ESRB
European Systemic Risk Board
European System of Financial Supervision

November 2013

Updated May 2015[1]

ESRB Recommendation on lending in foreign currencies (ESRB/2011/1)
Follow-up Report – Overall assessment

[1] This is an amended version of the report published in November 2013. The updated report includes an assessment of Croatia and the European Banking Authority (January 2015) as well as an assessment of the economic effects of the Recommendation (April 2015).

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Abbreviations

Abbreviations used in tables

FC	fully compliant
LC	largely compliant with minor discrepancies
PC	partially compliant
MN	materially non-compliant
NC	non-compliant
SE	inaction sufficiently explained
IE	inaction insufficiently explained

Countries

BE	Belgium
BG	Bulgaria
CZ	Czech Republic
DK	Denmark
DE	Germany
EE	Estonia
IE	Ireland
GR	Greece
ES	Spain
FR	France
HR	Croatia
IT	Italy
CY	Cyprus
LV	Latvia
LT	Lithuania
LU	Luxembourg
HU	Hungary
MT	Malta
NL	Netherlands
AT	Austria
PL	Poland
PT	Portugal
RO	Romania
SI	Slovenia
SK	Slovakia
FI	Finland
SE	Sweden
UK	United Kingdom

Introduction

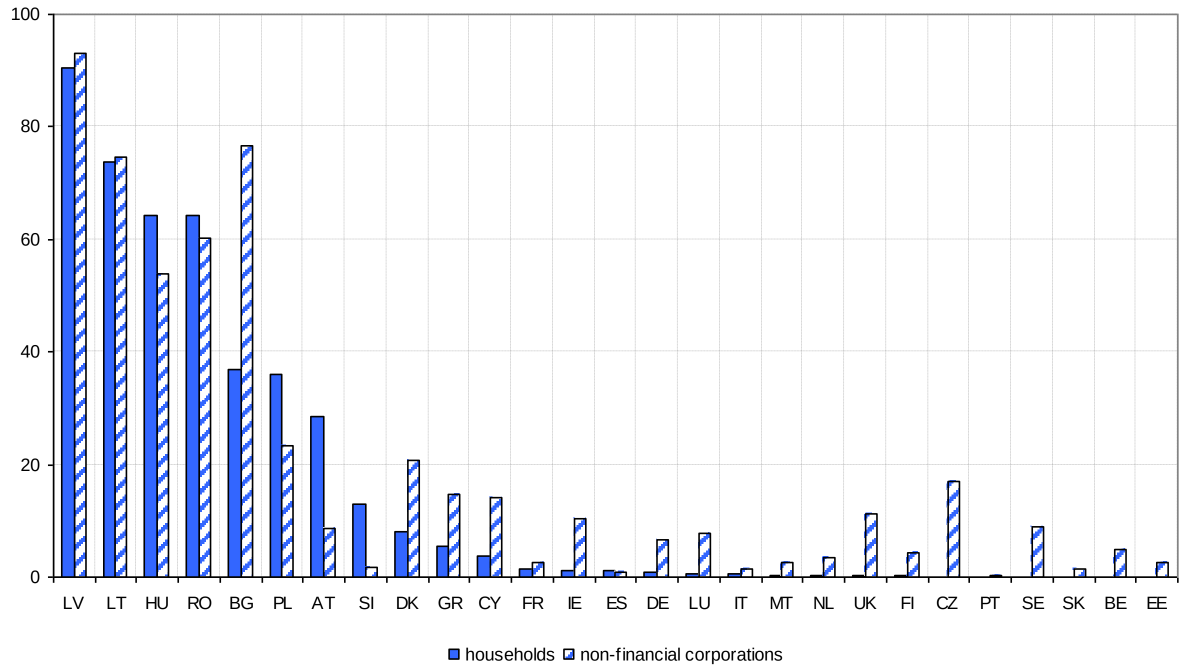
This report provides the European Systemic Risk Board's assessment of the implementation of Recommendation ESRB/2011/1 on lending in foreign currencies[2] (hereinafter, the "ESRB Recommendation" or the "Recommendation"). The deadline for addressees to provide information on the level of implementation was 30 December 2012 for national supervisory authorities and Member States, and 31 December 2013 for the European Banking Authority (EBA).

The follow-up report on the ESRB Recommendation was approved by the General Board in November 2013 and published thereafter. However, it was only possible to finalise the review of implementation with regard to Croatia and the EBA in January 2015.[3] Hence, this is an updated version of the original report.

