Mugur Isărescu: Issue of CHF-denominated loans

Presentation by Mr Mugur Isărescu, Governor of the National Bank of Romania, in front of the Budget and Finance Parliamentary Commission, Bucharest, 10 February 2015.

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Ladies and gentlemen, Members of Parliament,

First of all, I would like to thank you for the invitation to present, together with my central bank colleagues, the stance and action steps adopted by the National Bank of Romania in relation to the issue of CHF-denominated loans in Romania.

I assure you that we deem this debate to be very useful at the current juncture. The members of the central bank's top management have come before you in line with the legal obligation stipulated in the NBR Statute (Law 312/2004) of providing the Parliament and the general public with quality information for a clear image of the policies and the measures adopted by the National Bank of Romania in fulfilling its tasks.

I. The Swiss National Bank's decision

The public debate on CHF-denominated loans started on 15 January 2015, when the Swiss National Bank removed the 1.2 EUR/CHF floor, which led to the immediate and significant appreciation of the Swiss franc against the euro, the US dollar and other currencies. The decision adopted by the monetary authority of Switzerland took into account the fact that the floor – implemented in September 2011, when the Swiss franc was substantially overvalued against the euro – had become increasingly difficult to keep in place given the quantitative easing initiated by the European Central Bank and the significant capital inflows into Switzerland. The CHF appreciation against the leu was inevitable, even if the domestic currency had a relatively stable evolution against the reference currency (euro).

The literature refers to the Swiss franc as a safe haven currency. Owing to the small size of the local financial market, against the background of foreign capital inflows, the Swiss franc tends to strengthen significantly versus other currencies in times of turmoil on international markets.

The measures the National Bank of Romania can take in order to influence the exchange rate of the domestic currency against the Swiss franc are limited. The CHF/RON exchange rate is set indirectly. The euro is Romania's reference currency on the FX market, given the intensity of the country's trade with euro area states, the EU membership and Romania's intention to adopt the euro in the future. The EUR/RON exchange rate is the result of the foreign currency demand and supply generated by trade and financial flows, while the CHF/RON exchange rate is determined indirectly depending on the EUR/RON and EUR/CHF exchange rates. The developments in the EUR/CHF exchange rate depend on the foreign currency demand and supply between the euro area and Switzerland, Romania having no influence on its quotation. The EUR/RON exchange rate is relatively stable and it reflects the favourable performance of fundamentals. The recent depreciation of the RON against the

CHF is therefore entirely attributable to the appreciation of the CHF versus the EUR, USD and other currencies, as a result of the Swiss National Bank removing the 1.2 floor, following the European Central Bank's quantitative easing decision.

The NBR's intervention to bring the CHF/RON exchange rate back to the 14 January 2015 level is not possible, as the international arbitrage does not allow that only the CHF/RON exchange rate be influenced, while keeping unchanged the exchange rates of the leu versus the other currencies.

In order to reverse the impact on the CHF/RON exchange rate following the Swiss National Bank's decision, the leu would have to appreciate versus the euro to approximately RON 3.7 per euro. This EUR/RON exchange rate level could be maintained only temporarily, as pushing the EUR/RON exchange rate down to a level much lower than that perceived by the market to be correct would require considerable foreign currency sales (amounting to EUR billions) not only for achieving this objective, but also for enabling the systematic interventions necessary for subsequently maintaining this exchange rate.

This intervention by the NBR would have short-term effects and significant economic consequences. The sizeable contraction in foreign currency reserves would trigger the worsening of investor perception, as mirrored by the rise in risk premia. The external borrowings would become costlier for the state and the private sector, while the risk of speculative attacks on the domestic currency would increase.

The massive appreciation of the leu versus the euro would lead to the strong erosion of Romania's external competitiveness, having therefore a negative impact on the performance of Romanian exports. Under the circumstances, the economic activity would post a contraction, also reflected in an unfavourable evolution of the number of jobs. Furthermore, the decrease in exports, accompanied by the simultaneous spur in imports, would generate a worsening of the trade balance. In such a context, additional corrective pressures would emerge on the EUR/RON exchange rate towards the pre-intervention level. Mention should be made that the NBR's foreign currency sales would imply the absorption of liquidity in lei from the money market, leading to a substantial increase in domestic currency interest rates. This would not only deter leu-denominated lending and foster foreign currency lending (which would become cheaper), but it would also imply considerably higher costs for borrowers with outstanding leu-denominated loans. In other words, a low currency risk would come at the expense of a higher interest rate risk.

