Komisja
Nadzoru
Finansowego

Measures to reduce the scale of foreign exchange lending in Poland

Krzysztof Broda
Deputy Managing Director
Banking Supervision,
Polish Financial Supervision Authority

„Macroeconomic risks resulting from massive foreign exchange lending to household sector”

Warsaw, 20th October 2010

Komisja Nadzoru Finansowego

Agenda

- Some history
- Why? (limit FX lending for private individuals)
- How? (limit FX lending)
- Potential impact

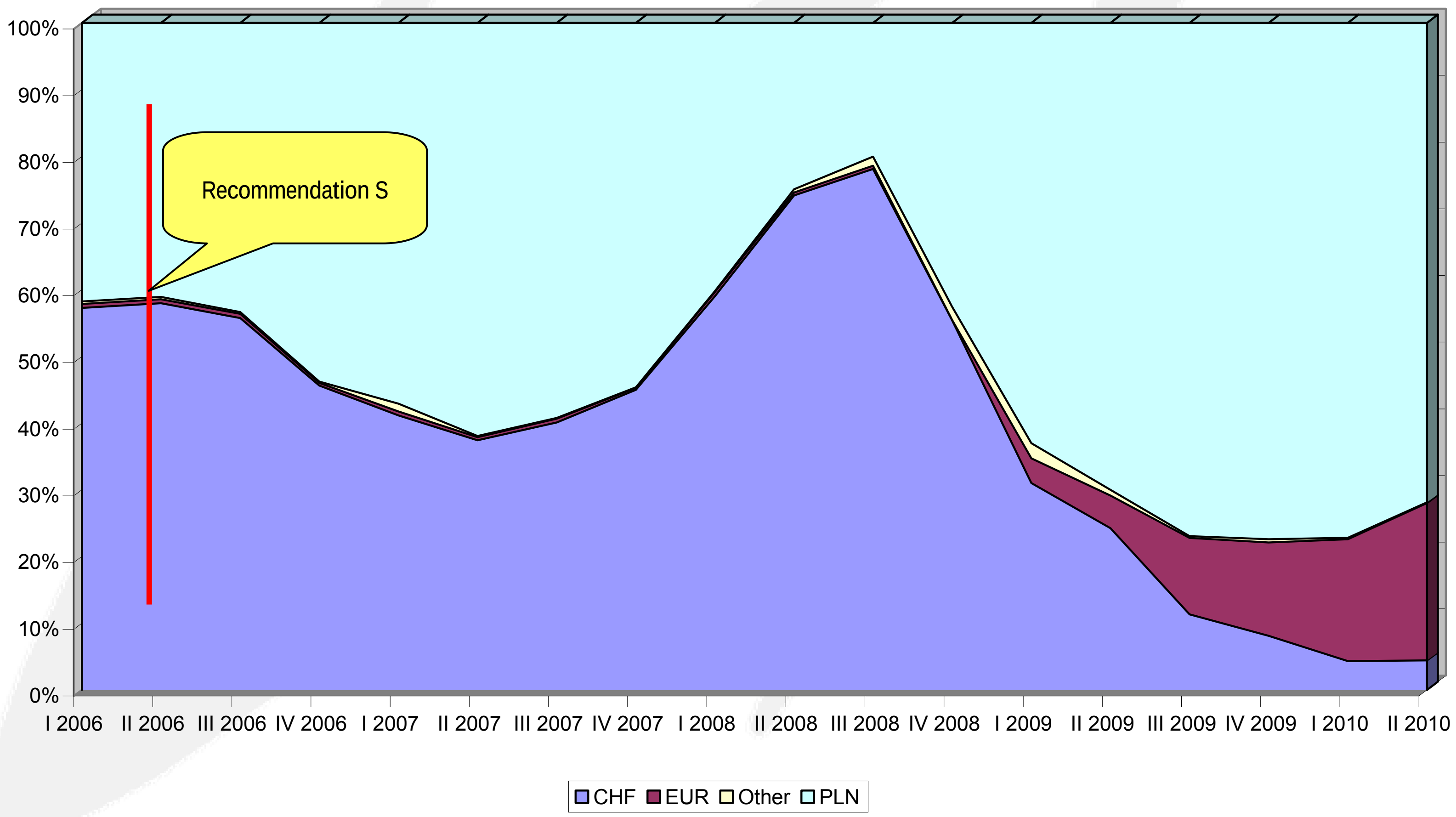
Komisja Nadzoru Finansowego

Some history – Recommendation S

- Issued in March 2006, valid since July 2006
- Considered options:
  - Full ban for FX mortgages.
  - Higher solvency requirements (higher risk weight).
  - Buffers to increase customer resistance.
- Basic recommendation for FX lending:
  - Banks shall offer mortgage loans in PLN first.
  - Banks shall analyze currency risk influence on credit risk level.
  - Banks shall include currency risk in creditworthiness assessment process (buffer: 120 % of initial loan amount and PLN interest rate).
  - Banks shall conduct stress tests for currency risk impact (30 % deprecation lasting 12 months).

