

OPINION OF THE EUROPEAN SYSTEMIC RISK BOARD

of 1 September 2023

**regarding the Polish notification of higher risk weights set for immovable property pursuant to Articles 124(2) and 125(1) of Regulation (EU) No 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012
(ESRB/2023/8)**

THE GENERAL BOARD OF THE EUROPEAN SYSTEMIC RISK BOARD,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board¹, and in particular Article 3(2)(j) thereof,

Having regard to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012², and in particular Article 124(2) and article 125(1) thereof,

Having regard to Decision ESRB/2015/4 of the European Systemic Risk Board of 16 December 2015 on a coordination framework for the notification of national macroprudential policy measures by relevant authorities, the issuing of opinions and recommendations by the ESRB, and repealing Decision ESRB/2014/2³.

Whereas:

- (1) The Polish Minister of Finance, acting as the designated authority for the purpose of Article 124 of Regulation (EU) No 575/2013, notified the European Systemic Risk Board (ESRB) on 4 August 2023 of her decision to temporarily extend the reduction of the previously set higher risk weights for exposures to a specific property segment secured by mortgages on immovable property, in accordance with Article 124(2) of that Regulation.
- (2) Under Articles 124 to 126 of Regulation (EU) No 575/2013, standard risk weights are assigned to exposures fully secured by mortgages on residential and commercial immovable property. Under Article 125(1) of Regulation (EU) No 575/2013, standard risk weights are assigned to exposures fully and completely secured by mortgages on residential property.

¹ OJ L 331, 15.12.2010, p. 1.

² OJ L 176, 27.6.2013, p. 1.

³ OJ C 97, 12.3.2016, p. 28.



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- (3) According to Article 124(2) of Regulation (EU) No 575/2013, the authority designated in accordance with Article 124(1a) of Regulation (EU) No 575/2013 must periodically, and at least annually, assess whether the standard risk weights assigned under Regulation (EU) No 575/2013 are appropriately based on: the loss experience of exposures secured by immovable property; and forward-looking immovable property markets developments. Where, on the basis of that assessment, the authority designated in accordance with Article 124(1a) of Regulation (EU) No 575/2013 concludes that the risk weights do not adequately reflect the actual risks related to exposures to one or more property segments, and if it considers that the inadequacy of the risk weights could adversely affect current or future financial stability in its Member State, it may increase the risk weights applicable to those exposures within the ranges determined in Article 124(2), subparagraph 4 of Regulation (EU) No 575/2013.
- (4) In the years 2003-2013, with peaks in 2007 and 2008, a substantial number of mortgages in Poland were contracted in foreign currency (hereinafter ‘foreign currency mortgages’). This was mainly due to the strength of the zloty (PLN) in relation to foreign currencies and the availability, for foreign currency loans, of lower interest rates, which allowed borrowers to benefit from advantageous financial conditions. However, to address potential threats associated with the excessive growth of foreign currency mortgages, the granting of new foreign currency mortgages was ultimately prohibited in 2013. Nevertheless, many of mortgages that were issued before the prohibition came into force in 2013 remain in the books of Polish banks.
- (5) Excessive foreign currency lending can be a source of significant systemic risks. In 2011 the ESRB issued a Recommendation on lending in foreign currencies⁴ to address such risks. In that Recommendation, the ESRB emphasised that foreign currency loans can, under certain circumstances, pose a threat to financial stability. The ESRB also noted that excessive levels of foreign currency lending have led to substantial currency mismatches, that they may create conditions for negative cross-border spillover effects, that they also have contributed to the reinforcement of credit cycles, and that they may eventually pose a systemic threat to the countries concerned.
- (6) By way of the regulation of 25 May 2017, which has been in force since 2 December 2017, the Polish Minister of Development and Finance set higher risk weights for foreign currency mortgages to: ensure the resilience of the financial system; guarantee a sufficient level of capital for banks exposed to foreign currency mortgages; and facilitate voluntary agreements to convert foreign currency mortgages into mortgages denominated in PLN.
- (7) However, setting higher risk weights for foreign currency mortgages did not result in a significant number of voluntary agreements to convert foreign currency mortgages into mortgages denominated in PLN. On 30 June 2023, the portfolio of foreign currency mortgages accounted for approximately 17 % of the entire domestic commercial banks’ housing loan portfolio, although

⁴ Recommendation ESRB/2011/1 of the European Systemic Risk Board of 21 September 2011 on lending in foreign currencies (OJ C 342, 22.11.2011, p. 1).



