NÁRODNÁ BANKA SLOVENSKA
EUROSYSTÉM

Recommendation No 1/2014 of Národná banka Slovenska of 7 October 2014 in the area of macroprudential policy on risks related to market developments in retail lending (Summary)

Notice

The purpose of this summary is to provide concise and clear information about Recommendation No 1/2014 of Národná banka Slovenska of 7 October 2014 in the area of macroprudential policy on risks related to market developments in retail lending. This summary is therefore a simplified version of the full text of the Recommendation published in the NBS Journal and is not to be treated as a substitute for it.

General principles of the recommendations

- The recommendations apply to all banks, home savings banks and branches of foreign banks.
- In general, the recommendations concern loans other than business loans provided to natural persons. However, they vary in the scope of their application to different types of loan (loans secured by real estate, unsecured loans, bridging loans, building loans).
- The recommendations do not apply to credit card and current account overdraft facilities.
- The recommendations are formulated with regard to banks' current internal systems and risk management methodologies, not on the assumption that these will be replaced.
- The recommendations vary in terms of when they should be implemented. Banks are supposed to implement some recommendations as of 1 November 2014 or as of 1 March 2015, and others during the course of 2015. Further details are given in the information about each recommendation.
- NBS will assess compliance with each recommendation on a regular basis. The first assessment will be conducted in the second quarter of 2015.

Recommendation A.1

Comply with loan-to-value (LTV) ratio limits

Loan type: New loans secured by real estate

Content: The share of new loans in a given quarter which have an LTV ratio of between 90% and 100% should not exceed:
a) 25%, until 30 June 2015;
b) 20%, from 1 July 2015 to 31 March 2016;
c) 15%, from 1 April 2016 to 31 December 2016;
d) 10%, from 1 January 2017.
No loan should have an LTV ratio of more than 100%.

Methodology: **The LTV ratio** is the ratio of the debt to the collateral value.
The debt is the sum of the new loan and all other outstanding loans secured by the same real estate.
The collateral value is the lower of either the independently appraised value of the real estate or its purchase price (assuming this information is available and is relevant). This value may be revised down by the bank on the basis of its internal appraisal.
Only senior security interests are to be considered, with the exceptions specified in the full text of the recommendation.

Commencement: As of 1 November 2014.

Assessment: Periodically, on the basis of quarterly data, beginning with the periods from 1 November to 31 December 2014 and from 1 January to 31 March 2015.

Recommendation A.2

Maintain a prudent approach when appraising real estate collateral

Loan type: New loans and the portfolio of loans secured by real estate.

Content: **Banks should observe the following prudential principles:**

a) Check and, if necessary, adjust independent appraisals.
b) Act prudently in dealings with appraisers whose appraisals have previously been found to be incorrect.
c) Periodically reappraise all real estate collateral in order to monitor LTV ratios in the current portfolio.

Commencement: The recommendation should be implemented gradually and by not later than the end of 2015.

Assessment: Compliance with the recommendation will be assessed at the end of 2015 and the extent of implementation will be assessed on an ongoing basis during 2015.

Recommendation B.1

Set and adhere to an internal limit for the indicator of customer repayment ability

Loan type: All new retail loans.

Content: Bank's internal systems should include a mandatory limit for the indicator of customer repayment ability.

Methodology: **The indicator of customer repayment ability** should take into account the customer's household income, standard household living costs, and total debt servicing requirements.

Exceptions: It is not necessary to verify the limit for so-called unsolicited loans, where the loan amount is set in a pre-approval process that does not involve the active participation of the customer and is based on the bank's internal historical data about the customer's financial situation. Such loans are, however, to be separately monitored, with the respective data to be reported to NBS.
This exception does not apply to loans secured by real estate, bridging loans, and building loans.

Commencement: As of 1 March 2015.

Assessment: Compliance with the recommendation will be assessed in the second quarter of 2015. Data about the amount and risk profile of unsolicited loans is to be reported to NBS on a quarterly basis.

Recommendation B.2

Verify customer income

Loan type: All new retail loans

Content: Banks should require documentation of customers' income and should verify income information with independent internal or external sources. Banks should not use tighter LTV ratio criteria as a substitute for the income verification requirement.

Methodology: A declaration of honour is not to be considered a suitable way of proving income. It is not necessary to perform income verification for unsolicited loans referred to in recommendation B.1.

Commencement: As of 1 March 2015.

Assessment: Compliance with the recommendation will be assessed in the second quarter of 2015.

Recommendation C

Maintain the limit for the indicator of customer repayment ability in the case of an increase in interest rates

Loan type: All new retail loans where the interest rate is not fixed for the entire term of the loan.

Content: The internal limit for the indicator of customer repayment ability should still be met in the event the loan were subject to an interest rate increase of 2 percentage points and assuming that the maturity period is at the maximum recommended limit (see Recommendation E.1).

