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The Legal Challenges of Foreign Currency-Based Consumer Lending

1. Economic Background

Hungary has witnessed radical changes in ownership on three occasions over the past 150 years. One of the achievements of the 1848–1849 revolution and war of independence was the termination of the feudal system of ownership. Then, after 1945, nationalisation affected all segments of society, and central economic planning took over. Both society and the economy were under state control. Private ownership was limited to a very small segment. Finally, in the wake of the political changeover in 1989 and 1990, a process in the opposite direction began: state ownership was dismantled and the process of privatisation and restitution commenced. Private ownership gained ground again and the number of privately owned businesses rose to several hundred thousand. That affected both the attitude of Hungarian society to ownership fundamentally and the development of the areas of law related most closely to the economy including civil law.[1]

Due to cataclysms in history, real estate ownership took on added importance in Hungary, and has been linked up to the present day to one's title to arable land and residential property as a legacy of archaic rural society. Real estate ownership is also a key component of the bourgeois mind: real estate has to be both protected and enlarged through new acquisitions.[2]

One characteristic of residential property is that it has to be renovated by each successive generation. Alternatively, a new home has to be built. In light of the current number of inhabitants and the average size of families, roughly 40,000 new homes should be built in Hungary each year. After the 1980s, this goal was

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1 For the impact of the past 150 years on civil law, see Attila Harmathy: Legal Policy – Civil Law. Magyar Jog (Hungarian Law), 2010, Volume 12, pp. 705–719.

2 Levente Kovács: Background to Forex Lending. Hitelintézeti Szemle (Credit Institution Review), 2013, Volume 3, p. 183.; see also Zoltán Katzenbach – Piroska Osváth: Housing and Investment – A New Model of Residential Financing. Hitelintézeti Szemle (Credit Institutions Review), 2012, Volume 4, pp. 289–297.

achieved once again during the first Orbán government. The first successful attempt was the availability of forint-denominated home loans extended at subsidised interest rate between 1998 and 2002, which increased the number of new homes and encouraged newlyweds to move into modern homes of their own.[3] As a result, residential construction started to take off from 1999.[4]

After the general elections in 2002, the new government abandoned the subsidised scheme for fiscal reasons. Nevertheless, the desire for owning a home remained. However, in the absence of state subsidies, forint-based residential lending could not be sustained at the prevailing base rate of 8–12% coupled with market rates ranging from 14 to 18%.[5]

High forint interest rates gave rise to the idea of switching forint-based retail lending to lending in foreign currencies, as the latter was available at lower rates. Unrelentingly high inflation and the high base rate diverted households towards foreign currency-denominated loans due to the significant spread between interest rates.[6] It was at that time that home loans denominated in foreign currency, primarily CHF, were first offered at low rates in the Hungarian market. These foreign currency-based home loans were coupled with a reduced burden resulting from lower interest rate payments. The loan amortisation profile of foreign currency loans was more attractive because the initial loan amortisation was lower. Accordingly, borrowers had to pay less in the initial phase than in the case of forint-based loans.[7]

However, principal debt calculated at a constantly changing exchange rate weighed against the lower interest payment burden. Also, the issue of exchange rate risk was put on the back burner initially, as the main argument for foreign currency loans was a stable and lower rate of interest than that charged for forint loans. In fact, a classic example of a growing bubble could be witnessed in the Hungarian market. Most borrowing households only considered low monthly instalments when making their decisions on borrowing. And as far as the banks

3 Kovács, ibid, p. 183.

4 The number of new homes in 1999, 2000, 2001 and 2002: 19, 287, 21,583, 28,054 and 31,511 respectively. Source: Central Statistical Office (CSO)

5 Kovács, ibid, p. 184. At the time, both the central bank base rate and inflation were high: 5.2% in 2002, 4.7% in 2003 and 6.8% in 2004. Source: CSO. Typically, rising inflation was the outcome of budgetary adjustments.

6 Orsolya Nyeste – Zoltán Árokszállási: Forex Lending in Hungary – a regional, macro-economic, fiscal and monetary policy approach. In Levente Kovács (Ed.): 25 years of the Hungarian Banking System, Hungarian Banking Association, Budapest, 2012 pp. 149 and 153.

