



POLISH BANK ASSOCIATION

Comments on Targeted consultation on the designation of a statutory replacement rate for CHF LIBOR

1. ON THE EFFECTIVE NEED FOR A REPLACEMENT FOR CHF LIBOR

Pursuant to article 23a of the EU BMR, the Commission may only designate replacement rates for third-country benchmarks “if their cessation or wind-down would significantly disrupt the functioning of financial markets in the Union or pose a systemic risk to the financial system in the Union.”

Question 1. Do market participants agree that the situation as described above, requires that the Commission exercises the statutory replacement powers for the CHF LIBOR? Please explain and provide data if available.

a) Yes

b) No

c) No opinion

First of all, we would like to express our gratitude to the European Commission that The Commission paid attention to this crucial problem. We also maintain the entire position of the Polish Bank Association presented in this topic earlier. We assess that the exposure of mortgage credits with CHF LIBOR in the Polish market and other Member States fulfils the premise of the significant disruption the functioning of financial markets in the Union.

Taking into account at least the amount of credits and their specificity we should consider cessation of CHF LIBOR as a high risk factor. In Poland at the end of 2020, the banks' portfolios performed 436 thousand mortgage loan agreements denominated or indexed to CHF for a total amount of PLN 99 billion, which is estimated approximately 21% of the value of entire mortgage loan portfolio and approximately 17.6% of the total number of mortgage loan agreements in Poland. It should be noted that the vast majority of mortgage loan contracts with consumers where CHF LIBOR is used as a benchmark were concluded between 2006-2008 year. Typically these contracts were concluded for tenor of 20-30 years and current maturity of outstanding portfolio is well beyond end 2021.

Similar cases of long-term contracts based on CHF LIBOR are present in Austria and Greece.

It should be noted that the vast majority of mortgage loan contracts with consumers where CHF LIBOR is used as a benchmark were concluded before the BMR came into force and they are missing fall-back provisions. There are no fall-back provisions in those contracts as there was no such legal obligation then and a concrete replacement indicator was not known or even predictable. There isn't any solution for systemic and equal solution possible to use. We see the possibility of the bilateral changes of each agreement but this solution won't guarantee an equal and effective for all clients solution. Polish banking sector considers as crucial and necessary to take appropriate systemic solutions that will allow to apply a single, common, effective and based on generally binding regulations approach to replacement benchmark for the CHF LIBOR. As these contracts are long-term and annexation of contracts one-by-one is hardly possible hence discontinuation of CHF LIBOR pose significant threat in terms of market stability and consumer relations

We assess that there is high risk of destruction of the functioning of financial markets in EU only on the basis on the risk mitigated in the retail area. One should consider that CHF LIBOR is as a benchmark used not only for the retail credits, mortgage credits and loans to small businesses, therefore the cessation CHF LIBOR could have also an impact on others agreements where there are no fallbacks provisions or where they are unsuitable. We strongly advocate to use power from the authorisation under art. 28b BMR and to designate a replacement for CHF LIBOR.

When we assess the impact of cessation of CHF LIBOR to the financial markets we should also take into consideration the possible spill over effect from one segment of financial markets to the others. We think that taking into consideration only the value or total amount of the agreements or financial instruments using CHF LIBOR as a benchmark is the most crucial thing but not the only one. From the perspective of Polish banking sector it is also important to see the impact of unsolved problem of lack of benchmark which was used in the mortgage or credit agreement concluded with consumer.

Although the number of contracts made after January 1st,2018 is low, in order to assure consistency and legal certainty, the designated replacement rate should apply to all contracts which do not contain fallback clause, regardless when they were concluded.

The Swiss National Working Group has identified compounded SARON as the replacement rate for CHF LIBOR, which is officially calculated and published by SIX, the SARON administrator.

We are of the opinion that replacement of the CHF LIBOR by SARON Compound rate is the best option and it ensures that the contract remains valid and a value transfer between contract parties is prevented. In case existing contracts referencing e.g. 3M CHF LIBOR, the economically closest rate would be the above-mentioned 3M SARON Compound, whereas an adjustment spread (calculated according to ISDA methodology) shall be applied on top, which is also recommended by the Swiss National Working Group.

The purpose of an adjustment spread is to assure the economical equivalence of an unsecured term rate (LIBOR) and a compounded ON (nearly) risk free rate. It shall not create an advantage or disadvantage to any of the contract parties. Its level can be positive as well as negative. Hence, the application of such a spread is per se not a compensation for the borrower.

