

# Consequences of the restructuring of loans in Swiss francs in Poland in the light of consumer protection

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**Abstract:**

**Aim:** The subject of the paper is to discuss the consequences of the changes in the legislation on mortgage loans in Swiss francs, proposed by the Polish Sejm in August 2015, to the situation in the banking sector and the economy. The topic is important because of the potential impact of such changes on Polish banking industry, and indirectly lower GDP growth rate.

**Design:** The article tries to assess consequences for the sector in next 5 years using set of quantitative and qualitative indicators. Author utilized literature review, experts' opinions selection, and desk research on statistics data.

**Conclusions / findings:** The author concludes that legislators proposal will bring negative impact of PLN >1 bn net income of the banking industry a year in next 5 years. However, if the legislation will be passed according to KNF's feedback, most of these costs will be mitigated due to spreading banks' losses over many years. The paper might be interested to banking and public sector analysts, as it brings a new opinion in the ongoing discussion. However, it is one of several voices in the public debate.

**Originality / value of the article:** The paper brings implications to the legislators and public sector observes, serving as an independent analyze of the topic. Its main limitation is lack of granular quantitative losses estimation for banks, based on a scenario approach, which could add more value added to banking analysts, helping them benchmark their internal assessments.

*Keywords: consumer protection, mortgage loan in Swiss francs, banking law in Poland, changes in the law.*  
JEL: K21

## 1. Introduction

The aim of this paper is to discuss the impact of legislative changes in the law on Swiss franc-denominated mortgage loans put forward by the Polish Sejm (the lower chamber of parliament) on the situation of the banking sector and the economy. The analysis focuses on the influence of the proposed changes on the situation of borrowers who have difficulties servicing their loans in foreign currencies. The author argues that the transfer of 50% to 90% of clients' costs related to CHF appreciation to PLN onto the banks would be a disproportionate move destabilizing the economy. The initial part of the paper sets forth the background for the increasing importance of foreign currency loans and their current position on the banks' balance sheets. Subsequently, the main postulates of the groups of "affected CHF borrowers" will be discussed along with legislative drafts on currency loans adopted by the parliament by the end of August. The third part analyses the consequences of proposed changes for the banks, the economy and the stock market. In conclusion, the author lays down his view on the proposed regulations and presents suggested changes that could eliminate some of their most harmful consequences.

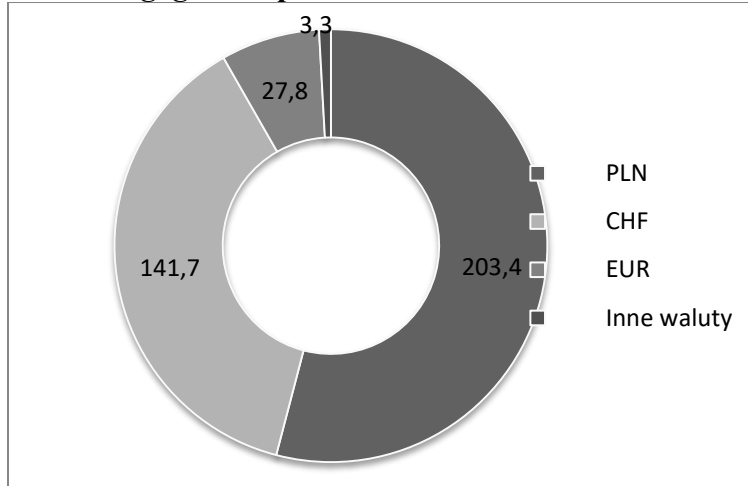
## 2. Mortgage loans in Swiss francs in Poland

Mortgage loans in Swiss franc extended by Polish banks account for a significant portion of the loan portfolio – nearly 40% of all mortgage loans and 9% of all the bank assets ([https://www.knf.gov.pl/opracowania/sektor\\_bankowy/dane\\_o\\_rynku/Dane\\_miesieczne.html](https://www.knf.gov.pl/opracowania/sektor_bankowy/dane_o_rynku/Dane_miesieczne.html), [31.07.2015]). It is a significant amount, meaning that the quality of the loan portfolio affects banks' profits and the scale of the lending business. It is also high when compared to the countries where mortgage loans are not extended by "regular" banks using clients' deposits, but by the issuance of covered bonds (see chart 1).