7 For the pricing of foreign currency-based loans, see Zoltán Schepp – Zoltán Szabó: The Pricing of Swiss Franc-denominated Retail Loans – Narratives and Beyond. Közgazdasági Szemle (Economic Review), Volume 2015/11, pp. 1140–1157.

were concerned, they only assessed creditworthiness and made their decisions on the basis of the LTV ratio of the real estate backing the loan rather than the living conditions and long-term earning capacity of prospective debtors.[8] With hindsight, one can ascertain that the banks were frequently rather perfunctory in their appraisals of real estate offered as collateral and also approved unmarketable real estate as a pledge.

The financial sector's legitimate expectation, fuelled by political communications in 2003 about introducing the euro as legal tender in Hungary in a few years, was one of the reasons why foreign currency lending gained ground in Hungary. Therefore, it seemed a logical conclusion that long-term debt should be denominated in the currency of the future, i.e. the euro or the Swiss franc, which was pegged to it, rather than in a consistently appreciating forint with its high forint interest rate. That solution allowed multitudes of households to modernise or buy homes for a few more years despite the relatively low level of wages in Hungary.[9]

As a result, residential construction continued to pick up in Hungary and peaked above 43,000 homes in 2004.[10] Later on, the number of new homes showed a slight downturn and some stagnation until 2008, only to fall sharply thereafter.[11]

In response to the financial and economic crises in 2008, the Hungarian forint depreciated significantly; by contrast, the euro and especially the Swiss franc appreciated markedly. In 2008, foreign currency-denominated loans accounted for 90% of new retail lending. Lending in foreign currencies became particularly widespread in Hungary between 2006 and 2009. The foreign currency loan portfolio of households grew from HUF 2,000 billion (EUR 6.4 billion) at year end 2006 to HUF 6,000 (EUR 19.3 billion) in early 2009. It is particularly puzzling that the retail FX loan portfolio grew by approximately HUF 1,000 billion (EUR 3.2 billion) in Hungary even after the onset of the 2008 crisis, although that was not attributable exclusively to new lending.

In fact, a new trend, later to become a major source of headaches for Hungarian debtors, had emerged, namely, that not only the forint but also the euro depreciated heavily against the Swiss franc. During the crisis, the Swiss franc became a reserve currency (i.e. a safe haven currency) and, as a result, picked up approximately 25% against the euro. Simultaneously, the forint lost about 10% against the

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8 Nyeste – Árokszállási, ibid p. 150.

9 Kovács, ibid, p. 185.

10 In 2003, the number of new homes was 35 543. Source: CSO.

11 The number of new homes in 2005, 2006, 2007 and 2008: 41,084, 33,864, 36,159 and 36,755 respectively. Subsequently, the number of new homes decreased fast: The number of new homes in 2009, 2010, 2011, 2012 and 2013: 31,994, 20,823, 12,.655, 10,560 and 7,293 respectively. Source: CSO.

euro. The overall outcome of the above was that while the CHF to HUF exchange rate was HUF 150 in early 2008, it stood at HUF 200 in 2010 and HUF 250 in 2012. Although less markedly, the forint also weakened against the euro: while the EUR/HUF rate was HUF 250 in early 2008, it stood at HUF 280 in 2010 and HUF 300 in 2012.

The HUF rapidly weakening, especially against the Swiss franc, also hit the financial position of indebted households severely. For banks, that translated into a deteriorating mortgage loan portfolio as the share of non-performing loans in the portfolio rose consistently.[12]

In response to the 2008 crisis, Hungary's country risk (CDS spread) rose considerably.[13] While in September 2008, the CDS spread of the 5-year Hungarian FX bond yield hovered around 100 basis points, two months later it shot as high as 700 basis points. Simultaneously, the refinancing costs of Hungarian banks increased. However, interest rate cuts by the European Central Bank and the Swiss National Bank prevented refinancing costs from increasing further.[14] As the Hungarian Financial Supervisory Authority still did not respond to the situation and as national legislation failed to set limits, Hungarian banks started to increase interest rates, often abusing their statutory right to modify agreements unilaterally. They started to use their right to unilateral contract modification as a means to increase profits, which was at variance with the original purpose of the right.

