

OPINION
on the Draft Law Amending the Law on the Conversion of Swiss franc (chf) -denominated Loans

I. PRINCIPAL REMARKS

1. The Central Bank of Montenegro (hereinafter: the Central Bank), has, prior to adopting the Law on the Conversion of Swiss franc (chf) -denominated Loans into euro (eur)-denominated Loans in July 2015, on multiple occasions suggested that the best solution would be to explore the possibility of negotiated resolution of issues that have emerged between the banks and loan beneficiaries, and that, in case of inability to reach a negotiated solution to these issues, they should be decided upon by a competent court.

The Central Bank has indicated that acting in this manner would ensure avoiding of all the risks arising from the adoption of the law, by which previously incurred legal contractual relationships between the bank and its clients are changed, and creating the possibility of justified individual approach to resolving this issue in the sense that, in redefining the bank's obligations, greater benefits are offered to the clients who used their loans for resolving their housing question in relation to the clients who used the loans for business purposes. In addition, the risk of insufficient legal security of investors that arises from the situations where the government interferes in concluded contractual relations and from the retroactive application of a law would be avoided.

In reference to the above stated, on this occasion, the Central Bank wishes to point to the following positions of the European Central Bank given in its Opinion of the European Central Bank of 18 September 2015 on the Conversion of Swiss franc Loans (CON/2015/32) (adopted after the adoption of the Law on the Conversion of Swiss franc (chf) -denominated Loans into euro (eur)-denominated Loans):

- That the conversion of loans might have some negative effects if it were to lead to a deterioration of foreign investor sentiment due to a perceived increase in legal uncertainty and country risk;
- It is for the specific country's authorities to assess whether this would be a retroactive encroachment on relations between specific contracting parties and whether it is in compliance with the country's legal and constitutional principles. However, the ECB notes that introducing measures with retroactive effect will undermine legal certainty and that it is not in line with the principle of legitimate expectations;
- That, when introducing measures in relation to converting foreign currency loans, due consideration should always be given to fair burden sharing among all stakeholders, thus also avoiding moral hazard in the future.

2. The adoption of the Law on the Conversion of Swiss franc (CHF) -denominated Loans into euro (EUR)-denominated Loans has left a significant number of open issues regarding its application that are currently being resolved by proposing alterations and amendments to the said law.

The delivered Draft Law Amending the Law on the Conversion of Swiss franc (CHF) -denominated Loans into euro (EUR)-denominated Loans expands the capacities of the Central Bank in order to include the following into the conversion:

- 1) Loans that were regularly repaid or prepaid prior to the entry into force of the Law on the Conversion, including the loans that the bank has terminated and collected the receivables by means of enforced collection (through court proceedings, collateral foreclosure, etc.);
- 2) Loans that the bank has terminated due to irregular repayment and transferred the receivables arising from those loan agreements to other parties.

The number of beneficiaries of these loans is 245 and the amount of these receivables is significant.

Conversion did not cover 116 credit lines that were repaid through regular repayment or prepayment or enforced collection (collateral foreclosure, etc.) before the Law on Conversion entered into force, whereby the total granted amount of these loans was 38,159,000 CHF (24,060,000 EUR).

In addition, as per the data acquired from the Bank, total number of receivables that were not covered by the conversion because they were ceded to third parties amounted to 129.

The bank has ceded, at a charge, a total of 124 loans to "HYPO DEVELOPMENT" d.o.o. Podgorica, which has since been renamed as "HETA ASSET RESOLUTION", and a total of five loans were ceded to B2 Holdings Kapital doo Beograd.

The structure and the amount of receivables that the Bank has ceded to other parties are presented in the following table:

Table: Loans denominated in CHF ceded to other parties, in thousand CHF (EUR)

	Number of credit lines	Granted amount (CHF)	Granted amount (EUR)	Exposure at the moment of cession (EUR)	Selling price
HETA ASSET RESOLUTION d.o.o. Podgorica	124	119,478	75,805	66,370	54,098
B2 Holdings Kapital d.o.o. Beograd	5	723	435	328	5
Total	129	121,706	76,230	66,698	54,103

The table shows that, at the moment of cession, the amount in question exceeded 66 million euros (an average of 517,000 euros per credit line). Data on the current number and amount of ceded receivables are not available to the Central Bank, since those receivables are in portfolios of subjects that are not subject to the surveillance of the Central Bank.