Recommendation ESRB/2011/1 contains seven recommendations (marked with letters "A" to "G"). The report contains a detailed assessment of the implementation of each one.

The Recommendation also contains an economic Annex, which documents the level of foreign currency lending in the Member States. Chart 1 is drawn from the Annex and refers to April 2011 data.

Chart 1 Foreign currency lending to households and non-financial corporations in the EU 27



Source: ECB balance sheet item statistics and own calculations.
Note: This chart depicts foreign currency lending by monetary financial institutions to resident counterparties, i.e. as a percentage of total outstanding loans in April 2011.

Implementation of the ESRB Recommendation was verified using the "act or explain" mechanism, where the addressee of a recommendation can either (i) take action in response to a recommendation and inform the ESRB of such action, or (ii) take no action to implement the recommendation but

[2] OJ C 342/1, 22 November 2011.

[3] Croatia was not included in the previous assessment since it was then undergoing the EU accession process. Therefore, as in the past review concerning the other Member States, it was assessed against the whole Recommendation. The assessment of implementation by the EBA, however, only concerns sub-recommendation E.2.

properly justify the reasons for inaction. The ESRB subsequently analyses the information provided and verifies whether the actions taken duly achieve the objective of the recommendation or whether the justification provided for inaction is sufficient. This analysis results in a final grade being assigned to each Member State.[4]

Positive grades	Mid-grade	Negative grades
Fully compliant (FC) – Actions taken fully implement the recommendation	**Partially compliant (PC)** – Actions taken only implement part of the recommendation	**Materially non-compliant (MNC)** – Actions taken only implement a very small part of the recommendation
Largely compliant with minor discrepancies (LC) – Actions taken implement almost all of the recommendation		**Non-compliant (NC)** – Actions taken are not in line with the nature of the recommendation
Sufficiently explained (SE) – No actions were taken but the addressee provided sufficient justification		**Inaction insufficiently explained (IE)** – No actions were taken and the addressee did not provide sufficient justification

The colour coding above allows the reader to understand the meaning of the different types of grades assigned.

The assessment was conducted at three levels:

(1) each individual section of the seven recommendations (sub-recommendations);

(2) each recommendation;

(3) the overall degree of implementation of the ESRB Recommendation.[5]

The assessment follows the methodology provided in the “Handbook on the follow-up to ESRB Recommendations” (the “Handbook”).[6] This document was approved by the General Board in April 2013 and is intended to act as a guidance tool for all future assessment teams. This follow-up report is the first time that the Handbook has been used.

[4] Recommendation ESRB/2011/1 limits, to a certain extent, the possibility for addressees to explain their inaction. For instance, the Recommendation refers to the principle of proportionality to ensure that measures are taken in those economies where the level of foreign currency lending to unhedged borrowers could create a systemic risk, also based on the overall size of the outstanding loans. At the same time, the Recommendation states that the principle of proportionality cannot be invoked to justify inaction with regard to some recommendations, i.e. Recommendations A and G, and explains the reasoning behind this exception. The ESRB also wants to prevent new adverse developments in those economies where foreign currency lending to unhedged borrowers has until now been fairly limited.

[5] The assessments took the form of a “bottom up” process, where grades assigned to the detailed individual sections of the Recommendation were used to compute the overall assessment of Member States. Some flexibility was envisaged. In general, more weight was given to the weakest spots in a country’s performance when computing the average final assessment. However, for Recommendation G, where non-compliance was most probably due to a defect in the original design of the ESRB Recommendation, non-compliance was not included in the computation of the average.

[6] The Handbook is available via the ESRB’s website (www.esrb.europa.eu).

The assessment of the implementation of the ESRB Recommendation was based on each Member State's own submissions. Additional information was collected on a voluntary basis and taken into consideration in the assessment.

To carry out the work, an assessment team was set up according to the rules contained in the Handbook. A number of ESRB member institutions were actively involved in assessing implementation. None of them, however, were directly involved in grading their own country's performance. The assessors were divided into two groups, with the first conducting its analysis of implementation by country, and the second focusing on recommendation type. After cross-checking the results of both groups, the assessment team agreed on the final outcomes.

The overall level of implementation of the ESRB Recommendation was high. On the basis of the information provided, no country received a non-compliant grade. In total, 13 countries were assessed as fully compliant, 14 countries as largely compliant and one as partially compliant. The implementing measures developed by the EBA were also evaluated as fully compliant.

