

FX MORTGAGE LOANS IN POLAND – BENEFITS OF BORROWERS VS. FINANCIAL SITUATION AND CONDITIONS FOR DEVELOPMENT OF THE BANKING SECTOR

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Purpose: The aim of the article is to characterize the specificity of fx mortgage housing loans (especially in Swiss francs in Poland), to present the conditions for granting them and to assess the financial and economic consequences, as well as the impact on the banking sector of the cancellation of these loan agreements.

Design/methodology/approach: The article has been prepared based on studies of literature in the field of banking and finance, analysis of the legal acts and sectoral data from the Polish Financial Supervision Authority and the National Bank of Poland, as well as data coming directly from banks granting FX housing loans. The paper also uses own calculations using the annuity account.

Findings: The research conducted in the paper indicates that the case law of the Court of Justice of the European Union in the years 2019-2023 and the adopted line of case law of Polish courts, which mainly provides for the cancellation of mortgage loan agreements in foreign currencies, contributed to the emergence of systemic credit risk among exposures that were considered to have the highest quality in the banking sector. The cancellation of loan agreements became a source of long-term free capital for fx borrowers, for whom the terms of lending in foreign currency were in many cases more favorable compared to loans in the Polish zloty. Disputes related to foreign currency loans place a significant financial burden on banks. On the one hand they cause the need to establish provisions and write-offs, and on the other hand, they contribute to the erosion of the equity and reduce growth potential of banks and ability to compete. The value of losses due to solving the problem of Swiss franc loans in Poland, estimated at approx. PLN 100 billion, may cause the bankruptcy of individual systemically important banks, as exemplified by Getin Noble Bank, and significantly reduce the capital adequacy of the entire sector, thus significantly reducing its ability to finance the economy. The legal and monetary conditions of 2020-2023 strongly encourage borrowers to take legal action against banks and limit the willingness to conclude settlements.

Research limitations/implications: The study was conducted in the legal and financial conditions of 2023, in which the final number of lawsuits and settlements in the banking sector has been unknown, and thus the amount of real losses to be incurred by banks and the Polish economy.

Originality/value: The article fills a research gap in the area of assessing the situation of foreign currency borrowers in Poland, the legitimacy and financial consequences of the cancellation of Swiss franc loan agreements as a result of the CJEU case law of 2019-2023

systemically sanctioning the beneficial settlement of disputes concerning Swiss franc loans for the benefit of borrowers.

Keywords: foreign currency loans in Poland, cancellation of the agreement, Swiss franc.

Category of the paper: Research Paper, Viewpoint.

1. Introduction

FX mortgage loans are one of the most significant items in the loan portfolio of banks in Poland. Although their value and number in the banking sector have been declining since 2011, the financial implications of foreign currency lending for residential purposes and the legal risks associated with them are increasing. In particular, since 2015, when there was noted a significant increase in the valuation of the Swiss franc on international markets and when lawsuits against banks for foreign currency loans intensified, portfolios of foreign currency credit exposures have become particularly problematic for the banking sector. The lack of systemic solutions in Poland, both on the part of the National Bank of Poland, the Polish Financial Supervision Authority, the Ministry of Finance, as well as the Polish parliament has implied that the center of gravity in the relationship between the borrower and the banks has been shifted to the courts. The emerging proposals to resolve disputes by means of individual settlements with borrowers have met with a lack of wider interest on the part of banks, and the concepts of systemic conversion of loans have not been implemented due to the estimated high level of losses and the possibility of creating a risk for the entire sector. The situation of banks changed significantly with the emergence of the case law of the Court of Justice of the EU in 2019, which was strictly favorable to borrowers, and then in 2023, which set the direction for court rulings in Poland, essentially making it possible to cancel foreign currency loan agreements in court. The growing number of lawsuits began to significantly burden commercial banks in Poland, resulting in the need to enter a mass dispute with borrowers and to make significant provisions for expected unfavorable litigation outcomes. As a result, based on unfavorable court rulings, a stress factor has emerged in banks, which means a significant increase in the cost of risk, a decrease in profitability and the ability to develop sustainably. The necessity to repay funds on account of already repaid FX mortgage loans and the inability of banks to repay claims have become a source of benefits for foreign currency borrowers, allowing them to use free capital for many years or significantly reduce interest costs to a level not occurred in the economy.

This article discusses the research problem of the conditions, legitimacy, and impact of the cancellation of indexation or the entire FX housing loan agreements on the functioning of the banking sector in Poland. The aim of the article is to characterize the specificity of FX housing loans in Poland, to assess the causes and conditions of their granting and the financial as well as economic consequences of the cancellation of their agreements.

For the purposes of the article, two research hypotheses were formulated. The first one states that FX housing loans are a source of significant financial losses for borrowers. The second states that in Poland there are favorable conditions for amicable settlement of disputes between borrowers and banks.

The article fills a research gap in the assessment of the situation of foreign currency borrowers in Poland, the legitimacy and financial and economic consequences of the cancellation of Swiss franc loan agreements, as well as the effects of legal and financial risk on the emergence of systemic credit risk related to the portfolio of foreign currency loans in the light of the case law of the CJEU and common courts from 2019-2023.

2. Research methods

This article has been prepared on the basis of literature studies on the subject and analysis of sectoral data provided by the National Bank of Poland, the Polish Financial Supervision Authority and banks. The paper also uses studies of key legal acts, determining the court rulings in Poland in the field of FX housing loans. For the purposes of the study, the calculation of the amount of loan installments in Swiss francs and Polish zlotys was also carried out using the annuity account. The author compared the financial situation of borrowers indebted in Swiss francs and Polish zloty, assuming a 30-year mortgage loan of the equivalent of PLN 100,000, indexed with WIBOR 3M and LIBOR CHF/SARON 3M rates, with a credit margin of 1.5% and an exchange rate margin of 6%.