In addition to those presented above, there were other reasons behind the widespread use of foreign currency lending in Hungary, including competition between banks based on risk to an increasingly large extent, information asymmetry between creditors and debtors becoming more and more pronounced, the issue of an intermediary network, deficiencies in financial literacy and the failure to introduce lending rates anchored to a benchmark rate. These issues were addressed in the February 2012 Report of the Parliamentary Committee for Constitutional, Justice and Procedural Matters.[15]

According to an opinion published in economics literature, the spread of foreign currency lending, i.e. the evolvement of open FX positions, is a natural phenomenon in small, open, liberalised, converging and under-capitalised economies. However, the share of open FX positions in the balance sheet of the Hungarian retail

[12] Nyeste – Árokszállási, ibid p. 150.

[13] This number shows how dangerous it is for a foreign bank to lend in a particular country.

[14] In response, LIBOR dropped to 0%. Meanwhile CHF LIBOR was in the negative domain. As at 27 February 2015, the 3-month LIBOR stood at -0.73%. On that same day, the same happened to the euro: the 1-week EURO LIBOR was -0.06%

[15] http://www.parlament.hu/irom39/05881/05881.pdf

sector was significantly higher than that of their counterparts in other countries in the region, which led to systemic problems when the 2008 crisis broke out. The indebtedness in foreign currencies of the retail sector, which subsequently turned out to be unsustainable, should be seen as a symptom that reflected the crowding out caused by disorderly fiscal policy, the conflicts between monetary and fiscal policy and the fundamental structural woes of the Hungarian economy.[16]

By the early 2010s, the retail FX loan portfolio, due to its size and the related risk, had become a factor hindering economic growth. The data below illustrate the burden to be borne by society as a whole: as at end-June 2014, the retail FX portfolio was still above HUF 4,147 billion (EUR 13.3 billion), including HUF 3,607 billion (EUR 11.6 billion) in mortgage lending. During the same period, the HUF-denominated retail portfolio amounted to HUF 3,792 billion (EUR 12.2 billion), including HUF 2,122 billion (EUR 6.8 billion) in mortgage loans. In aggregate therefore, there were more or less 872,000 foreign currency-denominated consumer loan contracts outstanding at the end of Q2 2014.[17]

That demanded legislative action for several reasons. Retail foreign currency lending was eventually banned in 2010. Further measures of both economic and legal importance ensued.[18] Consumer mortgage loans and personal loans were converted into HUF in 2014[19] and 2015 respectively.[20]

Nevertheless, the problem created by the scope of FX lending has not been fully resolved to this day. This is corroborated primarily by an extremely high proportion of non-performing consumer mortgage loans with roughly 135,000 debtors affected as at 31 December 2016, including borrowers with repayments overdue for at least 90 days. A legacy of FX lending is a particularly high number of non-performing retail loans.

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16 Nyeste – Árokszállási, ibid p. 164.

17 The number of debtors in default for over 90 days was 195,000, affecting an FX loan portfolio of HUF 973 billion. The share of bad loans exceeded 22-3%. Source: National Bank of Hungary.

18 The following are known as 'acts on FX borrowers': Act XXXVIII of 2014 on the Resolution of Questions Relating to the Uniformity Decision of the Curia Regarding Consumer Loan Agreements of Financial Institutions and Act XL of 2014 on the Rules of the Settlement of Accounts Provided for by Act XXXVIII of 2014 on the Resolution of the Curia Concerning the Uniformity of Law Regarding Consumer Loan Agreements of Financial Institutions, and on Certain Other Provisions.

19 Act LXXVII of 2014 on Settling Certain Issues Related to the Conversion of the Currency of Certain Consumer Loan Agreements and to the Rules Governing Interest Rates.

20 Act CXLV of 2015 on Resolving Issues Concerning the HUF conversion of Receivables Arising from Certain Consumer Loan Agreements.

2. The Legal Nature of Foreign Currency-Denominated Loan Agreements

2.1. Foreign Currency Loans and Foreign Currency-Denominated Loans

An examination of the legal characteristics of foreign currency-denominated loan agreements should start with the term itself. Uniformity Decision No 6/2013. PJE of the Curia also points out that there was no legal regulation providing a definition of foreign currency loans when Forex lending surged. Later on, Section 200/A, Sub-section (1) of Act CXII of 1996 on Credit Institutions and Financial Enterprises ('the Former Act on Credit Institutions') provided a definition, which was effective from 27 September 2010. It provided that credit contracts, loan agreements and financial lease agreements should be classified as foreign currency-based, provided they were recorded or extended in a foreign currency and amortised in HUF.