The popularity of currency loans offered on mass scale in the period 2004–2009 was a consequence of higher creditworthiness of clients who borrowed in foreign currencies as opposed to PLN loans. The clients, attracted by the appreciation of PLN against the Swiss franc, often believed that the favourable exchange trend would continue throughout the period of the repayment of their liabilities, meaning that their instalments would get lower and lower. An abrupt

appreciation of CHF changed the situation, resulting in difficulties in loan repayment faced by many clients and in increased banks' profits. Chart 2 presents the CHF exchange rate.

**Chart 1. Polish banks' mortgage loan portfolio of 31.07.2015 in PLN bn**



Source: own study based on the data published by the Polish Financial Supervision Authority (KNF): [https://www.knf.gov.pl/opracowania/sektor\\_bankowy/dane\\_o\\_rynku/Dane\\_miesieczne.html](https://www.knf.gov.pl/opracowania/sektor_bankowy/dane_o_rynku/Dane_miesieczne.html).

**Chart 2. CHF/PLN exchange rate in the period 2005–2015**



Source: <http://stoq.pl/q/?s=chfpln&c=10y&t=l&a=lg&b=0>.

### 3. Suggested amendments to the legislation concerning loans in foreign currencies.

In 2015, key postulates presented by the borrowers with CHF-denominated loans included:

- the abolishing of the bank enforcement titles from the Polish legal system,
- automatic invalidation of abusive clauses in bank agreements,
- limitation of the collateral for mortgage loans to the mortgage on the financed real property, instead of debtor's entire assets,
- restructuring of the loans extended to day to invalidate the existing abusive clauses<sup>1</sup>

Some of these postulates have been put in practice by the parliament in the subsequent months of 2015. For the first time in its judgement of April 14, 2015 (file ref. no. P 45/12), the Constitutional Tribunal found the provisions on the bank enforcement title incompatible with Article 177 of the Constitution of the Republic of Poland of 2 April 1997 (Dz.U. [Journal of Laws] of 1997, no 78, item 483 as amended) and Article 6 of Convention for the Protection of Human Rights and Fundamental Freedoms (Dz.U. [Journal of Laws] of 1993, no. 61, item 284). In consequence, the Sejm amended the Banking Law Act and certain other laws, removing all the content referring to the bank enforcement title, i.e. Articles 96–98 of the Banking Law Act of 2 November 2012 (consolidated text: Dz.U. [Journal of Laws] of 2016, item 1988 as amended).

The Parliament abstained from introducing bans on using other forms of collateral for mortgage loans than the mortgage on the financed property and did not present a clear-cut position on abusive clauses, but started works on the conversion of CHF loans into PLN loans and the transfer of a portion of clients' costs related to the increased value of CHF to the lenders. Pursuant to the “Draft Act on Special Rules of Restructuring Applicable to Currency-Denominated Mortgage Loans in Connection with Currency Exchange Rate Fluctuation and on Amendment of Certain Other Acts” adopted by the Sejm in July 2015, the following solutions were proposed:

- a loan is converted to PLN at the mean exchange rate of the National Bank of Poland from the date preceding the date of submission of the loan restructuring application;
- the bank redeems 50% of the principal amount of the mortgage loan in PLN which would be outstanding as of the date of the application if the borrower concluded a PLN-denominated loan with the same bank on the same date as he or she concluded the foreign-currency denominated

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<sup>1</sup> The postulates from the protests in February 2015 in Wrocław are quite representative of the movement (*Postulaty „frankowiczów”*).

loan with the repayment schedule arranged analogously as in the foreign-denominated mortgage loan;

- restructuring applies to mortgage loans in foreign currency for the purchase of a flat with the surface up to 75 sq. m or a single-family house with the surface up to 100 sq. m and the  $LtV^2$  value of at least 80%.