Some history – mortgage portfolio development

Currency structure of new mortgage loans

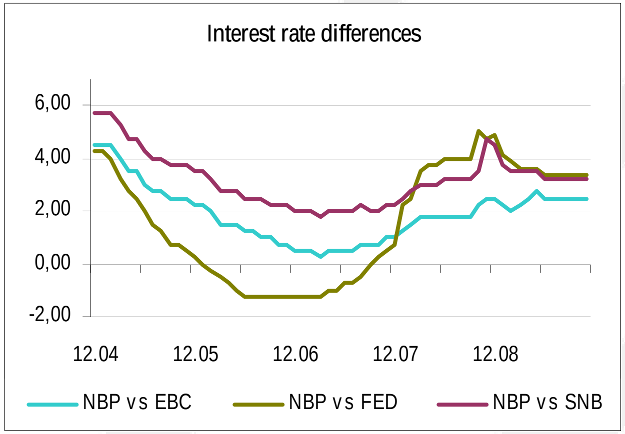


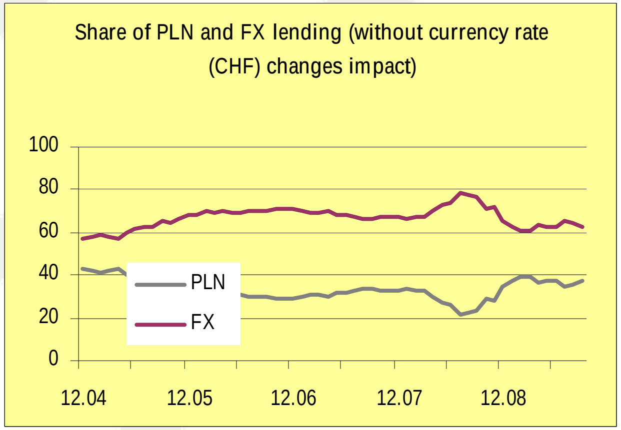
source: NBP

Komisja Nadzoru Finansowego

Some history – portfolio development drivers

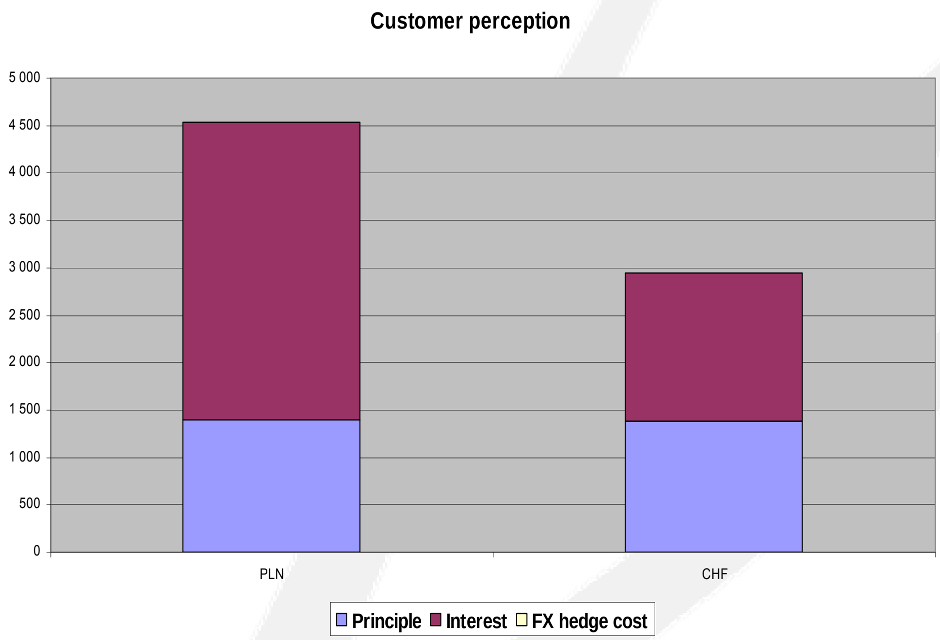
- Interest rates level