For ease of understanding, a table showing the overall level of implementation for each recommendation is included on page seven.

Notwithstanding the high level of implementation, two further actions are necessary.

First, the assessment took place at a time when financial activity was well below historical averages in many economies, owing to a compression of both the demand and supply of credit after the eruption of the financial crisis.[7] In other words, economic conditions have not yet materialised that could lead to a renewal of foreign currency lending to unhedged borrowers, which could in turn trigger new systemic vulnerabilities. Thus, the effectiveness of Recommendation ESRB/2011/1 has not yet been fully proven. This is shown by authorities persistently referring to the current low level of new foreign currency lending to justify their lack of action. The widespread reference to the principle of proportionality to justify inaction reveals that the need for macro-prudential action remains limited.

Therefore, there may need to be a repeat assessment of the implementation of the Recommendation in a few years, when economic activity and credit conditions should be more robust. The ESRB will continue to monitor developments and decide when a new assessment is necessary.

Second, the assessment has shown that there is still scope for immediate action with regard to information exchanges between national supervisory authorities. Recommendation G, which created a mechanism for the transmission of information between home and host authorities and to the ESRB and EBA on measures to address vulnerabilities, has only been partly successful. While there is evidence that information exchanges took place in colleges of supervisors, an ESRB-wide multilateral mechanism to share publicly available macro-prudential information seems warranted.

In many respects, the failure to fully implement Recommendation G is due to the complexity of the initial design for implementing information exchanges, including the lack of a centralised hub. A procedure based on the use of the ESRB website was established. However, it cannot be ignored that, in some cases, the lack of bilateral communication channels may show that authorities have given insufficient attention to possible cross-border spillover.

[7] While slower economic growth leads to lower demand for credit in general, it is not obvious that developments in foreign currency lending necessarily mirror developments in local currency lending. Although this may be the case, such a statement would require additional, more advanced research in the future and developments should continue to be closely monitored. Subdued levels of activity across the financial sector and low interest rates may influence some banks' business models. Banks with a low return on equity seeking higher yields may be looking for credit clients, perhaps to an excessive degree, and credit standards may be at risk of being compromised. Furthermore, in an environment of extremely low interest rates, the creditworthiness of some households may increase in foreign currencies as compared with their local currency.

Colour shade table – individual country results

This table shows, at a glance, the overall implementation level of the ESRB Recommendation.

Country	Recommendations								Overall
	A	B	C	D	E.1	E.2	F	G	
Belgium	LC	LC	SE	SE	LC		FC	IE	LC
Bulgaria	PC	PC	SE	PC	LC		FC	SE	PC
Czech Republic	SE	SE	FC	SE	SE		FC	SE	FC
Croatia	FC	LC	FC	FC	FC		FC	SE	FC
Denmark	SE	SE	SE	FC	FC		FC	IE	LC
Germany	LC	SE	FC	FC	SE		FC	SE	FC
Estonia	FC	SE	FC	LC	FC		SE	SE	FC
Ireland	SE	LC	FC	SE	SE		LC	SE	LC
Greece	FC	SE	SE	SE	SE		SE	FC	FC
Spain	LC[8]	SE	SE	FC	FC		FC	SE	FC
France	IE	SE	FC	SE	SE		FC	SE	LC
Italy	LC[9]	SE	SE	SE	SE		SE	FC	LC
Cyprus	SE	LC	FC	SE	LC		FC	SE	LC
Latvia[10]	SE	LC	FC	LC	LC		FC	SE	LC
Lithuania[11]	LC	LC	FC	FC	PC		LC	SE	LC
Luxembourg	FC	FC	FC	FC	FC		FC	SE	FC
Hungary[12]	FC	FC	FC	FC	PC		FC	SE	LC
Malta	FC	FC	FC	FC	FC		FC	FC	FC
Netherlands	SE	SE	SE	SE	SE		SE	SE	LC
Austria	FC	FC	FC	FC	FC		FC	FC	FC
Poland	FC	FC	FC	FC	FC		FC	SE	FC
Portugal	FC	FC	SE	SE	SE		FC	SE	FC
Romania	LC	FC	FC	FC	FC		FC	FC	FC
Slovenia	LC	LC	SE	SE	SE		LC	SE	LC
Slovakia	FC	SE	SE	SE	SE		SE	SE	FC
Finland	SE	SE	SE	SE	SE		SE	SE	LC
Sweden	SE	LC	SE	FC	SE		SE	SE	LC
United Kingdom	SE	SE	SE	LC	SE		LC	LC	LC

[8] In July 2014 the Banco de España introduced new measures to address discrepancies concerning the implementation of Recommendation A. Since the publication of Circular BE 3/2014 of 30 July 2014, the Spanish self-assessment implies full compliance with this Recommendation. Measures taken are adequate and justify an upgrade of Spain's compliance level. However, this can only be done through a fully-fledged assessment procedure where all addressees are assessed on an equal footing by the Assessment Team.