Methodology: In the case of **mortgage loans for young people** that attract a state interest subsidy, compliance with the limit for the indicator of customer repayment ability should be verified under the scenario of a 2 percentage point increase in the unsubsidised rate.
Where **instalments are set in advance** for the whole term of the loan and their amount varies, banks should verify that the limit for the indicator of customer repayment ability is met in the case of the highest instalment.
Where a credit agreement sets the maximum cumulative increase in the interest rate at less than 2 percentage points, that level shall be used for assessing the impact of an increase in interest rates.

Commencement: As of 1 March 2015.

Assessment: Compliance with the recommendation will be assessed in the second quarter of 2015.

Recommendation D

Perform stress testing

Loan type: The whole portfolio of loans secured by real estate, building loans and bridging loans.

Content: Banks should **stress test** the portfolio for **increases in interest rates and unemployment.** The outcomes should be taken into account when revising the internal limit for the indicator of customer repayment ability.

Methodology: **Stress testing assumptions:**

- the interest rate increase currently expected by the market, according to forward curves, over a horizon of five years (but an increase not lower than 3 percentage points);
- the simulated performance of individual loans where the customer becomes unemployed or experiences a substantial decline in earned income.

Commencement: The recommendation should be implemented gradually and by not later than the end of 2015.

Assessment: Compliance with the recommendation will be assessed at the end of 2015 and the extent of implementation will be assessed on an ongoing basis during 2015.

Recommendation E.1

Comply with maturity limits for retail loans

Loan type: All new retail loans

Content: Banks should limit the maturity period of new loans:

a) which are loans secured by real estate, bridging loans, or building loans, to **30 years;**
(No more than 10% of the amount of new loans provided in a given quarter should have a maturity of more than 30 years.)

b) which are other loans, to:
- **9 years,** from 1 March 2015 to 31 December 2015;
- **8 years,** from 1 January 2016.

Methodology: Banks should take due account of the extent by which the customer's income will decline during retirement.

Commencement: As of 1 March 2015.

Assessment: Compliance with the recommendation will be assessed in the second quarter of 2015.

Recommendation E.2

Avoid providing loans with deferred payment

Loan type: All new retail loans

Content: Banks should not provide loans with progressive repayment – i.e. loans where the credit agreement allows (partially) deferred payment of the interest or principal – gradually increasing instalments, temporarily reduced interest payments, or instalments at frequencies of less than once a month.

Exceptions: Possible exceptions include cases where:

- the interest rate is readjusted in line with financial market movements at the time of resetting of the interest rate;
- the interest rate on mortgages for young people is reduced by a state interest subsidy or the interest rate on other housing loans is temporarily reduced, provided that the amount of each instalment is contractually agreed in advance for the whole term of the loan;
- mortgage instalments are reduced upon the birth of a child;
- and cases which do not have a significant financial impact on the customer at a later date and pertain to a period not longer than six months (or pertain to not more than six instalments) from first drawdown of the loan. In the case of gradual drawdown for the financing of a residential real estate construction, this period can be further extended to 18 months.

Commencement: As of 1 March 2015.

Assessment: Compliance with the recommendation will be assessed in the second quarter of 2015.

Recommendation F

Maintain a prudential approach to loan refinancing

Loan type: Loan refinancing if the sum of the outstanding principals is increased by more than €2,000 or 5%.

Content: **Banks should observe the following prudential principles:**

a) When refinancing with a loan secured by real estate, comply with the **LTV ratio limits** referred to in recommendation A.1. The ratio is to be calculated on the basis of the current value of the collateral, determined in accordance with the bank's internal appraisal.

b) For each loan, require **documentation of income** and verify **compliance with the internal limit for the indicator of customer repayment ability** referred to in recommendations B.1 and B.2.

c) Where loan maturities are extended, comply with the **maximum maturity limits** referred to in recommendation E.1.

Commencement: As of 1 March 2015.

Assessment: Compliance with the recommendation will be assessed in the second quarter of 2015. Part (a) of this recommendation will be assessed in accordance with Recommendation A.1 on the basis of quarterly reporting.

Recommendation G

Maintain a prudential approach to lending through intermediaries

Loan type: New loans provided through intermediaries and the portfolio of retail loans provided in this way (not including loans provided through tied agents).

Content: **Banks should comply with the following prudential principles:**

a) Independently assess and manage credit risk on such loans, including compliance with the other recommendations above.

b) Ensure that the share of these loans in the credit portfolio is such that does not create pressure to loosen lending conditions, and maintain an appropriately diverse pool of intermediaries.

c) Closely monitor these loans and compare them with other loans in terms of credit risk.

Commencement: The recommendation should be implemented gradually and by not later than the end of 2015.

Assessment: The share of loans provided through intermediaries is to be reported to NBS. Compliance with the recommendation will be assessed at the end of 2015 and the extent of implementation will be assessed on an ongoing basis during 2015.