It can be stated that it is necessary for the EU Commission to designate a statutory replacement rate for CHF LIBOR by making use of its new powers granted under the amended BMR. This replacement rate shall be the SARON Compound with the Adjustment Spread as proposed by the Swiss National Working group and applied according to the “last-reset” convention. This is the only way to assure legal certainty for both borrowers and lenders and to prevent any event being disruptive to financial stability and contractual continuity in the European financial market.

We also would like to emphasize that the designation of a statutory replacement rate for CHF LIBOR would be the first real touching point of consumers with the BMR. Therefore, any measure by the Commission should bring clarity and not leave any open questions.

2. ON THE FAIRNESS AND ACCEPTABILITY OF THE SOLUTION RECOMMENDED BY THE SWISS NATIONAL WORKING GROUP

Question 2. Do consumers, small and medium enterprises and relevant consumer bodies agree that the proposed replacement rate (3M SARON calculated as a compounded SARON under a last reset methodology) plus the ISDA adjustment spread (calculated as a historical median approach over a five-year lookback period) is a fair and equitable solution for a replacement of CHF LIBOR in mortgages and small business loans and consumer credit agreements? Please explain and, if necessary, provide alternative solutions.

a) Yes

b) No

c) No opinion

We are not a consumer organization, but a chamber of commerce of Polish banks, but we would like to respond to the question posed. First of all, we assess that taking into account the context of the mortgage credits, the most important aim is to guarantee the possibility of continuity of the agreement after cessation of CHF LIBOR. Otherwise we will have to deal not only with disturbances on financial markets but also with the huge social consequences. At the market of benchmark we don't see a lot of benchmarks which could be used as a replacement for CHF LIBOR. Actually, according to our assessment only SARON measures the market for this particular currency - Swiss Franc. Therefore we see the strong justification for using SARON as a replacement for a CHF LIBOR. Practically, there is no alternative to SARON Compound as CHF LIBOR successor on the market.

Taking into account the fact, that LIBOR is a term rate (1M, 3M, 6M, 12 M) we see also a need to use not SARON ON but SARON Compound rate to at least try to adjust the overnight rate to the disappearing reality of term rates. We are aware that there isn't a possibility to use exactly the same rate therefore we suggest something which is the closest version of current term rates. We are of the opinion that replacement of the CHF LIBOR by SARON Compound rate is the best option and it ensures that the contract remains valid and a value transfer between contract parties is prevented. In addition, we assume that this question should not refer to 3M tenors only, but also to other tenors in accordance to a more general approach of this consultation paper. Moreover, we would like to underline that the Commission should consider not only designation of replacement for CHF LIBOR 3M but also for other tenors with the adequate Compound SARON rate, e.g.:

- CHF LIBOR 1M – replaced by SARON 1 month compound;
- CHF LIBOR 3M – replaced by SARON 3 months compound;
- CHF LIBOR 6M – replaced by SARON 6 months compound.

In almost all loan contracts monthly payments have to be fixed using the interest rate observed at the beginning of the interest period. SARON Compound can be applied in advance for the subsequent interest period. Statutory implementation of replacement benchmark of LIBOR will assure smooth and effective performance of the concluded agreements, in particular the long term loans where no fall backs were predicted. We believe that the proposed approach is very fair for retail clients, as it gives them the opportunity to know the amount of the obligation at the beginning of a given period. We can see the difference between the CHF LIBOR and SARON calculation method, and it is precisely taking these differences into account that an approach should be developed that will enable the application of the SARON Compound Rate to already ongoing contracts that currently use CHF LIBOR as a benchmark. Transformation taking place on the benchmark market are something completely new, something that

market participants (contracting parties) were not able to predict when concluding a long-term loan agreement (especially a mortgage loan agreement), therefore in order to ensure the performance of concluded agreements, a solution should be found that will allow the use of the new benchmark for the existing legal relations and ensure the maximum level of transparency. This is also how we perceive the solution proposed by the Commission.

Moreover we consider using SARON Compound as a benchmark just because it is BMR compliant benchmark. Thus why, we have a guarantee of high standards and quality of the method of calculation. The only question is how to use the backward looking rate to the relations with the clients where you need to know the value of the benchmark before the given period (before the payment day), therefore we consider the last reset methodology as a justify.