[9] The Banca d'Italia has been in the process of amending secondary regulation on the transparency of banking operations and services and the fairness of relations with customers. The amended regulation should raise risk awareness among clients and broaden Italy's compliance with Recommendation A. Measures to be taken are adequate and might justify an upgrade of Italy's compliance level. However, this can only be done through a fully-fledged assessment procedure where all addressees are assessed on an equal footing by the Assessment Team.

[10] In January 2014 Latvia joined the euro area and the risk related to foreign currency lending became immaterial. Although an upgrade of Latvia's overall compliance level could be justified, this can only be done through a fully-fledged assessment procedure where all addressees are assessed on an equal footing by the Assessment Team.

[11] In January 2015 Lithuania joined the euro area and the risk related to foreign currency lending became immaterial. Although an upgrade of Lithuania's compliance level for sub-recommendation E.1 and/or the overall compliance level could be justified, this can only be done through a fully-fledged assessment procedure where all addressees are assessed on an equal footing by the Assessment Team.

[12] In Hungary, a recent regulatory initiative concerning the household foreign currency loan portfolio (Act LXXVII of 2014) markedly reduced households' exposure to foreign currency lending to a marginal level. Although an upgrade of Hungary's compliance level for sub-recommendation E.1 and/or the overall compliance level could be justified, this can only be done through a fully-fledged assessment procedure where all addressees are assessed on an equal footing by the Assessment Team.

Colour shade table – EBA

ESA	Recommendations								Overall
	A	B	C	D	E.1	E.2	F	G	
EBA						FC			FC

Assessment

1. Objective of the ESRB Recommendation

Under Article 16 of Regulation (EU) 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 Board,[13] the ESRB is required to issue recommendations for remedial action whenever a significant systemic risk is identified.

The ESRB Recommendation was issued accordingly, proposing a series of measures to tackle the significant systemic risks that foreign currency lending could pose. These measures are designed to:

(i) limit exposures to credit and market risks, thus increasing the resilience of the financial system;

(ii) control excessive foreign currency credit growth and avoid asset price bubbles;

(iii) limit funding and liquidity risks;

(iv) create incentives to improve risk pricing associated with foreign currency lending;

(v) avoid circumvention of national measures through regulatory arbitrage.

These measures have been introduced to improve the resilience of the financial institutions providing this type of loan and thus shield the whole financial system against negative developments in exchange rates. The measures also have the positive side effect of increasing the level of consumer protection.

2. Overall level of implementation of the ESRB Recommendation

As mentioned above, the overall level of implementation of the ESRB Recommendation is high. Almost all of the Member States (27) were considered to fulfil the requirements of the Regulation in full or at least to a very large extent. Just one Member State was considered to be only partially implementing the ESRB Recommendation and no Member State was categorised as non-compliant.

The EBA, for its part, was also considered fully compliant with the ESRB advice.

The table below shows the grades assigned to each Member State:

Fully or largely compliant	Partially compliant
BE, CZ, HR, DK, DE, EE, IE, EL, ES, FR, IT, CY, LV, LT, LU, HU, MT, NL, AT, PL, PT, RO, SI, SK, FI, SE and UK	BG

[13] OJ L 331/1, 15 December 2010.

2.1 Level of implementation of Recommendation A

Recommendation A requested national supervisory authorities or Member States to:

(i) require financial institutions to provide their borrowers with sufficient information to enable them to know the risks involved in this type of loan and to take a well-informed decision;

(ii) encourage financial institutions to offer domestic currency loans for the same purposes as foreign currency loans as well as financial instruments to hedge against the risks involved.

This Recommendation does not only aim at protecting consumers; it also follows a precise macro-prudential objective: when consumers take well-informed decisions, it is in the interest of the economy as a whole. Institutions will also face less credit risk, since by having this knowledge, their borrowers should only take on those risks that they consider manageable.