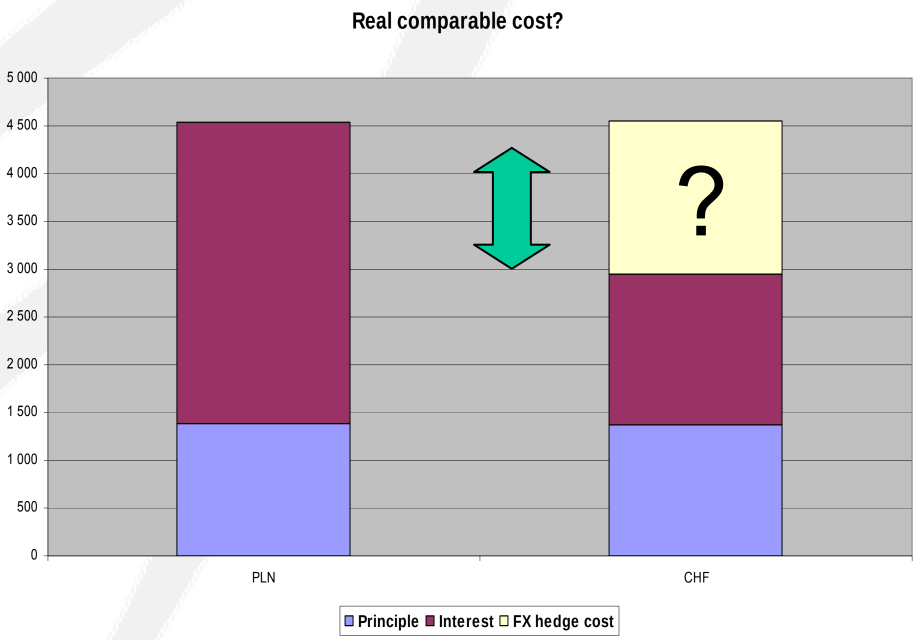




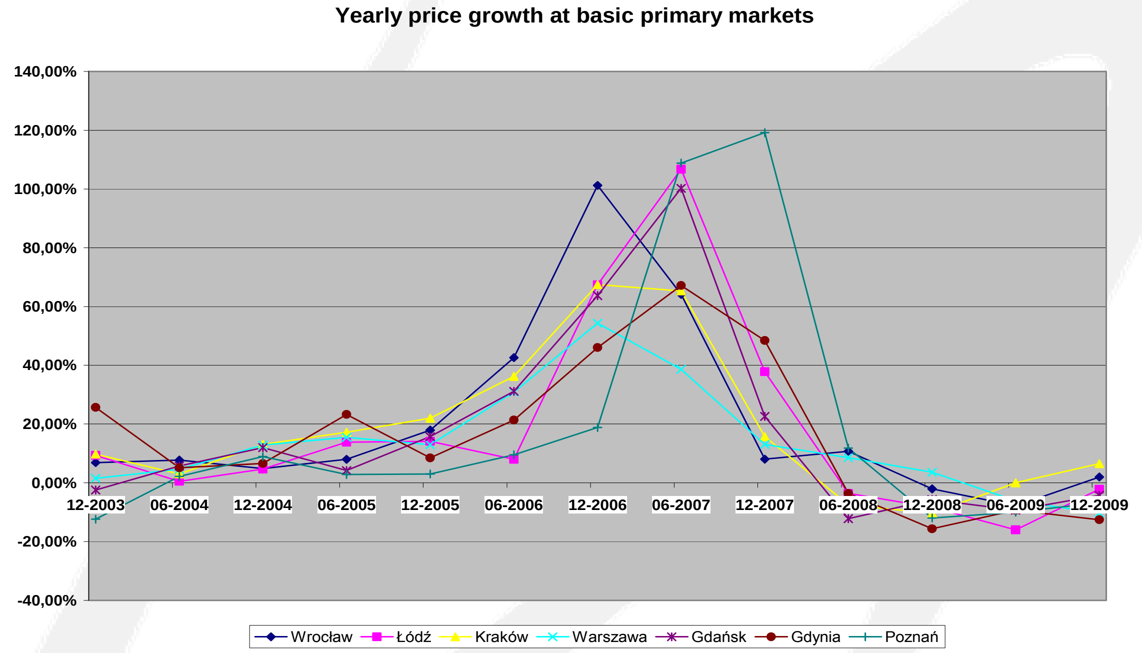
- Higher banks margins for FX lending, additional FX operation revenues (spreads)
- Lack of minimum standards for creditworthiness assessment (relaxation of rules for PLN neutralized buffer for FX)
- Pressure on conservative banks loosing market share