3. In reference to the proposed amendments, the Central Bank emphasises that expanding the circle of parties covered by the law enhances all the adverse effects to which the Central Bank has pointed on multiple occasions.

By including the receivables regulated before the Law on the Conversion of Swiss franc (chf) -denominated Loans into euro (eur)-denominated Loans (repaid loans, etc.) into the conversion, the proposed alterations and amendments will additionally affect the financial position of the bank that has granted these loans.

The proposed law will have a particularly negative effect on the financial position of the third parties on which the loan receivables were ceded.

Bearing in mind the above stated, the Central Bank is of the opinion that, before adopting alterations and amendments to the Law on the Conversion of Swiss franc (chf) -denominated Loans into euro (eur)-denominated Loans, it is necessary to, once again, analyse in detail and recognise all potential risks and adverse effects possibly stemming from the adoption of the proposed legal solutions.

II. REMARKS IN POINT

Should the legislator decide to adopt the proposed amendments to the Law on the Conversion of Swiss franc (chf) -denominated Loans into euro (eur)-denominated Loans, the Central Bank underlines that the proposed wording of the Draft Law:

- Failed to precisely define issues of relevance, in particular the issue of the treatment of the receivables ceded to the third parties, and
- Contains a significant amount of legal and editorial flaws that need to be removed.

Therefore, the Central Bank finds that the wording of the Draft Law Amending the Law on the Conversion of Swiss franc (chf) -denominated Loans into euro (eur)-denominated Loans needs to be altered, i.e. amended, and in that aim, proposes appropriate alterations and amendments in the form of the following amendments to this Draft Law, that could be proposed by the authorised proponent:

AMENDMENT I

The rubric of the Draft Law Amending the Law on the Conversion of Swiss franc (chf) -denominated Loans shall be replaced by the following: Draft Law Amending the Law on the Conversion of Swiss franc (chf) -denominated Loans into euro (eur)-denominated Loans.

Argument:

The proposed amendment is given for the purposes of legal and editorial harmonisation with the rubric of the law that is being altered and amended.

AMENDMENT II

Article 1 of the Draft Law shall be replaced with the following:

“Article 1

In Article 1, paragraph 1 after the word: “banks” a coma and the following wording shall be added: “third parties to which the banks ceded loan receivables (hereinafter: third parties)”.

At the end of paragraph 2, the full stop shall be replaced by a coma and the following shall be added: “as well as loan receivables ceded by banks to third parties and loans repaid during the regular repayment period or enforced collection”.

Argument:

The proposed amendment is given for the purposes of legal and editorial improvement of the wording.

AMENDMENT III

Article 2 of the Draft Law shall be replaced with the following:

“Article 2

In Article 2 the following paragraph 2 shall be inserted:

“Third parties to whom the banks ceded receivables under this law shall also make the conversion referred to in paragraph 1 above”.

Argument:

The proposed amendment is given for the purposes of legal and editorial improvement of the wording, which defines more clearly the obligation of the third parties to apply the conversion referred to in this law.

AMENDMENT IV

Article 3 of the Draft Law shall be replaced with the following:

“Article 3

Article 3 and heading shall be replaced with the following:

“Calculation of loans and/or receivables

Article 3

After the conversion of loans into EUR, the commercial banks and/or third parties shall recalculate loans and/or receivables at fixed interest rate of 8.2% per annum.

Paragraph 1 above shall be also applied to loans which have been repaid during the regular repayment period or enforced collection, therefore the commercial banks, i.e. third parties shall repay to the client funds exceeding the obligation stipulated under this law.