We are concerned that the Commission is considering only the 3M LIBOR issue. We believe that the designation of replacement for only one tenor and leaving the remaining tenors without a systemic solution will cause huge chaos on the market and unjustifiably differentiate the situation of customers who have 3M LIBOR in their contracts from those with others CHF LIBOR tenors. We consider it necessary to comprehensively determine replacement for all LIBOR tenors. As an absolute minimum, to designate replacement for under EU law at least for 3M and 6M (the biggest amount of mortgage credits in PL use CHF LIBOR 3M and 6M). Remaining the possibility for the bilateral arrangements (between banks and clients) for others than 3M tenors will never ensure such convergence as in the case of the using systemic solution from 23b BMR. We estimate that even ca. 48 thousand contracts from the above mentioned CHF mortgage credit portfolio refer to CHF LIBOR 6M.

We also consider that Commission should assess the impact of cessation CHF LIBOR as a complex of all tenors not by dividing the impact of particular tenors on the financial markets. Only by assessment of the whole range of CHF LIBOR tenors EC will see the real impact on the market.

We also consider spread adjustment as a needed tool, therefore we strongly advocate to indicate by the Commission the spread adjustment in the implementing act. We suggest ISDA adjustment spread because it was established by experts from financial sector. We see an advantage of this solution which is an independent proposal of experts from financial sector, not individual decision of particular bank based on its credit portfolio. Moreover, the aim of ISDA organisation is the introduction of solutions that contribute to the formation of widely used standards.

We understand that ISDA adjustment spread is calculated as a suitable for derivatives and hedging, but there isn't strong contradiction by using it to the

others goals. Therefor we assume that the implementing act with indicated ISDA spread adjustment will be sufficient legal basis to us in in other contracts.

3. ON THE COMPATIBILITY OF THE CHOSEN METHODOLOGY WITH EU AND MEMBER STATES LAWS PROTECTING CONSUMERS

Question 3. Do market participants agree that the proposed calculation method (so called last reset) is compatible with the requirements of the MCD, the CCD, Directive 93/13/EEC and of other legislation protecting consumer credit and national implementation laws and with any other applicable legislation? Please explain.

a) Yes

b) No

c) No opinion

We are strongly convinced that there isn't any contradiction between using the method last reset and the requirements of the MCD, the CCD and Directive 93/13/EEC.

Please find below a legal assessment of Polish law provisions implementing the requirements of above-mentioned directives.

CCD is implemented in Poland in in the Act of 12 may 2011 on consumer credit (Ustawa z dnia 12 maja 2011 r. o kredycie konsumenckim, Dz.U. 2011 nr 126 poz. 715, available: <http://isap.sejm.gov.pl/isap.nsf/DocDetails.xsp?id=WDU20111260715>) and MCD inthe Act of 23 March 2017 on mortgage loans and supervision over mortgage brokers and agents (Act of 23 March 2017 on mortgage loans and supervision over mortgage brokers and agents, Dz.U. 2017 poz. 819, available: <http://isap.sejm.gov.pl/isap.nsf/DocDetails.xsp?id=WDU20170000819>). The consumer protection is assured in the Polish Civil law, which follows the rules of Directive 93/13/EEC.

The rules established in the Polish Act of 12 May 2011 on consumer credit indicate the different obligations to deliver particular information to the consumers before concluding the agreement, e.g. "the borrowing rate, the terms of application of that borrowing rate and, if available, any indices or reference rates applicable to the original borrowing rate and the periods, conditions and procedures for changing the borrowing rate; if the consumer credit agreement provides for different interest rates, this information shall be provided for all the interest rates used in the given term of the contract" (art. 13).

Art. 36 of the Act of 12 May 2011 on consumer credit establishes an obligation that in the event of a change in the interest rate during the term of the consumer credit agreement, the consumer should receive from the lender, on a durable medium, before its execution, the information about this change. Art. 37 of the Act establishes the obligation to deliver on every request of the consumer the

loan repayment schedule. So, the most important from the perspective of consumer protection rules is to deliver a clear and transparent information before concluding the agreement or before the changes in interest rate will take place. The issue of changing a benchmark used in the agreement – by the virtue of directly applicable source of law such as EU Regulation and its delegated acts - is not addressed directly in the Polish legislation on financial services consumer protection. General rules of transparency and information obligation – as explained above - shall apply.

Analogous rule is established in the Polish Act of 23 March 2017 on mortgage loans and supervision over mortgage brokers and agents: Art. 10 of this Act implements a requirement of delivering information before conclusion of the credit agreement. The bank should e.g., provide the consumer with the basic information on the benchmark (name and administrator) and additional information on the potential impact for the consumer resulting from using those benchmarks and the information about the types of available mortgage rates, indicating whether it is a fixed (or not).