Some history – customer perception

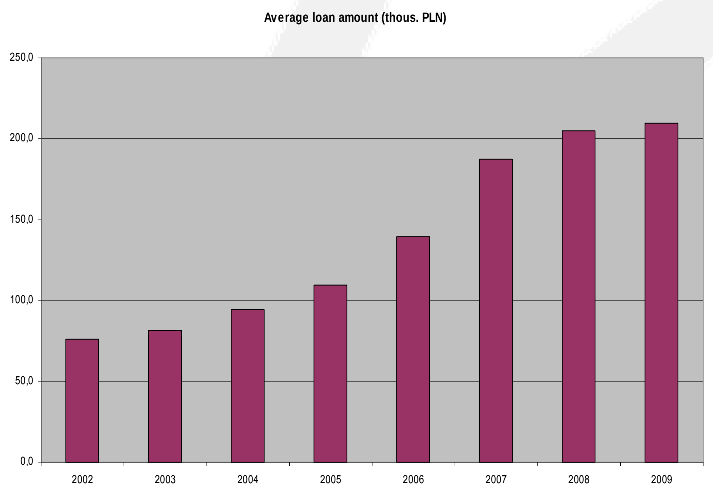


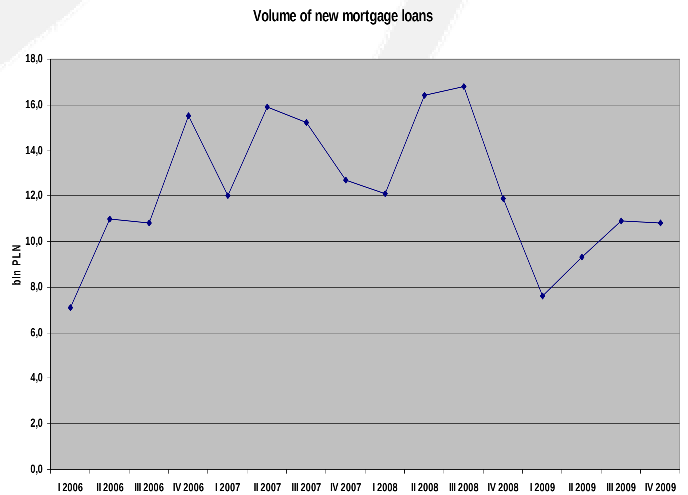


