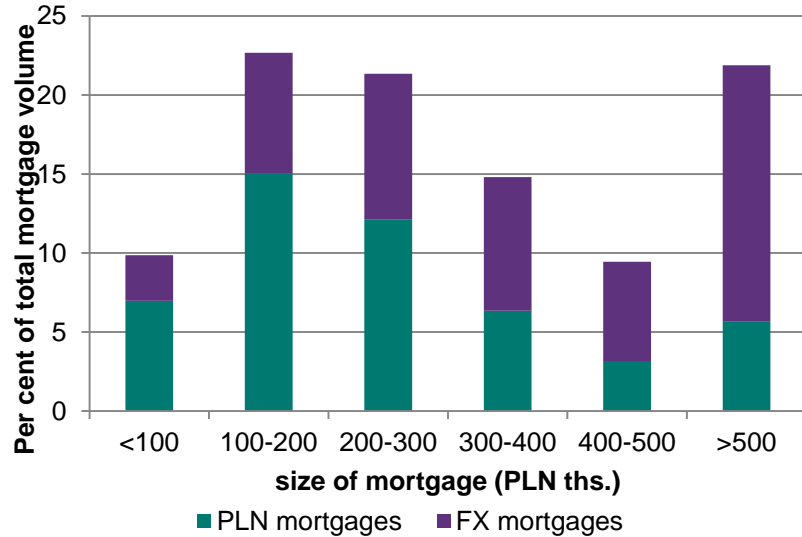
- Stricter capital requirements for high-LTV FX loans in 2007.
  - Risk weight increased from 50% to 75% for part of the FX mortgage loan below 50% of the real estate collateral value.
  - Rest of the for FX mortgage loan (above 50% collateral value) with standard 100% risk weight.
  - Risk weight for PLN mortgage loans decreased from 50% to 35%.
- Minimum risk weight for FX mortgage loans increased from 75% to 100% since June 2012 (adopted in June 2011).

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# FX mortgage portfolio – current situation