3. Results

3.1. The essence of FX mortgage loans

FX mortgage housing loans appeared in Poland thanks to the activity of banks with foreign capital (Brown, De Haas, 2012; Pann et al., 2010) and became one of the main types of credit exposures already in the period 2004-2005. Their popularity was mainly due to the relatively low interest rates – significantly lower compared to the interest rates on loans in the Polish zloty and easier availability than loans in the national currency due to the lower value of installments. The above features made mortgage financing in foreign currencies popular in many CEE countries, where active foreign currency financing began at a similar time as in Poland. On the Polish banking market, as in Hungary and Croatia, Swiss franc loans were the most widespread (Yeşin, 2013; Brown, Peter, Wehrmüller, 2009), which resulted from the relatively higher interest rate on the euro currency, as well as the high availability of Swiss franc financing

in leading banks. Swiss franc mortgages were also intensively promoted and advertised (Alt et al., 2017). The massive borrowing of foreign currencies in Poland was also stimulated by the relative stability of the exchange rate of foreign currencies against the Polish zloty, and since 2004 also by the successively increasing value of the Polish currency against the Swiss franc. Other factors encouraging indebtedness in foreign currencies included favorable prospects for the development of the Polish economy after accession to the EU and confidence in the Swiss currency as a safe and reliable currency. In the case of other CEE countries, the lack of trust in domestic financial institutions and local currencies was also a motivation to borrow in foreign currencies (Fidrmuc et al., 2013). Undoubtedly, the process of development of Swiss franc financing in Poland was also secured by the banks themselves due to the possibility of obtaining financing abroad with relative ease and achieving additional benefits from foreign exchange and insurance of low own contribution of loans. As a result of banks' sales policy and high demand for mortgage loans reported by customers, in 2008, i.e. in the year of the outbreak of the supprime financial crisis, foreign currency loans in Swiss francs were the dominant type of exposure both in terms of annual growth and the value of the banking sector portfolio in Poland (Buszko, 2018). Thanks to them, Polish borrowers counted on lower interest rates and smaller installments, as well as faster repayment of loans against the background of PLN debts. However, these loans exposed them to exchange rate risk, weakened monetary policy and the impact of domestic interest rates (Brzoza-Brzezina et al., 2017), and generated systemic risk (Yesin, 2013).

The problem related to FX mortgage loans began to become apparent after the start of the financial crisis in 2008 and in the following years, when, as a result of a significant appreciation of the Swiss franc, there was an increase in the installments of foreign currency loans and the amount of debt to be repaid measured by the LtV ratio (Buszko, Krupa, 2015). In the case of the Polish market, the increase in the Swiss franc exchange rate was significantly offset by a sharp decline in interest rates in Switzerland, which fell below 0.5% in February 2009 and became negative in 2015. The accumulated risk for borrowers became apparent only after the outbreak of the war in Ukraine, when interest rates in Switzerland and the valuation of the Swiss franc against other currencies began to rise at the same time (Figure 1).

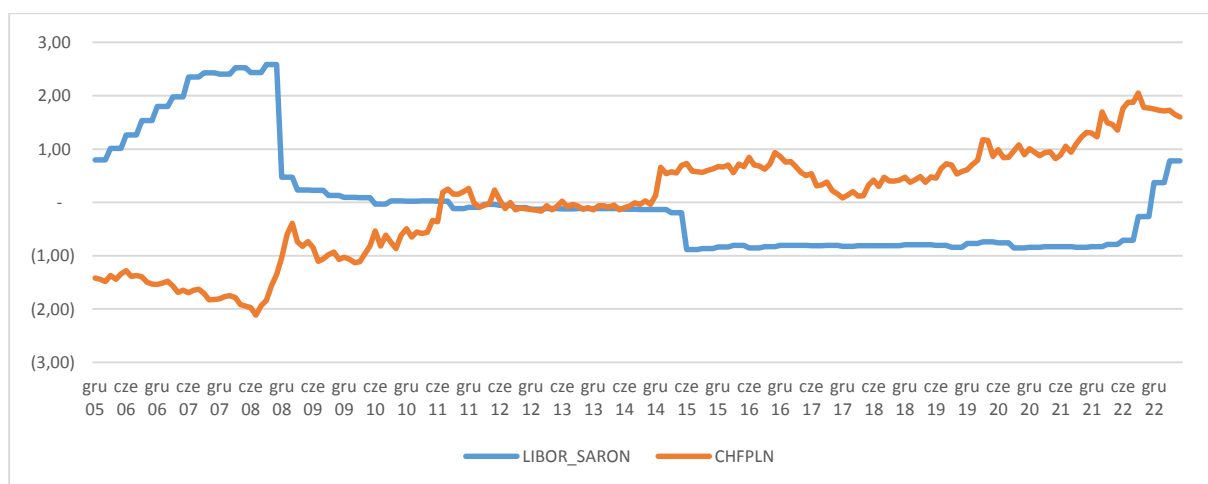


Figure 1. Z-score statistics of Swiss franc borrowers in the period 2005-2023.

Source: Author's own elaboration.

From the point of view of the borrowers, the change in the Swiss franc exchange rate was of key importance in the period under consideration, as it determined not only the current value of the installments paid, but also the value of the total outstanding debt, which was and still is the biggest issue of foreign currency loan agreements and at the same time the basis for the dispute with banks. Thanks to the increase in the franc exchange rate, the borrowers, despite the repayment of total installments equaled or even higher to the original loan, still had a large part of the debt to repay.

3.2. Legal regulations, supervisory and sectoral initiatives in the field of FX loans

Due to the significant demand for foreign currency loans in the years 2005-2006, and then changes in the interest rate and the exchange rate of the Swiss franc after the outbreak of the financial crisis of 2008-2009, attempts to manage the risk of foreign currency exposures on the part of the Polish Financial Supervision Authority, the Ministry of Finance, the National Bank of Poland and the Parliament were made relatively quickly, aimed at reducing the risk on the part of both banks and borrowers. Between 2019 and 2023, the case law of the Court of Justice of the European Union (CJEU) appeared, which, unlike previous solutions, had a systemic impact on the problem of foreign currency exposures in Poland. The systemic nature of the case law was based on the establishment of a line of jurisprudence for common courts, which strengthened the protection of borrowers, but also became a catalyst for litigation (Table 1). Unlike other countries in the region, especially Hungary, Croatia, Serbia, Cyprus, Montenegro and Romania, Poland has not carried out a systemic conversion of Swiss franc loans into the national currency to hedge against future exchange rate shocks (Fischer, Yesin, 2019).

Table 1.