These assumption underwent significant changes in the legislative process. As of September 2015, the draft act with Senate's amendments was based on the assumptions outlined above. However, the original draft prepared by the Sejm stipulated the redemption of as much as 90%, and not 50% of the principal amount and made restructuring available to a broader range of borrowers. It should be emphasized that the restructuring in the form adopted by the Senate would be available to the majority of borrowers making a currency loan extremely attractive as compared to the PLN mortgage loans extended at that time. It also applied to loans denominated in other foreign currencies apart from CHF, such as EUR. However, finally, Senate's amendments were not accepted by the Sejm before the end of the 7<sup>th</sup> term of the parliament and the draft act did not come into force.

#### **4. Economic consequences of proposed legislative changes**

In this part of the paper economic consequences of the proposed changes concerning the loan currency conversion are discussed. First of all, pros and cons of these solutions are presented from the perspective of borrowers. The currency conversion would bring about the following benefits to borrowers who have incurred a CHF loan:

- a) lower value of loan instalments,
- b) elimination of volatility of the instalments to be repaid.

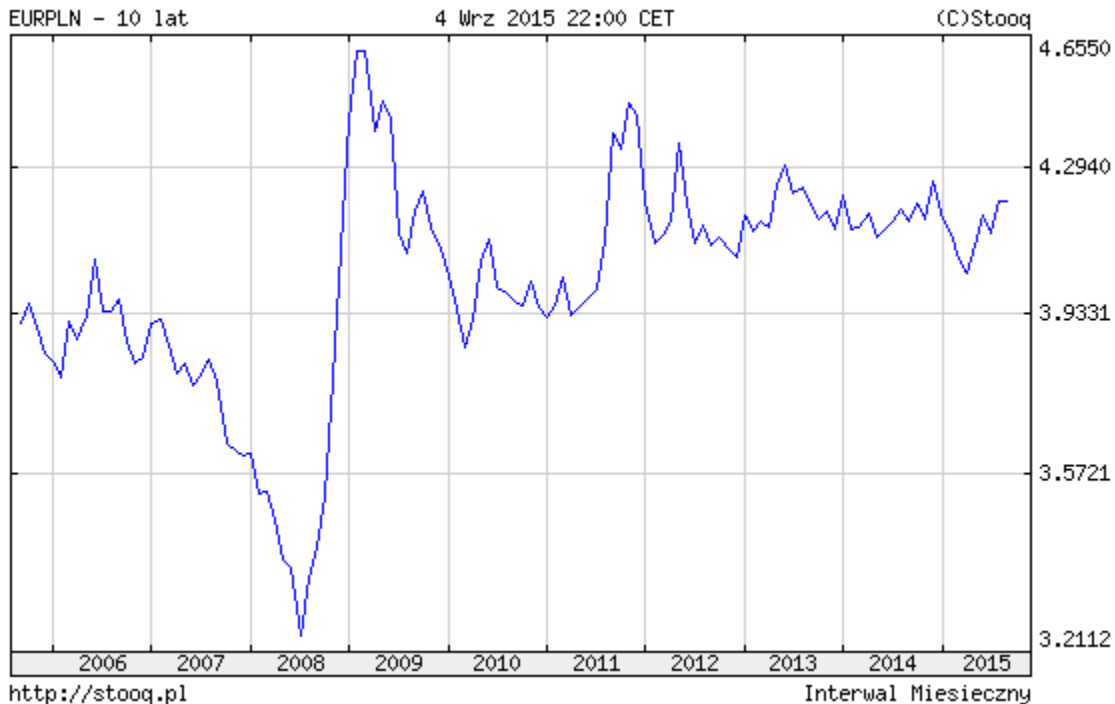
These factors are beneficial to substantially all borrowers who took out mortgage loans before the CHF/PLN rate collapsed in the second half of 2008 (see chart 2), though they do not eliminate the risk of insolvency or falling victim to a debt spiral. Nonetheless, it must be said that these benefits do not apply in any way to borrowers who took out loans in PLN, have been typically paying higher instalments than CHF borrowers and will not receive any additional compensation

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<sup>2</sup> Loan to Value, the relation between the value of the liability and the value of the object of liability.

from the state. The benefits for the borrowers – quite numerous – who took out loans in EUR would be lower, as this currency did not appreciate as much as CHF did (see Chart 3).

