EUROPEAN CENTRAL BANK

EUROSYSTEM

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

Main conclusions:

- In the letter of intent from 4 July 2019 to join the Exchange Rate Mechanism II (ERM-II) and Banking Union,[1] the Croatian authorities committed *inter alia* to broaden the macroprudential toolkit in Croatia by establishing the legal basis for borrower-based measures.
- Croatia adopted the relevant legislation in April 2020. In particular, the Croatian Parliament adopted amendments of the Credit Institutions Act and the Croatian National Bank Act in order to explicitly empower the Croatian National Bank (HNB) 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, loan amortisation requirements and other requirements aimed to prevent and mitigate systemic risks.
- 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/40282/letter-of-intent.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, 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 Croatia. Instead, the framework mainly relied on capital instruments based on the Capital Requirements Directive IV (CRD) and the Capital Requirements Regulation (CRR), such as the countercyclical capital buffer. Although the Croatian National Bank (HNB) 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 Croatian authorities committed to broaden the macroprudential toolkit by providing the legal basis for borrower-based measures.

2. Implementation by the authorities

In April 2020, the Croatian Parliament adopted legislative amendments of the Croatian National Bank Act and Credit Institutions Act in order to explicitly empower the HNB with borrower-based measures. The amendment to the Croatian National Bank Act provides that HNB is competent for the definition and implementation of Croatia's macroprudential policy, acting in accordance with relevant EU legal acts.[6] The amendment to the Credit Institutions Act contains further provisions regulating HNB's macroprudential mandate and tools. In particular, where necessary to safeguard financial stability and mitigate systemic risks, HNB must adopt subordinate legislation to set appropriate measures that may include: (i) the highest permitted ratio of the approved loan amount to collateral value; (ii) the highest permitted ratio of the loan amount to the income of the loan beneficiary; (iii) the highest permitted ratio of the amount of loan instalment repayment or annuity to the income of the loan beneficiary; (iv) the maximum duration of the loan agreement; (v) requirements related to the loan repayment calculation method; or (vi) other measures and requirements aimed at safeguarding the stability of the financial system and preventing and mitigating systemic risks.[7]

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 HNB with a set of borrower-based measures which *inter alia* 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.[8] The current provisions in the Law on Credit Institutions give the HNB flexibility with respect to the implementation of borrower-based and other measures necessary to achieve the objectives of its macroprudential mandate.[9]

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[6] See Articles 4, 10, 25 and 27 of the draft law on HNB (amending Articles 4, 43 and 89 and introducing new Article 77a of the Law on HNB).

[7] See Article 39 of the draft law on credit institutions (introducing Article 144a of the Law on credit institutions).

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

[9] See the Opinion of the European Central Bank of 25 March 2020 on close cooperation between the European Central Bank and Hrvatska narodna banka (Croatian National Bank, HNB) within the Single Supervisory Mechanism, and on the macroprudential mandate and tools of HNB (CON/2020/10), in which the ECB welcomed the implementation of a legislative framework for borrower-based measures and took positive note of the fact that HNB may activate part or all of the abovementioned tools, as well as any other measures and requirements aimed at safeguarding the stability of the financial system as a whole and preventing and mitigating systemic risks, thereby responding in a flexible and proportionate way to potential financial stability risks.