Foreign currency-denominated loans belong to a larger group of foreign currency loans. In Hungary, foreign currency loans are defined as loans where the currency of the claim is not denominated in HUF. This means that the debtor is indebted in a foreign currency (foreign exchange), not in forint. In the absence of a statutory prohibition, the parties to an obligation to provide money are free to select the currency of the claim (*the principle of free settlement*). On that basis, foreign currency-denominated loans are also foreign currency loans because the debt is determined in a foreign currency. What is specific to foreign currency-denominated loans is the lender's duty to disburse and the debtor's duty to repay in HUF, i.e. both creditor and debtor pay HUF against an amount of debt determined in a foreign currency.

In that respect, Uniformity Decision No 6/2013. PJE of the Curia stresses that nothing hinders parties from agreeing that both parties are obliged to honour their obligation in the currency of the debt (*an enforcement clause effective in a foreign currency*). In this case, both disbursement and amortisation are in the currency of debt (in this case a foreign currency). It follows that there are two types of foreign currency loans: (genuine) foreign currency loans with an enforcement clause effective in a foreign currency, and foreign currency-denominated loans without an enforcement clause effective in a foreign currency. In the absence of an agreement between the parties, foreign currency-denominated loans were the main rule based on Section 231 of Act IV of 1959 on the Civil Code ('the Former CC'). Genuine foreign currency loans were an exception that required an express agreement of the parties.

Genuine foreign currency loans oblige borrowers to repay their debt in the same currency (e.g. Swiss franc) in which the creditor disbursed the loan. Such a genuine foreign currency loan constitutes the subject-matter of the underlying procedure of case C–186/16 (*Ruxandra Paula Andriciuc and Others v. Banca Românească SA*). An Opinion of the Advocate General dated 27 April 2017 also refers to this (Paragraphs 32, 42–44).

The essence of foreign currency-denominated loans is that the debtor is granted a right to temporarily use a foreign currency under a facility pursuant to the conditions of which the currency of the debt and that of repayment are different. As the Uniformity Decision No 6/2013. PJE of the Curia also points out, that means that the parties determine cash debt in a manner that enables the debtor to pay, at the due date, an amount in forints that is identical to the monetary debt determined in a foreign currency specified in the contract (typically Swiss franc, euro or Japanese yen).

When entering into a foreign currency-denominated loan agreement, the borrower intends both to borrow and to repay in forints at a much lower interest rate than that applied to forint loans at contract date. Based on the rules set out in Section 231 of the Former CC, foreign currency-denominated loan arrangements fulfilled that requirement.

However, having regard to public law rules applicable to financial institutions,[21] there are foreign currency funds behind both genuine foreign currency loans and foreign currency-denominated loans. Accordingly, exchange rate fluctuations subsequent to the conclusion of the contract should be stated in contracts for both loan types.

The opinion of the Curia suggests that the essence of a foreign currency-denominated loan is that the debtor incurs a debt in a foreign currency, and the loan is disbursed and amortised in forints. As the amount of the debt is established in a foreign currency, the debtor's payment obligation in forints depends on the strengthening and weakening of the forint. If it weakens, the debtor has to repay more than the initial amount of the debt, i.e. the debt burden increases; while if the HUF strengthens, the debtor has to repay less than the initial amount of the debt, i.e. the debt burden diminishes. Changes in the exchange rate, however, leave the lender's position unaffected, as the amount of the foreign currency that it receives when the debtor repays the debt in forints is equal to the amount the lender disbursed.

Referring to such contracts, Section 231(2) of the former Civil Code stipulated that a debt specified in a different currency was to be converted on the basis of the

[21] Decree no 23/2013. (XI. 6.) MNB of the governor of the National Bank of Hungary pertains to the same issue. It stipulates, among other things, that credit institutions should prepare daily reports on changes in their FX position.

exchange rate (price) applied at the place and date of the payment.[22] According to the Curia, a conversion of this nature does not correspond to exchanging money, it only involves the calculation of the amount disbursed and the one repaid at the exchange rate prevailing at the given due date.

The Curia holds that it follows from the very selection of a debt currency and a repayment currency that the opinion according to which the exact amount of the instalments cannot be determined at the contract date is wrong. Debt under foreign currency-denominated loan is determined just as accurately as that under a foreign currency loan with an enforcement clause effective in a foreign currency. The amount owed by the debtor is clearly recorded in both cases at the contract date: it is the amount determined in the currency of the debt. It follows from the difference between the currency of the debt and that of the repayment that the amount of the currency of repayment enabling the debtor to repay his or her debt cannot be determined at the contract date. That does not, however, affect the exact specification of the amount owed.

