

Foreign currency loans, restitution claims, and the European Court of Justice

Nikolai Badenhoop: Foreign currency loan restitutions carry a risk for banking crises



Imagine you want to buy a house and seek cheap borrowing conditions at a time when interest rates are high. You go to a bank that offers you two different mortgage solutions – the conventional high-interest loan in your home currency or a low-interest loan in a foreign currency. The latter means that the amount of your debt will vary according to the exchange rate changes between your home currency and the foreign currency. If you are risk-averse, you certainly won't opt for such a solution because it bears the risk that your national currency devaluates against the foreign currency and your debt will increase accordingly. However, if you are risk-prone and bet that your national currency will become stronger so that your debt diminishes, you might opt for the foreign currency loan.

The stakes are high and a change in the exchange rate can have very serious consequences for you as a borrower, including personal bankruptcy. In addition, foreign currency loans carry political systemic risks. Research shows that debtor distress due to foreign currency loans has fostered the rise of the populist far right in Hungary. Despite these individual and political risks, the European Mortgage Credit Directive allows foreign currency loans for consumers on condition that either the consumer borrowers have a right to convert the credit agreement into their home currency or other protection mechanisms are in place to limit the exchange rate risk. While the current position of the European Court of Justice (ECJ) strengthens the claims of consumer borrowers of a foreign currency loan, it neglects the systemic risks for the issuing banks. At the regional level, restitution claims could lead to bank failures.

In Eastern Europe, foreign currency loans have dominated the mortgage market since the early 2000s. Some say this is because the concept of a mortgage was relatively new to Eastern Europeans. Others say that Eastern Europeans thought their countries would soon join the euro. According to an ECB statistic of 2023, foreign currency loans are still a significant part of the overall existing loans in Eastern European countries: roughly 20 percent of all loans in Poland and the Czech Republic, roughly 25 percent in Hungary and Bulgaria, and roughly 33 percent in Romania. In Poland and Romania, foreign currency loans are still dominant in consumer loans. The main foreign currencies are the euro and the Swiss franc.

The systemic impact of foreign currency loans

Many of the foreign currency loans were agreed upon under standardized contract terms offered by the banks. As the home currencies dramatically devaluated, consumers started facing serious difficulties in repaying their loans and brought these cases to court. National courts started annulling foreign currency loan agreements because they judged them "unfair" according to the national norms that implement the EU's Unfair Contract Term Directive.

Once the contract is declared void, judges have to decide what the former contractual parties owe each other in terms of restitution. In principle, they aim to create a situation as if the contract had not existed. For a foreign currency loan, this is not an easy exercise because it is unclear which sums are due under which exchange rate. In addition, it is not clear which additional payments both sides can claim, e.g., lost investment opportunities. This issue has a systemic side, as the details of such restitution claims could lead to the bankruptcy of one or more systemically relevant banks in Poland.

While these are, in principle, questions of national civil law particularly the law of unjust enrichment, the origin of the question is European because the nullity stems from the Unfair Contract Terms Directive. Hence, the restitution claims must be in line with EU law guidance. This guidance can be drawn from the very principles of EU unfair contract terms law, including the principles of private autonomy, consumer equality (not superiority), good faith and fairness, and no penalization. Further guidance arises from the

Mortgage Credit Directive that explicitly allows foreign currency loans if the consumers' individual choice and informational autonomy are upheld. Also, the consumer creditworthiness assessment and national sanctioning regimes show that there is no credit without interest. Even in cases of wrongful creditworthiness assessments, banks receive a minimum market interest rate. And according to the European Court of Justice (ECJ) in the [case Schyns](#), the Mortgage Credit Directive also has a retroactive effect and applies outside its scope.

So the best and fairest way to empower consumer borrowers of standardized foreign currency loans ex-post would be to give them the choice between various offers they could have had at the time the contract was agreed upon. This would balance the above-mentioned principles in line with the information paradigm that is at the center of EU consumer law.

Restitution claims: impact on banks and consumers

When asked by a Polish court about restitution claims in the case [Arkadiusz Szcześniak v Bank M. SA](#), the ECJ took a rigid and formal stance that privileges consumer borrowers and penalizes banks. The ECJ held that EU law does not prevent national law from granting consumer borrowers additional restitution claims (e.g., loss of investment opportunities). Instead, banks are only entitled to claim back the sums paid to the consumers plus statutory interest payments from the moment that they claim the sums. Regarding the de facto credit they granted over the years, banks are not allowed to receive interest payments. The ECJ interprets the Unfair Contract Terms Directive in such a way that it penalizes banks that use unfair contract terms. While this judgment seems clear-cut, the details will depend on national courts implementing the decision case-by-case.

The ECJ seems to have substituted the balanced consumer equality (not superiority) principle with a business penalization principle. It is striking that the ECJ dismissed systemic risk for the banking system as a valid argument to be considered in such an unfair contract terms case. While the ECJ usually follows a holistic approach that takes all relevant EU laws into account, in this case, neither the Mortgage Credit Directive nor the detailed EU rules of financial supervision seemed to matter. It will now be up to national courts to decide all individual restitution cases that, in sum, could still lead to a regional banking crisis.

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