When calculating the debt based on receivables under the agreement terminated unilaterally by the commercial banks, including receivables ceded to third parties, the provisions of the Law on Default Interest Rate (OGM 83/09) shall not be applied.“

ALTERNATIVE TO PARAGRAPH 3:

When calculating the debt based on receivables under the agreement terminated unilaterally by the commercial banks, including receivables ceded to third parties, the legal default interest rate calculated pursuant to the Law on Default Interest Rate (OGM 83/09) shall be included.“

Argument:

Amendment proposed in reference to paragraphs 1 and 2 herein is given for the purposes of legal and editorial improvement of the proposed wording.

Paragraph 3 is proposed for the purposes of explicit regulation of the treatment of default interest rates in the event of unilaterally terminated agreements and/or agreements ceded to third parties and thereby avoiding the potential different interpretation in practice.

Specifically, the Law on the Conversion of Swiss franc (chf) -denominated Loans into euro (eur)-denominated Loans, as well as the proposed amendments and alterations to that law, do not contain provisions that clearly define whether when calculating the debt based on receivables under the terminated agreements, including receivables ceded to third parties, the provisions of the Law on Default Interest Rate (OGM 83/09) shall be applied or not. In such situation, the conversion obligor – commercial bank or a third party can include accrued legal default interest into the debt calculation by increasing

the amount of debt, calculated by applying the 8.2% interest rate (concluding with the agreement termination date), by the amount of legal default interest rate from the agreement termination date to the date when conversion is performed pursuant to the Law on the Conversion of Swiss franc (chf) -denominated Loans into euro (eur)-denominated Loans.

If this issue is not clearly defined in the amendments to the law, there is a high risk that in the application of provisions referring to the calculation of debt arising from terminated agreements various interpretations by conversion obligors –commercial banks or third parties and their clients, will emerge, therefore, it is necessary to clearly define whether the Law on Default Interest Rate shall apply to these cases or not. .

In that sense, the proposed amendment referring to paragraph 3 of Article 3 of the Law on the Conversion of Swiss franc (chf) -denominated Loans into euro (eur)-denominated Loans also contains alternative solution, and the choice between the two solutions shall depend on the position of the legislator.

AMENDMENT V

After Article 3 of the Draft Law the following new Article 4 of the Draft Law shall be inserted:

“Article 4

After Article 3 the following new Article 3a and heading shall be inserted:

“Treatment of receivables ceded to third parties

Article 3a

For determining the amount of receivables ceded to third parties based on loans to be converted pursuant to this law (hereinafter: the debt), the commercial banks that have ceded these receivables shall, within 15 business days following that of the entry into force of this law, submit for each ceded receivable to third parties the following, for the purpose of the calculation of debt and conclusion of corresponding agreement:

- 1) Loan agreement, with the initial repayment plan;
- 2) Data on the amount of loan granted in Swiss francs and amount in Euro stipulated in accordance with Article 2 paragraph 1 herein;
- 3) Loan repayment plan drawn up for the life of the loan using nominal interest rate of 8.2% and applying compound interest account and decursive interest calculation;
- 4) Data on total payments to commercial bank based on loan agreement, which the loan beneficiary has made until the ceding of receivable, including dates and amount of individual payments.

The debt shall be calculated by harmonising the amount of outstanding principal from the repayment plan under paragraph 1 point 3 above as of the debt establishment with the difference in value of all cash inflows and outflows arising from the loan agreement.

Third party shall, for the amount of debt established in accordance with paragraph 2 above, within 60 days following the day of the entry into force of the law, that was ceded to such party (hereinafter: the debtor), offer adequate agreement on debt repayment with annual interest rate that shall not exceed 8.2%, and final repayment which cannot be shorter than the deadline established in the initial loan agreement to the loan beneficiary.

Agreement on debt repayment shall not contain provisions requiring the debtor to have additional security interest, fees for agreement preparation and other similar payments nor shall other rights and obligations be determined under this agreement without debtor's consent which would put the debtor in an unfavourable position relative to the debtor's rights and obligations under the initial loan agreement.