It is worth noting that the principle of proportionality is expressly excluded from Recommendation A. Hence, addressees cannot justify their inaction in implementing this recommendation by simply alleging that the level of foreign currency loans is limited in material terms and thus these measures are not relevant in their country. As explained above, establishing a functioning regime of consumer protection is seen as a first line of defence to prevent foreign currency lending to unhedged borrowers from becoming an acute problem in countries that until now have not experienced this problem. Similarly, in accordance with the Mortgage Credit Directive[14] and the Consumer Credit Directive,[15] the ESRB does not consider that the implementation of sub-recommendation A.1 poses any major challenges for addressees.

As regards the level of implementation, 17 Member States were considered to have followed Recommendation A in full or to a very large extent. Nine Member States sufficiently explained their lack of action.

However, Bulgaria was deemed to be only partially compliant since the authorities here have stated that, in view of the country's foreign exchange regime, the euro should not be treated by domestic prudential regulation as a foreign currency. Bulgaria was therefore considered as fully compliant with regard to other foreign currency loans, but not euro-denominated loans.

Finally, the inaction of one Member State was considered as "inaction insufficiently explained". This was because the second part of this recommendation requires national authorities to encourage institutions to offer consumers a loan in their national currency so that they do not feel compelled to take on foreign currency liabilities because of a lack of alternative financial products. The French authorities saw no need for any measures to be taken, since the limited use of foreign currency lending shows that equivalent domestic currency loans are already being offered.

[14] Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010, OJ L 60/34, 28 February 2014.

[15] Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC, OJ L 133/66, 22 May 2008.

The table below shows the grades assigned to each Member State:

Fully or largely compliant	Inaction sufficiently explained	Partially compliant	Inaction insufficiently explained
BE, DE, EE, EL, ES, IT, LT, LU, HR, HU, MT, AT, PL, PT, RO, SI and SK	CZ, DK, IE, CY, LV, NL, FI, SE and UK	BG	FR

2.2 Level of implementation of Recommendation B

Recommendation B requested national supervisory authorities to:

(i) monitor the level of foreign currency lending and adopt the necessary measures to reduce it;

(ii) only permit foreign currency loans to be granted to borrowers that demonstrate their creditworthiness;

(iii) consider setting more stringent underwriting standards, such as loan-to-value ratios.

This recommendation is intended to increase the resilience of the financial system against negative developments with interest rates that might affect a borrower's capacity to repay a loan. This is done in two ways:

(i) by only allowing loans to be granted to borrowers that are expected to be able to repay them;

(ii) by imposing measures to tackle excessive levels of foreign currency lending.

The degree of implementation of Recommendation B is very high. Indeed, 15 Member States were considered to have followed Recommendation B in full or to a very large extent. Meanwhile, 12 Member States sufficiently explained their lack of action, which was mainly attributed to low levels of foreign currency lending.

Only Bulgaria partially implemented this recommendation, giving the same reasoning mentioned above.

No Member State has been categorised as non-compliant and no inaction has been considered insufficiently explained.

The table below shows the grades assigned to each Member State:

Fully or largely compliant	Inaction sufficiently explained	Partially compliant
BE, IE, CY, HR, LV, LT, LU, HU, MT, AT, PL, PT, RO, SI and SE	CZ, DK, DE, EE, EL, ES, FR, IT, NL, SK, FI and UK	BG

2.3 Level of implementation of Recommendation C

Recommendation C requested national supervisory authorities to monitor whether foreign currency lending is inducing excessive credit growth. If this was found to be the case, then these authorities were asked to adopt more stringent measures than those set out under Recommendation B.

Compared with the previous recommendation, whose purpose was to prevent an excessive cyclical development of credit growth, Recommendation C was written against a background of already significant cyclical developments that would therefore require a stronger counter-cyclical response by authorities.

There was widespread evidence of monitoring. All Member States were considered either fully compliant with Recommendation C or, if they did not implement any measure, provided sufficient explanation for their inaction.

Similarly, no Member States were categorised as non-compliant and any inaction on their part was considered sufficiently explained.

However, it goes without saying that, as previously mentioned, dynamics leading to excessive credit growth are improbable in the current situation. This recommendation, on the other hand, was not written to cope with insufficient credit provision for foreign currency. Therefore, it may be difficult to activate its second part at the current juncture.

The table below shows the grades assigned to each Member State:

Fully or largely compliant	**Inaction sufficiently explained**
CZ, DE, EE, HR, IE, FR, CY, LV, LT, LU, HU, MT, AT, PL and RO	BE, BG,DK, EL, ES, IT, NL, PT, SI, SK, FI, SE and UK

2.4 Level of implementation of Recommendation D

Recommendation D requested national supervisory authorities to address guidelines to financial institutions in their jurisdictions, so that foreign exchange lending risks are better incorporated into their internal risk management systems. These guidelines should cover internal risk pricing and capital allocation.