Moreover, the strengthening of the domestic currency would induce a deflationary shock across the Romanian economy, with the potential of creating a loop of mutually-reinforcing falling prices and broad-based delay in consumption, conducive to economic downturn and consequently to layoffs.

Apart from the adverse economic effects, the NBR's intervention to help the domestic currency appreciate against the CHF to a level similar to that recorded prior to the Swiss National Bank removing the 1.2 EUR/CHF floor would also impact public policy. Such an intervention would result in changing the benchmark currency on the foreign exchange market from EUR to CHF, contradicting not only the economic reality, but also the EU membership legally binding Romania to adopt the single currency at a certain point in time.

As for the possibility of the NBR imposing a ban on CHF-denominated loans, such a decision would have entailed the restriction of CHF-denominated capital flows, thus violating one of the fundamental prerequisites of Romania's accession to the EU: full capital account liberalisation, completed in 2006.

Besides, even assuming such a measure had been possible, it would have affected trade with and investment from Switzerland, as well as the financing of CHF hedged borrowers (exporters, as well as employees of companies with Swiss capital, whose incomes are expressed in CHF).

The relevant presence of Swiss capital in Romania is pointed out by the direct investment from Switzerland, which totals around EUR 2 billion, as well as by the number of companies with Swiss capital (over 2,000). These companies' annual turnover is worth about EUR 7 billion, while the number of employees has ranged between 50,000 and 60,000 (nearing the number of CHF borrowers). The main Swiss investors in Romania are present in significant economic sectors: building materials, energy, petrochemicals, pharmaceuticals, food industry, tobacco, agriculture and stockbreeding. Over the last years, trade flows with Switzerland exceeded the EUR 250 million threshold for exports and the EUR 400 million threshold for imports.

The situation generated by the CHF appreciation should be approached rationally, rather than emotionally. First and foremost, before coming up with a solution, we should make sure that the situation has stabilised. Frequently, FX markets tend to overreact at the incipient stage of such events. From this standpoint, mention should be made that about 40% of the rise in the CHF/RON exchange rate was already corrected: it started off at 1 CHF = 3.74 RON on 14 January 2015, peaked at 4.58 on 23 January and stood at 4.21 on 9 February 2015.

Moreover, given the considerable financial impact, time is necessary for solutions to be formulated so that the additional burden generated by the stronger CHF might be rationally and realistically shared among the parties involved.

To sum up, we believe that, before adopting any measures, the following should be analysed: the actual situation of CHF-denominated loans in Romania, the current economic environment, the approach to the effects generated by the stronger CHF in other countries in the region, as well as the viability of the solutions recommended.

II. Information on CHF-denominated loans

CHF-denominated loans do not pose a systemic risk because they hold a small share in GDP and also in total loans.

CHF lending to the private sector stands for 1.4% of Romania's GDP, while Poland and Hungary report levels five and seven times higher respectively. The proportions are the same as regards the share of CHF-denominated loans in total private sector loans: in Romania they account for 4.7%, while Poland and Hungary report levels three and five times higher respectively. The weight of CHF lending in total loans to non-financial corporations and households in Romania has followed a downward path since 2012, to 4.7% of total loans to these sectors. The development is also attributable to the notable decline in CHF-denominated loans granted since 2009.

CHF-denominated loans were almost exclusively taken by individual borrowers. These loans account for around 10% of total loans to households, and individuals with CHF-denominated loans (75,412) account for 2.1% of the total number of individual borrowers. For comparison, in Poland, the number of CHF borrowers exceeds 500,000.

The rationale behind the boom in CHF lending during 2007-2008 is in close connection with the social factors. The CHF borrowing costs were lower at the credit agreement date, which ensured easier access to lending for lower income borrowers, as well as larger loans for larger income borrowers. On the other hand, the unfavourable developments in the CHF may have a major adverse impact on debtors' capacity to repay the loans. A simulation of the instalments of a standard loan in CHF, RON and EUR respectively, extended in December 2008, shows that: (i) at the credit agreement date, the monthly instalments on CHF-denominated loans were lower compared with similar monthly instalments on loans granted in RON or EUR, and (ii) the impact of the change in the exchange rate and/or the interest rate was stronger on CHF loans than on those in the other currencies.

