

FX Loans

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FX Loans are not typical loans in the sense of article 806 of the Greek Civil Code, but high risk banking products including complicate clauses and terms which set out to swaps and derivatives. For this type of banking products, borrowers' information needs to be delivered pursuant to provisions of Law no. 3606/2007 regarding the provision of investment services and the Bank Of Greece Governor' s Act No. 2501/2002. Since in these products currency risk is high, Credit institutions are also obliged to provide borrowers with practical tools throughout the duration of the loan in order to hedge currency risk (both at capital level and installments level). As per the disclosure requirements, in accordance with Bank's of Greece legislation obligatory information should be delivered by competent and suitably qualified officers, holding the B1 certificate.

foreign currency loan - loan in Swiss francs - derivative - Currency risk – exchange rate volatility - currency - consumer – disclosure obligation - investment services - currency and interest rate exchange - currency risk protection – labor interest rate.

A. History of FX Loans

Since 2005, given that Greek economy was rated at level AAA, credit institutions could easily seek funding with a minimum interest rate around 1%. As a result, financial institutions tried to take advantage of this ease to be financed by converting it to a facility to provide low cost financing to businesses and individuals, mainly by means of mortgage loans, secured by the collateral of the borrower's property. Therefore, a competitive trend was inevitably created among banks and, in

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fact, through marketing campaigns banks were promoted in order to attract more customers the inception that, the lower the interest rate is the lower the cost of borrowing is and thus the lower monthly installments are.

At the same time, in the international currency market outside the European Union, interest rates were extremely low. Hence, credit institutions, aspiring to make high profits arising from multiple activities, encouraged individuals to take out low rate foreign currency loans and activated their marketing departments in order to advertise the lower interest rate of foreign currency loans compared to loans in euro and consequently the lower monthly installments.

Given that borrowers were enticed by the idea that that lower interest rates leads to lower borrowing cost and, consequently, lower installments, they were attracted by foreign currency loans, though completely ignoring their risks and, in particular, the currency risk.

In cases of lending in Swiss francs, in order to benefit from low rates, loans should be denominated in Swiss francs. Therefore, the borrower borrows the amount of the loan in Swiss francs and monthly installments are linked to Swiss francs. However, taking into consideration that the borrower is domiciled in Greece and his monthly income is in euro, all payments should be converted from euro into Swiss francs and as a consequence, monthly installment payment denominated in one currency is converted to the equivalent amount in the other currency (Currency swap) and thus, the borrower is subjected to currency changes.

Whereas currency fluctuations depend on many unspecified parameters, they often result in offsetting the profit from a low interest rate and lead to immense losses. In order to eliminate or mitigate currency risk, hedging should be used as a tool, though it has a cost, and certainly, the duration of exposure to currency risk should be as short as possible. As a result, loans denominated in Swiss francs differentiate from typical loans, and constitute complex banking products of high risk which include clauses set out to swaps and derivatives.

Financial institutions pursuant to legal framework established by the Bank of Greece Governor's Act No. 2501/2002, according to its authority regarding transparency in bank transactions, are obliged to adequately inform borrowers before signing any contract as well as during its operation.

Particularly, as regards loans in foreign currency, financial institutions are required to provide borrowers with a minimum of prior information concerning exchange rate, volatility risks, options and cost of hedging techniques (Chapter. B par. 2 a (x) and a (xi) of the above Act). These rules are, indeed, harmonized with the relative reports recently issued by the European Systemic Risk Board with regard to obligatory sufficient information on lending in foreign currency (2011 / C 342/01).

Subsequently, Bank of Greece by referring to the cost of hedging currency risk (Chapter. B par. 2 a (x) and a (xi) of the above Act), clearly means suggesting a «currency swap» (fx swap / derivative product), namely a derivative – bank product which will hedge the risk arising from the exchange rate volatility, in order for it to be eliminated or minimized as much as possible and cause mitigated losses.

Besides, in the occasion that the offered by the financial institution product in foreign currency is considered on the basis of its characteristics as a contract itself, it falls within the scope of Law No. 3606/2007 regarding the provision of investment services, (integration of MiFID) and, as a consequence, obligation of disclosure is governed by the relevant provisions of the above mentioned law, the compliance to which belongs to the competence of the Hellenic Capital Market Commission.