Some history – side effect



source: NBP





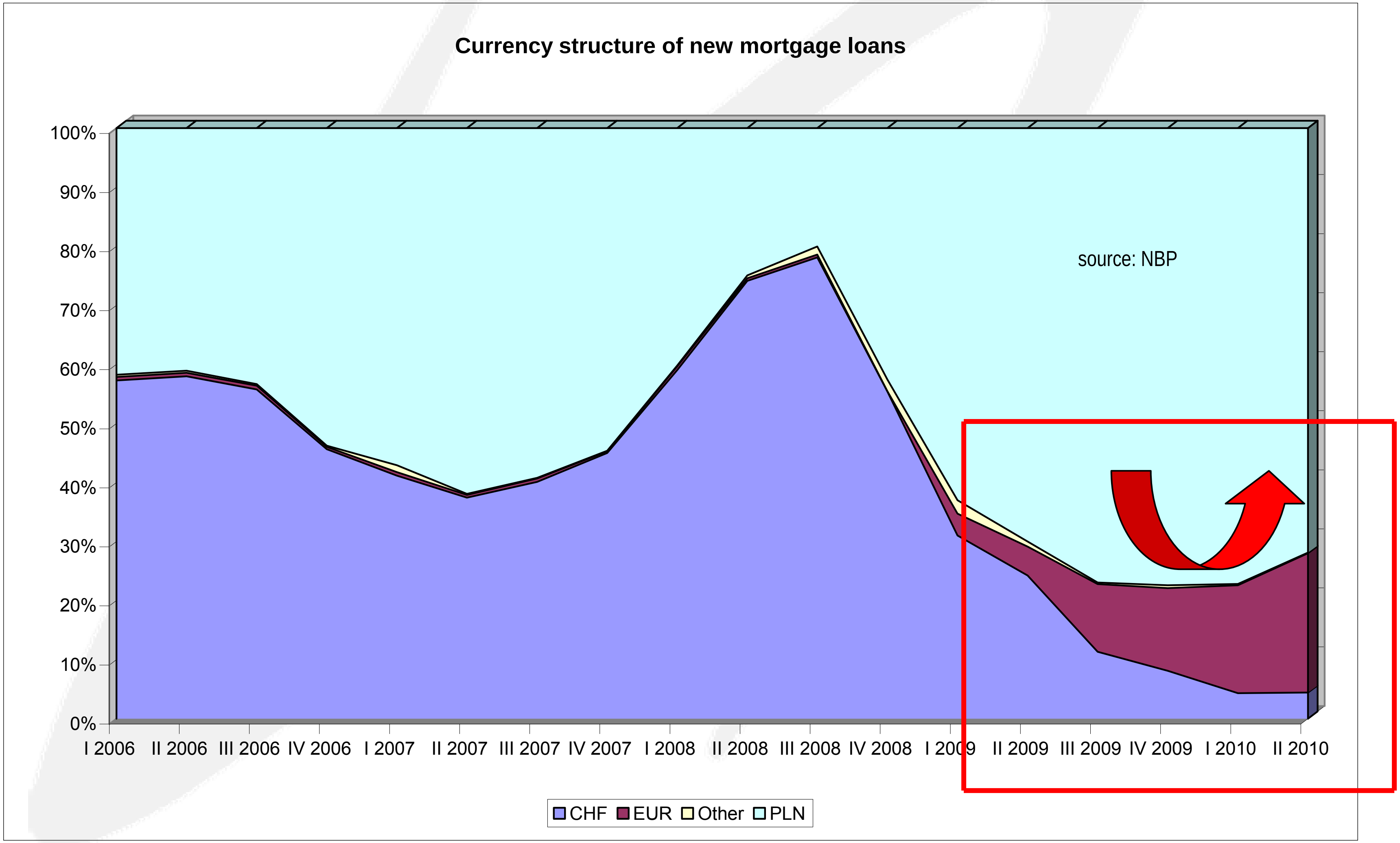
source: ZBP

Why limit FX exposures?