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the granting of new foreign currency mortgages was prohibited in 2013. In addition, many borrowers have filed lawsuits against banks that issued foreign currency mortgages, and Polish courts have regularly invalidated this form of lending citing consumer protection concerns, such as that the so-called indexation clauses used in the foreign currency mortgages were considered abusive. The rulings of the Polish courts led to the reversal of foreign currency mortgages that were declared invalid, which predominantly benefitted the borrowers. This approach of the Polish courts was in line with the case-law of the European Court of Justice on the interpretation of EU consumer protection laws. In 2019⁵ and in 2022⁶, the Court of Justice ruled on foreign currency mortgage loans to consumers, finding that the consequences of an agreement's invalidity due to its abusive clauses must be handled according to national law. As a result, the number of claims has increased, and more than 127 000 claims were filed before the end of June 2023. Narodowy Bank Polski estimates the overall amount of additional provisions required to be raised by the banks at around PLN 50 billion⁷.

- (8) To increase the number of voluntary conversions of foreign currency mortgages into mortgages denominated in PLN, in particular to acknowledge the timing mismatch in capital requirements because of necessary loan loss provisions and write-offs or adjustments that banks must make before voluntarily offering the conversion of foreign currency mortgages into mortgages denominated in PLN, the Polish Minister of Finance has, by way of a regulation, reduced the risk weights for specific foreign currency mortgages. The risk weights are set at: (i) 50 % for housing loans with loan loss provisions and write-offs or adjustments amounting to at least 35 % of the gross foreign currency mortgages exposure; (ii) 75 % for housing loans with loan loss provisions and write-offs or adjustments amounting to at least 28 % of the gross foreign currency mortgages exposure; and (iii) 100 % for housing loans with loan loss provisions and write-offs or adjustments amounting to at least 20 % of the gross foreign currency mortgages exposure. Moreover, these reduced risk weights only apply to foreign currency mortgages for which banks offer voluntary settlements involving arbitration courts to clients. For other foreign currency mortgages, the risk weight remains at 150 %.
- (9) These risk weights apply to outstanding foreign currency mortgages only. New mortgage loan contracts that provide for repayment in a currency different from the one of the borrower's principal income have been banned altogether. This temporary adjustment of previously increased risk weights for specific foreign currency mortgages has been in place since 18 March 2022. It was introduced for a fixed period and will expire at the end of September 2023. After this measure expires, the risk weight for all foreign currency mortgages should automatically return to the level of 150 %.

⁵ Judgment of 3 October 2019, Dziubak, C-260/18, EU:C:2019:819.

⁶ Judgment of 8 September 2022, M. (Crédit hypothécaire libellé en devises étrangères), C-80/21, EU:C:2022:646.

⁷ Narodowy Bank Polski, Financial Stability Report (June 2023), p 35.