The most important regulatory and legislative initiatives in the field of control and arrangement of foreign currency mortgage exposures in Poland

Unit	Year	Instrument	Description
PFSA	2006	Recommendation S	A regulation restricting access to foreign currency loans through higher requirements for creditworthiness and creditworthiness. Granting the loan required creditworthiness with an interest rate equal to the loan denominated in Polish zloty, with the amount 20% higher than required in the loan application. The client should sign a document on the acceptance of currency risk. A loan in Polish zloty should be presented to the customer as a loan of first choice.
Banks	2008-2009	Currency conversion to PLN	In the aftermath of the financial crisis and problems with the refinancing of Swiss franc liabilities, banks began to offer voluntary conversion of CHF loans into the Polish zloty.
PFSA	2009	Recommendation S(II)	The recommendation made it possible to repay foreign currency loans directly in foreign currencies and required the publication of transparent information on currency spreads and their calculation mechanisms.
Banks and private companies	2010	Online Currency Exchange Platforms	Reduction of the CHF spread to approx. 0.5% and free CHF transfers between bank accounts in Poland for loan repayment.
Parliament	2011	Anti-Spread Act – amendment to the Banking Law of 29 August 1997	The first act supporting foreign currency borrowers, which allowed for the repayment of foreign currency loans directly in foreign currency without additional costs of amending the loan agreement. Banks were required to open free foreign currency accounts for borrowers to repay loans and could not charge fees for using such accounts. Borrowers were not required to buy currency from the lending bank.
PFSA	2013	Recommendation S (III)	Foreign currency loans became available only to borrowers with income in the currency of the loan. A maximum of 25 years of credit was used to examine the creditworthiness of customers
PFSA	2010, 2013	Recommendation T	Introduction of an obligation to implement a transparent spread policy in retail currency exposures. The Dti should not exceed 50% (or 65%). In the case of foreign currency loans, a safety margin of 20% was required due to the change in the exchange rate.
Banks	2015	Acceptance of negative CHF LIBOR	Reduction in the value of installment repayments (return of part of the principal repaid by the borrower in installments).
Banks	2015	Reduction of CHF spreads	Voluntary reduction of the CHF/PLN exchange rate spread to approx. 1%.
Banks	2015	Extension or temporary suspension of loan repayment	At the customer's request, it has become possible to change the parameters of the loan (repayment time, grace period) in order to facilitate its repayment
Banks	2015	Opting out of additional security features	With respect to customers repaying their loans on time, additional costly collateral has been waived.
Banks	2015	Possibility to change the currency at the average NBP exchange rate	Possibility to convert the debt into Polish zlotys at the official exchange rate without having to pay the spread
Banks	2015	Flexible approach to loan restructuring	The ability to negotiate loan repayment in a way that is more affordable for the borrower

Cont. table 1.

Parliament	2017	Act of 23 March 2017 mortgage credit and supervision of credit intermediaries mortgage and mortgage agents	The ability to issue a mortgage only in the currency in which you receive your income or if you own the majority of your funds or other assets.
Ministry of Economic Development and Finance	2017	Regulation on a higher risk weight for exposures secured by mortgages on immovable property	Banks were obliged to apply a risk weight of 150% (which reduced their capital adequacy) for exposures secured by residential real estate, in the case of which the amount of the principal or interest instalment depends on changes in the exchange rate of a currency or currencies other than the currencies of the debtor's revenues.
Ministry of Economic Development and Finance	2017	Systemic Risk Buffer Regulation	Due to the portfolios of FX mortgage exposures, an additional capital requirement (3%) was introduced across the sector.
CJEU	2019	Judgment of the Court of Justice of the European Union in Case C-260/18	A contractual term that is considered unfair must, in principle, be regarded as never having existed, so that it has no effect on the consumer. The national court, having found that certain provisions of the contract were unfair, held on the basis of national law that the contract could not be continued. The possibility of substituting clauses deemed unlawful opens only if the cancellation would have particularly harmful consequences for the consumer.
Advocate General CJEU	2023	Opinion of the Advocate General Michael Collins in Case C-520/21	If the loan agreement between the bank and the borrower is found to be invalid due to unfair contractual terms being entered into by the bank, the bank has no right to demand any other benefits from the consumer than the return of the principal paid and the payment of statutory interest for delay from the moment of the demand for payment. On the other hand, in such a situation, the consumer has the right to pursue claims against the bank that go beyond the reimbursement of monetary benefits. The admissibility and merits of such claims under national law should be decided by the courts.
CJEU	2023	Judgment of the Court of Justice of the European Union in Case C-520/21	The consumer has the right to demand compensation from the credit institution in addition to the reimbursement of monthly instalments and costs paid for the performance of the contract and beyond the payment of statutory default interest from the date of the demand for payment. Banks do not have the right to demand remuneration for the use of capital. Such a request may be available to borrowers and the merits of such claims will be assessed in accordance with national law.
Banks	2023	Introduction of a settlement policy in disputes with foreign currency borrowers	Actively advocating for settlements with clients instead of lawsuits.
Supreme court	2023	Judgment of the Supreme Court in case II CSKP 1627/22	A defect in the "spread clause" does not have to cause the entire contract to collapse. It remains for the court to consider whether the market rate or the average rate of the National Bank of Poland may be introduced instead of the spread clause.

Cont. table 1.

CJEU	2023	Judgment of the Court of Justice of the European Union in Case C-287/22	The borrower may apply to the court for a freezing order, resulting in the suspension of installment payments for the duration of the process.
CJEU	2023	Judgment of the Court of Justice of the European Union in Case C-139/22	A court may declare a term of a contract to be unfair only because it is the same as a term entered in the register of prohibited clauses. A term of a contract cannot be considered unfair to some consumers and fair to others. The Bank is obliged to inform all borrowers about the essential features of the agreement and the risks associated with it, even if the consumer has adequate knowledge of the contract being concluded.

Source: Author's own elaboration.