2.2. About the Invalidity of the Contractual Arrangement

The question whether foreign currency-denominated loans can be deemed valid had already arisen in Hungarian judicial practice several years before. Regarding invalidity, distinction must be made between the invalidity of individual consumer loan agreements and the arrangements known as foreign currency-denominated loan agreements.

As regards the latter, the Uniformity Decision No 6/2013. PJE of the Curia states such arrangements do not contravene any statutory regulation. Nor are they immoral according to the Curia. The Curia's main argument in that respect says foreign currency-denominated loan agreements were not reviled by the public at large at their respective contract dates.

Simply by reason of the contractual arrangement, foreign currency-denominated loan agreements are not usurious or sham, nor are they contracts for the purpose of providing impossible services.

The Curia held that overall, the unforeseeable one-way shift of contractual burdens after the conclusion of the contract cannot be evaluated from the viewpoint of invalidity. However, changes might arise during a long-term lending relationship that will subsequently upset the balance of economic risk involved in the contract and will lead to disproportions. Although that does not affect or interfere with the

[22] Basically, the same provision is contained in Section 6:45, Sub-section (2) of Act V of 2013 on the Civil Code ('the new CC').

validity of the contract, subsequent interventions may become necessary unless the parties agree to remedy those disproportions mutually through contract modifications. Conditions for and limitations on such subsequent interventions are set out in part in the Civil Code and in part in the judicial practice of the Hungarian Court of Constitution.

2.3. Separation of Exchange Rate Risk from the Bid-Ask Spread

The reason why exchange rate risk must be separated from the spread is that they are two totally different concepts even if they are both related to foreign currency-denominated loan arrangements.

The nullity of the spread provision was laid down in Section 3 of Act XXXVIII of 2014 on the Resolution of Questions Relating to the Uniformity Decision of the Curia Regarding Consumer Loan Agreements of Financial Institutions. Pursuant to Section 3, Sub-section (1), with the exception of contract terms which have been individually negotiated, any term in a consumer loan agreement where the buying rate stipulated by the financial institution for the advancement of the loan or the funds provided for purchasing the leased asset differs from the selling rate or from the rate fixed on the date of advance of the funds for the purposes of repayment shall be null and void. Pursuant to Sub-section (2), the annulled term referred to in Subsection (1) shall be replaced – save where Subsection (3) applies – by a provision for the application of the official exchange rate of the National Bank of Hungary having regard to the advance of the funds and repayment, covering all instalment payments, and the payment of any cost, fee or commission charged in a foreign currency. The Act lent legislative power to the provisions of Resolution No 2/2014. PJE of the Curia.

That is to say the Act modified the foreign currency-denominated loan agreements still outstanding at the time. It specified the provision that should replace the (partially) voided contractual condition pertaining to the spread (by requiring parties to apply the official exchange rate of the National Bank of Hungary). This provision does not, however, bear any relevance to exchange rate risk.

For the purposes of foreign currency-denominated loans, the spread is the difference between the exchange rate applied to the disbursement of the loan and the one applied to loan amortisation. Financial institutions disbursed foreign currency-denominated loans at their own buying exchange rate or that quoted by another financial institution, whilst consumers repaid their debt at the selling exchange rate quoted by the financial institution concerned (*different exchange rates*). As the buying rate is always lower at a certain moment in time than the selling rate, financial institutions earned income, while consumers incurred expenses under the above contractual provision. The difference between that buying exchange rate and that selling one was the spread. Now, Section 3 of Act XXXVIII of 2014 declared that spread null and void and laid down the mandatory rule that the official exchange rate quoted by the National Bank of Hungary be applied generally.

In contrast, exchange rate risk stems from two foreign currencies, i.e. the one in which the financial institution records the loan (the currency of the debt) and the one in which the debtor repays his or her debt (which is converted into the currency in which the creditor records the loan). If the currency of the consumer's debt is Swiss francs, but the consumer repays the debt in HUF, an exchange rate risk exists between Swiss francs and the forint.

Based on the foregoing, the statutory provision establishing the nullity of the spread provision is unrelated to which of the parties is running the exchange rate risk under a foreign currency-denominated loan agreement.

