EUROPEAN FINANCIAL CONGRESS

Open Letter (*amicus curiae brief*)
from the Experts of the European Financial Congress
to the Court of Justice of the European Union

For many years now, we have been taking an active part in debates concerning the development of a single financial market in the European Union by presenting our views and responding to consultation questions of the European Commission, the EBA and the FSB.[1]

We would like to present our stand on the economic and social consequences of the interpretation of Directive 93/13/EEC, as presented in May 2019 by the Advocate General of the Court of Justice of the European Union (CJEU), should it be taken into account in the CJEU's interpretation.

In the public debate in Poland there is an increasing recognition that the possible CJEU's verdict based on the literal interpretation of Directive 93/13/EEC in formal and legal terms, may threaten the stability of the banking system. This belief derives from the fact that on 14 May 2019 Advocate General Giovanni Pitruzzelli gave his opinion on the interpretation of Directive 93/13/EEC on unfair terms in consumer contracts. The opinion was given in response to the request for a preliminary ruling from the Regional Court in Warsaw (case C-260/18) on the abusiveness of terms in an agreement on a mortgage loan granted in PLN but indexed to the Swiss franc. The Advocate General was of the view that a national court has no right to change a contractual term that it finds unfair, therefore such a term should be stricken out from the contract but the court has no right to fill the gap.[2] That means that where an exchange rate difference clause is found to be an unfair contractual term, then "*that would have the effect of transforming the type of the contract from one indexed to CHF and subject to the interest rate of that currency, to one indexed to PLN but still subject to the lower interest rate of the CHF*" (cf. 41 of the Advocate General Opinion).

[1] The European Financial Congress took part in many consultations, including the following:
- FSB consultations on the proposals for a common international standard on total loss absorbing capacity as presented in TLAC (2015),
- EBA consultations on prudential requirements concerning exposures secured by residential and commercial properties (2015),
- EC consultations on covered bonds in the EU (2016),
- FSB consultations on provisional financing of banks in resolution (2016),
- EC consultations on the single market for retail financial services (2016),
- EBA consultations on PSD2 (2016)
- EC consultations on the development of secondary markets for non-performing loans and distressed assets (2017)
- FSB consultations on the bail-in execution principles (2018),
- EBA consultations on outsourcing in the financial sector (2018), and
- EC consultations on the Consumer Credit Directive (2019).

For more details please visit: https://www.efcongress.com/en/consultations.

[2] If we adopt a rule that the national court does not have the right to fill the gap that emerges in a contract after an unfair term has been stricken out, then it may, in practice, make it impossible to shape a fair/balanced relationship between the parties to the agreement, and that would be against the public interest.

It should be underlined at the beginning that the interest rate is also known as the price of the principal amount lent, to which the owner of the principal amount is entitled for lending it to others for a specified period of time. The principal may be expressed in different currencies. The essence of the interest rate lies in the fact that it is inextricably related to the currency, just like the essence of the price is that it is inextricably related to a specific product.

In formal terms, it is not forbidden to grant loans, for example, in EUR at a price of a loan in PLN, just like it is not forbidden to sell gold at a price of silver; however, that would be a sign of extreme economic ignorance. If the verdict of the CJEU regarding abusive clauses in the indexation mechanism made Polish courts face the alternative of either annulment of the existing agreements or expressing them in PLN but retaining interest rates based on LIBOR (CHF), grave consequences would follow for the sustainable development of the financial system in the European Union and in Poland:

1. Such a verdict would be in conflict with the BMR.[3] The price of loans based on a variable interest rate (and these are the loans the possible CJEU verdict will refer to) is based on the reference rates currently undergoing reform on the single financial market of the EU in line with the BMR regulation. The regulation implies the need to apply reference rates that are adequate to economic reality, and most significantly to the transaction prices on the financial markets. It seems impossible to imagine lending currency X, for example EUR, at the transaction price of currency Y, for example, PLN.[4] **From the economic point of view, contractual terms concerning currency conversion (indexation) and the reference rates applied must not be considered separately.**
2. It will create a precedent that will be dangerous in economic terms as it might threaten the stability of the financial system and lead to a banking crisis in Poland as several largest banks would lose capital adequacy. Using an interest rate that is adequate for a specific currency and applying it to another currency might unsettle the state's monetary policy and cause serious disturbances in the economy. Interest rates represent a material element of any state's economic processes because the authorities in charge of the state's monetary policy use the interest rate level to affect monetary institutions (banks) with a view to influencing the level of prices and money supply. Therefore, interest rates should not be used for a purpose that distorts their construct, that is as a form of "punishing" banks for using clauses that are considered abusive, especially since the consequences of such conduct may be much more far-

[3] Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014.