**Chart 3. EUR/PLN exchange rate in the period 2005–2015**



Source: <http://stooq.pl/q/?s=eurpln>.

As shown in chart 3, in the period 2005–2007 one EUR corresponded on average to ca. PLN 3.90, that is an amount similar as in the period 2010–2015, when the EUR/PLN rate fluctuated within the EUR 3.93–4.29 range. The charges of unequal treatment of borrowers based on the currency of the loan, legislator’s disregard for the borrowers’ awareness of the risk and granting benefits to CHF borrowers are being put forward not only by other borrowers, but also by the Polish Financial Supervision Authority (*Ocena wpływu...* 2013).

The ratio of costs and benefits arising of currency conversion is much more unfavourable from the perspective of financing institutions, as pointed out by KNF as well (*Ocena wpływu...* 2013):

- Pursuant to the KNF data, the cost of redemption of 50% of the principal amount referred to earlier would cost at least PLN 40-50 bn<sup>3</sup>– MPs intended to transfer this loss to the banks.
- Taking into account the different exposure of banks to foreign currency loans, it should be considered that the losses of particular banks would range from 0.1 to 7 billion PLN. These losses would virtually eliminate the banks' annual profits, significantly reducing their market value.
- The banking sector would lose nearly 30% of equity, resulting in a substantial restriction of financing availability, and in consequence would hinder the economic growth in Poland in the subsequent years. Additionally, three banks would lose their entire equity and would become insolvent.
- Taking into account the policy of ensuring stability of financing institutions, the state would have to nationalise the above-mentioned three banks and increase the capital and grant liquidity loans to a number of other financing institutions. Depending on the scale of actions undertaken, the multi-billion cost for the state budget would be involved.

To sum up this part of the paper, one must conclude that the currency conversion of even 50% of the principal loan amounts means decreasing the economic growth in Poland for several years, significant decrease in Polish banks' valuation and, in consequence, a stock market plunge,<sup>4</sup> as well as increase in the state deficit, particularly risky given the recently discontinued excessive deficit procedure Poland was subjected to.

If we consider assistance to CHF borrowers necessary (which is disputable), the proposal put forward by KNF is more realistic: according to experts, its cost over 20–25 years would equal PLN 25bn, corresponding to only several percent of banks' profits per year (*Frank podskoczył, a szef KNF nadal przekonuje do swojej propozycji przewalutowania kredytów*). Pursuant to this proposal, CHF loans would be split into two parts: a mortgage-backed loan (corresponding to the value of the CHF loan converted into PLN at the exchange rate of the date of the loan) and an unsecured loan (with the value corresponding to the difference between the current liability of the borrower and the mortgage-backed loan). The first of the loans would be repaid in PLN, substantially on the same terms as the loan before restructuring, while the second one would be

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<sup>3</sup> According to some analysts, even as much as PLN 59 bn (*Banki: Choć gospodarka sprzyja, akcje banków nadal będą pod presją*).

<sup>4</sup> Banks account for ca. 30% of WSE capitalisation.

extended by the bank to the client at the fixed 1% interest rate to be repaid over subsequent years. This proposal would slightly reduce banks' profits and their valuation in the long-perspective, but the banks would avoid insolvency and significant loss of equity, leading to the restriction of financing availability and the decreased ratio of economic growth. Taking into account the actual decrease in the value of banks already discounted by the markets (see chart 4), one could argue that this proposal would be of substantial help to CHF borrowers, practically removing the currency risk in the CHF mortgage loans sector and without causing damage to the economy.