- So far measures (Recommendation S) were not suffiecient
- There are still serious risk (presented at next slides)
- Volatility of markets is high and market development disruptions are more likely
- FX lending may result in higher credit losses because more risk sensitive LtV
- Customer perception does not recognize additional risk cost
- Some banks prefer FX because of higher margins, additional spread revenues and lower competition at FX market (less players currently)
- Pressure on conservative market players can repeat in better times (when they start loosing market share)
- and

Komisja Nadzoru Finansowego

Why limit FX exposures?



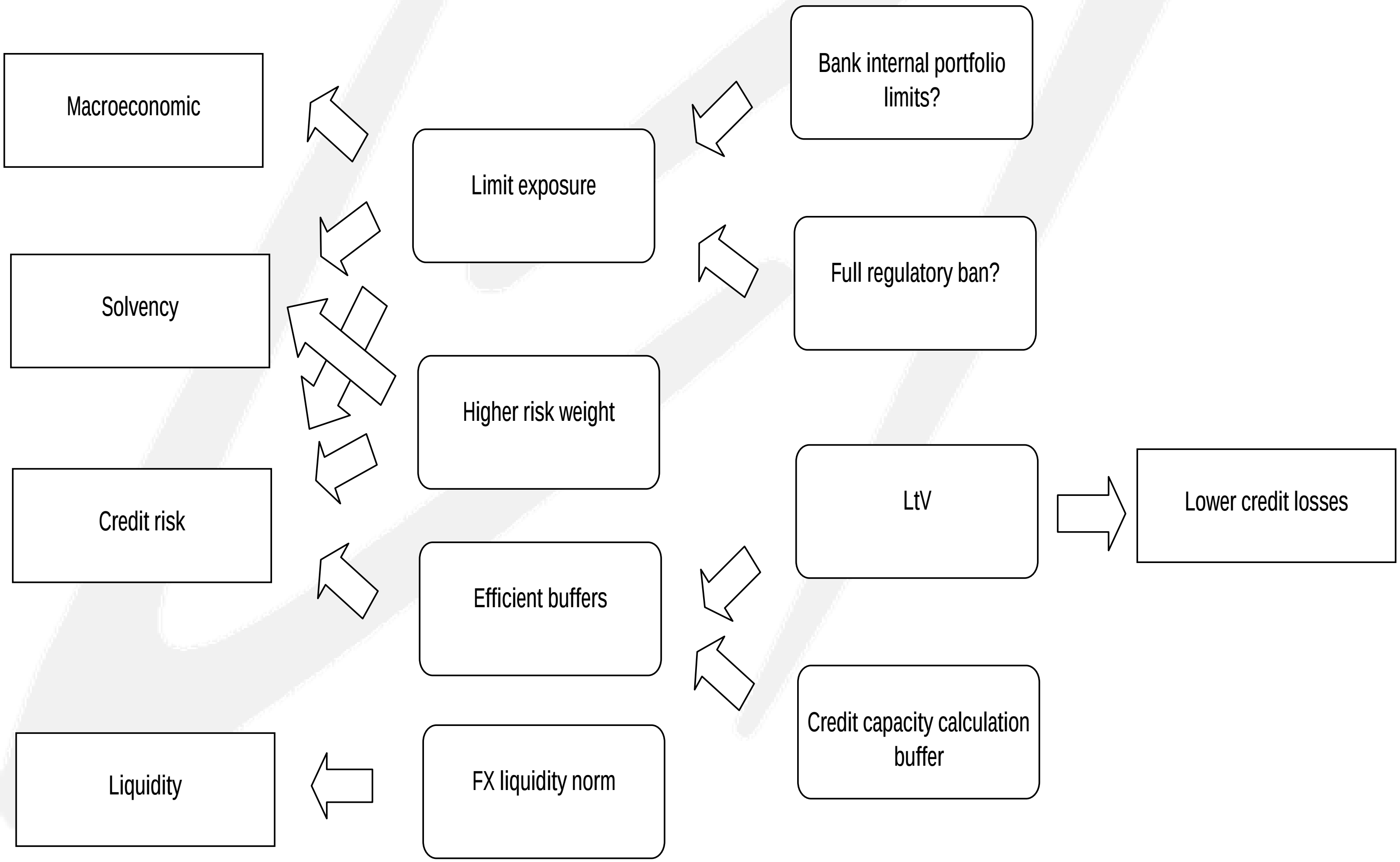
Komisja Nadzoru Finansowego

Why? Address the risk

- Macroeconomic
  - Unbalanced economic growth (credit booms).
  - Influence monetary policy power.
- Micro (bank level):
  - Liquidity:
    - Lack of liquid market (SWAP, CIRS) as during last crisis.
    - Short of long term funding > profitability.
  - Solvency (if not naturally hedged by FX capital).
  - Business (strategic) – monoline business concentration (Ireland case).
  - Credit risk (indirectly) – change of credit capacity of customer.
- Micro (customer level):
  - Credit risk – change of credit capacity.
  - Problem with full repayment if LtV>100 %.
  - Reduced refinancing opportunities if LtV>100 %.

