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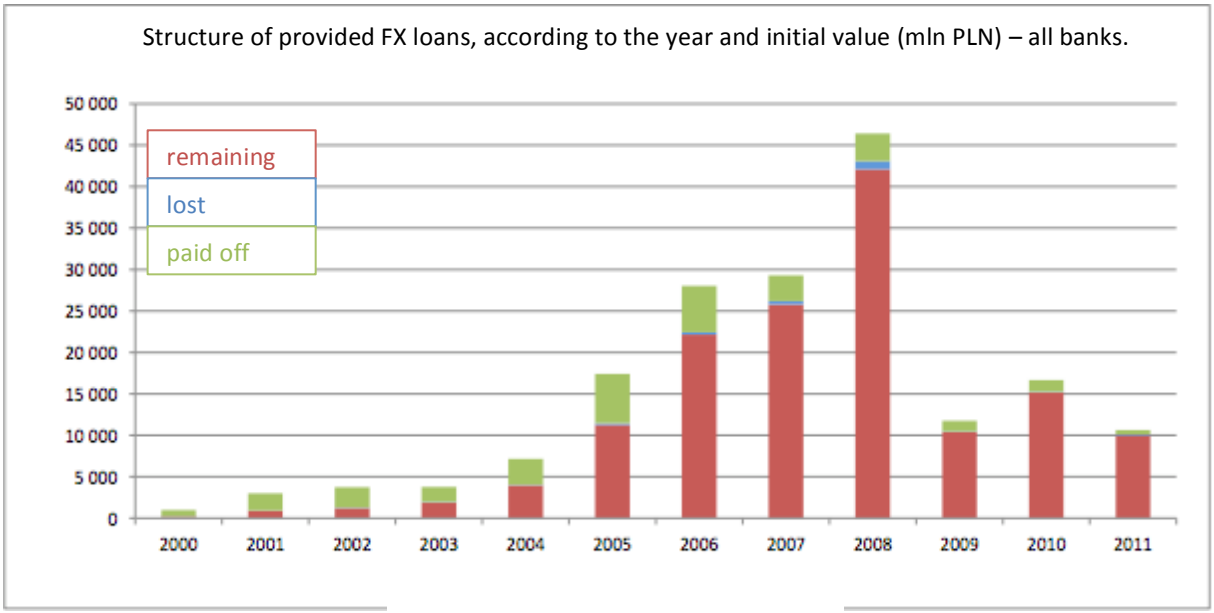
A note on the FX loans in Poland

I. OVERVIEW

According to the Polish Financial Supervision Authority, there were approx. 700.000 FX mortgage loans given to Polish consumers in the period 2003-2011, and still some 500 thousands of them are active, with the total number of 900 thousand borrowers.

The total initial value of these loans is 178,823 million Polish zloties (PLN), i.e. approx. 45 billion Euro[2]. Currently, FX loans constitute around 40% of all mortgage loans in Poland. FX mortgage loans were particularly popular in the period of 2005-2008, as shown on the graph below:



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[2] See the report of the Polish Financial Supervision Authority of March 2016, available at: http://www.knf.gov.pl/Images/Skutki_finansowe_projektu_tcm75-46244.pdf

The most popular foreign currency was Swiss Franc (CHF). CHF loans were particularly popular in years 2005-2008, when they constituted up to 70% of all mortgages given at this period. Since tighten regulations came into force in 2009, the popularity of the FX loans dropped dramatically, and for those who remained, Euro became the currency of choice, instead of Swiss Franc.

The FX loan contracts were formulated in two slightly different forms: indexed and denominated loans.

More popular was the form of the **FX indexed loan –** the credited amount was expressed in PLN and it was paid to the borrower in PLN, but at the time of the transfer, the amount of credit was calculated in foreign currency (mostly in CHF), by using the currency bid price of the bank. Then, the equivalent of the credit expressed in foreign currency is used to calculated the monthly payment in foreign currency, which is then recalculated into Polish zloties by using the ask price of the currency of the bank.