The configuration whereby it is the consumer that runs the exchange rate risk stems from the legal arrangement laid down as the main rule in Section 231 of the Former CC, as presented above. However, none of the contractual clauses contains this contractual term. No Hungarian statutory regulation prohibited this loan arrangement when the popularity of foreign currency-denominated loan agreements started to rise. However, that does not mean that a contractual term pertaining to exchange rate risk would qualify as a condition laid down in law. Accordingly, the unfair nature of the contractual term pertaining to exchange rate risk can be evaluated on the basis of Directive 93/13/EEC.

3. The Issue of Unfairness

Based on the previous section, foreign currency-denominated consumer loan arrangements are not invalid. A reason for invalidity may, however, exist in respect of individual loan agreements. In that case, the reason must be established by a court (or by a legal rule in exceptional cases). Unfair contractual terms in consumer loans are one of the most important grounds for invalidity.

This is the only ground for invalidity with a European legal background in Hungarian law. A separate piece of EU legislation, specifically, Directive 93/13/EEC, enshrines provisions about unfair general contractual terms in consumer contracts and unfair contract terms not negotiated individually. The relevant provisions of Act V of 2013 on the Civil Code ('the new CC') transpose the provisions of Directive 93/13/EEC on unfair terms in consumer contracts. As these regulations are set out in a directive, ultimately, the European Court of Justice is authorised to interpret the directive. Therefore, Hungarian legislators must take both Hungarian judicial practice and the case law of the European Court of Justice into consideration.

Pursuant to Article 4(2) of the Directive, "assessment of the unfair nature of the terms shall relate neither to the definition of the main subject matter of the contract nor to the adequacy of the price and remuneration, on the one hand, as against the services or goods supplied in exchange, on the other, in so far as these terms are in plain intelligible language". As an exception to the main prohibitive rule, the unfair nature of these terms may be reviewed if they are not in plain intelligible language. This is the requirement of transparency, which has been growing in importance in both EU legislation and Member State civil codes.[23]

4. Interpretation of the Requirement of Transparency

In 2013, the Curia lodged a request for a preliminary ruling with the European Court of Justice asking the Court to decide whether the contractual clause concerning the rate of exchange of the currency, which was not individually negotiated, may form part of the "definition of the main subject matter of the contract" (Case C–26/13). In this case (the Kásler Case), therefore, the Curia and the European Court of Justice assessed the unfair nature of the contractual terms pertaining to the different exchange rates (known and the spread) applied by banks.

In its judgement adopted in Case C–26/13 on 30 April 2014, the European Court of Justice established that the requirement of transparency of contractual terms laid down by Directive 93/13/EEC cannot be reduced merely to their being formally and grammatically intelligible. According to the Court, as "the system of protection introduced by Directive 93/13 being based on the idea that the consumer is in a position of weakness vis-à-vis the seller or supplier, in particular as regards his level of knowledge, the requirement of transparency must be understood in a broad sense".

According to the Court, "Article 4(2) of Directive 93/13 must be interpreted as meaning that the requirement that a contractual term must be drafted in plain intelligible language is to be understood as requiring not only that the relevant term should be grammatically intelligible to the consumer, but also that the contract should set out transparently the specific functioning of the mechanism of conversion for the foreign currency to which the relevant term refers and the relationship between that mechanism and that provided for by other contractual terms relating to the advance of the loan, so that that consumer is in a position to evaluate, on the basis of clear, intelligible criteria, the economic consequences for him which derive from it".

Regarding the case at hand, the Court also points out that "Article 6(1) of Directive 93/13 must be interpreted as meaning that, in a situation such as that at issue in the main proceedings, in which a contract concluded between a seller or suppli-

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[23] See Leitner, Max: Transparenzgebot. Manzsche Verlag- und Universitätsbuchhandlung, Wien, 2005. p. 160.

er and a consumer cannot continue in existence after an unfair term has been deleted, that provision does not preclude a rule of national law enabling the national court to cure the invalidity of that term by substituting for it a supplementary provision of national law".

The European Court of Justice upheld and expounded on its judgement adopted in the Kásler Case in its subsequent decisions. In its judgement adopted in joined cases C–154/15, C–307-15 and C–308/15 on 21 December 2016, the European Court of Justice held that the requirement of transparency, referred to in Article 4(2) of the Directive, is not limited to the requirement for formal transparency of contractual clauses in relation to the plain and intelligible nature of their drafting, but extends to their substantive transparency. Transparency should be linked to the adequacy of the information supplied to the consumer concerning the extent, both legal and economic, of the consumer's contractual commitment. The Court reiterated the fundamental importance of the consumer having a genuine opportunity to take full cognisance of the contractual terms and the consequences of the entry into the contract before the conclusion of the contract.