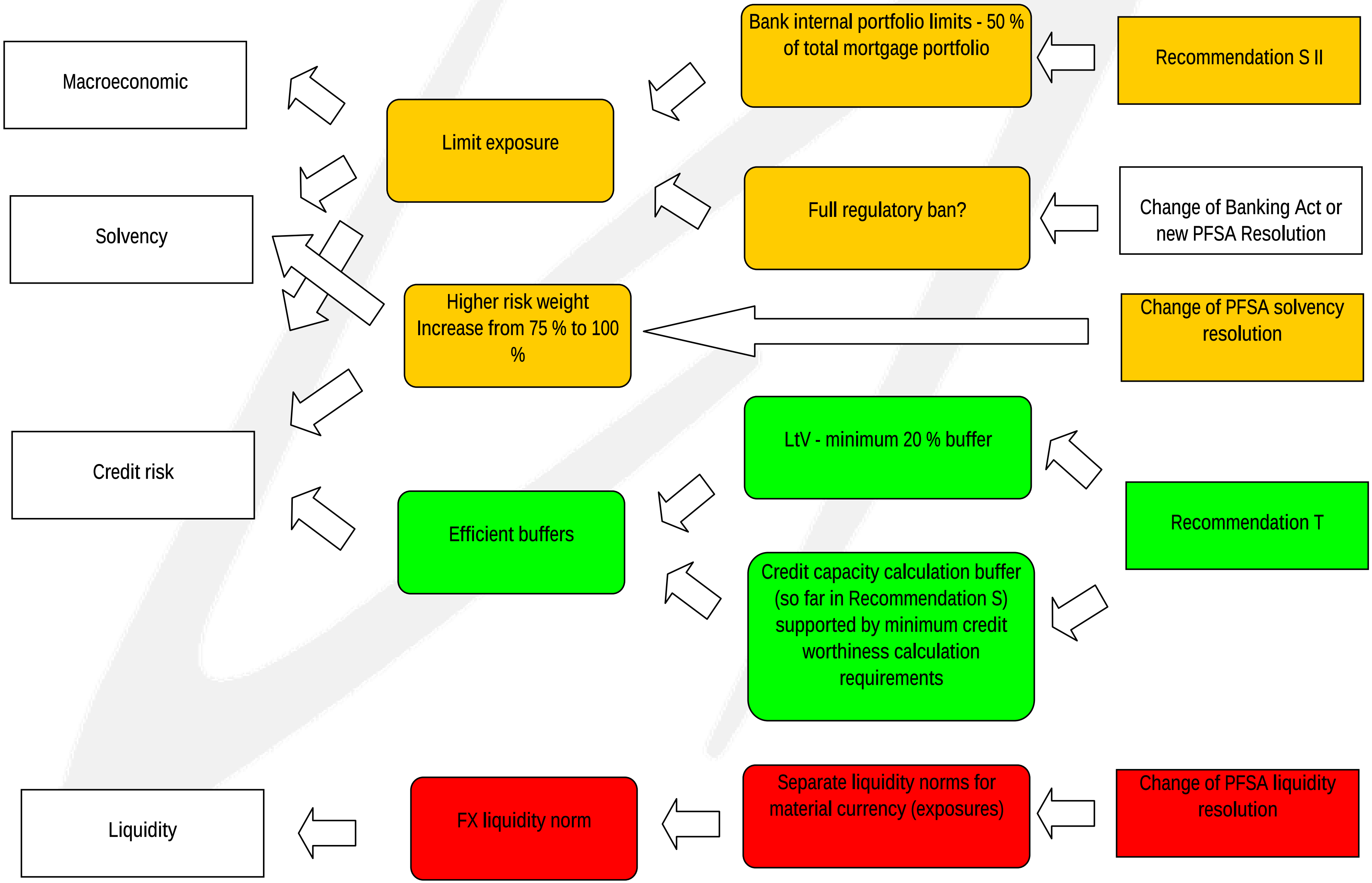
Komisja Nadzoru Finansowego

How?



Komisja Nadzoru Finansowego

How? Some details



Komisja Nadzoru Finansowego

Why? Selection reasons

- Internal limits or ban
- Ban:
  - (+) Seems to be more supported by banking sector (the same competition rules)
  - (+) Resistant for any „creativeness”
  - (-) Higher impact on credit market
- Internal limit
  - (+) Allow for FX lending for selected customer groups
  - (+) Smaller adaptation
  - (-) Potentially exposed to new „initiatives” (ex. change of segmentation)
  - (-) Different „starting point” for market players
- Recommended: ban because so far experience and market transparency

Komisja Nadzoru Finansowego

Why? Selection reasons

- Higher risk weight
- Because currency risk increase volatility of PD and LGD and in result unexpected losses that should be addressed in capital calculations
- 100 % as this is basic risk weight, we do not increase level but take off preferences

Komisja Nadzoru Finansowego

Impact – opponent arguments first – why not!

- Badly influence market, cut customers out of the own flats
- Not shared as:
  - Currently FX lending contribute in 30 % for new mortgage loans.
  - All customers should pass credit capacity FX buffer test (120 % of initial loan and PLN interest rate) so they can afford to pay PLN loans (they will not loose credit capacity because of lack of FX lending).
  - Most of demand is consumer not speculative nature.
  - Change in demand depends on customer willingness to pay higher but stable installment (difficult to assess).
  - There is still place for residential real estate price cutting as developers profits are reported at 35-55 % (depends on city) level by Central Bank report on price and situation at residential real estate market.