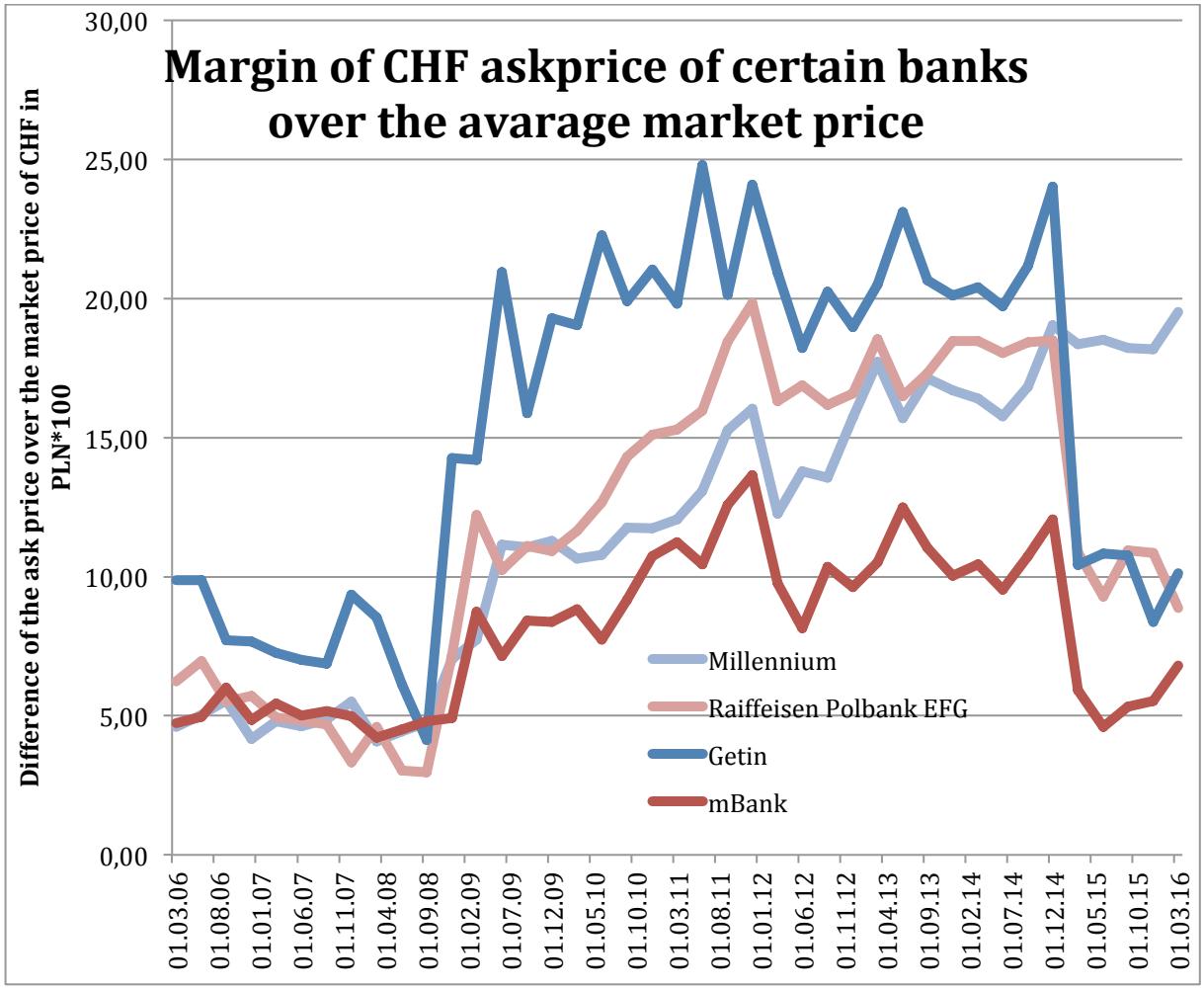
Less popular was the form of the **FX denominated loan**. In such loan, the amount of credit was expressed in foreign currency. However, the borrower can receive only Polish zloties, by recalculating the amount of credit by the currency bid price of the bank. Then, his monthly payments where calculated in foreign currency, and then recalculated in PLN by using the currency ask price of the bank.

Therefore, in both cases, borrowers could not receive nor repay the loans directly in the foreign currency, but they had to use Polish zloties, and therefore they additionally incurred the cost of currency spread (difference between the bid and ask price of the currency) imposed by banks.