Therefore, banks, in cases of granting loans in foreign currency, and, especially, in Swiss francs, should in parallel: a) hedge the currency risk due to the exchange rate volatility, b) inform their client in written form regarding the cost of hedging techniques, c) advise and help their clients find ways to minimize losses due to currency fluctuations, namely, act investment services required in transferrable securities and provide advise in favor of their clients. As a result, banks, according to the directives of Bank of Greece, provide investment services, exchange currencies, get involved to derivatives and act in favor of their client.

B. Derivative products (derivative instruments) – Definition

A "derivative product" or "financial product" is a bilateral contract, whose value depends on the value of an underlying security or rate. Derivatives are traded on various exchanges worldwide. However, apart from the exchange-traded derivatives, there are derivatives traded over the counter.

Contracts traded on exchanges are known as options and futures, while over-the-counter traded derivatives are known as forwards and swaps.

The term "derivative" or "derivative instruments" generally refers to all derivatives, regardless of the type of the underlying asset. A derivative instrument takes the form of a contract under which the parties agree to payments between them based upon the value of an underlying asset at a particular point in time. Due to the underlying asset, the value of a derivative mainly depends on the current value of the underlying asset (e.g. currency), and its value at the time of the payment.

The term "underlying asset" (underlying security / underlying asset) means, according to Article 50 par. 2 of the law no. 3371/2005, "... *transferrable securities, rates, money market securities and other securities* (...). " The underlying assets of these contracts are actively traded in different markets regarding the markets that derivatives are traded, namely the so-called markets of spots, mainly stock exchanges, securities and foreign currency markets. Derivatives are divided by the type of the underlying asset and they are established when the underlying security is a financial instrument (stocks, bonds, rates, currencies etc.), as the case in point, where the underlying asset is currency.

The value of derivatives, their movements and return depend on the underlying assets and they have little or no direct value until their expiration- their value is based on the expected future price of the underlying asset. Similarly, the risk of a derivative depends on the risk inherent in the underlying asset.

Due to the high risk in derivative market, it is highly possible a derivative market to convert from a hedging tool into directed gambling.

Legal framework:

As defined in law no. 3606/2007 "derivatives" includes, among others, currency swaps, forward rate agreements and futures.

Pursuant to law no. 3371/2005 Article 50 par. 1, " 19. "*derivatives*"means contracts on financial instruments, particularly options, futures and swaps related to transferrable securities, rates, money market instruments, currencies and interest rates (...). "

C. Complex and non-complex financial instruments

Under Article 25 par. 6 of the law no. 3606/2007, in conjunction with Article 15 under the title "Non-complex financial instruments" of the decision no 1/452/2007 of the Board of Directors of the Hellenic Capital Markets Commission (Government Gazette no. 2136/01.11 .2007) non-complex financial instrument is regarded as the financial instrument which is not included either in securities of subparagraph (c) of paragraph 13 of Article 2 of Law no. 3606/2007 or in derivatives mentioned at cases (d) to (j) of Article 5 of the above law. Consequently, non-complex financial instruments are considered those expressly mentioned as such in the above provisions (e.g. shares, bonds even if they do not involve any actual or potential financial obligation for the investor, exceeding the acquisition costs, etc.).

As a consequence, securities of subparagraph (c) of paragraph 13 of Article 2 of Law no. 3606/2007 and derivatives of cases (d) to (j) of article 5 of the same law on securities swaps, are excluded from the scope of the above provisions and it is concluded (a contrario) that they cannot be characterized as non-complex financial instruments and are explicitly considered by the law as complex derivative instruments. Hence, transferable securities based swaps are characterized as complex financial instruments.

D. OTC derivatives

There are complex financial instruments that are traded on a regulated market, namely in Greece in the Athens Stock Exchange – derivatives department (Law no. 2533/1997 set the necessary legal framework for the establishment of an official and regulated derivatives market in Greece, which started operating at April 1999). Nevertheless, there are others that are traded on non-regulated

markets (**O**ver **T**he **C**ounter) and are offered usually by credit institutions. Derivatives traded on exchange are known as options and futures, while over the counter, banks trade almost identical products known as forwards and swaps.

The main disadvantage of over-the-counter derivatives is that they are not characterized by sufficient transparency and control and do not obey to prudential rules and regulations. In addition, they are not approved by any competent body or organization and nobody can restrict positions in them or guarantee relevant transactions, and, therefore, credit risk cannot be dealt with. Swaps constitute off-balance sheet banking derivatives according to Annex III of the Bank of Greece Governor's Act No. 2054/1992 for banks' solvency, as currently in force ("Annex III" Off balance sheet Items: 1. rate agreements a) single-currency interest rate swaps, b) basis swaps, c) forward-rate agreements d) interest -rate futures e) interest-rate options purchased) f) Other agreements 2. Foreign exchange and Gold agreements. a) cross-currency interest rate swaps b) forward foreign - exchange contracts, c) currency futures d) currency options purchased e) other similar agreements (...) ").