The recommended measures should also create incentives for institutions to better identify the risks associated with foreign currency lending and internalise its potential costs.

The response to this recommendation was also very positive. Almost all Member States implemented measures that follow the provisions of Recommendation D in full or to a very large extent or, if they did not implement any measure, provided sufficient explanation for their inaction.

Only one country, Bulgaria, was considered partially compliant with regard to actions taken, for similar reasons to those mentioned above.

No Member States were categorised as non-compliant and any inaction on their part was considered sufficiently explained.

The table below shows the grades assigned to each Member State:

Fully or largely compliant	Inaction sufficiently explained	Partially compliant
DK, DE, EE, ES, HR, LV, LT, LU, HU, MT, AT, PL, RO, SE and UK	BE, CZ, IE, EL, FR, IT, CY, NL, PT, SI and SK and FI	BG

2.5 Level of implementation of Recommendation E

Recommendation E requested national supervisory authorities to implement specific measures under Pillar 2 and, in particular, to require financial institutions to hold adequate capital to cover risks associated with foreign currency lending. The European Banking Authority was also requested to issue guidelines to national supervisory authorities to guide the application of capital requirements for foreign currency lending risks.

The goal of this recommendation is to “adjust” the pricing of foreign currency lending risks. This higher capital increases the resilience of the system against negative shocks, given the higher loss-absorbing capacity of the institutions.

In total, 13 Member States were deemed to follow sub-recommendation E.1 in full or to a very large extent. Another 13 Member States sufficiently explained their lack of action, which was mainly attributed to the low level of foreign currency lending.

Hungary was only graded partially compliant, since the Hungarian authorities state that foreign currency lending risks are already considered in the Supervisory Review and Evaluation Process. However, due to the high level of foreign currency lending in this Member State, the ESRB believes that a special capital add-on addressing such lending should be effectively implemented. Lithuania was also considered only partially compliant since the Lithuanian authorities treat lending in euro as similar to lending in domestic currency for these purposes.

No Member States have been categorised as non-compliant and no inaction has been considered as insufficiently justified.

The table below shows the grades assigned to each Member State:

Fully or largely compliant	Inaction sufficiently explained	Partially compliant
BE, BG, DK, EE, ES, CY, HR, LV, LU, MT, AT, PL and RO	CZ, DE, IE, EL, FR, IT, NL, PT, SI, SK, FI, SE and UK	LT and HU

In response to sub-recommendation E.2, the EBA issued its “Guidelines on capital measures for foreign currency lending to unhedged borrowers under the supervisory review and evaluation process (SREP)” on 20 December 2013. These guidelines were assessed as fully compliant.

2.6 Level of implementation of Recommendation F

Recommendation F requested national supervisory authorities to monitor funding and liquidity risks taken by financial institutions in connection with foreign currency lending, together with their overall liquidity provisions.

Given that short-term funding normally costs less than long-term funding, institutions may tend to obtain excessive short-term funding, entering into refinancing risks which could be exacerbated by foreign exchange volatility. This recommendation intends to address the problem by limiting refinancing and concentration risks in order to achieve more sustainable levels of maturity mismatches and greater resilience to negative developments in the funding markets.

Almost all Member States have implemented measures that follow the provisions of Recommendation F fully or to a very large extent or, if they did not implement any measure, provided sufficient explanation for their inaction.

The table below shows the grades assigned to each Member State:

Fully or largely compliant	Inaction sufficiently explained
BE, BG, CZ, DK, DE, IE, EL, ES, FR, CY, HR, LV, LT, LU, HU, MT, AT, PL, PT, RO, SI and UK	EE, IT, NL, SK, FI and SE

2.7 Level of implementation of Recommendation G

Recommendation G requested that:

(i) national supervisory authorities of relevant financial institutions' home Member States impose measures addressing foreign currency lending that are, at a minimum, as stringent as the measures imposed by the host supervisor;

(ii) national supervisory authorities of the home Member States publish the measures taken by the relevant host supervisors on their websites. To enable this to happen, it was recommended that the national supervisory authorities of the host Member State communicate the relevant measures to the home supervisors, to the EBA and to the ESRB.