The contract obligation to use the bid and ask price of the bank was also the reason of the increased obligations of a borrower since the first day. Let us take a following example: a borrower is provided a credit of 100.000 PLN, and the current bid price of the bank is 1,90 PLN/CHF, and ask price is 2,10 PLN/CHF, when the average market price is 2,00 PLN/CHF. Therefore, when the borrower is given 100.000 PLN credit, it is recalculated into the equivalent of 52.631,58 CHF. However, the amount of debt has to

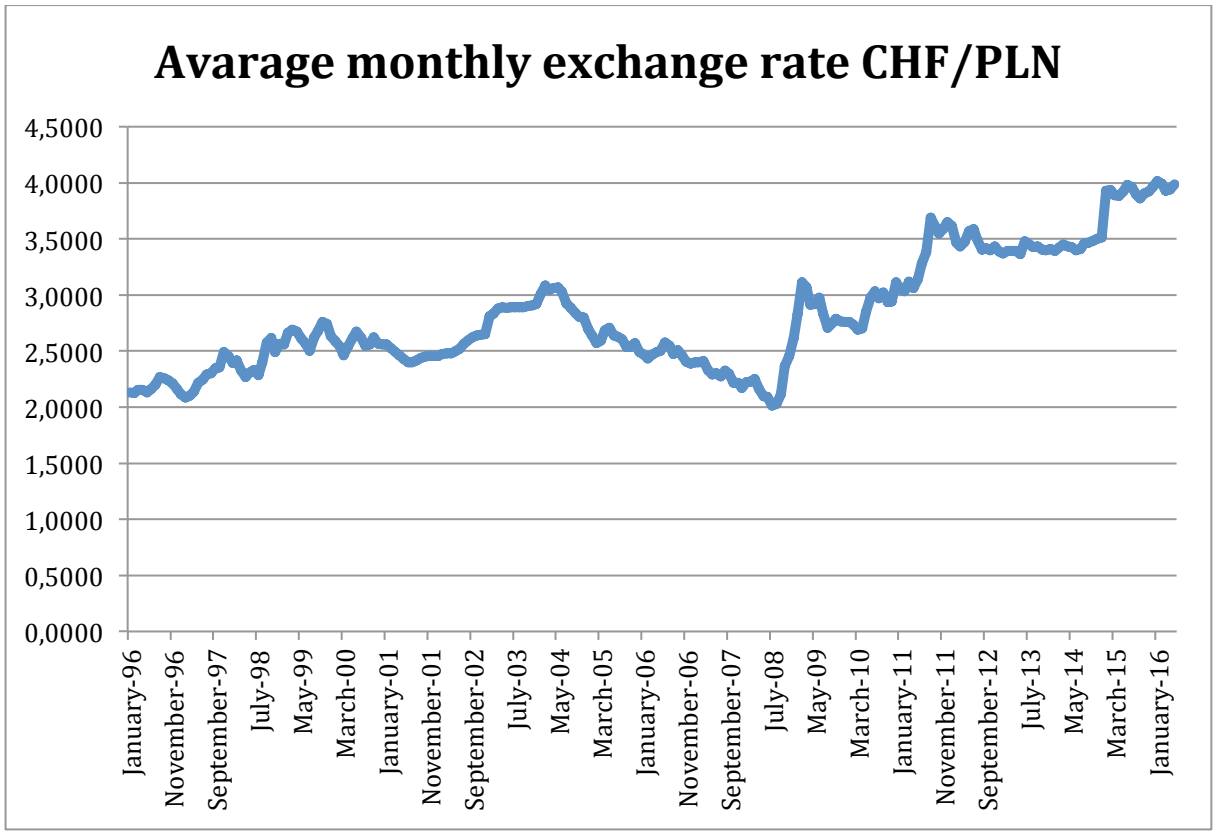
be calculated by using the ask price, so the obligation of the borrower is 110.526,31 PLN. Therefore, by using two different indexing rates, banks since the very first day increased the obligation of borrowers by a serious amount.