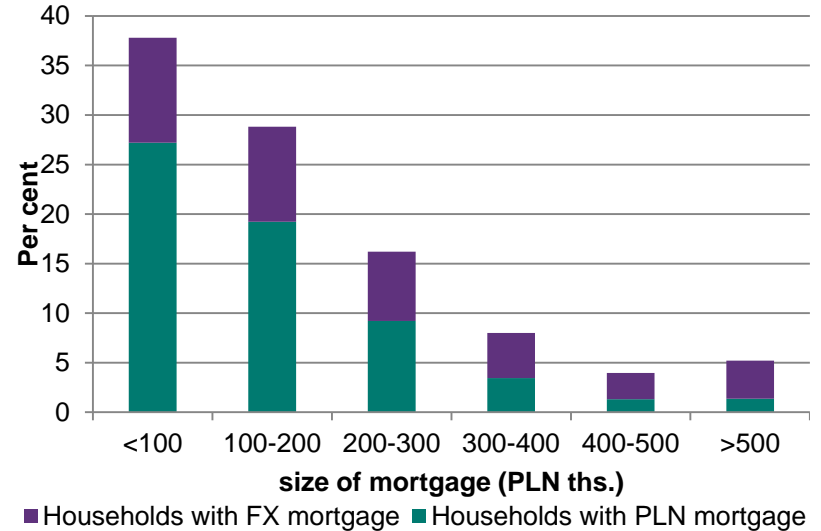


# FX mortgages having large average size...



Distribution of loan volumes by loan amount

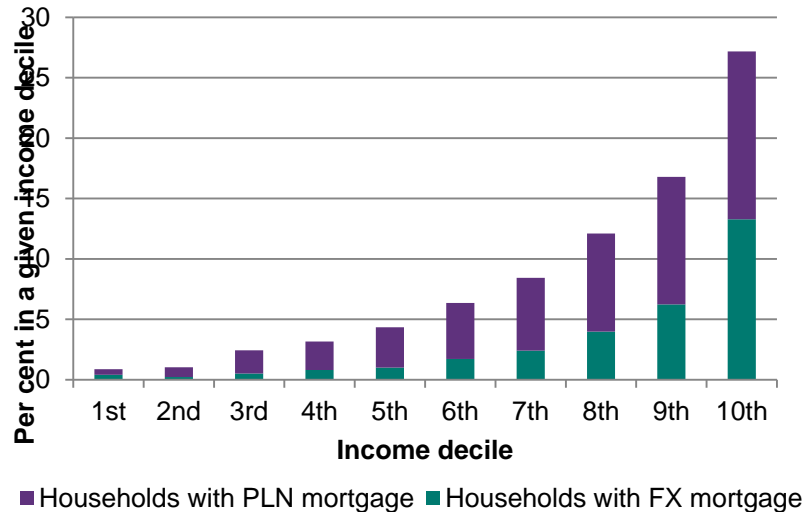
Source: PFSA



Distribution of mortgage borrowers by loan amount

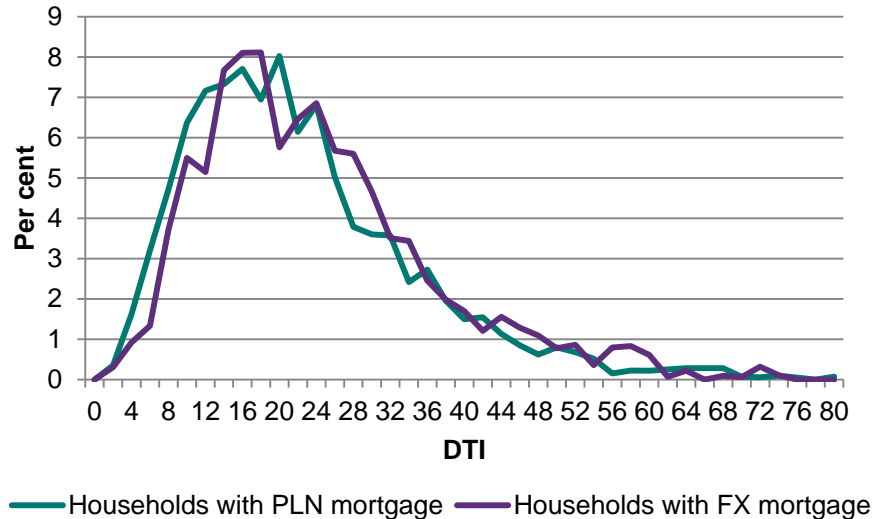
Source: PFSA

# ...granted mostly to high-earners, but debt burdens not much different depending on currency...



Share of mortgage borrowers by income decile

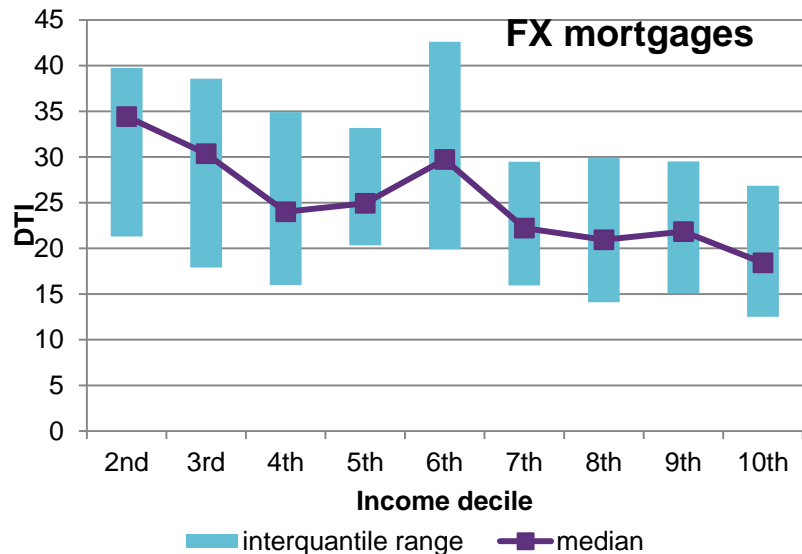
Source: NBP calculations based on PHBS data



Distribution of mortgage borrowers by DTI

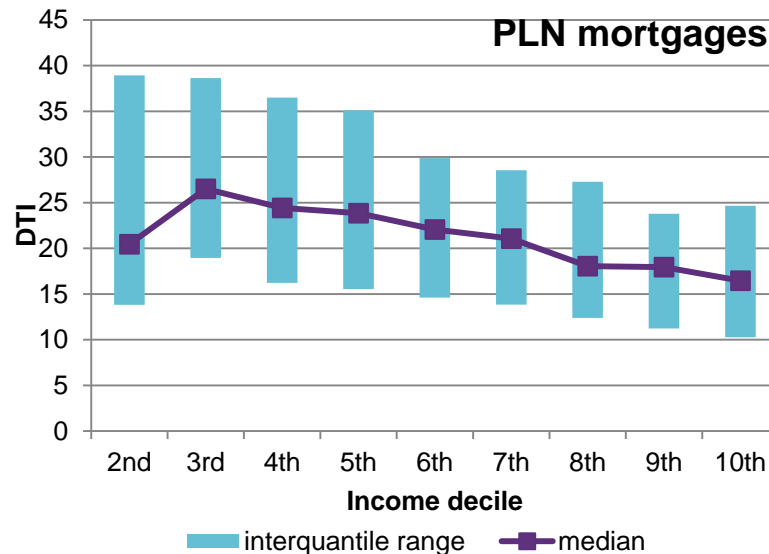
Source: NBP calculations based on PHBS data