3.3. Contesting contracts and transferring benefits to borrowers

When examining the reasons for questioning FX mortgage loans, the most frequently raised legal issue of foreign currency loans (in francs) were conversion clauses allowing for indexing the value of loan installments and debt amounts in accordance with the change in the exchange rate. It was considered abusive to refer to the exchange rates included in the banks' exchange rate tables, i.e. unspecified in the years of popularity of granting loans as to the method of determination and the possibility of change. In this regard, it was argued on legal grounds, that the failure to specify in the loan agreement restrictions related to the method of determining the exchange rate gave the bank virtually unlimited power to determine the amount of loan installments and the amount of borrowers' debt (Kwiatkowski, 2022; Wierzbowski, 2019). Both conversion clauses and exchange rate tables were the most frequently reported thematic areas of complaints to the Financial Ombudsman in Poland (Rzecznik Finansowy, 2016). Since the determination of the abusiveness of clauses generally concerns the moment of conclusion of the agreement, the recognition of the provisions as unlawful means that they are ineffective in relation to borrowers from the moment of conclusion of the agreement, and thus cannot be replaced by dispositive provisions. In general, the right of banks to unilaterally determine exchange rates while simultaneously applying different rates for loan disbursement and repayment (the so-called spread) was considered abusive in loan agreements (Mroczkowski, 2017). Since the settlements of disbursement and repayment of loan installments were carried out according to the tables of purchase and sale rates of currencies set by banks, where customers had no influence on the level of valuations, while being bound by the loan agreement, the bank acquired the right to decide on the amount of the loan disbursed and the repaid installments. It can be concluded that this violated the interest of borrowers and was contrary to the definition of a loan agreement governed by the provisions of Article 69 of the Banking Law. The banks were also accused of failing to adequately inform customers about the risk of changing loan installments due to a change in the exchange rate, as well as the fact that the customer was not sufficiently informed about the exchange rate at which the loan was to be repaid. It is assumed that the bank was free to choose the rate that was the most

advantageous for it and at the same time the least favorable for the customer. Such a situation meant an uneven distribution of rights, obligations, and risks between the parties, leading to an imbalance in the contract and, at the same time, to the generation of additional risks on the part of the borrower (Mroczkowski, 2017).

The removal of clauses considered abusive in the agreement in Polish practice means either the removal of the mechanism of indexation of the loan to the foreign currency exchange rate while maintaining the interest rate on the loan according to foreign currency rates (a solution rarely used) or the complete cancellation of the agreement, which is not ultimately postulated in the case law of the Court of Justice of the European Union and Directive 93/13/EEC on unfair terms in consumer contracts (Council Directive, 1993). Until the end of September 2023, court rulings favorable to borrowers, especially at first instance, usually resulted in the complete cancellation of the loan agreement. In both cases of rulings in favor of the borrowers, there are actual benefits in the form of a reduction in the amount of debt and the amount of instalments or the return of all instalments paid with interest. This also applies to loans that have been fully repaid in the past. From 2023, it has become possible for borrowers to pursue additional claims in addition to the main benefit returned to the bank.

The benefits obtained by foreign currency borrowers because of the line of case law adopted by the courts in Poland translate into the possibility of long-term use of the debt without incurring the costs of interest and commission. This should be compared with the financial situation of borrowers taking out loans in the Polish zloty. In many cases, the cancellation of a loan agreement applies to borrowers who, having a loan in Swiss francs, were in a better situation compared to PLN borrowers. The profitability of CHF housing loans in relation to loans in the Polish zloty depended primarily on the moment of taking out the loan, i.e. the level of the exchange rate at which the loan was converted at the time of disbursement. A comparison of the value of instalments of Swiss franc and PLN loans taken out at two extreme moments, i.e. unfavorable (07.2008) and favorable (03.2009) exchange rate for loans in CHF, is presented in Figures 2 and 3.



Figure 2. Monthly difference in the amount of PLN vs. CHF instalment.

Source: Author's own elaboration.

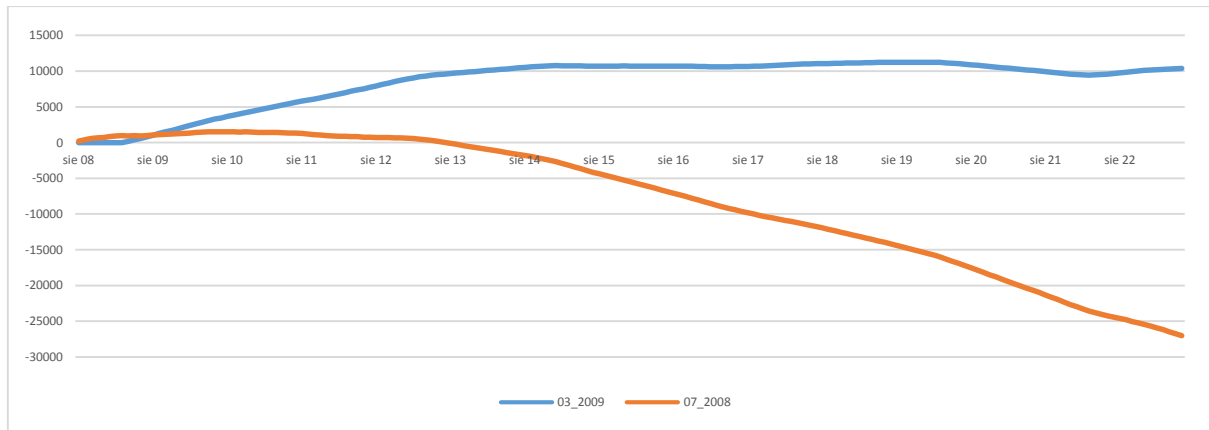


Figure 3. Cumulative differences in the amount of PLN vs. CHF instalments.

Source: Author's own elaboration.

The charts show a large variation in the profitability of foreign currency lending compared to the zloty. For 30-year foreign currency loans contracted in July 2008, the total repayment of installments until June 2023 is about PLN 27 thousand higher compared to PLN loans for every PLN 100 thousand. On the other hand, the repayment of the Swiss franc loan taken out in March 2009 gives the borrower about PLN 10,000 of benefits for every PLN 100,000 of debt compared to loans in the Polish zloty.

3.4. Financial condition of the banking sector – cost of loans

Borrowers entering disputes with banks and, in particular, court rulings in favor of foreign currency borrowers mean that there are significant risk costs for banks. In this case, the burden applies to many entities, including most banks listed on the stock exchange. Figure 4 presents portfolios of Swiss franc loans in listed banks.

