

Polish Banks: What is the Risk of “Hungarian-style” Solution for FX Mortgages?

Alert: Good, Bad and Ugly Scenarios

mBank (MBK.WA; ZI479.20; 2) lost a court case challenging the method used to set interest rates on a small part of its FX mortgage book. The verdict of the appeal court was announced in April 2014 but the legal justification was published last week. The court ruled that provisions in the loan contract giving the bank the right to set the interest rate depending on unspecified financial market parameters was unclear and unfair. The remaining part of the loan agreement remains valid and the loan should be deemed a fixed-rate loan. mBank has stated that it will appeal the decision to the Supreme Court but given the strength of the court's justification we are sceptical mBank will get a much different ruling.

Why it matters? The direct impact of the lost case is insignificant (less than ZI10m) but the indirect influence may be more material. If all 26,000 clients with the product in question sue the bank, the cost may be significant. Additionally, should the court's decision to require banks to honour the remaining valid parts of the contract become a precedent, this can lead to damaging consequences in other litigation cases involving disputes over FX loan contracts.

The provisions on setting FX rates for loan granting (in Millennium (MILP.WA; ZI8.04; 3) and loan repayments (in Millennium and mBank) were put by antimonopoly courts on the list of unfair provisions. In June 2014 Millennium was sued by 2,273 clients claiming that they are not bound by provisions in loan contracts setting FX rates and thus the loans should be deemed Zloty-denominated loans, while mBank's clients engaged in the previous case regarding interest rate suggest that they can also sue mBank for unfair setting of the FX rate as well. **We see three potential scenarios:**

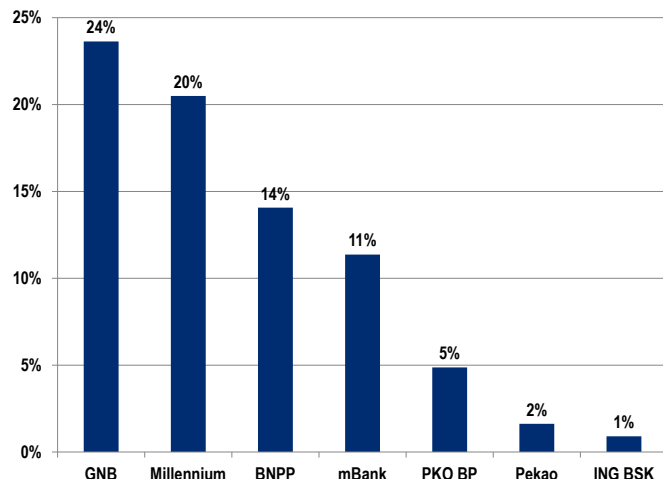
- **“Good”** – the courts rule that clients knew the bank FX rate at the moment of loan granting (in cases challenging the FX rate on loan granting) or that loans could be paid by clients in FX (in cases challenging FX rates for loan repayment) – no material impact on earnings;
- **“Bad”** – the courts rule that NBP or market average FX rates should have been used instead of the FX rates set by the banks (the same conclusion may be reached if courts follow the Hungarian court and decide that there was no real exchange of FX as loans were distributed in Zloty and are paid back in Zloty) – the impact on banks may vary in the range of between 24% and 1% of equity (Fig. 1);
- **“Ugly”** – FX mortgages are deemed Zloty loans but at rates linked to CHF/EUR LIBOR – the impact on the banks most exposed to FX mortgages (Millennium and GNB) may exceed their equity.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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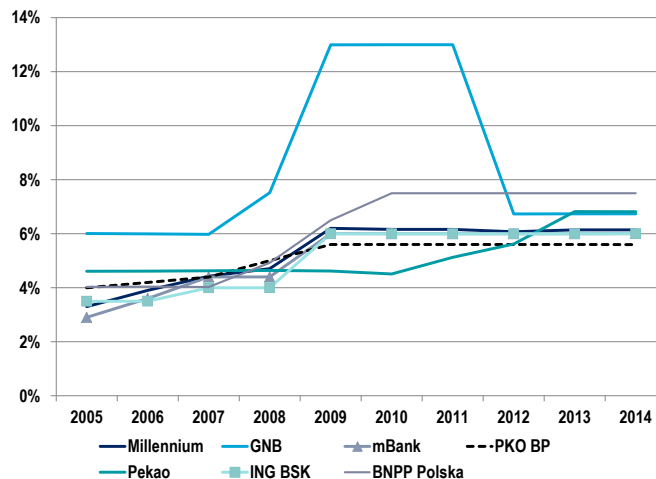
Figure 1. Polish Banks – Impact of the “Bad” Scenario* on Bank Equity, 1Q14 (Percentage)



*We assume the banks will have to return to clients FX spread charged at the moment of loan granting and repayment, in the calculation we include also the loss of the future revenues from the FX spreads on future loan repayment, historical spread estimated as the average of spreads as of June 6th in 2005-2014; the actual impact may be higher as our calculation don't include FX spread on paid interest rates; Equity as of 1Q14

Source: Company reports, bank websites and Citi Research

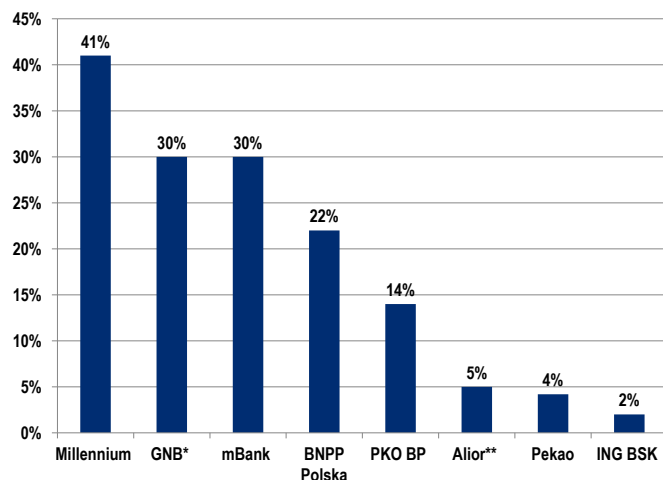
Figure 2. Polish Banks – CHF/PLN Spread*, 2005-2014 (Percentage)



*Spreads as of June 6th, 2005-2014

Source: Banks and Citi Research

Figure 3. Polish Banks – Share of FX Mortgages, 1Q14 (Percentage)



Source: Company reports

Figure 4. Poland – CHF/PLN Rate, 2005-2014



Source: stooq.pl

Companies Discussed: Alior Bank (ALRR.WA; ZI79.00; 2H); BNPP Polska (BNP.WA; ZI53.50; 2); Getin Noble Bank (GNB.WA; ZI2.65; 3H); ING Bank Slaski SA (INGP.WA; ZI133.00; 2); mBank SA (MBK.WA; ZI479.20; 2); Bank Millennium SA (MILP.WA; ZI8.04; 3); Bank Pekao SA (PEO.WA; ZI185.05; 1); PKO BP (PKO.WA; ZI39.40; 2)

Appendix A-1

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