## ...although now income level matters more than currency



DTI characteristics by income decile (FX mortgage borrowers)

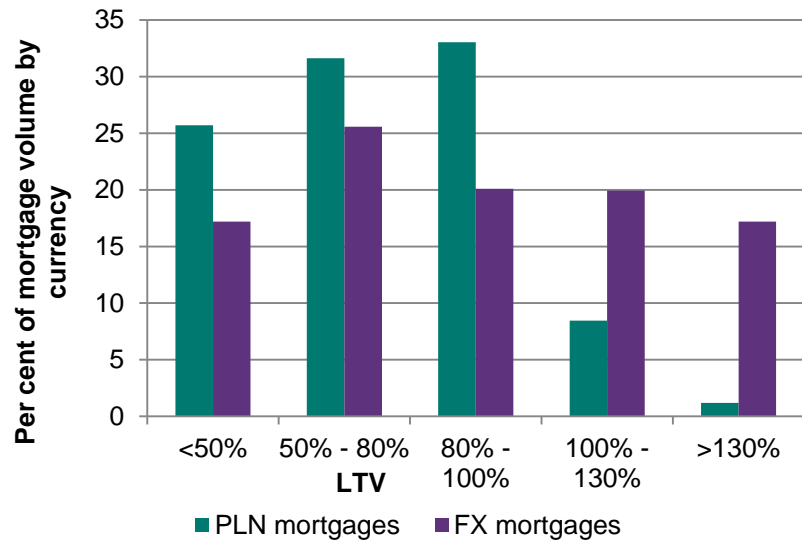
Source: NBP calculations based on PHBS data



DTI characteristics by income decile (PLN mortgage borrowers)

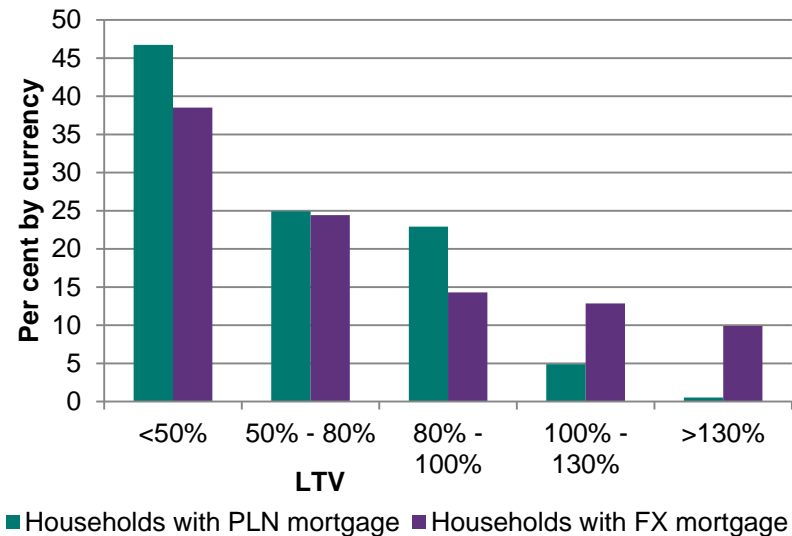
Source: NBP calculations based on PHBS data

## ...but close monitoring still needed



Distribution of loan volumes by currency and LTV

Source: PFSA



Distribution of mortgage borrowers by currency and LTV

Source: PFSA

## Conclusions

- **Need for a policy action** in a small open economy with large cross-border bank ownership, a flexible exchange rate and direct inflation targeting strategy.
- **Regulatory concerns:** rise of FX mortgage lending contributing to an accumulation of credit risk, an asset price bubble and disturbances in the monetary transmission mechanism.
- **Limitations on viable policy options**, given ban on capital controls, real threat of regulatory arbitrage and strong capital and/or liquidity position of banks.
- **FX mortgage lending successfully eliminated**, although changing environment (the financial crisis) helped as well.
  - The legacy of FX mortgage lending remains an issue.

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**Thank you!**



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