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- (10) Based on the Polish Financial Stability Committee's recommendation of 6 July 2023⁸, the Polish Minister of Finance intends to extend the temporary adjustment of risk weights for specific foreign currency mortgages by a further 24 months, from 1 October 2023 and until on 30 September 2025. As a result, for foreign currency housing loans, risk weights higher than the 35 % risk weight provided for in Article 125 of Regulation (EU) No 575/2013 would ultimately be maintained for these exposures. The extension of this measure would continue to encourage banks to offer voluntary settlements to borrowers to convert the foreign currency mortgages into loans denominated in PLN.
- (11) Pursuant to Article 124(2), subparagraph 3, of Regulation (EU) No 575/2013 the ESRB is to provide the Member State concerned with an opinion on the proposed measure within one month of receipt of notification from the competent authority.
- (12) The ESRB agrees in principle with the assessment of the financial stability of the residential real estate sector in Poland that banks' legacy portfolios of foreign currency mortgages pose a certain risk of potential losses on their profitability. In particular, the share of foreign currency mortgage contracts currently in litigation is high. It amounts to over 127 000 claims. The ESRB therefore reiterates the need ensure that banks have a sufficient amount of capital to cover potential losses due to legacy portfolios of foreign currency mortgages by increasing capital requirements, either through increased risk weights, the introduction or increase of capital buffers, such as the sectoral systemic risk buffer, or through the use of Pillar II measures.
- (13) The ESRB would have also appreciated more detailed information in the notification on the effectiveness of the measure, on how loss experience and property market developments were taken into account in the calibration of the measure and the target level of outstanding foreign currency mortgages which would no longer necessitate such a risk weight measure.
- (14) Since the measure, which is an adjustment of previously adjusted risk weights to reflect the actual risks related to exposures to one or more property segments, has been in place since March 2022 and is now to be extended by 24 months, Polish authorities are encouraged to assess periodically, and at least annually, whether this measure has significantly contributed to an increase in the voluntary conversion of outstanding foreign currency mortgages into mortgages denominated in PLN. With a view to the multifaceted nature of these foreign currency mortgages' riskiness, it appears to be worth considering that the Polish authorities could also choose another, non-macroprudential, instrument to achieve their objective of setting incentives to convert outstanding foreign currency mortgages into mortgages denominated in PLN after the extended measure will have expired,

HAS ADOPTED THIS OPINION:

⁸ Uchwała Nr 69/2023 Komitetu Stabilności Finansowej z dnia 6 lipca 2023 r. w sprawie rekomendacji dotyczącej wag ryzyka dla ekspozycji zabezpieczonych hipoteką na nieruchomości mieszkalnej.

1. The extension of the measure adjusting the elevated risk weights applicable to specific foreign currency mortgages in Poland by the Polish Minister of Finance is considered to address the legal risks associated with foreign currency mortgages, as it encourages banks to voluntarily convert foreign currency mortgages into mortgages denominated in PLN. The reduction in the number of foreign currency mortgages will have a positive impact on the total amount of additional provisions that banks need to set aside to cover potential losses from their exposures to foreign currency mortgages, and will thus also contribute to preserving financial stability.
2. The extension of the measure adjusting the elevated risk weights applicable to specific foreign currency mortgages in Poland by the Polish Minister of Finance, as well as the duration of this temporary adjustment, is assessed as appropriate and effective to address the identified risks. Under the current circumstances, the measure does not entail disproportionate adverse effects on financial stability in Poland and is not expected to form or create an obstacle to the proper functioning of the internal market. In addition, the measure is assessed as being in line with the ESRB's view on foreign currency lending, as expressed in Recommendation ESRB/2011/1. While banks are required to hold adequate capital to cover risks associated with specific foreign currency lending, the temporary adjustment of the risk weights for risks related to exposures to one or more property segments is encouraging banks to voluntarily offer agreements to convert foreign currency mortgages into mortgages denominated in PLN.
3. The Polish Minister of Finance, acting as the designated authority for the purpose of Article 124 of Regulation (EU) No 575/2013, must periodically, and at least annually, assess whether the risk weights provided for in Regulation (EU) No 575/2013 or set by the authority designated in accordance with Article 124(1a) of Regulation (EU) No 575/2013 adequately reflect the actual risks related to exposures to one or more property segments, and if it considers that the inadequacy of the risk weights could adversely affect current or future financial stability in Poland. This applies to the risk weights set for exposures denominated in foreign currency and secured by mortgages on residential property, which were increased in 2017.
4. As for the aim of converting outstanding foreign currency loans secured by mortgages on residential property into loans denominated in Polish PLN, which is not solely macroprudential in nature, the Polish national authorities should also consider a broader set of potential measures in order to, among others, set additional incentives for voluntary agreements on such a conversion.
5. The attached assessment note entitled 'Assessment of the extension of higher risk weights for exposures secured by mortgages on residential property in accordance with Article 124 of the Capital Requirements Regulation in Poland' is an integral part of this Opinion.



Francesco Mazzaferrò

Head of the ESRB Secretariat, on behalf of the General Board of the ESRB

Francesco MAZZAFERRO