

Dear madam / sir

Foreign currency lending to unhedged borrowers has increased recently in a number of EU Member States. Excessive foreign currency lending may produce significant systemic risks for those Member States. Among the risks from foreign currency lending to unhedged borrowers the most prominent ones are the risk of change in the credit quality of the borrower due to changes in foreign exchange rate and foreign interest rates, funding in foreign currency risk and foreign currency liquidity risk, excessive credit growth, potential asset bubbles and potential contagion between EU Member States.

Therefore, the European Systemic Risk Board (ESRB) issued on 21 September 2011 the recommendation no. ESRB/2011/1 on lending in foreign currencies (OJ C 342/1 22.11.2011). The individual recommendations cover the following issues:

- A. Risk awareness of borrowers,
- B. Creditworthiness of borrowers – national supervisory authorities shall monitor the situation and adopt measures to limit foreign currency lending
- C. Credit growth induced by foreign currency lending – national supervisory authorities shall monitor whether foreign currency lending is inducing excessive credit growth as a whole and, if so, adopt new or more stringent rules than those set out in Recommendation B
- D. Internal risk management – national supervisory authorities shall address guidelines to financial institutions so that they better incorporate foreign currency lending risks in their internal risk management systems
- E. Capital requirements – national supervisory authorities shall implement specific measures under the Second Pillar of the Basel II revised framework, and in particular to require financial institutions to hold adequate capital to cover risks associated with foreign currency lending
- F. Liquidity and funding – national supervisory authorities shall monitor funding and liquidity risks taken by financial institutions in connection with foreign currency lending
- G. Reciprocity – national supervisory authorities in Member States shall impose measures addressing foreign currency lending at least as stringent as the measures in force in the host Member State.

As the risks stemming from foreign currency lending to unhedged borrowers has not been a systemic risk in Slovak Republic, it is not necessary to implement recommendations B – F in Slovak Republic. However, the recommendation A must be implemented by all Member States in order to avoid potential regulatory arbitrage and to prevent possible future risk accumulation.

Therefore the National Bank of Slovakia recommends to banks and branches of foreign banks in the Slovak Republic to:

1. provide borrowers with adequate information regarding the risks involved in foreign currency lending. Such information should be sufficient to enable borrowers to take well-informed and prudent decisions and should at least encompass the impact on installments of a severe depreciation of the legal tender of the Member State in which a borrower is domiciled and of an increase of the

foreign interest rate (Recommendation A1 of the Recommendation ESRB/2011/1)

2. offer customers domestic currency loans for the same purposes as foreign currency loans as well as financial instruments to hedge against foreign exchange risk (Recommendation A2 of Recommendation ESRB/2011/1).

The National Bank of Slovakia will be regularly monitoring how banks and branches of foreign banks implement this recommendation. At the same time the National Bank of Slovakia will continue to monitor foreign currency lending to unhedged borrowers and in case of its increase it will consider the implementation of the recommendations B – F.

With kind regards