The number of CHF borrowers is on the decline (by 31.8% in November 2014 compared with December 2008, i.e. by around 35,200). The drop is due to loan repayment, loan conversion into another currency, their removal from the balance sheets or their sale. The number of CHF borrowers fell at a faster rate compared with the household loan dynamics at aggregate level, the number of debtors moving down 15% between December 2008 and November 2014. The number of CHF loans witnessed a similar development.

Credit risk associated with CHF-denominated loans is relatively higher compared with other currencies. In November 2014, the NPL ratio on household loans in CHF stood at around 12% versus 9.4% for all foreign currency-denominated loans to households, yet the dynamics were similar to those of foreign currency-denominated loans overall.

Recent studies also identify heightened risks and correspondingly high costs associated with CHF loans to unhedged borrowers at an international level, particularly in non-euro area countries.

Individuals with CHF-denominated loans are not a homogeneous group. The distribution of such loans shows a large variety in terms of: loan destination, loan value, borrowers' income level, borrowers' indebtedness level, and loan maturity.

CHF-denominated loans to households have had different purposes. About 35% of CHF-denominated loans are housing loans and 58% of them are mortgage-backed consumer loans. Real estate lending to households is mostly denominated in EUR, with CHF-denominated loans accounting for merely 7.7% of the said loans versus 37% in Poland.

CHF-denominated loans are not homogenous in terms of value. Large value loans (exceeding CHF 47,000) are concentrated: 25% of borrowers hold two thirds of the loan stock. At the other end, another 25% of borrowers have taken small value loans (lower than CHF 4,000), accounting for only 1% of the loan stock.

The breakdown of CHF borrowers by income group points to the existence of vulnerable social groups among them. About half of the CHF borrowers have a net monthly income lower than lei 1,500 and up to 75% of them have a net monthly income lower than lei 2,500.

The average DTI ratio of CHF borrowers currently stands at 92%, higher than in December 2008, i.e. 64%. Indebtedness distribution is strongly uneven, as borrowers with a net monthly income below lei 2,500 are currently over-indebted, as a result of both income contraction during the crisis and CHF appreciation. Borrowers whose income is below the average wage economy-wide were the hardest hit by CHF appreciation. Debt-servicing costs of borrowers whose net monthly wage is lower than lei 500 rose by 32.2% of the said income, whereas those of borrowers with an income higher than lei 3,000 increased by less than 7% of their net monthly wage.

Designing similar solutions for both borrowers with income lower than lei 700 and an average DTI ratio of 184% and borrowers with income higher than lei 7,000 and an average DTI ratio of 26% is not warranted.

CHF-denominated loans are usually long-term loans, with an average residual maturity of 13.2 years. However, about 40% of CHF-denominated loans have a residual maturity shorter than five years and other 40% of them have a residual maturity longer than 15 years. In fact, the average value of CHF-denominated loans is significantly higher than that of leu-denominated loans, but it also varies a lot depending on borrowers' income level.

Such disparities argue against applying a similar approach to borrowers' debt-servicing difficulties: there are various individual specific situations, therefore one size does not fit all, which calls for the adoption of several differentiated solutions.

CHF-denominated loans are concentrated among a handful of banks (three banks account for 77% of CHF borrowers and for 69% of the CHF-denominated loan volume; these banks jointly held 14% of total bank assets in November 2014). Moreover, the net currency position in CHF was not a source of speculation for banks, given its very low share in total own funds and its extremely low volatility when compared with other currencies. Mention should be made that banks showed caution in managing CHF-denominated assets and liabilities.

III. The current economic environment

The analysis of the current economic environment reveals two significant characteristics.

First, Romania has maintained sustainable macroeconomic balances over the last years, also as a result of the counter-cyclical monetary and prudential policies implemented by the National Bank of Romania. Romania further enjoys robust economic growth and solid growth prospects, of 2.7% in 2015 and 2.9% in 2016. The annual inflation rate has remained on a downward path, while the general government balance and the current account balance stand at sustainable levels. These arguments show that the movements in the CHF/RON exchange rate should not be seen as a depreciation of the domestic currency (which is supported by strong economic fundamentals), but as CHF appreciation following the Swiss National Bank's decision.