The debtors shall, within 60 days following that of the reception of the proposal of the agreement on debt repayment, make a statement on the acceptability of such an agreement and if the agreement is accepted, they shall sign the agreement on debt repayment with the third party

The establishment of the debtor-creditor relationship in the sense of paragraph 3 herein shall not be regarded as prohibited performing of banking operations.

Third parties shall, from the day of the entry into force of this law, suspend all activities concerning enforced collection for settling debtor's receivables.

If debtors do not sign this agreement, within 60 days following the day of the reception of the proposal of the agreement on debt repayment with third parties, the enforced collection may continue."

Argument:

The proposed amendment is given for the purposes of detailed regulation of the treatment of receivables ceded to third parties. Disregarding this amendment would leave open significant issues necessary for the application of this law by third parties.

AMENDMENT VI

Article 4 of the Draft Law shall be deleted.

Argument:

Article 4 of the Draft Law is no longer necessary, because the deadlines for drafting and concluding of debt repayment agreements are provided for in the new Article 3a of the Law.

AMENDMENT VII

Article 5 of the Draft Law shall be replaced with the following:

“Article 5

“In Article 5 paragraph 2 after the word “banks” the following shall be inserted:
“and third parties “.

Argument:

This amendment defines that the Central Bank shall draft its own regulation that shall regulate in more detail the surveillance of the application of this law by third parties.

AMENDMENT VIII

Article 6 of the Draft Law shall be replaced with the following:

“Article 6

After Article 5 the following new Article 5a and heading shall be added:

“Penalty provisions

Article 5a

A fine ranging from 20.000.00 euros to 40.000.00 euros shall be imposed against a commercial bank or third party, if:

- 1) It fails to recalculate loan and/or receivable (Article 3a paragraph 1);
- 2) It does not repay the funds exceeding the obligation determined in this law based on loans that have been repaid during regular repayment period or enforced collection (Article 3a paragraph 2);
- 3) It fails to submit data and documentation to third party within the prescribed timeframe (Article 3b paragraph 1);
- 4) It fails to submit to the debtor the proposal of the agreement on debt repayment within the prescribed timeframe (Article 3b paragraph 3);
- 5) It does not suspend all activities pertaining enforced execution for settling debtors’ receivables from the entry into force of this law (Article 3a paragraph 7).

For the offence specified in paragraph 1 above, a responsible person in the commercial bank or in third party shall be also imposed a fine ranging from 2.000.00 euros to 4.000.00 euros.

Argument:

Proposed amendment is given for the purposes of harmonising the misdemeanour provisions with the substantive law rules to which they refer.

AMENDMENT IX

In Article 7 of the Draft Law the wording: “Article 6 shall become the following Article 7” shall be deleted.

Argument:

Proposed amendment is given for the purposes of legal and editorial improvement of the wording.

*

*

*

With a view to easier appreciation of the solutions proposed in given amendments the text of the Draft Law with imbedded proposed amendments is given below:

Draft Law Amending the Law on the Conversion of Swiss franc (chf) - denominated Loans into euro (eur)-denominated Loans

Article 1

In Article 1, paragraph 1 after the word: “banks” a coma and the following wording shall be added: “third parties to which the banks ceded loan receivables (hereinafter: third parties)”.

At the end of paragraph 2, the full stop shall be replaced by a coma and the following shall be added: “as well as loan receivables ceded by banks to third parties and loans repaid during the regular repayment period or enforced collection”.

Article 2

In Article 2 the following paragraph 2 shall be inserted:

“Third parties to whom the banks ceded receivables under this law shall also make the conversion referred to in paragraph 1 above”.

“Calculation of loans and/or receivables

Article 3

After the conversion of loans into EUR, the commercial banks and/or third parties shall recalculate loans and/or receivables at fixed interest rate of 8.2% per annum.

Paragraph 1 above shall be also applied to loans which have been repaid during the regular repayment period or enforced collection, therefore the commercial banks, i.e. third parties shall repay to the client funds exceeding the obligation stipulated under this law.

