

57. Provisions for legal risk related to foreign currency-indexed mortgage loans in Bank Millennium (Poland)

1. Current provisions for legal risk

As at 31 December 2020, Bank Millennium had 5,018 loan agreements and, additionally, 496 loan agreements from former Euro Bank, S.A. (98% loan agreements before the court of first instance and 2% loan agreements before the court of second instance) under individual ongoing litigations (excluding claims submitted by Bank Millennium against clients, i.e., debt collection cases) concerning indexation clauses of FX-indexed mortgage loans, submitted to the courts with the total value of claims filed by the plaintiffs amounting to PLN 562.4 million (Euros 123.33 million) and CHF 34.3 million (Euros 31.72 million) [Bank Millennium portfolio: PLN 508.2 million (Euros 111.44 million) and CHF 33.4 million (Euros 30.89 million); former Euro Bank, S.A. portfolio: PLN 54.1 million (Euros 11.86 million) and CHF 0.9 million (Euros 0.83 million)]. The outstanding amount of the loan agreements under individual court cases, as at 31 December 2020, is PLN 1.794 million (Euros 393.40 million).

Until 31 December 2020, only 69 lawsuits had been definitively resolved (49 cases regarding claims submitted by clients against Bank Millennium and 20 cases regarding claims submitted by Bank Millennium against clients, i.e., debt collection cases).

The claims deduced by the clients in individual cases refer mainly to the declaration of nullity of the contract or the obligation to reimburse, due to the alleged abusive nature of the indexation clauses.

In addition, Bank Millennium is a party to a group proceedings (class action) which aims to determine Bank Millennium's liability towards the group members based on alleged unjust enrichment (undue benefit) in connection with FX-indexed mortgage loans. It is not a lawsuit requesting the payment of a certain amount of indemnity. The judgment that may be issued in this case, if unfavorable to Bank Millennium, will not grant per se any credit rights required by the group members of this class action. The number of loan agreements covered by these proceedings is of 3,281. At the current stage, the composition of the group members if this class action has been established and confirmed by the court. On 11 August 2020, the claimant requested granting interim measures to secure the claims presented against Bank Millennium. In a decision of 18 August 2020, that request for granting interim measures was dismissed. On 26 October 2020, the claimant filed another application for granting interim measures to secure claims against Bank Millennium concerning two group members. By decision of 6 November 2020, the application was also rejected. The court's decision dismissing the request for interim measures with a justification has not been notified yet. During the session occurred on 26 October 2020, the Court conducted a hearing of the parties' position and, afterwards, postponed the session without setting the next term. The outstanding amount of the loan agreements under the class action proceeding is PLN 1.000 million (Euros 219.28 million) as at 31 December 2020.

Bank Millennium remains open to negotiating agreements with its customers that put an end to that dispute. Bank Millennium is receptive to negotiate case-by-case favourable conditions for early repayment (partial or total) or the conversion of loans to PLN. On the other hand, Bank Millennium will continue to take all possible actions to protect its interests in courts while, at the same time, being open to find settlement with customers in the court under reasonable conditions. Bank Millennium has already reached agreement with 117 borrowers that participated in that class action.

According to the Polish Bank Association (ZBP), data gathered from all banking institutions that granted FX-indexed mortgage loans show that vast majority of lawsuits have obtained a final decision in favour of creditor banks until the year of 2019. However, after the CJEU decision was issued on 3 October 2019, regarding Case C-260/18, this trend has adversely changed and most of those lawsuits have been decided against creditor banks.

Considering the increased legal risk related to FX-indexed mortgages, Bank Millennium created in 2019 a provision in the amount of PLN 223 million (Euros 48.9 million), while in 2020 constituted a provision in the amount of PLN 713 million (Euros 156.35 million), which includes a provision in the amount of PLN 677 million (Euros 148.46 million) for legal risk regarding Bank Millennium’s portfolio and a provision of PLN 36.4 million (Euros 7.98 million) for legal risk regarding former Euro Bank, S.A.’s portfolio. The methodology developed by Bank Millennium is based on the following main parameters: (i) the number of current (including class actions) and potential future court cases that will appear within a specified (three-year) time horizon; (ii) the amount of Bank Millennium’s potential loss in the event of a specific court judgment (three negative judgment scenarios were taken into account); and, (iii) the probability of obtaining a specific court verdict calculated on the basis of statistics of judgments of the banking sector in Poland and legal opinions obtained. Variation in the level of provisions or concrete losses will depend on the final court decisions about each case and on the number of court cases.