Second, the downtrend in interest rates on leu-denominated loans, also as a result of the NBR's decisions to gradually cut the monetary policy rate and to pursue adequate liquidity management, is supportive of the solution of converting foreign currency-denominated loans into the domestic currency in the case of currently unhedged borrowers.

The analysis of the latest statistical data points to a further decline in the annual inflation rate, which followed a lower-than-forecasted path and ran below the lower bound of the variation band of the flat target, due to the steeper drop in volatile prices and to the increasingly weak inflation on external markets, overlapping the lingering negative output gap and the ongoing downward adjustment in inflation expectations. In December 2014, the year-on-year inflation rate stood at 0.8%, while the average annual inflation rate stuck to 1.1% and the annual average inflation rate based on the Harmonised Index of Consumer Prices – which is relevant for assessing convergence with the European Union – came in at 1.4%, the same as in the previous month.

The fall in the inflation rate allowed for successive policy rate cuts (to an all-time low of 2.25% in February 2015) and for interbank rates to decline markedly to record lows, amid favourable liquidity conditions in the money market. In August 2014, the NBR resumed the rate cutting cycle so that in February 2015 the monetary policy rate ran at 2.25% versus 5.25% in June 2013. Moreover, January through November 2014, the NBR gradually lowered the minimum reserve requirement ratios. Thus, at present the minimum reserve requirement ratio on leu-denominated liabilities of credit institutions is 10% (from 15% at end-2013) and that on foreign currency-denominated liabilities is 14% (from 20% in December 2013). The aforementioned movements in the policy rate and reserve ratios led to a significant reduction in the debt service of borrowers with loans in domestic currency, an increase in leu-denominated loans and a contraction in foreign currency-denominated loans, confirming the stronger preference for loans in domestic currency. Consequently, the currency risk has receded.

Prudential indicators show that the banking sector is stable and sound. The loan-to-deposit ratio (LTD), a relevant financial stability indicator, has fallen below 100%, coming in at 91.3% in December 2014. The solvency ratio stood at 17.1% in September 2014 against 15.5% in December 2013, significantly above the international prudential requirements, and liquidity is at an adequate level.

The removal of non-performing loans from the balance sheets has led to negative profitability of the banking system, with credit institutions incurring net losses worth around EUR 1 billion in 2014.

Out of the total stock of loans to households amounting to lei 101 billion, foreign currency-denominated loans account for the equivalent of lei 62 billion (or 61% of total). Mention should be made that out of foreign currency-denominated loans worth 62 billion when expressed in domestic currency, EUR-denominated loans held 83.8%, CHF-denominated loans accounted for 15.7%, and USD-denominated loans took 0.5%, as of November 2014.

Individuals' substantial foreign currency indebtedness and the adverse movements in the exchange rates of several currencies of late (the strong appreciation of the CHF and of the US dollar, as well as the uncertainties surrounding the euro exchange rate) make it even more difficult for a number of borrowers to repay their debt.

Other countries reported similar repayment difficulties on loans to households as well and applied various government-backed schemes to support individuals improve their debt service (the United Kingdom, Ireland, the US, Latvia, Croatia, Iceland).

IV. NBR measures vis-à-vis foreign currency lending

The NBR has implemented at an early stage a mix of measures to deter the unsustainable increase in foreign currency lending. The measures envisaged: (A) monetary policy, (B) prudential regulation, (C) prudential supervision, (D) public warnings, and (E) implementing the recommendations of the European Systemic Risk Board (ESRB) on lending in foreign currencies. Romania ranks among the countries that had to come up with unorthodox measures in order to deal with the challenges arising from the full capital account liberalisation, euroisation of the economy, massive foreign capital inflows, etc. Some of these measures, previously seen as administrative measures at the moment of their implementation, are currently deemed macroprudential instruments (e.g., debt service to disposable income ratio and loan-to-value ratio).