**Chart 4. WIG-Banks index in the period: September 2014–August 2015**



Source: [http://stooq.pl/q/?s=wig\\_banki&c=1y&t=l&a=lg&b=0](http://stooq.pl/q/?s=wig_banki&c=1y&t=l&a=lg&b=0).

As show in chart 4, the commencement of the legislative process aimed at currency conversion of the loans significantly decreased the capitalisation of banks. In the period from May to the beginning of September 2015, WIG-Banks index fell from ca. 8,300 points to 6,300 points, that is by nearly 30%. Banks' share price fluctuations in the summer of 2015 (especially when compared to stable historic data) reflect the lack of stability and negative outlook prevailing among investors. One should note that the implementation of the most radical versions of loan currency conversion involves a significant risk that Poland would be charged with infringing foreign



investors' interests (which is important in the context of high involvement of foreign entities in the Polish banking sector).

## **5. Conclusion**

In author's view, the solutions concerning the loan conversion put forward by the parliament in August 2015 would have negative impact on the economy and would be unfair to consumers. First of all, legislator's proposals generate banks' loss to the amount of several dozen billion PLN to be paid immediately, resulting in several banks' insolvency. Secondly, the costs of saving the financial sector would force the state to exceed the three percent deficit cap for the public finance sector and would increase public debt up to the 60% threshold. Thirdly, it would significantly and permanently decrease the attractiveness and credibility of Poland to investors. Fourthly, it treats borrowers unfairly, favouring one group of borrowers (CHF borrowers) at the expense of borrowers who have taken out loans in other currencies and citizens paying for the costs of saving the banks after the loans have been converted. The proposals involving spreading the loss over many years (including the discussed KNF proposal) mitigate most of the disadvantages inherent to the MPs proposal. However, one should bear in mind that, faced with potential changes to the EU case law on currency loans, it would be advisable to postpone rushed drafts on loan restructuring.

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### **Legal acts**

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### **Judgements**

Judgement of Constitutional Tribunal of April 14, 2015, file ref. no. P 45/12.

***Konsekwencje restrukturyzacji kredytów frankowych w Polsce w świetle ochrony konsumentów***

***Streszczenie***

**Cel:** Tematem artykułu jest omówienie konsekwencji zmian w prawie o kredytach hipotecznych we frankach szwajcarskich, procedowanych w Sejmie w sierpniu 2015 r. dla sytuacji polskiego sektora bankowego i gospodarki. Temat jest istotny ze względu na potencjalny wpływ tych zmian na polski sektor bankowy, a pośrednio na tempo wzrostu PKB.

**Opracowanie / Metody badawcze:** Artykuł podejmuje próbę oszacowania konsekwencji dla sektora w kolejnych 5 latach, przy pomocy zestawu mierników ilościowych oraz jakościowych. Autor wykorzystał analizę literatury, wybór opinii ekspertów i badania na publicznych danych statystycznych.

**Konkluzje / Wyniki:** Konkluzja artykułu stwierdza, że ustawa w proponowanym kształcie może zmniejszyć zyski banków w Polsce o >1 mld zł rocznie przez 5 lat. Jednakże, wykorzystanie pomysłu KNF o rozłożeniu strat na szereg lat, znacząco zmniejszy straty wynikające z ustawy.

**Oryginalność / Wartość artykułu:** Dokument może być wykorzystany przez analityków bankowych i sektora publicznego, jako że wnosi nowy głos do toczącej się debaty publicznej. Przynosi on pewne implikacje dla pracodawców i obserwatorów życia publicznego, służąc jako niezależna analiza tematu. Główne ograniczenie to brak dokładnego ilościowego oszacowania strat dla poszczególnych banków, opracowanego w oparciu o podejście scenariuszowe. Mogłoby to dodać dodatkową wartość dodaną dla analityków bankowych, porównując ich wewnętrzne oszacowania.

**Słowa kluczowe:** ochrona konsumenta, kredyt hipoteczny we frankach szwajcarskich, prawo bankowe w Polsce, zmiany w prawie

JEL: K21