As at 31 December 2020, Bank Millennium’s balance sheet value of provisions set aside for FX-indexed mortgages legal risk regarding Bank Millennium’s portfolio reached PLN 924 million (Euros 202.62 million) and PLN 36.4 million (Euros 7.98 million) regarding former Euro Bank, S.A.’s portfolio. Legal risk from former Euro Bank, S.A.’s portfolio is fully covered by an Indemnity Agreement established with Société Générale.

Bank Millennium analysed the sensitivity of the methodology for calculating provisions, for which a change in the parameters would affect the value of the estimated loss to the legal risk of litigation:

Parameter	Scenario	Impact on loss due to legal risk related to the portfolio of mortgage loans in convertible currencies
Change in the number of lawsuits	Additionally, 1 p.p. of active clients file a lawsuit against Bank Millennium	PLN 33 million (Euros 7.24 million)
Change in the probability of winning a case	The probability of Bank Millennium winning a case is lower by 1 p.p	PLN 25 million (Euros 5.48 million)

On 3 October 2019, the CJEU issued a judgment on Case C-260/18, responding to the request for a preliminary ruling from District Court of Warsaw in the lawsuit against Raiffeisen Bank International AG. The judgment of CJEU regarding the interpretation of European Union Law, is binding to the national judge who proceeded with the preliminary ruling, and this interpretation must be accepted by the other community judges who judge on the application of the same rules. The referred judgment was based on the interpretation of Article 6 of Directive 93/13, concluding that it must be the following: (i) the national court can declare nullable a loan agreement if the removal of abusive terms detected compromises the subject matter of the agreement; (ii) the effects on the consumer’s situation resulting from the annulment of the agreement must be assessed in the light of the existing or foreseeable circumstances at the time of the decision of the dispute, and the will of the consumer is decisive as to whether he wishes to maintain the agreement; (iii) Article 6 prevents the integration of gaps in the contract caused by the removal of unfair terms from it solely on the basis of national legislation of a general nature or established customs; and, (iv) Article 6 precludes the maintenance of unfair terms in the contract which, at the time of the decision of the dispute, are objectively favourable to the consumer, in the absence of express manifestation to that effect by the latter. It can be inferred from this decision that the CJEU considered doubtful the possibility of a loan agreement remaining in force in PLN while interest is calculated in accordance with LIBOR.

CJEU’s judgment respects only to situations where the national court has previously found the contract terms to be abusive. It is the exclusive competence of the national courts to assess, in the course of judicial proceedings, whether a certain contract term can be qualified as abusive in the specific circumstances of the lawsuit. It can be reasonably assumed that the legal issues relating to FX-indexed mortgage loans will be judged by the national courts within the framework of the disputes considered, which could possibly result in the emergence of new legal interpretations relevant for the assessment of the risks associated with the subject matter of these proceedings. This circumstance justifies the need for constant accompaniment of these matters. Further requests for clarification and ruling addressed to the CJEU and the Supreme Court of Poland with potential impact on the outcome of the court cases have already been and may still be filed.

In this context, taking into consideration the recent unfavourable evolution to creditors of the court verdicts regarding FX-indexed mortgage loans, and if such trend continues, Bank Millennium will have to regularly review the provisions allocated to court litigations and it may need to constitute new provisions reinforcements.

The annulment of Bank Millennium’s loan agreements currently subject to those lawsuits can have a cost, before tax, of up to PLN 2.385 million.