A. Monetary policy

In order to deter foreign currency lending and, implicitly, to strengthen the traditional channels of monetary policy transmission, the NBR actively used as an instrument the minimum reserve requirements ratio on foreign currency liabilities. This ratio continued to be raised during 2004-2006, its level increasing by 5 percentage points each time in August 2004, January 2006 and March 2006 to 40%. Additionally, the NBR extended the scope of minimum reserve requirements to foreign currency-denominated liabilities with residual maturity of over two years, as follows: (i) starting February 2005, on the liabilities incurred subsequent to this date; (ii) starting July, on the liabilities incurred prior to February 2005. The high restrictiveness thus imposed on the minimum reserve requirements ratio on foreign currency-denominated liabilities of credit institutions was kept in place until 2009, when the knock-on effects of the economic crisis on Romania prompted the central bank to implement a countercyclical monetary policy.

B. Prudential regulation

- In 2003, prior to Romania's joining the European Union, the central bank issued norms setting forth certain conditions for granting loans to households, such as:
  - capping the indebtedness level at 35% of the net income for mortgage loans;
  - requiring from borrowers a down-payment of 25%;
  - providing real and/or personal collateral equal to at least the amount of the loan requested for consumer loans that are not intended for goods purchasing;
  - capping the LTV ratio at 75%.
- In July-September 2005, additional lending requirements were imposed, as follows:
  - capping the overall household debt service ratio at 40% of net income on condition that the borrowers' commitment arising from mortgage loans does not exceed 35% of their net income;
  - capping aggregate exposure from foreign currency-denominated loans at 300% of the credit institution's own funds, or endowment capital in the case of branches of foreign credit institutions, for loans granted to households and companies earning incomes in currencies other than the loan currency.
- In the context of Romania's accession to the EU (in 2007), the prudential regulatory framework for lending activity was adjusted in line with the provisions of the *acquis communautaire*, including the provision on full capital account liberalisation.
- Thus, in order to comply with Romania's commitment to capital account liberalisation, it was necessary to firstly remove the cap on credit institutions' aggregate exposure from foreign currency-denominated loans as of 1 January 2007. Keeping the cap in place would have been tantamount to a capital restriction, i.e. a

breach of Romania’s commitment to full capital account liberalisation at the time of EU accession.

- Additionally, in March 2007, the central bank’s regulations on lending were aligned to the relevant EU practices, which did not comprise any administrative restrictions, by promoting the bank self-regulation model.

  In line with new framework, banks establish maximum indebtedness levels by category of customers based on internal lending norms, by observing the risk profile and strategy assumed by banks in relation to borrowers’ financial capacity. These caps are subject to prior validation by the central bank.

- In February 2008, stricter requirements were applied for the provisioning of foreign currency-denominated loans granted to borrowers earning incomes in currencies other than the loan currency.

- In August 2008, the regulation on lending to households was amended so that banks were required to determine borrowers’ indebtedness levels in such a way that the debt service might accommodate the materialisation of currency and interest rate risks, as well as higher fees and commissions, over the entire life of the loan.

  On the same date, the legal provisions were supplemented by imposing the use of the borrower’s annual tax record instead of the monthly income certificate throughout the income validation process.

- In October 2011, the NBR introduced additional restrictions on foreign currency-denominated loans to households, consisting in stricter requirements on establishing the maximum indebtedness level allowed for consumer loans, loan collateralisation, etc.

C. Prudential supervision

Prudential supervision of credit institutions is one of the NBR’s main tasks, according to the law. To this end, the NBR is empowered to check, based on reports and on-site inspections, the compliance with legal provisions and with the NBR regulations in order to limit and prevent risks specific to the banking activity. Based on the examinations and assessments it undertakes, the NBR ascertains to what extent the management framework, the strategies, processes and mechanisms implemented by a credit institution ensure the proper management of risks given the particular risk profile of the credit institution. Thus, the supervision carried out follows the risk-based approach rather than the compliance-based one.

In exercising its supervisory task, the NBR issues recommendations, adopts measures and imposes sanctions on the credit institutions themselves or on their executive and governing bodies in order to ensure that the proper remedial measures are adopted and compliance with the regulations in force is restored.

D. Implementation of recommendations of the European Systemic Risk Board (ESRB) on lending in foreign currencies

At EU level, the first recommendations on lending in foreign currencies were issued by the ESRB in 2011 (with implementation deadline in December 2012). The recommendations were not aimed at banning foreign currency-denominated loans by way of administrative measures, but at setting forth measures that would ensure borrowers have the capacity to service their debt even in the context of adverse developments. With some of these recommendations already regulated, the NBR supplemented the national legislation with the required provisions.