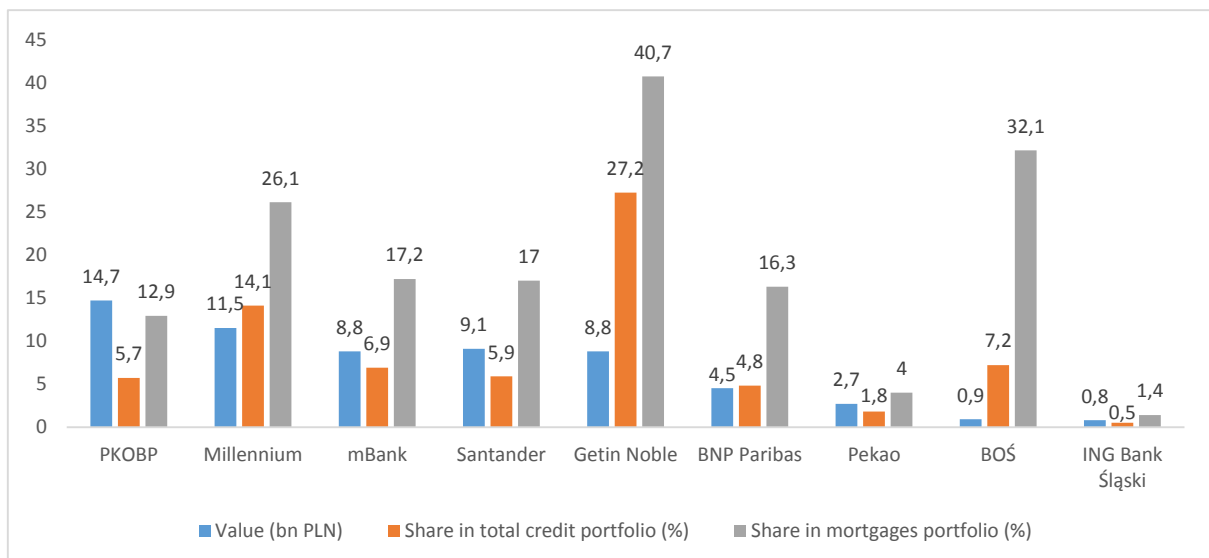


Figure 4. Swiss franc loans in banks' loan portfolios

Source: Author's own elaboration based on: <https://www.bankier.pl/wiadomosc/Ile-frankow-maja-banki-I-kwartal-2022-r-8340133.html>, 2023.10.05.

While the quality of FX housing loans remained stable until the end of 2021 and was not actually the subject of banks' concerns, the increase in the SARON rate and, in particular, the line of case law adopted by Polish courts after 2019 became a source of significant legal risk transmitted into credit risk and the possibility of instability in the domestic banking sector. Since 2021, FX housing loans have become the only type of exposure, apart from loans for individual entrepreneurs, that is rapidly deteriorating in quality. The NPL ratio for Swiss franc loans, which remained relatively stable in the period 2015-2019 at around 3%, began to grow dynamically, reaching 7.8% in September 2023 (BFG, 2023). Since 2019, i.e. the year of the favorable ruling by the CJEU, the costs of credit risk on Swiss franc loans have also started to increase in the banking sector. Due to the phenomenon of an increase in the number of lawsuits and non-repayment of instalments, combined with an increase in interest rates in Switzerland, the sector recorded a significant increase in impaired loans in relation to non-performing loans, as well as a significant increase in provisions for outstanding Swiss franc loans (Figures 6 and 7).

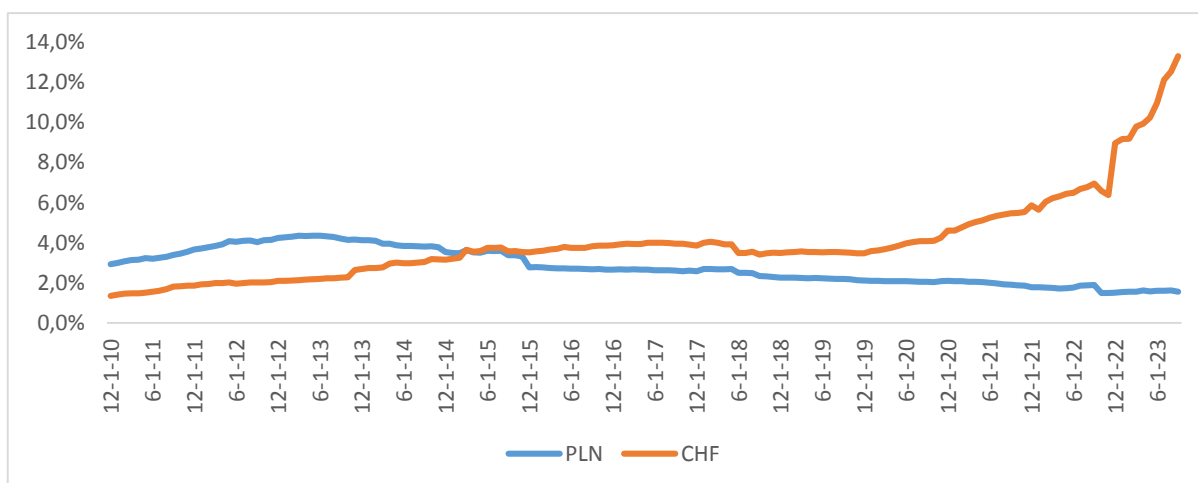


Figure 6. Ratio of impaired mortgage loans to non-impaired loans.

Source: In-house analysis based on KNF data.