Legal framework:

Law no. 2533/1997 "*Establishment of derivatives market and other provisions*": Article 1 subparagraph 5, Article 12 "*off exchange contracts' conclusion*", Article 14 "*transactions' transparency* ", Law no. 2396/1996: Article 2 subparagraph 20 "*OTC derivatives*", Article 2 subparagraph. 21 "*credit institutions or Investment Services Firm trading book*".

From the above mentioned it can be concluded:

1st Conclusion: Each derivative contract, even if/when concluded without participation in the securities exchange session, is characterized as securities exchange contract (Article 1 subparagraph 5. "off exchange contracts" means a security exchange contract which is concluded without participating in the securities exchange session).

2nd Conclusion: OTC derivatives market is not transparent.

3rd Conclusion: Transparency should be established in OTC derivatives markets, as it happens with other transactions.

4th Conclusion: Credit institutions offer complex financial instruments (which constitute investment services) over the counter, besides their non- transparency and without disclosing their nature as financial instruments (eg swaps, currency exchange) and, consequently, as investment service.

E. Disclosure obligation and professional competence

Due to the multiplicity and complexity of financial instruments, which are difficult for an average investor to understand, the bank officers' obligation to demonstrate diligence, honesty, impartiality and professionalism in the provision of investment services, requires experience. In this respect, in Article 4 of Law. no 2836/2000, as replaced by article 49 of Law no. 3371/2005 and Article 16 of Law no. 3606/2007 provides that officers responsible for analyzing transferrable securities and money and capital markets are required to have a certificate of professional competence issued by Bank of Greece. Relevant exams are conducted jointly by Bank of Greece and Hellenic Capital Market Commission.

In this framework, the pre-existing joint decision of Bank of Greece and Hellenic Capital Market Commission no. 3130/2006 (Government Gazette no. B 1114 / 16.08.2006), which was abolished since decision no. 4/505 / 03.04. 2009 concerning professional certification of employees and executives of credit institutions with respect to the provision of investment services came into force (Government Gazette no. B 1168 / 16.06.2009), it set the conditions for granting the professional competence certificate above and highlighted the importance of the demonstration of professionalism at the provision of investment services.

For this purpose, Bank of Greece, after successful participation in relevant exams, grants four kinds of professional competence certificates, (six in total number) depending on the services provided by certified persons (Articles 3-4 of the decision), as follows:

(Certificate A1) reception and transmission of orders in transferable securities. This certificate relates to services of reception, transmission and execution of orders on behalf of third parties according to par. 1 (a) and 1 (b) of Article 4 of Law. 3606/2007 and par. (A) (b) and (c) of Article 5 of Law no. 3606/2007.

(Certificate A2) reception and transmission of orders with regard to derivatives. This certificate relates to services of reception, transmission and execution of orders on behalf of third parties according to par. 1 (a) and 1 (b) of Article 4 of Law. no 3606/2007 and par. (d) (e), (f), (g), (h), (i) and (j) of Article 5 of Law. no 3606/2007.

(Certificate B) provision of investment advice. This certificate relates to providing investment advice according to par. 1 (e) of Article 4 of Law. no 3606/2007 and Article 5 of Law. no 3606/2007.

(Certificate B1) provision of investment advice on transferrable securities. This certificate relates to providing investment advice according to par. 1 (e) of Article 4 of Law. no 3606/2007 and par. (A), (b) and (c) of Article 5 of Law. no 3606 / 2007 (transferrable securities, units in collective investment undertakings, money market instruments) as well as investment advice on customers' portfolio management, financial instrument analysis and issuers.