Furthermore Art. 29 states the requirements for the minimal contents of the mortgage credit agreement. One of them is the information on the method and conditions for determining the interest rate on the basis of which the amount of principal and interest instalments is calculated.

Taking into consideration the topic of replacement of CHF LIBOR by other benchmark, one should analyse the Art. 31 of the he Polish Act of 23 March 2017 on mortgage loans and supervision over mortgage brokers and agents. According to this article if the mortgage rate specified in the contract is directly related to change in the benchmark and the new benchmark is made public, the mortgage contract should indicate that the change in the benchmark will be communicated to the consumer at the latest with the new repayment schedule, in accordance with the way of providing information agreed in the contract. Therefore, we assume that Polish legal frameworks require to inform client on the changes before the next payment period and there aren't any restrictions on the choice of a particular benchmark.

Finally, we would like to inform the EC that in art. 32 of the he Polish Act of 23 March 2017 on mortgage loans and supervision over mortgage brokers and agents one will find the crucial requirement for the benchmarks used in the contracts. Polish law requires to use understandable, accessible, objective and verifiable by the parties to a mortgage contract benchmarks. We are more than sure that SARON Compound fulfil all of those features. Polish law doesn't directly include the requirements for the methodology of calculation benchmark, which is use in products for consumers. Therefore there is a freedom of choose of any index (no matter if it is a backward or forward looking).

As we stated above we consider the methodology last reset as a fair and the only possible to use when SARON Compound is as a benchmark used in the contract. This methodology allows clients to have full and transparent information about the amount of their obligations (instalment amount) before start of each settlement period. The adoption of such a solution will be transparent and understandable to the consumers and will allow to provide a specific amount of the consumer loan instalment for a given period. Otherwise, there is a risk of providing to the consumers information about the amount of the interest rate retroactively only after the end of the settlement period.

In our opinion using SARON as a replacement rate (3M SARON calculated as a compounded SARON under a last reset methodology), for the purpose of calculating credit instalment amount for the following period is not contrary to Polish regulations and provisions of the MCD, the CCD and Directive 93/13/EEC.

The last reset method does not interfere with provisions of the Polish Act of 23 March 2017 on mortgage loans and supervision over mortgage brokers and agents, implementing provisions of the MCD. It does not prevent banks from fulfilling in contractual relations with customers the obligation of using benchmarks which have to be clear, available, objective and possible to verify by parties of a mortgage credit agreement and competent authorities. The last reset method also provides protection of consumer's interests with respect to information obligations imposed on crediting banks provided in article 31 of this Act, pursuant to which if the interest rate specified in a mortgage credit agreement is directly related to change in a benchmark and a new benchmark is made public, the mortgage credit agreement should indicate that the change in the benchmark will be communicated to the consumer at the latest with a new repayment schedule, in accordance with the way of providing information agreed in the agreement.

The last reset method does not also interfere with provisions of the Polish Act of 12 May 2011 on consumer credit, implementing provisions of the CCD. Art. 37 of the Act includes a protection system element for the entire term of a consumer credit agreement, concluded for a defined period, granting a consumer the right to receive at any time from a crediting bank a credit repayment schedule, including such information as credit instalment amount, detailing its individual components particularly capital, interest and all other credit costs incurred by the consumer, and in case of possibility of changing an interest rate information that data included in the credit repayment schedule applies until change of the interest rate or any other credit costs included in the credit instalment amount. Whereas art. 36 of this Act states that in the event of a change of interest rate during the term of a credit consumer agreement, before such change a consumer should receive from a crediting bank information about this change,

including interest rate and credit instalment amount. In addition, pursuant to article 30 section 1 point 8 of this Act information about such right should be included in the consumer credit agreement document.

Above mentioned provisions provide to consumers current knowledge concerning amounts of capital-interest instalments during a term of a credit agreement. Their functional interpretation indicates that information concerning interest change cannot be delivered to a consumer on a date of repayment of interest or capital-interest instalment, to which a change of interest rate applies, or after such date, and the consumer should receive information needed to determine the amount sooner enough, to prepare payment of an appropriate amount on repayment date specified in the agreement.

We would like to also underline that the SIX Administrator also has opened the access to the historical information about the SARON Compound Rate on his website. Thanks to this solution, the client can verify the index value independently of the bank (https://www.six-group.com/exchanges/indices/data_centre/swiss_reference_rates/compound_rates_en.html).

Taking into account the abovementioned considerations we don't identify any problems with the compatibility of SARON Compound Rate with the Polish consumer protection rules related to credit agreements.

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