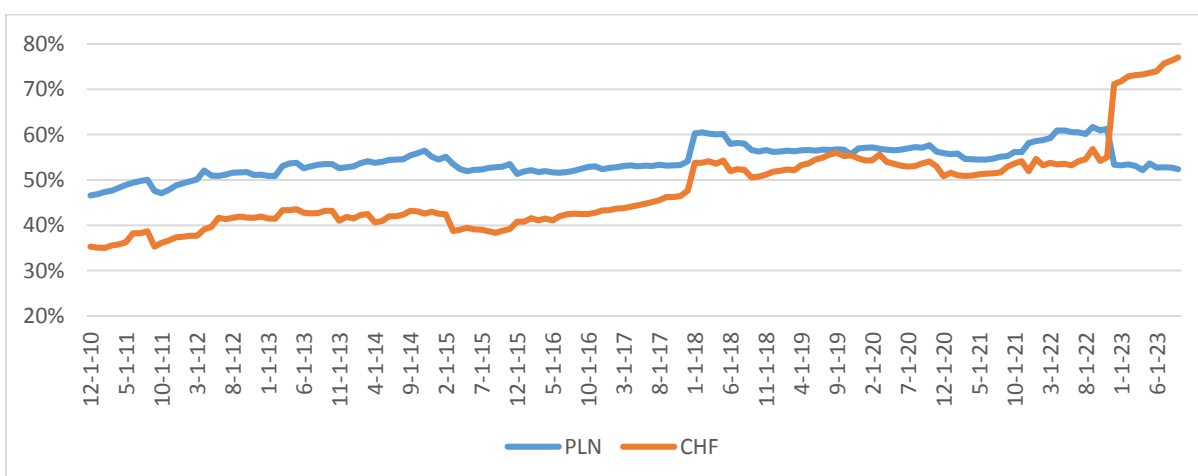


Figure 7. Charge of impaired loans.

Source: In-house analysis based on KNF data.

Because of the increase in the share of impaired loans and the increase in the value of provisions, the banking sector resulted in an increase in volatility and the level of the burden on net operating income of total costs of provisions and write-offs (Figure 8).

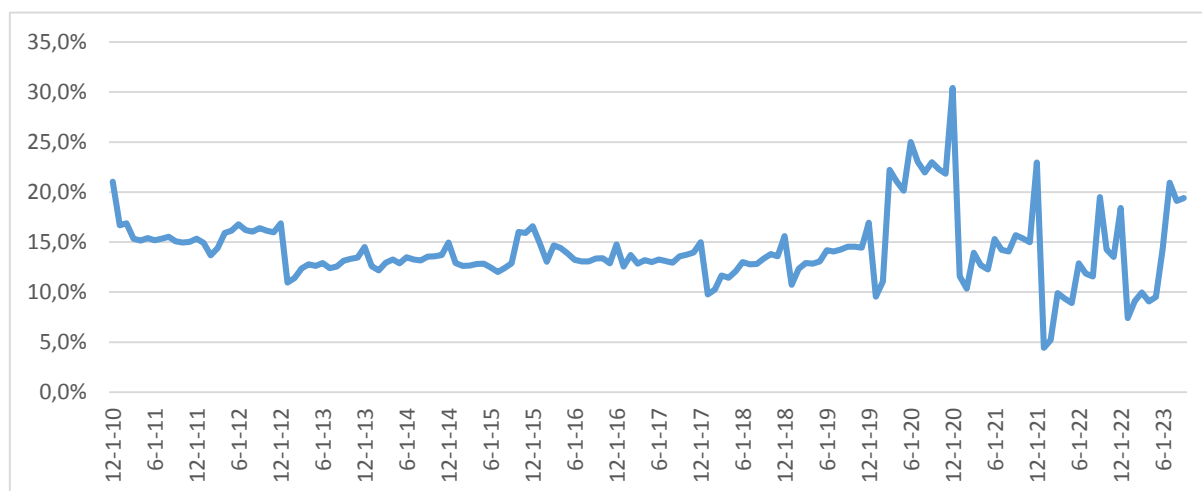


Figure 8. Burden of banks' net operating income on costs of provisions and write-offs.

Source: In-house analysis based on KNF data.

In June 2023, the portfolio of Swiss franc loans, due to the new provisions, impairment charges, repayments and settlements concluded with borrowers, shrank to approx. PLN 40 billion with 228 thousand agreements (ZBP, 2023), accounting for approximately 7.5% of the value of housing loans in the sector. This value is significantly lower than the value of the portfolio of these loans in 2011, which amounted to approx. PLN 168 billion (UKNF, 2023). Estimates by the Polish Financial Supervision Authority made in 2022, i.e. before the CJEU's case law (Jastrzębski, 2022) were formed, indicate that the total costs of cancelling or "de-francing" loan agreements will reach PLN 100 billion. In view of the expected unfavorable case law in connection with the CJEU's rulings from 2019-2023, the estimates of the Polish Bank Association have increased the value of costs for the banking sector to PLN 109 billion (ZBP, 2023). This value means that further provisions for Swiss franc exposures will need to be created in the coming years, beyond the level of approximately PLN 40 billion of provisions created by 2023. The cost estimates presented above pose a significant challenge to the entire banking sector and represent a loss of around 43% of banks' equity at the end of September 2023. The problem is undoubtedly that write-offs for litigation may hit banks unevenly, causing the insolvency of some systemically important entities. An example of such a bank bankruptcy due to the burden of loan write-offs was Getin Noble Bank SA from top 10 banks in Poland, which was de facto forced to restructure due to the risk arising from the Swiss franc loan portfolios. The cost burden on banks is reflected in a significant transfer of free capital from banks to a narrow group of Swiss franc borrowers. The benefit of the court rulings in their case can be confirmed by a significant number of lawsuits against banks selling Swiss franc loans, which already in 2022 exceeded 100 thousand, i.e. about one third of the agreements. In 2023, a total of more than 100,000 lawsuits were

recorded in only eight operating listed banks. In the second quarter of 2023 alone, there were about 10,000 such lawsuits, confirming a significant growth dynamic. Along with the increase in the dynamics of the number of lawsuits, there was a decrease in interest in settlements with banks, the total number of which in 2023 amounted to over 77 thousand for listed banks (Cieślak-Wróblewska, 2023). The justification for this phenomenon is undoubtedly the very high rate (97-98%) of judgments in favour of borrowers by common courts (Banki..., 2023) and the possibility of suspending the repayment of installments for the duration of the process.

4. Discussion

Swiss franc loans cause a significant annual as well as total burden for the banking sector in Poland and today can be considered the greatest threat and source of systemic risk for the Polish banking sector. Since Swiss franc loans have not been granted since 2011-2012, their real portfolio only shows a tendency to deteriorate in quality. Nevertheless, it should be remembered that until the CJEU ruling, which was favourable to borrowers, these loans were characterized by a very high quality and regularity of repayment compared to all types of loans. The jurisprudence in the cases of Swiss franc borrowers, in particular the judgments of the Court of Justice of the European Union (CJEU) and the activity of law firms, have significantly shaped the conditions for the stability and functioning of the banking sector.