Following up on the action steps of the Romanian authorities, the ESRB concluded that the aforementioned recommendation had been fully implemented by Romania.

E. Public warnings

In the past decade, the NBR has constantly issued public warnings regarding the risks related to foreign currency loans, including CHF-denominated loans, taken by individuals earning incomes in currencies other than the loan currency. These recurrent warnings were disseminated via several communication channels: studies, conferences and seminars on financial stability and supervision issues, legal colloquia (available on the NBR's website), statements made by central bank representatives during the quarterly press conferences, monthly meetings with the representatives of the Romanian Banking Association and other specialised associations (Association of Financial-Banking Analysts in Romania, National Association of Romanian Exporters and Importers, etc.). Most warnings were issued concomitantly with the release of prudential norms and/or restrictions by the NBR. We hereby underline that these activities are current and permanent, and are reported in the Annual Reports and the Financial Stability Reports published on the NBR's website.

V. Other countries in the region – approaches to the situation caused by CHF appreciation

The measures taken by other EU Member States to deal with the challenges posed by CHF-denominated loans show that the solutions were different relative to the particular features of such loans in each country. Therefore, Romania must identify solutions that would fit its own situation. To cherry-pick the favourable components of the measures taken by other countries without revealing the context and the associated costs would be counterproductive.

The significant CHF appreciation in early January 2015 has entailed measures tailored to the particular features of each country. Specifically, Polish authorities recommended banks to come up with individual solutions to cut down on debtors' debt service. Croatia introduced a fixed exchange rate of the kuna against the Swiss franc for a one-year period. The Hungarian authorities took over much of the effort of managing the consequences of the developments in the CHF/HUF rate; it should be mentioned, though, that CHF-denominated loans accounted for approximately 50% of local government borrowings and would have had a significant impact on the budget assuming inaction on the part of the authorities.

VI. Pseudo-remedies vs. realistic and balanced solutions

There may be various ways of action to solve the issue of CHF-denominated loans, but any negotiated solution should be based on the following principles:

- target those individuals in real need of support;
- reasonable burden-sharing;
- not generate moral hazard, i.e. not lead to unreasonable expectations in the future (related to not paying the debt service) and not discriminate debtors in other currencies (RON, EUR, USD);
- not impair financial and banking system stability. Financial system stability is essential for: (i) ensuring financial intermediation and hence the funding of economic growth, (ii) job creation, (iii) higher household income, (iv) paving the way for credit repayment, (v) preserving depositors' confidence in the banking sector;
- comply with the EU Treaty and Romania's accession conditions, i.e. not restrict free capital movement.

VI.1. Unrealistic solutions

We deem the following solutions as unrealistic given their cost-benefit ratio:

A. NBR intervention to bring the CHF/RON at the level of 14 January 2015, which would involve an appreciation of the EUR/RON from around 4.4 (where it currently stands) to 3.7; such an operation would keep the desired level in place only in the short run, because the level would be unsustainable and would entail arbitrage. The associated costs would translate into substantial FX reserve losses, seriously detrimental impact on exports and larger disequilibrium on the FX market

B. Conversion of CHF-denominated loans into lei at exchange rates other than the market exchange rate applicable on the conversion date.

- Assuming credit conversion ***at the historical rate*** in the month of extending the credit, banks would incur losses (calculated as the difference between the exchange rate on 23 January 2015, i.e. 4.58, and the historical CHF/RON rate) estimated at lei 5.66 billion (around 0.85% of GDP). Four credit institutions would see their solvency ratio fall below the minimum regulated threshold. The solvency ratio across the banking sector would diminish from 17.1% to 14%.
- Credit conversion ***at the historical rate + 20%*** would generate losses worth around lei 4.5 billion for the entire banking sector, while three credit institutions would see their solvency ratio fall below the minimum regulated threshold. The solvency ratio across the banking sector would diminish from 17.1% to 14.6%.
- Credit conversion at a ***monthly average rate*** (from the credit agreement date to present) would generate losses worth around lei 3.2 billion for the entire banking sector, while two credit institutions would see their solvency ratio fall below the minimum regulated threshold. The solvency ratio across the banking sector would diminish from 17.1% to 15.3%.