[4] In light of the authorisation made by the European Securities and Markets Authority (ESMA), LIBOR should not be used at all in contractual terms concerning currencies other than the ones for which it is published.

As LIBOR administrator, ICE Benchmark Administration is required to publish (in line with Article 27.1.a of BMR) a benchmark statement that "(...) shall clearly and unambiguously define the market or economic reality measured by the benchmark and the circumstances in which such measurement may become unreliable (...)".

Item 2 of the official Benchmark Statement of ICE LIBOR (pp. 1-2) reads that: "*LIBOR is published every UK business day for five currencies: US Dollars; Pound Sterling: Euros: Japanese Yen; and Swiss Francs. Each currency has seven tenors: Overnight/Spot Next; 1 Week; 1 Month; 2 Months; 3 Months; 6 Months and 12 Months. LIBOR is determinated using Contributions of input data from contributor banks in five currency panels that range in size from 11 to 16 banks. The LIBOR banks in each currency panel are required on every UK business day to send IBA the rates at which they believe they would be able to obtain funding in each of the maturities in the currency.*"

If the CJEU gives a verdict that is consistent with the opinion of the Advocate General, then it will undermine ESMA's position.

reaching. As a result, such a form of "punishing" banks for using abusive clauses would in fact punish the depositors, creditors and taxpayers.

3. It would breach the principle of equality and proportionality as it would be to the disadvantage of lenders who entered into loan agreements in the national currency (which in Poland are subject to a much higher WIBOR) and who knowingly took advantage of a more expensive offer that does not entail the FX risk. Please note, for example, that banks in Poland have granted approx. 2.2 million housing loans, of which around 21% are loans indexed to and denominated in CHF. Borrowers who took out loans indexed to/ denominated in CHF would be in a privileged position. We would then have two types of PLN-denominated loans in Poland: a standard one (WIBOR plus the margin) and a much cheaper one (LIBOR plus the margin) – granted to CHF borrowers based on individual court rulings. Under such a scenario, selected CHF borrowers would receive a considerable (tax-free) financial advantage compared to borrowers who have taken out loans in PLN.

   It would lead to social tensions and public discontent caused by a sense of discrimination of PLN borrowers; the number of disgruntled and – more importantly – afflicted customers would be 3-4 times higher than the current number of CHF borrowers who demand compensation for abusive terms concerning the rules of loan indexation to a foreign currency in their agreements.

   It would favour speculation and stimulate moral hazard. If the CJEU shares the opinion of the Advocate General, then the court rulings based on that opinion would force banks to refinance lending portfolios at a price higher than the portfolio profitability, i.e. to sell money at a price lower than the price of purchase. Rather than to make an early repayment of the loan, a privileged CHF borrower could pay the amount to a PLN deposit account which bears a higher interest rate and receive unjustified additional benefits.

   In addition, the ruling would also create a serious legal risk from the customers who had taken out PLN housing loans, since CHF borrowers would not only pay lower loan instalments, but they would also receive an unjustified privilege of having the loan interest rate drastically cut.[5]

   Adopting the precedent opinion of the Advocate General which allows for replacing reference rates arbitrarily, might cause chaos on the international financial markets that is hard to define and estimate, where IBOR rates and their successors are fundamental metrics used for underlying transactions (such as the said housing loans) and derivative transactions to hedge the market risk of interest rate and investment objectives.

   It is worth adding that it may reinforce the belief that a borrower does not need to exercise any caution or diligence when entering into an agreement with banks because the state (or the CJEU) will always take care of his/her interest. Neither is it an encouragement to enter into agreements wisely; on the contrary, it promotes moral hazard that destabilises the financial markets and the economy. Paradoxically, in the long term, such a solution may prove to work against consumers.

[5] The scale of the problem is illustrated by the size of housing loans granted by banks in Poland. As at the end of 2018, it was more than PLN 421 billion (39% of total assets of banks in Poland), of which FX loans, mainly in CHF, were worth PLN 132 billion (31%).

We hope that the CJEU judges will review our synthetic opinion, if only to have a full view of the case at hand.

The purpose of this open letter addressed to the Court of Justice of the European Union as an *amicus curiae brief* is only meant to support the CJEU in settling the case at hand in such a way as to prevent chaos on the financial market and mitigate the risk of the financial system destabilisation and public dissatisfaction.

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