When assessing the problem of the alleged abusiveness of the clauses of foreign currency loan agreements, it should be pointed out that it is difficult to assume that banks operating in Poland within the framework of the continental model of the financial system, i.e. based on long-term relations, mutual benefits and public trust, deliberately sought to act systemically to the detriment of customers and the desire to achieve short-term profits at the expense of the loss of long-term stable proceeds from relations with their clients. As a rule, the structure of foreign currency loans was to generate benefits on both sides, i.e. profits from interest margins and foreign exchange on the part of banks and savings on account of reduced loan installments compared to loans in the Polish zloty, and possibly shortening the loan period on the part of borrowers. Although it was argued that their construct was only intended to increase the demand for new banking products (Żywicka, 2018), the dominance of the Swiss currency financing rather than in euro proves that customers were aware of the benefits which they expected and preferred to borrow at a lower rate in less popular currency than to take less beneficial loans but given in the commonly available European currency. It is worth noting that the very problem of risk related to the possible weakening of the zloty against foreign currencies was noticed by representatives of the banking sector as early as 2005, which resulted in the raising of proposals for solutions limiting lending in foreign currencies (ZBP, 2015). However, the real slowdown in the foreign currency lending processes occurred only because of the limited availability of

the Swiss franc after the crisis of 2008-2009 and the increase in foreign exchange risk, but not as a result of the recognition of the terms of loan agreements as abusive. The abusiveness of contractual clauses began to be raised primarily because of the significant appreciation of the Swiss franc, i.e. about 10 years after the start of the lending process. At that time, a discussion devoted to the issue of indexation and the effects of potential cancellation of clauses or loan agreements began (Rzecznik Finansowy, 2016; Mroczkowski, 2017). Moreover, the possibility of losing the financial solvency by the households (Jagoda, Kryska, 2016), the effects of CHF loans systemic conversion into PLN or the legitimacy of granting financial support to Swiss franc borrowers against the background of the situation of borrowers in PLN were also analyzed (Buszko, 2016; Barembruch, 2016; Buszko, 2018).

The high appreciation of CHF versus PLN, which started the legal disputes in Poland about Swiss franc mortgages, resulted in an increase in loan installments, but in the case of many Swiss franc borrowers, it did not mean that their financing became less favorable compared to PLN loans. Nevertheless, the fact of a gradual increase in the amount of loan installments and the persistence of a high amount of debt to be repaid due to its valuation at a high exchange rate of the Swiss franc contributed to a massive dispute with banks.

The conversion (indexation) mechanism of Swiss franc loans, which is the basis for disputes and is evaluated as abusive, does not necessarily have to be considered as detrimental to the interests of borrowers from a financial point of view. Firstly, the use of loans indexed to the Swiss franc was intended to protect customers against the risk of unwanted change in the exchange rate (weakening of the franc) between the moment of signing the agreement and the moment of disbursement of the loan. This was particularly important for loans intended for construction and housing purposes and disbursed in tranches. Secondly, if Swiss franc loans were paid to customers in the lending currency, i.e. Swiss francs, there would be another significant risk, i.e. the need to transfer the Swiss franc to another foreign exchange institution and the risk resulting from the foreign exchange in a place other than the lending bank. This fact would mean that ultimately the loan amount could not go to the seller of the property, and thus put the borrowers in a situation where the terms of the loan agreement have not been fulfilled, i.e. the loan has been used in accordance with the declared purpose. In this context, the use of both indexation and conversion should be justified for the exchange of the loan amount and the repayment of instalments. In the context of favorable exchange rates, the problem has been properly solved by the introduction of recommendation S (II) by Polish Financial Supervision Authority (KNF) and the amendment to the Banking Law Act in 2011, giving the possibility of repaying loans directly in the currency of lending and purchasing the currency at any place and time. The introduction of the above legal solutions contributed to the creation of currency exchange offices, and thus to a new model of buying and selling currencies in Poland (Kowalewska, 2019).

Since the court rulings in Poland predominantly decide on the cancellation of loan agreements, this means that borrowers effectively sanction the use of free capital by borrowers in the long term. Free capital does not exist under normal market conditions, much less is it possible for it to function cost-free in a systemic form. An inherent feature of capital is the presence of an opportunity cost, an interest or dividends. The problem of using free credit capital in Poland has become strengthened by the possibility for borrowers to pursue claims for loans that have already been repaid. Therefore, it can be concluded that the scale and costs associated with foreign currency loans will continue to burden the sector in the long term, and in the event of a decrease in interest rates in Poland, the burden of the costs of provisions and write-offs on foreign currency loans will become more significant.

Capital transferred at no cost to borrowers is a direct burden on banks' own funds, which are the foundation for financing economic development. Passing on all interest benefits to borrowers means a loss of equity by banks and a transfer of the lost amount to customer deposits. This action, in addition to the potential threat of bank failure and the erosion of funds stabilizing operations, reduces the potential for financing economic development by banks to a degree of 12.5 times for every PLN 1 loss due to the deterioration of the capital adequacy ratio. At the same time, it is difficult to expect that the funds obtained by borrowers in court will be spent on an ongoing basis and will stimulate demand in the economy.

In a broader context, if we consider the activity of banks as institutions acting to support the creation of the wealth of the entire society, the costs of cancelling Swiss franc loans will reduce the ability and willingness of banks to finance the needs of civilizational changes, i.e. especially the process of digitization and financing the energy transition. In the first area, banks may lose their high position to digital but unregulated institutions, which may lead to the emergence of new systemic risks. In the second area, the use of foreign financing may prove to be crucial. Banks in Poland will have funds to lend, but they will not be able to use them due to too low capital adequacy.

Thanks to the costs of cancelling loans, banks will also have a limited investment attractiveness. As a result, it should be expected that there will be problems with their financial supply in the event of the need for recapitalisation or for development purposes.