2. Events that may impact the provision for legal risk

On 29 January 2021, it was published a set of questions addressed by the First President of the Supreme Court to the Civil Chamber of the Supreme Court, which may have important consequences in terms of clarifications of relevant aspects of the court rulings and their consequences. The Civil Chamber of the Supreme Court was requested to respond to certain requirements related to FX-indexed mortgage agreements: (i) is it permissible to replace - through legal or customary provisions - the abusive provisions of an agreement which refer to FX exchange rate determination; moreover, (ii) in case of impossibility of determining the exchange rate of a foreign currency in the indexed/denominated loan agreement - is it possible to keep the agreement in force in its remaining scope; as well as, (iii) if, in case of invalidity of the CHF loan agreement, there would be applicable the theory of equity (i.e., does it arise a single claim which is equal to the difference between value of claims of bank and the customer), or the theory of two conditions (separate claims for the bank and for the client that should be dealt with separately). The Supreme Court was also requested for commenting on (iv) the determination of the moment from which the limitation period should start counting in case of a claim being filed by a lending bank for repayment of borrowed amounts and, (v) whether banks and consumers may receive remuneration on their pecuniary claims on the other party arising from the contract. The date of the Supreme Court meeting, which was scheduled for 25 March 2021, has since been changed to 13 April 2021. Bank Millennium will assess in due time the implications of the potential decisions of the Supreme Court on the level of provisions constituted for the legal risk. Given the Group's inability to predict the results of that Supreme Court decision, this matter was not considered in the determination of the provision.

On 8 December 2020, Mr. Jacek Jastrzębski, the Chairman of the Polish Financial Supervision Authority (PFSa), proposed a sectoral solution to address the sector risks related to FX-indexed mortgages. The solution would consist in banks offering to their clients a possibility of concluding liability settlement agreements based on which a client would conclude with the bank a settlement as if the loan had been, from the very beginning, a PLN-indexed loan, bearing interest at an appropriate WIBOR rate, increased by the margin historically employed for such loan.

Following that public announcement, the idea has been subject of consultations between banks under the auspices of the PFSa and Polish Bank Association. Banks are assessing the conditions under which such solution could be implemented and consequent impacts.

In the view of Bank Millennium's Management Board, important aspects to be taken into consideration when deciding on potential implementation of such program are: a) favourable opinion or, at least, non-objection from important public institutions; b) support from the National Bank of Poland (NBP) for the implementation; c) level of legal certainty of the settlement agreements to be signed with the borrowers; d) level of the financial impact on a pre- and after tax basis; e) capital consequences, including regulatory adjustments in the level of capital requirements associated with FX-indexed mortgage loans.

At the time of publishing the Group's Consolidated Report, neither its Management Board nor any other corporate body of Bank Millennium or of the Bank took any decision regarding the implementation of such program. For this reason, the potential effects of this matter were not reflected in the determination of the provision. If, or when, a recommendation regarding the program is ready, Bank Millennium's Management Board will submit it to the Supervisory Board and General Shareholders' meeting, taking into consideration the relevance of such decision and its implications.

According to preliminary calculations, implementation of a solution whereby loans would be voluntarily converted to PLN as if they had been a PLN loan from the very beginning, bearing interest at an appropriate WIBOR rate increased by the margin historically employed for such loans, could imply provisions for the losses resulting from conversion of such loans (if all the current portfolio would be converted) with a pre-tax impact between PLN 4.100 million (Euros 899.06 million) to PLN 5.100 million (Euros 1,118.35 million) (non-audited data). The impacts can significantly change in case of variation of the exchange rate and other assumptions of diverse nature. Impacts on capital could be partially absorbed and mitigated by the combination of the existing surplus of capital over the current minimum requirements, the reduction of risk-weighted assets and the decrease or elimination of Pillar 2 buffer. The above mentioned impact would be substantially higher than the estimated impact of PLN 500 million (Euros 109.64 million) to PLN 600 million (Euros 131.57 million) (non-audited data) in the scenario of replacing the exchange rate applied in the contracts by the average NBP exchange rate. Finally, it should be mentioned that Bank Millennium, as at 31 December 2020, maintained additional own funds for the coverage of additional capital requirements related to FX-indexed mortgage portfolio risks (Pillar II buffer), in the amount of 3.41 p.p. (3.36 p.p. at the BCP Group level), part of which is allocated to operational/legal risk.

Due to the complexity and uncertainty regarding the outcome of court cases, as well as due to the potential implementation of PFSa Chairman's solution or potential Supreme Court decisions, it is difficult to reliably estimate potential impacts of such outcomes and their interaction as at the date of publication of the Group's financial statements.