Komisja
Nadzoru
Finansowego

Impact – opponent arguments first – why not!

- Bias for competition
- Shared:
  - Because some banks benefited or suffered after building of existing FX mortgage portfolio (about 60 % of total) any limit (even full stop) is not fair in long run, but looking forward we share view that ban for FX lending for private individuals is more transparent for the market and competition.

- Good credit quality
- Not shared:
  - Supervisory reaction when long term portfolio is already at bad shape is late.
  - So far fortunately currency risk impact was compensated by low interest rates at almost all markets (that is not standard)
  - There is some bias because FX>PLN conversion for defaulted loans (31/12/2009 estimation: PLN 2,43 % > 1,97 %; FX 0,97 % > 1,22 %)
  - Credit quality shall be better if we believe in credit capacity FX buffer (higher requirements)

Komisja Nadzoru Finansowego

Impact – opponent arguments first – why not!

- Change of business model
- Not shared:
  - Monoline business model is very sensitive if meets specific risk (examples from other market: Ireland, USA).
  - Mortgage portfolio is difficult to rebuild (especially at our market – lack of securitization) – difficult to react
  - Operationally there is no difference between FX and PLN model (risk management is different).
  - As competition is smaller such model may protect less efficient players.
  - Supervisory massage was clear already at 2006 and ignored by some banks.
  - During the last crisis some banks have been able to stop FX lending immediately.

Komisja
Nadzoru
Finansowego

Questions?

Thank You for Your attention!