The cancellation of Swiss franc loan agreements results in the emergence of social costs, especially equal rights for borrowers taking loans in the Polish zloty. As it was indicated in the earlier part of the paper, the financial situation of foreign currency borrowers against the PLN ratio largely depends on the moment of taking out the loan. Some foreign currency borrowers, especially those taking loans at the end of 2008 and later, who thanks to Swiss franc loans are already benefiting from cheaper financial benefits compared to borrowers in the Polish zloty, will receive additional benefits. Therefore, there is a problem of unequal treatment of different groups of borrowers.

The very favorable case law of the Court of Justice of the European Union combined with the case law of common courts developed in Poland, relatively high interest rates and the diversified financial situation of Swiss franc borrowers compared to PLN borrowers result in a significant weakening of the potential to conclude settlements with banks. In fact, the certainty of winning the lawsuit, combined with the possibility of suspending the repayment of installments and the lack of the need to pay interest, given the very developed market of litigation services provided by law firms, encourages people to take legal action rather than exchange the Swiss franc debt for a higher-interest PLN loan.

Shifting the burden of the dispute between banks and borrowers to the courts has resulted in loans with the best repayment quality becoming loans of very rapidly decreasing quality. At the same time, they became the fastest decaying loans among all loans in Poland. Due to their presence in all major banks in the banking sector in Poland, they thus become a de facto source of credit risk in the systemic sector, which would not have materialised without the CJEU's case law.

The legal risk and, as a result, the credit risk related to foreign currency loans was generated due to the increase in instalments of Swiss franc loans, even though the exchange rate risk was mitigated for a long time by the decline in interest rates in Switzerland. Against this background, housing loans in the Polish zloty turned out to be riskier in 2022 due to a sharp increase in installments solely because of the change in interest rates. Therefore, the litigation experience of Swiss franc borrowers may be transferred to the group of mortgage borrowers borrowing in the Polish zloty, which would mean the collapse of the banking system in Poland.

5. Conclusions

FX mortgage housing loans, particularly those indexed or denominated in Swiss francs, should be considered the biggest contemporary challenge facing the banking sector and the Polish financial system. The jurisprudence of the Court of Justice of the European Union (CJEU) and then of common courts in Poland resulted in a massive establishment of provisions in banks and an increase in write-offs on the loans under consideration and estimates of the costs of this process carried out by the Polish Financial Supervision Authority and the Polish Bank Association indicate the amount of up to PLN 100 billion. Therefore, credit risk caused by legal risk materialized in Poland. This is an unprecedented situation and will undoubtedly weigh heavily on both the sector and the financial system for many years to come. The Polish banking sector has never experienced mass disputes with clients and undermining the basic types of contracts used in the economy. The costs of disputes, both current and future, are likely to be passed on to customers and, ultimately, to the economy and the society. It is also difficult to expect that banks will be able to develop and strengthen their ability to compete on the market

with other entities, including those from abroad, by conducting long-term litigation with their clients. Behind banks, which are generally commercial institutions, there are owners who expect a certain rate of return on capital. Burdening banks with the costs of cancelling loan agreements will therefore create pressure to recover lost profits in the form of higher interest margins and an increase in commissions and fees. While in the latter case, the possibility of passing on the costs to customers will be limited due to the activities of digital entities (fintech or neobanks), the burden on customers will be primarily in the form of higher interest rates on loans and lower interest rates on deposits. Due to the different burden on banks of foreign currency loans, the serious threat of losses or bankruptcy of some systemically important entities may be a problem.

The need to safeguard the interests of consumers, who are the weaker party in their relationship with financial institutions, should not, as a rule, consist in cancelling contracts, but in restoring the contractual balance of the parties and remedying the actual financial damage caused by the financial institution, if any. Such a loss may be considered a situation in which the bank would overstate the conversion rate of installments on the days of repayment of loan installments in relation to the other days of the month. Otherwise, there is unjust revenue and enrichment. In the case of Swiss franc borrowers who took out loans at a relatively high CHF valuation (2004-2005 and 2009-2011), this financing is more advantageous in terms of the value of installments paid so far compared to loans in the Polish zloty. The first hypothesis put forward in the introduction should therefore be considered negatively. The real problem of Swiss franc borrowers, which remains to be solved, is the very value of the outstanding debt. Here, therefore, the actions of the regulator or legislator are needed.

Questioning Swiss franc loans due to the volatility of the exchange rate and interest rate, as well as the case law that has been developed in Poland in this area, may indicate that virtually any product indexed to an economic variable in the economy may be challenged in court, provided that the change in the index is not in line with the expectations of the financial institution's customer. Index-linked products are particularly desirable in a high interest rate environment with the expectation to fall in the future. If index-linked financial products based on long-term contracts were unavailable, fixed-rate products would generate excessively high costs, which could also be challenged in court.

The case law of the Court of Justice of the European Union (CJEU) and the case law of common courts in the field of Swiss franc loans, combined with the environment of increased inflation, and thus interest rates, depreciate the possibility of concluding settlements between borrowers and banks. The certainty of winning in court and the reluctance to take on debt in high-interest national currency significantly discourage out-of-court dispute resolution. Thus, the second hypothesis put forward in the introduction of the paper should be negatively verified.

To sum up this paper, it is necessary to point out the limitations of the conducted research and conclusions regarding the results obtained. In the first place, it should be emphasized that the study was conducted in the legal and financial conditions of 2023, in which the final number of lawsuits and settlements in the banking sector, and thus the volume of possible losses to be incurred by the sector, was unknown. On the legal basis in Poland, the borrowers have been given the right to pursue claims for the repayment of the loan as well as other additional costs. In addition, it is now possible to seek reimbursement of foreign currency loans that have been fully repaid in the past. In 2023, the possibility of implementation of the systemic solution to the problem of disputes between borrowers and banks (other than through the lawsuits) was also unclear. Although the issue of mortgage lending in foreign currencies concerns many countries in the CEE region, Poland is the only country where the resolution of disputes has been fully transferred to common courts with all its consequences. Therefore, the Polish example should be considered rather as specific and not necessarily a model for solving the problems of foreign currency lending in other countries of the region.

Further research in the scope of foreign currency lending should focus primarily on the conditions of systemic (out-of-court) solutions to the problem of borrowers' claims against banks. At the same time, the experience and problems of foreign currency lending should be used to conduct research around the possibility of preventing the occurrence of legal risk of a systemic nature, including the development of a universal, commonly accepted, and indisputable model of mortgages.

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