C. Conversion of CHF- and EUR-denominated loans into lei at exchange rates other than the market exchange rate applicable on the conversion date.

- Assuming the cumulated conversion of CHF- and EUR-denominated loans at the historical rates in the month of extending the credit, banks would incur losses (calculated as the difference between historical rates and the exchange rates on 23 January 2015, when the CHF/RON was 4.58 and the EUR/RON was 4.49) estimated at lei 9.8 billion. The solvency ratio across the banking sector would diminish from 17.1% to 11.7%. Four credit institutions would see their solvency ratio fall below the minimum regulated threshold and would require recapitalisation.
- Cumulated credit conversion at the historical rates + 20% would generate losses worth around lei 5.5 billion for the entire banking sector. The solvency ratio across the banking sector would diminish from 17.1% to 14.1%. Four credit institutions would see their solvency ratio fall below the minimum regulated threshold and would require additional capital injections.
- Cumulated credit conversion at monthly average rates would generate losses worth around lei 4.5 billion for the entire banking sector. The solvency ratio across the banking sector would diminish from 17.1% to 14.6%.

VI.2. Realistic solutions

The NBR advocates the implementation of customised solutions, negotiated between the parties directly involved in the credit agreement (i.e. the credit institution and the borrower). The solutions take into account the specifics of CHF-denominated loans, in particular, and FX loans in general on the Romanian market and combine: (i) free market principles, (ii) state support for vulnerable household groups, and (iii) the carrying out by the NBR of its legal tasks on safeguarding financial stability.

The realistic solutions are complementary and each bank may apply an adequate mix tailored to each individual case. They are equally valid for loans in other currencies as well and may be optimised on a case-by-case basis. The solutions which may be deemed as both realistic and balanced include those whose outcome is keeping the domestic currency equivalent of monthly instalments of CHF-denominated loans close to the December 2014 level, with several options available to the parties to credit agreements:

A. *Converting CHF-denominated loans into lei at the market exchange rate and/or granting a discount on the debt service amount* – which may be tantamount to a conversion at an exchange rate below the market rate

B. *Temporary cut in the interest rate on CHF-denominated loans in order to offset the impact of the stronger CHF*

May be a valid option, given that both the benchmark rate of the Swiss National Bank and the CHF market rate have reached negative values.

C. *Implementing a debt rescheduling scheme, with the award of a compensation* by the State

Such a solution would be efficient in light of at least four arguments. First and foremost, it would contribute to a higher disposable income of the beneficiaries of this scheme (performing borrowers), with favourable effects on consumption and economic growth. Secondly, it represents a burden-sharing approach among creditors, borrowers and the State. Thirdly, enforcing the relevant law implies favourable effects also in terms of managing the structural liquidity surplus in the banking sector. Fourthly, the measure targets the segment of vulnerable borrowers, with gross monthly incomes of up to lei 3,000, given households' high degree of indebtedness and its uneven distribution across various income groups. The measure proposed by the Government consists in amending Government Emergency Ordinance 46/2014 by extending its scope of applicability and introducing simpler and more flexible loan rescheduling procedures, and may be applied to CHF-denominated loans as well.

The legislative enhancements are aimed at providing some relief to low-income borrowers facing temporary difficulties in repaying their loans, while also improving the mechanism so as to be promoted by banks and requested by eligible debtors. The main proposals by the Ministry of Public Finance to enhance Government Emergency Ordinance 46/2014 refer to: (i) rendering the rescheduling mechanism and the maturity more flexible vis-à-vis borrowers' financial capacity, (ii) extending the scope of eligible debtors, (iii) simplifying the administrative procedures for loan rescheduling, (iv) strengthening borrower protection in relation to banks, which remain bound, during the rescheduling process, not to tighten contractual terms regarding the interest rate, the level of commissions, or fresh collateral.

With a view to tailoring banking prudential regulations to the new financial market conditions, the NBR has initiated several legislative changes to facilitate the conversion of foreign currency-denominated loans into lei and to ensure the effective enforcement of Government Emergency Ordinance 46/2014 with the amendments proposed by the Ministry of Public Finance.

Summing up, we at the National Bank of Romania remain open to dialogue for clarifying the issue of CHF lending, finding solutions and getting involved in accordance with the legislation in force.