When calculating the debt based on receivables under the agreement terminated unilaterally by the commercial banks, including receivables ceded to third parties, the provisions of the Law on Default Interest Rate (OGM 83/09) shall not be applied.“

ALTERNATIVE TO PARAGRAPH 3:

When calculating the debt based on receivables under the agreement terminated unilaterally by the commercial banks, including receivables ceded to third parties, the legal default interest rate calculated pursuant to the Law on Default Interest Rate (OGM 83/09) shall be included.

Article 4

After Article 3 the following new Article 3a and heading shall be inserted:

“Treatment of receivables ceded to third parties

Article 3a

For determining the amount of receivables ceded to third parties based on loans to be converted pursuant to this law (hereinafter: the debt), the commercial banks that have ceded these receivables shall, within 15 business days following that of the entry into force of this law, submit for each ceded receivable to third parties the following, for the purpose of the calculation of debt and conclusion of corresponding agreement:

- 1) Loan agreement, with the initial repayment plan;
- 2) Data on the amount of loan granted in Swiss francs and amount in Euro stipulated in accordance with Article 2 paragraph 1 herein;
- 3) Loan repayment plan drawn up for the life of the loan using nominal interest rate of 8.2% and applying compound interest account and decursive interest calculation;
- 4) Data on total payments to commercial bank based on loan agreement, which the loan beneficiary has made until the ceding of receivable, including dates and amount of individual payments.

The debt shall be calculated by harmonising the amount of outstanding principal from the repayment plan under paragraph 1 point 3 above as of the debt establishment with the difference in value of all cash inflows and outflows arising from the loan agreement.

Third party shall, for the amount of debt established in accordance with paragraph 2 above, within 60 days following the day of the entry into force of the law, that was ceded to such party (hereinafter: the debtor), offer adequate

agreement on debt repayment with annual interest rate that shall not exceed 8.2%, and final repayment which cannot be shorter than the deadline established in the initial loan agreement to the loan beneficiary.

Agreement on debt repayment shall not contain provisions requiring the debtor to have additional security interest, fees for agreement preparation and other similar payments nor shall other rights and obligations be determined under this agreement without debtor's consent which would put the debtor in an unfavourable position relative to the debtor's rights and obligations under the initial loan agreement.

The debtors shall, within 60 days following that of the reception of the proposal of the agreement on debt repayment, make a statement on the acceptability of such an agreement and if the agreement is accepted, they shall sign the agreement on debt repayment with the third party

The establishment of the debtor-creditor relationship in the sense of paragraph 3 herein shall not be regarded as prohibited performing of banking operations.

Third parties shall, from the day of the entry into force of this law, suspend all activities concerning enforced collection for settling debtor's receivables.

If debtors do not sign this agreement, within 60 days following the day of the reception of the proposal of the agreement on debt repayment with third parties, the enforced collection may continue.“

Article 5

In Article 5 paragraph 2 after the word “banks” the following shall be inserted: “and third parties “.

Article 6

After Article 5 the following new Article 5a and heading shall be added:

„ Penalty provisions

Article 5a

A fine ranging from 20.000.00 euros to 40.000.00 euros shall be imposed against a commercial bank or third party, if:

- 1) It fails to recalculate loan and/or receivable (Article 3a paragraph 1);
- 2) It does not repay the funds exceeding the obligation determined in this law based on loans that have been repaid during regular repayment period or enforced collection (Article 3a paragraph 2);
- 3) It fails to submit data and documentation to third party within the prescribed timeframe (Article 3b paragraph 1);
- 4) It fails to submit to the debtor the proposal of the agreement on debt repayment within the prescribed timeframe (Article 3b paragraph 3);

- 5) It does not suspend all activities pertaining enforced execution for settling debtors' receivables from the entry into force of this law (Article 3a paragraph 7).

For the offence specified in paragraph 1 above, a responsible person in the commercial bank or in third party shall be also imposed a fine ranging from 2.000.00 euros to 4.000.00 euros.

Article 7

This law shall enter into force on the eighth day following that of its publication in the "Official Gazette of Montenegro".