The main objective behind this recommendation is to avoid regulatory arbitrage and the circumvention of the measures implemented after the ESRB Recommendation, by making all stakeholders aware of the measures taken by the relevant authorities.

As explained above, the assessment demonstrated that there is still scope for action with regard to information exchanges between national supervisory authorities. Recommendation G, which had created a mechanism for the transmission of information between home and host authorities and to the ESRB and EBA as regards national prudential measures to address vulnerabilities, has been only partly successful. While there is evidence that information exchanges took place in colleges of supervisors, an ESRB-wide, macroprudential mechanism for transmission of information seems warranted.

Accordingly, only six Member States (Greece, Italy, Malta, Austria, Romania and the United Kingdom) were considered to have followed Recommendation G in full or to a very large extent. Meanwhile, 20 Member States sufficiently explained their lack of action, even though some of them relied heavily on information obtained via the colleges of supervisors.

As for the remaining two Member States, their justification for lack of action was considered insufficient. The main reason behind this grade was inaction by the authorities with regard to the second part of this recommendation, i.e. information exchange between host authorities and home authorities, and publication on their websites. Some of them expressly asked the ESRB to establish a centralised hub for the transmission of information. Although the ESRB agreed to this request, setting up this platform was not originally part of this recommendation.

As mentioned above, a more multilateral mechanism for information exchange and publication is being prepared.

The table below shows the grades assigned to each Member State:

Fully or largely compliant	**Inaction sufficiently explained**	**Inaction insufficiently explained**
EL, IT, MT, AT, RO and UK	BG, CZ, DE, EE, IE, ES, FR, CY, HR, LV, LT, LU, HU, NL, PL, PT, SI, SK, FI and SE	BE and DK

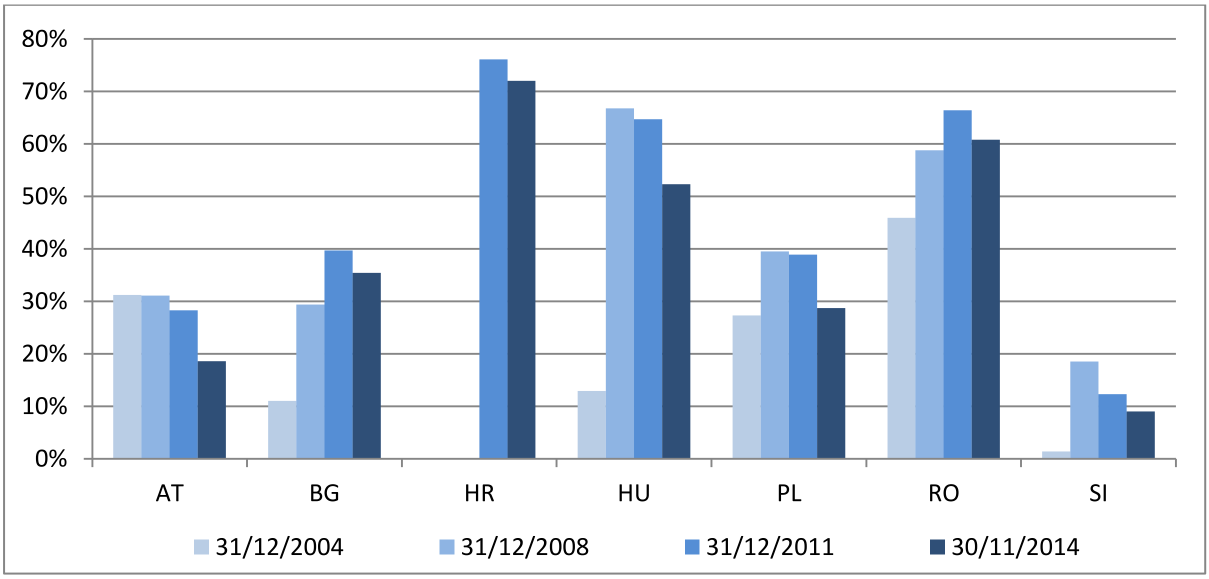
Please note that, as mentioned above (see footnote 5), the degree to which Recommendation G was followed was not taken into account in the overall assessment and grading of the implementation of the ESRB Recommendation by each Member State. This is because it was recognised that the proposed bilateral mechanisms could be too complex. Replacing them with a centralised hub procedure involving the ESRB, as requested by some Member States when reporting on their implementation of Recommendation G, could be a more efficient option.