Moreover, since 2009, banks greatly increased the value of currency spread that was imposed on borrowers. While in 2006-2008 their ask price was approx. 0,05 PLN higher than the average market price, the banks then increased the spread three and even fourfold in 2009-2014, up to 0,20 – 0,25 PLN to increase their revenues from the loans.



This increase in spread additionally worsened the situation of borrowers. Borrowers were affected by the rise of exchange rate of CHF/PLN. Most loans were provided in the years of 2005-2008 when the CHF exchange rate was around 2,00 – 2,50 PLN/CHF. The

rise of the exchange rate to 3,00 then to 3,50 and now to 4,00 PLN/CHF in many cases doubled the amount of borrowers' debt and seriously increased the amount of monthly instalment payment.



While historically low interest rates (negative for CHF in fact) to some extent alleviate the effect of the increase in exchange rate, it is no help for those borrowers who have defaulted on their loans. In such cases, their debt is recalculated from the foreign currency equivalent into Polish zloties by using the current ask price of the bank. For those who took credits in 2007-2008, it means that their current obligations exceed the initial amount of borrowed money, notwithstanding the already paid instalments. The amount of debt often exceeds the market value of the credited real estate (usually apartments in big cities), and therefore borrowers effectively went bankrupt.

II. Legislation

The already mentioned fact of the increased spreads banks imposed on creditors was the reason of many borrowers protests, which eventually led to the change in law. In 2011, the Parliament adopted so-called anti-spread law, a novelisation of the banking law[3].

This novelisation for the first time introduced the terms of indexed and denominated FX loans into the polish legal system (before that time the only legal basis for such credits were the general provision of the Civil Code providing for the possibility of indexation of the monetary obligations).

The novelisation also provided borrowers with the right to repay the loans directly in indexation currency, i.e. without using the ask price of the bank. Such change requires an annex to the loan contract. However, the novelisation did not affect payments made before it came into force in November 2011.

The novelisation also requires that in new FX loan contracts, the methods of setting the exchange rates have to be directly stipulated.

In 2015, at the very end of the term, the lower house of the Parliament adopted the law that would convert the FX loans on the request of the borrower into PLN loans. The conversion would have been made by using the current exchange rate, then the sum of already paid instalments on the FX loan would have been compared to the sum of instalments paid on an hypothetical, equivalent PLN loan. The difference would be have been cancelled in 90%.

This law faced a huge opposition from the side of the government and the banks. The ruling party decided to delay the proceedings, and the Parliament term ended without this law being finally adopted.

[3] The law of 29 July 2011 changing the Banking Law of 29 August 1997.

During presidential elections in 2015, the presidential candidate Mr Andrzej Duda made a promise to convert FX loans at the rate from the time of obtaining the loan. When Mr Duda became the president, he set up a team working on possible solution of the problem. The draft proposal was presented in November 2015, but was heavily criticized by the financial sector, including the National Bank of Poland and the Financial Supervision Authority and subsequently was withdrawn. Now the President is expected to present another proposal.

On the 6 June, 2016, the Financial Ombudsman provided its report on the FX loans. In the report, the Ombudsman stated that according to her opinion the FX loan contracts were contradictory to Polish civil and banking law, and should be declared partially void. The Financial Ombudsman has no administrative power, but can help consumers during legal proceedings against financial institutions.

III. CASE LAW OF THE COMPETITION AND CONSUMER PROTECTION COURT

Indexation clauses used by banks in FX loans have been subject of scrutiny of the Competition and Consumer Protection Court. This court, a part of the Warsaw district and appellate Court, is a specialised court, which deals with preformulated standard terms of contracts, proposed to consumers.

All four times when the Court dealt with the problem, it declared these clauses unfair and forbade banks to use it in contracts.

Indexation clauses used by Millennium Bank (controlled by Banco Comercial Portugues) were declared unfair on 14 December 2010 r. (XVII AmC 426/09), those of mBank (controlled by Commerzbank) on 26 January 2011 (XVII AmC 1531/09) and those of Bank BPH (controlled by General Electric) on 27 August 2012 (XVII AmC 5344/11). In all cases the Court found that banks had unlimited freedom in setting the exchange rates which were then used for indexation. The court stressed that such a leeway is unfair as it exposed consumers for arbitrary decisions of the bank to their detriment.

