Interest calculation for a Libor mortgage

Topic: **Mortgage in general** Case number: **2021/14**

In January 2021, the press reported on a ruling by the Zurich High Court concerning a dispute regarding the calculation of the interest rate for a Libor mortgage. Based on this, the client took the view that his bank should have taken a negative Libor interest rate into account when calculating the interest rate for his Libor mortgage and had charged him an excessive amount for several years. He demanded the corresponding difference back from the bank, which the latter refused. In the ombudsman proceedings, the bank gave detailed reasons for its position and again refused to repay the client. The Ombudsman wrote a final decision to the client in which he explained the controversial views on this well-known problem.

The client had concluded a Libor mortgage with the bank in 2011. This provided that the interest rate was made up of a base rate consisting of the 3-month CHF Libor plus a margin of 1.08%. The mortgage was mutually terminable with 60 days' notice at the end of each three-month fixed-rate period. The possibility of a negative base rate was not mentioned in the contract. The contract did not contain any explicit provision on how the interest was to be calculated in the event of a negative Libor interest rate.

From December 2012 onwards, the bank indicated in its interest rate notices that in the event of a negative Libor interest rate, the base interest rate for the interest calculation would be assumed to be 0%. From January 2015, the 3-month CHF Libor rate was actually negative and the client was charged interest at the agreed margin of 1.08%. The client was of the opinion that the contract had never been adjusted by the bank and should be interpreted according to its strict wording. Any negative interest rate had to be taken into account in the calculation. For example, if the interest rate was -0.5%, the client owed the bank only 0.58% and not 1.08%. He claimed back the corresponding interest difference for the debits of the last 5 years that were not yet time-barred. He referred to a high court ruling that had been reported in the press in January 2021 and according to which, according to the press reports, a contractual regulation for the interest rate calculation cannot be adjusted with uncontested interest rate notices. In his view, such a change should have been made explicitly.

In fact, the Ombudsman received various complaints of the same nature after the press reports on the Supreme Court's decision. Pre-formulated letters were also circulated with which customers could assert claims for repayment from the banks with reference to this decision. In the ruling in question, a framework agreement played a role in which an interest calculation clause similar to the one in the case at hand was included without mention of any negative base interest rates. In the course of these court proceedings, the bank claimed that it had agreed with the customer representative that the base interest rate would always be at least 0%, even in a negative interest rate situation. The individual interest rate confirmations had been prepared on the basis of this agreement. The lower court had apparently failed to clarify in evidence whether such an agreement had actually been reached, even though both parties had called the client representative as a witness. According to the Ombudsman's understanding, the Supreme Court found that the interest confirmations were indicative of such an agreement. Whether such an agreement had actually been made, however, had to be clarified by means of evidence. It therefore referred the case back to the lower court for

clarification of this question. The Ombudsman was not aware of the final outcome of the case, but was sympathetic to the bank's view that the ruling the client had referred to was not pertinent to his situation. In contrast to the court case recorded by the press, in the case submitted by the client to the Ombudsman, the bank did not claim that the arrangement for calculating interest made in the framework agreement had subsequently been changed by a separate agreement, which was the basis for the interest confirmations issued thereafter. The only issue was how the interest calculation clause was to be interpreted.

The bank was of the opinion that it was clear from the contract concluded with the client that the latter owed the full interest margin in any case. This margin was determined depending on the property mortgaged and the creditworthiness of the debtor. This would cover the risks taken by the bank in granting the loan and the costs incurred. The margin was not subject to the fluctuations of the base interest rate. In view of the interest rate situation when the contract was concluded in 2011, there had been no reason to explicitly regulate the situation of negative interest rates, which was not yet foreseeable at that time. With the individual interest rate notices from December 2012, the bank had not brought about an adjustment of the contract, but had merely clarified its understanding of the contractual situation. Even if, contrary to the bank's view, one had to assume that the zero interest rate floor and the protection of the margin did not already result from the contract, in its opinion there was no claim for repayment, since the client had not objected to the interest charges over several years and had thus approved them.

Any claim for repayment would ultimately be processed according to the rules of the law of enrichment and would for the most part already be time-barred. The limitation period under enrichment law mentioned by the bank in this context used to be one year from knowledge of the claim. Since January 2020, it has been three years. In its detailed response, the bank cited various legal doctrines and case law. It was not prepared to accommodate the client.

The Ombudsman first commented on such a dispute in his 2015 annual report in case number 2015/06. Even then, it could not be resolved in the ombudsman procedure. He took the view that both parties had presented valid reasons for their positions, but had to refer the customer to the courts. Even six years after the introduction of negative interest rates in the Swiss Franc, the complex legal questions that arise in these disputes are the subject of lively and controversial discussions among lawyers.

The Federal Supreme Court summarised the prevailing opinions in its decision BGE 145 III 241: A first group of legal scholars is of the opinion that the disputed contractual provisions on the calculation of interest should be interpreted in such a way that in a negative interest rate situation the bank may assume a base interest rate of 0% and is always entitled to at least the agreed interest margin. Not surprisingly, the financial service providers known to the Ombudsman hold this opinion. A second group of legal scholars takes an intermediate position. According to this, the margin decreases with a negative base rate, but this cannot become smaller than 0%, i.e. there is never a reversal of the payment flow, as this would not be compatible with the remunerative nature of the loan. A third group of legal scholars is of the opinion that the disputed clauses have a clear wording and should be implemented as such. According to them, a reversal of the payment flow can occur if the sum of the margin and the negative interest rate becomes less than zero. In such a situation, the lender would have to compensate the borrower accordingly.

In the above-mentioned decision, the Federal Supreme Court rejects the third opinion and states that even in a negative interest situation, there can never be a reversal of the payment flow, i.e. the interest owed on the loan is at least 0%. The Federal Supreme Court also comments on the first opinion and states that it considers this interpretation to be justifiable, without making a binding decision in this regard, as corresponding party allegations were missing.

To the Ombudsman’s knowledge, a decision by the highest court that would make a binding ruling on the issue at stake in the present case is still pending. In view of the overall economic importance of the problem, the diversity of legal opinions and the fact that the legal situation has not yet been clarified by the highest courts, the Ombudsman had to consider further mediation efforts in the present case to be futile in view of the bank’s consistently defended position and close the file. The same applied to the analogous cases that were submitted to him. In this situation, it is up to the clients to submit their case to the ordinary courts. The Ombudsman recommended that clients seek advice from a competent lawyer if they were considering taking such a step, and to have the chances and risks of such proceedings explained to them. In his opinion, the latter are considerable.