Economic effects of the ESRB Recommendation

The significance of foreign currency lending varies greatly across jurisdictions. While in most western European countries lending in foreign currencies remains relatively low, countries in central, eastern and south-eastern Europe (CESEE) have experienced an excessive flow of foreign currency loans since the early 2000s and accession to the European Union.

Adverse exchange rate events that may have a negative impact on unhedged borrowers' foreign currency lending could potentially impair the stability of the financial sector across the region. The proportion of total loans accounted for by foreign currency loans was high in the Baltic countries,[16] Bulgaria[17] and Croatia. And exposure to risks related to foreign currency lending proved material for Hungary, Poland and Romania (as illustrated in Chart 2 below). The Austrian authorities have also recognised the need to address such risks, though in this case most foreign currency lending was in Swiss francs: as confirmed by end-2014 data, nearly 96% of Austrian household non-euro loans were denominated in this currency. This meant that Austria was heavily exposed to recent exchange rate misalignments of the Swiss franc. Exposure to lending in this currency was systemically significant for Hungary, where Swiss franc loans represented approximately 86%[18] of total household foreign currency loans by the end of 2014. The corresponding figure for Poland was 22%. Croatia and Romania were relatively less exposed, with around 17.5% and 10% respectively.

Chart 2 Household foreign currency loans in selected CESEE countries, as a share of total loans



Sources: ECB and ESRB calculations.

[16] Estonia, Latvia and Lithuania had currency board arrangements in place prior to their entry to the euro area in 2011, 2014, and 2015 respectively. When these countries joined the euro area, foreign currency risks became irrelevant as lending in US dollars and Swiss francs constituted only a limited portion of their loan portfolios, with most clients able to mitigate their risks with natural or financial hedges.

[17] The Bulgarian authorities noted that the existing currency board regime serves as a hedge and the risks related to euro-denominated loans are immaterial. As for other foreign currencies, they indicate that lending in US dollars and Swiss francs is insignificant in terms of the proportion of total lending accounted for by unhedged borrowers.

[18] A recent Hungarian regulatory initiative concerning Hungary's household foreign currency loan portfolio imposed an obligation to convert Hungarian households' foreign currency exposures into national currency loans (Act LXXVII of 2014). As a result, risks related to sudden exchange rate misalignments of the Swiss franc have almost fully disappeared. In March 2015 household loans in Swiss francs accounted for 4.2% of total household loans.

The ESRB Recommendation was particularly relevant for the CESEE region. To assess the effectiveness of actions taken at the EU and national levels, the ESRB analysed how the Recommendation was implemented and to what extent it was important for specific EU jurisdictions to mitigate risks related to foreign currency lending. The overwhelming majority of Member States suggested that the ESRB Recommendation was perceived as not being relevant for their jurisdictions as foreign currency lending did not raise financial stability concerns, mainly because its level was insignificant or related exposures were reported as naturally hedged (as in the case of five countries with slightly elevated foreign currency lending). However, for those CESEE countries where the proportion of foreign currency lending accounted for by unhedged borrowers was significant, national authorities noted that the Recommendation played a useful role in addressing foreign currency-related vulnerabilities.

The need to introduce appropriate mechanisms of reciprocation was considered the most relevant expected objective of the ESRB Recommendation. The second and third most important objectives identified were to target exposures to credit and market risks related to foreign currency lending and to improve risk pricing of such lending in banks, respectively; goals which would be in keeping with Recital 4 of the Recommendation guiding supervisory actions at the national level. However, when referring to actual deficiencies at the national level (namely, in the context of assessing the significance of specific recommendations), addressees considered the ESRB Recommendation to be most effective in helping authorities increase borrowers' risk awareness (Recommendation A) and in addressing the issue of clients' creditworthiness (Recommendation B).

There was a decrease in stocks of foreign currency lending following the 2011 ESRB Recommendation. While many authorities had started introducing national measures to reduce the flow of foreign currency lending before the Recommendation was issued, it was recognised that this ESRB initiative supported their efforts to facilitate the implementation and enforcement of existing measures in place. Some authorities also suggested that the Recommendation had been instrumental in triggering formal action and introducing new regulatory initiatives at the national level. Furthermore, available data indicate that there has been a gradual reduction in households' foreign currency exposures since the 2011 ESRB Recommendation was issued, owing to the introduction of national measures to mitigate risk related to foreign currency lending. Although many factors have played a role here, it certainly appears that the flow of new lending has been curbed and the repayment of existing foreign currency loans is continuing, as indicated by Chart 2.