NÁRODNÁ BANKA SLOVENSKA
EUROSYSTÉM

Measures in the area of prudent principle for consumer loans effective from 1st January 2018, amended from 1st July 2018 (Review)

Introduction

The aim of this document is to provide a brief and comprehensive review of measures in the area of prudent principles for consumer loans.

The legal framework for these measures is based on Act No 129/2010 Coll. on consumer credits and other credits and loans for consumers and amending certain laws, as amended and Decree of NBS No 10/2017 of 14 November 2017 amended by Decree of NBS No 6/2018 of 29 May 2018 by laying down the details of the assessment of the consumer's ability to repay consumer loans.

These measures apply to all providers of consumer loans, including both banks and non-bank financial firms.

The review is simplified and does not replace the full text of these legal provisions.

General principles

- **The main objective of the measures is to reduce risks for both consumers and creditors** and to mitigate potential imbalances in the financial market. This ensures that the growth of consumer loans will be healthy and sustainable.
- **These measures are largely based on the recommendations issued by NBS in 2014**. Moreover, some additional requirements are based on current market practice and shall be phased-in over a longer period. These measures are therefore not expected to have any significant impact on the consumer loan market.
- Creditors are required to verify the limits and conditions only when new loan is granted or when there is a significant increase of the existing loan.
- The measures **do not apply** to refinancing loans, provided that the outstanding amount is not increased **by more than € 2,000 or 5%** (whichever is lower).
- These measures represent only minimum requirements to be applied when consumer loans are provided and do not replace the limits set by creditors within their own risk management system.

Limit for the indicator of the consumer's ability to repay the loan

$$\text{Indicator of the consumer's ability to repay} = \frac{\text{payments of all fin. liabilities (subject to the increase in interest rates)}}{\text{net income less the subsistence minimum}}$$

Indicator of the consumer's ability to repay cannot exceed 80 % since 1 July 2018.

Exceptions

- consumer loans, which, together with the existing debt of the consumer, do not exceed his/her annual net income,
- leasing with a deposit of at least 20%, which together with an existing debt of the consumer does not exceed 1.5 times his/her annual net income.

In these cases, **the limit for the indicator of the consumer's ability to repay the loan is 100%.**

Payments of all financial liabilities = installment of the new loan + installments of all existing loans + other expenses on consumer's financial liabilities. Repayments of existing loans are accounted for in full, even if they are repaid by the consumer together with another co-debtor. It also takes into account the potential increase in interest rates.

Note

The methodology of calculating the impact an increase in interest rates on the amount of installments

- For new and existing loans with a residual maturity of more than 8 years, creditors are obliged to take into account that interest rates may increase in the future. In addition to current loan installment, they have to therefore calculate also the installment in case of an interest rate increase of 2 percentage points (with a ceiling of 6% for loans secured by a real estate), assuming maturity of 30 years. If this installment is higher than the original one, it has to be used when calculating the indicator. For this calculation it is also necessary to adequately take into account the possible reduction of consumer's income in the event of retirement.
- The test of an interest rate increase for existing loans needs not to be done if the consumer credit is repaid before the nearest interest rate refixation is made on this existing loan.
- For interest rate fixation over 10 years it is sufficient to perform the test assuming an increase of the interest rate by 1 p. p.
- In case of mortgages for young people with subsidized interest rate the impact of the increase in interest rate should be added to the non-subsidized rate.
- For loans with fixed interest rates over the whole maturity this test is not to be carried out.

Net income less the subsistence minimum = consumer's net monthly income (i. e. net of tax and levies), less the subsistence minimum for the consumer and children in accordance with Act No. 601/2003 Coll. on the subsistence minimum. The subsistence minimum for a spouse is deducted only if he / she is a co-debtor. The consumer's income must be documented or verified by the creditor from independent internal or external sources.

Aim of the limit for the indicator of the consumer's ability to repay the loan

The aim of the limit is to ensure that consumers have a sufficient financial buffer in their income as a reserve for contingencies. The aim is to avoid cases in which the consumer is left for basic needs only with a subsistence minimum. Consumer's net income is therefore first reduced by the subsistence minimum for the consumer and children. 85% of the rest of the consumer's income can be used for the repayment of financial liabilities (subject to a potential increase in interest rates), so the reserve is 15%. This reserve will increase to 20% from 1 July 2018.

Example

Married couple with two children, with a total net income of € 1,200 already has a housing loan € 100,000 at an interest rate of 1.8% and maturity of 30 years. Now they ask for a consumer loan at an interest rate of 8% and maturity of 8 years.

Net income of this household	€ 1,200.00
Subsistence minimum for this household	€ - 520.76
Difference between income and subsistence minimum	€ 679.24
Reserve requirement (20% of this difference)	€ - 135.85
Maximum total loan installments	€ 543.39
Installments of the housing loans (at interest rate 1.8 % + 2 %)	€ - 465.96
Maximum installments of the consumer loan	€ 77.43

Hence, the creditor may provide consumer credit where the payment does not exceed the amount of € 77.43. The maximum amount of loan that can be granted in this case is € 5,477.24 (with the maturity 8 years and interest rate 8% p.a.).

Limit on debt-to-income ratio (DTI)

$$\text{Debt to income ratio} = \frac{\text{total debt}}{\text{annual net income}}$$

The maximum share of new loans for which the debt-to-income ratio exceeds 8 will be gradually reduced to 10% from 1 July 2019.

Period	The maximum share of new loans for which the debt-to-income ratio exceeds 8
1 July 2018 to 30 September 2018	20%
1 October 2018 to 31 December 2018	15%
1 January 2019 to 30 June 2019	10%
After 1 July 2019	5% + 5% if additional conditions are met

* **Additional conditions:** Housing loans provided to customers aged up to 35 with income not exceeding 1,3 times the average wage and DTI for these loans does not exceed 9.

Total Debt = Loan provided + all other existing loans except for loans repaid by the loan provided. Existing credit cards and allowed overdrafts on current accounts are also included. In case of new credit cards and allowed overdrafts, only 20% of the approved credit line is included.

Aim of the limit for the debt-to-income ratio

The aim is to mitigate the risks associated with the rapid growth of household indebtedness. The indebtedness is growing in the low interest rates environment at an excessive pace and it is not sustainable in the longer term. Households with too high debt compared to their income may have serious problems with repaying these loans later. And if there are many such cases, serious problems can affect the financial sector and the domestic economy as a whole.

Limits on maximum maturity and requirements for regular repayment

Loan category	Limit
Consumer loans provided by building societies	30 years
Consumer loans provided by other creditors	8 years

Creditors cannot provide consumer 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. In the case of a leasing with a deposit of at least 20%, the repayment frequency may be annual.

The restriction on deferred payments does not apply to the postponed payments or temporary reduced installments if the consumer during the loan repayment gets into unexpected financial difficulties. In addition, this requirement may not be met in case of standard changes of installments due to interest rate refixation and in cases not related to a very long period.

The aim of limits on maximum maturity and requirements for regular repayment
These measures aim to ensure that the maturity is in line with character of the loan and also that these loans are repaid regularly. This will, inter alia, mitigate the risk of rising household indebtedness.

Requirements for a prudent approach to lending through intermediaries

The creditor is required to independently monitor the loans provided through financial intermediaries and to compare their credit risk to the other loans. If a significantly higher credit risk is identified, creditor is obliged to immediately take the necessary measures to reduce this risk.