Banco de Portugal

Circular Letter No 86/2012/DSC of 20 December 2012

SUBJECT: Guidelines on lending in foreign currencies to be followed by credit institutions

The European Systemic Risk Board has approved a set of recommendations on lending in foreign currencies addressed to European Union Member States and their supervisory authorities. These recommendations were published in the Official Journal of the European Union of 22 November 2011, their addressees being bound to take the necessary national measures for their implementation.

On the basis of these recommendations was the pursuance of financial stability objectives related to the stock of foreign currency loans in a number of EU Member States, most notably to reduce exposures of credit institutions to credit and market risks, thus increasing the resilience of the financial system.

For the European Systemic Risk Board, one way of reaching financial stability objectives would be to reduce asymmetric information between customers and credit institutions, as it improves customers' risk awareness and fosters responsible lending.

Given that these recommendations should be implemented in the light of principles of proportionality and adequacy, and taking into account how intensively this type of credit is used in the Portuguese financial market, Banco de Portugal believes that the set targets are properly protected by adopting a series of guidelines addressed to credit institutions which provide foreign currency loans.

Therefore, with a view to implementing European Systemic Risk Board's recommendations, Banco de Portugal, pursuant to Article 17 of its Organic Law, discloses a set of guidelines to be followed by credit institutions when providing foreign currency loans:

1. Scope

In this Circular Letter, Banco de Portugal discloses guidelines that must be followed by credit institutions when providing credit agreements with retail bank customers, in a currency other than legal tender in Portugal.

2. Risk awareness of customers

2.1. Credit institutions must provide customers with adequate information regarding the risks involved in foreign currency lending, in order to enable customers to take well-informed and prudent decisions.

2.2. In these cases, credit institutions must, prior to entering into an agreement, inform the customer on (i) the impact on instalments of a severe depreciation of the legal tender, and (ii) the impact on instalments of a severe depreciation combined with an increase of the foreign interest rate.

2.3. A severe depreciation of the legal tender corresponds to a devaluation of at least 5 per cent against the loan currency.

2.4. Information mentioned in paragraph 2.2 shall be provided as follows:

a) For credit agreements covered by Decree-Law No 51/2007, of 7 March of 2007: by filling in Table 7 of Chapter C of Part I of the Standardised Information Sheet approved by Instruction of Banco de Portugal No 10/2010, regarding “Other situations likely to affect the cost of the loan” and by providing the corresponding amortisation tables of the loan;

b) For consumer credit agreements covered by Decree-Law No 133/2009, of 2 June of 2009: by filling in the field regarding the “Instalment amount”, in Section 5.3 of Chapter B of the European Standardised Information Sheet on consumer credit, approved by Instruction of Banco de Portugal No 8/2009, as well as by providing the corresponding amortisation tables;

c) For credit agreements not covered in the foregoing subparagraphs: by presenting the loan approval documentation or any other documents provided to the customer prior to entering into an agreement.

2.5. Where customers apply for a foreign currency loan, credit institutions must offer them:

a) Domestic currency loans for the same purposes as foreign currency loans; and

b) Financial instruments to hedge against foreign exchange risk.

3. Creditworthiness of customers

3.1. Credit institutions must enter into foreign currency credit agreements only with customers that demonstrate their creditworthiness, taking into account the payment structure of the loan and the customers’ capacity to withstand adverse shocks in exchange rates and in the foreign interest rate.

3.2. For the purposes of the foregoing paragraph, prior to entering into foreign currency credit agreements, institutions must adopt stringent underwriting standards, namely as regards debt service-to-income and loan-to-value ratios.

Sent to:
Banks, Caixa Central de Crédito Agrícola Mútuo (Central Mutual Agricultural Credit Bank), Caixa Económica Montepio Geral (savings bank), Caixa Geral de Depósitos, *caixas de crédito agrícola mútuo* (mutual agricultural credit banks), *caixas económicas* (savings banks), credit financial institutions, factoring companies, mutual guarantee companies, investment companies, financial leasing companies, branches of credit institutions whose head office is an EU country or third country, and payment institutions.