EUROPEAN CENTRAL BANK

EUROSYSTEM

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Bulgaria – assessment of ERM II prior commitment No. 2 on the macroprudential toolkit

Main conclusions:

- In the letter of intent from 29 June 2018 to join the Exchange Rate Mechanism II (ERM-II) and Banking Union,[1] the Bulgarian authorities committed *inter alia* to broaden the macroprudential toolkit in Bulgaria by establishing the legal basis for borrower-based measures.
- Bulgaria adopted the relevant legislation in December 2018. In particular, the Bulgarian National Assembly adopted amendments of the Law on Credit Institutions in order to explicitly empower the Bulgarian National Bank (BNB) with borrower-based measures. The set of available borrower-based measures includes limits to loan-to-value (LTV), loan-to-income (LTI) and debt-service-to-income (DSTI) ratios, maturity limits and loan amortisation requirements.
- The ECB assesses the prior commitment to be fulfilled.

1. Overall objective, rationale and commitment

Macroprudential instruments that impose certain minimum standards on the issuance of new residential mortgage loans can play an important role in counteracting the build-up of systemic risks and strengthening the resilience of the financial system. Borrower-based measures, such as imposing limits on the debt service burden of borrowers relative to their income, can be an effective way to contain excessive credit dynamics during boom phases by promoting sound lending standards and reducing the tails of the risk distribution. Their active use can support intermediate macroprudential policy objective of "mitigating and preventing excessive credit growth and excessive leverage" (ESRB 2013).[2]

A strong legal basis can support the effectiveness and active use of borrower-based measures. As of June 2020, almost all euro area member states had legal provisions in their respective national legal frameworks for the adoption of borrower-based measures[3], as called for by the Governing Council in 2016.[4] In 13 euro area member states at least one of the borrower-based measures was in force.[5] For countries joining ERM-II, a legal basis for borrower-based measures could be of particular importance in

[1] The letter of intent is available at https://www.consilium.europa.eu/media/36125/st11119-en18.pdf.

[2] See the Recommendation of the ESRB of 4 April 2013 on intermediate objectives and instruments of macroprudential policy (ESRB/2013/1).

[3] While the scope of the legal basis is heterogeneous across member states, in most countries it includes limits to the loan-to-value (LTV), loan-to-income (LTI), debt-service-to-income (DSTI) ratios, as well as maturity limits. The only two member states of the euro area that do not yet have a dedicated legal basis for taking borrower-based measures are Italy and Greece.

[4] See Governing council statement on Macroprudential Policies (15 December 2016), https://www.ecb.europa.eu/press/pr/date/2016/html/pr161215_1.en.html

[5] Austria, Belgium, Estonia, Finland, France, Ireland, Latvia, Lithuania, Malta, the Netherlands, Portugal, Slovakia, and Slovenia.

view of the potential impact of ERM-II participation on investor behaviour, the real estate market, capital flows and the credit cycle.

At the time of expressing the intent to join ERM-II, borrower-based measures were not explicitly listed in the macroprudential framework in Bulgaria. Instead, the framework mainly relied on capital instruments based on the Capital Requirements Directive IV (CRD IV) and the Capital Requirements Regulation (CRR), such as the countercyclical capital buffer. While the Bulgarian National Bank (BNB) had broad powers to issue recommendations on new lending practices, these were not as legally binding and enforceable as borrower-based measures.

In its letter of intent to join ERM-II, the Bulgarian authorities committed to broaden the macroprudential toolkit by providing the legal basis for borrower-based measures.

2. Implementation by the authorities

In December 2018, the Bulgarian National Assembly adopted legislative amendments of the Law on Credit Institutions in order to explicitly empower the BNB with borrower-based measures. The amendment to Law on Credit Institutions[6] (Article 79 (3)) extends the existing macroprudential mandate of the BNB with a number of specific macroprudential powers, notably including the competence: (i) to collect information for macroprudential purposes; (ii) to monitor, identify and assess systemic risks; (iii) to develop and implement national measures to mitigate macroprudential or systemic risk identified at the level of a Member State under Article 458 of CRR; (iv) to develop and implement measures to limit systemic risks stemming from the accumulation of excessive credit growth (i.e. borrower-based measures); (v) to develop and implement measures to limit the risk of concentration to certain economic sectors and industries; (vi) to develop and implement additional minimum requirements in respect of liquidity; and (vii) to carry out any other actions necessary to achieve BNB's macroprudential objectives. In terms of scope, the powers related to borrower-based measures cover all banks licensed in the Republic of Bulgaria (including third-country bank branches and branches of banks from EU Member States), and comprise domestic activities as well as activities carried out through a branch or directly in the territory of a Member State or a third country.

3. Assessment

The ECB assesses that the prior commitment related to broadening the macroprudential toolkit by providing legislative basis for borrower-based measures is fulfilled. Legislative amendments have provided the BNB with a set of borrower-based measures which includes limits to loan-to-value (LTV), loan-to-income (LTI), debt-service-to-income (DSTI) ratios, maturity limits and loan amortisation requirements. The list of potential borrower-based measures is comprehensive, as called for by the ECB Governing Council for all euro area countries.[7] The current provisions in the Law on Credit Institutions give the BNB flexibility with respect to the implementation of borrower-based and other measures necessary to achieve the objectives of its macroprudential mandate. A legally-binding borrower-based measure could be implemented by either a Central Bank Regulation or a BNB Governing Council decision.[8]

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[6] https://dv.parliament.bg/DVWeb/showMaterialDV.jsp?idMat=133131

[7] See Governing Council statement on Macroprudential Policies (15 December 2016), https://www.e cb.europa.eu/press/pr/date/2016/html/pr161215_1.en.html

[8] See also the Opinion of the European Central Bank of 19 November 2018 on the macroprudential Българска народна банка (Bulgarian National Bank, BNB) on the draft law, in which the ECB welcomed the implementation of a legislative framework for borrower-based measures and took positive note of the fact that BNB may activate part or all of the abovementioned tools, thereby responding in a flexible and proportionate way to potential financial stability risks.