In order to participate in certification exams, candidates should prove their reliability. Especially, Article 5 of the decision above states that “1. *While reviewing the minimum requirement of personal reliability, suitability and integrity, no approval to participate in the exams is given in cases that: (a) the interested persons have been convicted for crimes impeding appointment in a civil service position in accordance with the provisions of paragraph 1 of Article 8 of Law. no. 2683/1999 (Government Gazette no. 19 / A`), or have been already dismissed for disciplinary reasons according to the above law or have been convicted for crimes of Articles 398 and 406 of the Greek Penal Code or for crimes concerning the protection of capital market from people holding inside information and market manipulation (Law no. 3340/2005, Government Gazette no. 112 / A` and pre-existing Article 34 of Law no. 3632/1928, Law no. 1969/1991 Article 71 and Article 33 of Law no. 1806/1988) and money laundering crimes (Law no. 3691/2008, Government Gazette no. 166 /*

A, and pre-existing Law no. 2331/1995, Government Gazette no 173 / A), (b) a fine has been imposed of at least ten thousand euro (€ 10.000) for which time for action has expired or a final decision has been issued, dismissing an action, with regard to infringement (aa) of Regulations and Codes of Conduct relating to the financial sector and particularly, depending on the time of infringement, of ministerial decision no. 122/1997 (Government Gazette no 340/B), of ministerial decision no. 15/1998 (Government Gazette no. 1257 / B) and of Hellenic Capital Market Commission decision no. 8422/1998 (Government Gazette no. 615 / V`), as amended and in force of Hellenic Capital Market Commission Board of Directors decision no. 1/452 / 1.11.2007 regarding Code of Conduct for Investment Services Firms (Government Gazette no. 2136 /B`), of Hellenic Capital Market Commission decision no. 1/462 / 7.2.2008 for Mutual Funds Management Companies and Investment Funds Code of Conduct (Gov. Gazette no. 297 / B`), of Hellenic Capital Market Commission Board of Directors decision no. 3/460 / 10.1.2008 regarding rules for underwriters (Government Gazette no. 97 /B) and Hellenic Capital Market Commission decision no. 5/204 / 2000 (Government Gazette 1487 / B), as in force, (bb) the provisions of Law no. 3340/2005 and the pre-existing Law no. 1969/1991 (Article 72) and the Presidential Decrees no. 53/1992, depending on time of crime commitment, (cc) the provisions of Law no. 3691/2008 and the pre-existing Law no. 2331/1995 depending on time of crime commitment, (dd) of paragraph 1 of Article 8 of Law no. 3606/2007 and pre-existing paragraph 1 of Article 4 of Law. 2396/1996 depending on time of crime commitment 2. The adverse conditions of the previous paragraph are applied also in cases where the reported infringement took place outside Greek territory or the corresponding sanction or sentence was imposed by competent foreign authority or body, and in cases where the competent authority or body of foreign jurisdiction has refused to provide or withdraw the certificate of professional competence to interested persons on grounds relating to their overall personal reliability".

Furthermore, the candidate should: (a) be at least eighteen (18) years old and (b) meet at least the minimum standards of eligibility as defined according to the type of services pursuant to Article 9 or Article 15, as applied (Article 8 of the decision above). Especially, "(...) 2. Applicants applying for participation in the exams for the Certificate B1 and B should have: (a) Degree from a Greek higher educational institution or a Greek Technological Educational Institution or under the judgment of Bank of Greece, any equivalent of at least a three-year previous course from a post secondary domestic or foreign educational institution and (b) proven work experience as follows: (aa) at least six months full-time work in the financial sector, after acquiring the post-secondary degree of at least a three-year course in economics or sciences, or, alternatively, (bb) at least six

months of internship at the precise position, in accordance with the provisions of Section C. Alternatively to conditions (a) and (b) above, under the judgment of Bank of Greece, candidates may participate in the exams in case they have a high school diploma and proven work experience of seven (7) years minimum in the financial sector, as well as sufficient training in provision of investment advice. "

According to the above mentioned, it is clear that Greek law requires successful participation in the exams in question in order to secure that the candidate has fully understood the nature and essence of financial instruments, and since they have understood them, they are able to explain them in simple terms to potential customers. Indeed, a bank employee, who has not studied economics, cannot be considered by law as able to provide investment services. Also, special skills need to be evidenced, apparently via written exams, so as to indicate that the candidate has understood financial instruments and is, therefore, able to present them to potential investors.

In conclusion, considering that a loan agreement in Swiss francs is not simply a home loan, but in fact, a complex financial instrument, officers who are assigned with disclosure obligation should have the above type B1 certificate. This would guarantee that both at the time of loan negotiations, which preceded the conclusion of the final contract, at the time of signing and on an ongoing basis, bank officers had the necessary professional competence and reliability for the effective provision of services in financial instruments, such as transferable securities and currencies. Nevertheless, this cannot also guarantee disclosure of the obligatory information. Finally, if such employees have the above certification (B1), they will be able to provide specific information on hedging foreign exchange risk, which, in the case of foreign currency loans, is a key issue.

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