In the last judgment, of 25 June 2014 (VI ACa 1930/13), the Court declared unfair the clause of DNB Bank. In this case, the bank stated that its exchange rates would not differ by more than 10% from the market rate. The court anyway declared such freedom as too excessive, giving the bank to much power over consumers.

There is controversy in Polish law what effects the judgments of the Competition and Consumer Protection Court have on deciding in individual claims. Definitely, the judgments forbid the use of given terms in contracts to be made. It is unclear, however, what is the effect on existing contracts. Some courts perceive judgments of the Competition and Consumer Protection Court as definitive assessment of illegality of given terms, while other courts insist on individual assessment of the fairness of given terms in the individual contract. Therefore, according to this view – which is more common – there is a possibility that in individual case the same terms which have been declared unfair and invalid by the Competition and Consumer Protection Court, will be declared fair and valid by a civil court in an individual proceeding.

IV. CASE LAW OF CIVIL COURTS

There are no final judgments of civil courts on validity of indexation clauses yet.

However, two different lines of reasoning have emerged.

One is that indexation to the foreign currency was in general legal and fair as it provided consumers with lower interest rate. The freedom of the bank to set the exchange rate in general was also legal, however if the bank misused its freedom and imposed exchange rates grossly different than the market rates, then such excess might be declared unfair (see for example the verdict of the Warsaw Regional Court on 2 March, 2016 r., XXV C 1005/15).

The second line is that indexation clauses were unfair, what had already been decided upon by the Court of Competition and Consumer Protection, and these clauses cannot be used in any extent. Therefore, the FX loan contract is a contract without indexation clauses, therefore the amount of credit is in Polish zloties, but the interest rate remains

as stipulated for in the contract, i.e. according to the foreign currency interest rate (see the verdict of the Warsaw District Court on 29 April, 2016, VI C 1713/15).

The main controversy in jurisprudence is what are the effects of declaring indexation clauses unfair, and in particular whether it means that the indexation mechanism is totally excluded from the contract, or it means that instead of the bank exchange rate the market rate should be used in indexation clauses.

These conflict views are expected to continue, with the Supreme Court to decide on the issue in the future. It is also probable that some court will ask the European Court of Justice for the preliminary ruling on the interpretation of the Directive 96/13/EEC, and art. 6.1 thereof.

In particular the question will be whether the unfairness of the indexation clauses can be solved by just eliminating the freedom of the bank to set the exchange rates and providing the market rates instead, or whether the directive stipulates that the indexation clause should be void in total.
According to the case law of the Court of Justice, the unfair term should be eliminated from the contract and cannot be substituted by any other provision. In the verdict of 14 June 2012 in the case of Banco Español de Crédito SA v Joaquín Calderón Camino, C-618/10), the Court repeated that „if it were open to the national court to revise the content of unfair terms included in such contracts, such a power would be liable to compromise attainment of the long-term objective of Article 7 of Directive 93/13. That power would contribute to eliminating the dissuasive effect on sellers or suppliers of the straightforward non-application with regard to the consumer of those unfair terms (see, to that effect, the order in *Pohotovost'*, paragraph 41 and the case-law cited), in so far as those sellers or suppliers would remain tempted to use those terms in the knowledge that, even if they were declared invalid, the contract could nevertheless be modified, to the extent necessary, by the national court in such a way as to safeguard the interest of those sellers or suppliers".

Therefore, it clearly seems from the purpose and provisions of the Directive 93/13/EEC that the only acceptable solution is to eliminate the indexation clauses altogether from

the contract, without modifying them by supplying the market exchange rate instead of banking one.

However, as such decision will imply huge financial consequences for creditors, it is still open what way the Polish courts will undertake.

V. Conclusions

There is a growing understanding that by offering FX mortgage loans, banks misled consumers and imposed on them unfair terms. As the amount of borrowers reaches almost one million people, the problem is a political one as well. Therefore, we may expect some political solutions to be proposed. However, any new laws will rather deal with those most in need, and will not try to resolve the problem for all borrowers.
Civil courts will be solving problems of individual borrowers case by case. 3 or 4 year will pass until the definitive approach will be set and we may witness many conflicting verdicts in the meantime. The legal battle will continue for some time to come.