Under the case law of the European Court of Justice, the scope of Directive 93/13/EEC covers the assessment of the unfair nature of the terms related to the definition of the main subject matter of the contract if, before the conclusion of the contract, the consumer did not receive sufficient information on the contractual terms and the consequences of the conclusion of the contract.

When evaluating the transparency requirement, it is important to stress the continuous development and broadening of the related case law of the European Court of Justice. It is also clear, however, that the cases involving the violation of the obligation to provide information prior to the conclusion of a contract and the question of unfairness both arise when the transparency criterion set out in Directive 93/13/EEC is interpreted. This is hardly an issue for the European Court of Justice as EU legislation only provides for the consequences of unfairness. Pursuant to Article 6(1) of Directive 93/13/EEC, "Member States shall lay down that unfair terms used in a contract concluded with a consumer shall not be binding on the consumer. The contract shall continue to bind the parties upon those terms if it is capable of continuing in existence without the unfair terms".

Hungarian law satisfies this requirement by stipulating the nullity, i.e. the invalidity of unfair contractual terms. This ground for invalidity gives rise to partial invalidity under the main rule. Section 6:103, Sub-section (3) of the new CC expressly refers to this when it lays down the nullity of unfair contractual terms rather than that of the entire contract. Pursuant to Section 6:114 (2) of the new CC, in the case of the partial invalidity of a consumer contract, the entire contract shall fail only if the contract cannot be performed without the invalid part.

The intermingling of the obligation to provide information prior to contract conclusion and the invalidity of unfair terms gives rise to more serious problems at the level of the civil codes of the individual member states. Section 6:62, Sub-section (1) of the new CC lays down the duty to communicate information prior to the conclusion of the contract as one of the contractual obligations. With that given, the parties are required to cooperate during contractual negotiations, at the conclusion and during the lifecycle of and when terminating a contract, and shall be bound by the duty to communicate information to each other on circumstances relevant to the contract. Under Sub-section (3), once a contract is concluded, any party who breaches the obligations referred to in Sub-section (1) shall be subject to liability for damages for loss caused to the other party by non-performance of an obligation. Under Sub-section (5), if the contract is not concluded, the party who breaches the obligation referred to in Sub-section (1) shall be liable for damages in accordance with the general provisions of non-contractual liability.

It is clear from the foregoing that Hungarian law lays down a liability-related sanction rather than declaring invalidity when the obligation to communicate information prior to the entry into contract is breached. The same logic is adopted in Section 16 Sub-section (5) of Act CLXII of 2009 on Consumer Loans, pursuant to which, the failure to include a required requisite of content will not affect the conclusion of an agreement, and the creditor is liable for compensating the consumer for losses incurred due to the failure to include any one of the required elements of content in accordance with the rules governing liability for damage incurred by breach of contract. If the creditor fails to lay down any one of the required components of content in a credit (loan) agreement to be concluded with a consumer, but that does not affect the making of the contract itself (i.e. it is not a significant component of content), the contract is validly made, but the consumer may file a claim against the creditor citing contractual liability.

An interpretation of the requirement of transparency under Directive 93/13/EEC should consider the dogmatic differences between the two legal constructs. Cases where the lack of information qualifies as a violation of the obligation to provide information before the conclusion of a contract, and where it involves a contractual term not sufficiently plain and intelligible should be clarified more precisely.

However, it is not always easy to make this distinction, as in practice, providing it is exactly an inadequate explanation given before the conclusion of the contract about a contractual term which is not sufficiently plain and intelligible, that will confuse the consumer. In theory, consumers could argue that if they had been provided with a proper explanation regarding the contractual term in question and had understood the very essence of that term, they would not have entered into that contract. That could, however, lead to a more complex situation, as it is a typical example of an error. An error is a reason for contesting a contract, based on which a contract may be challenged within one year from the contract date. All of this suggests that frequently the same lack of information may lead to the violation of the disclosure obligation before entering into an agreement, to errors and to the nullity of an unfair contractual term.

5. A Short Evaluation of the Arrangement

In our opinion, the biggest problem about foreign currency-denominated consumer loan agreements is the imposition of nearly all the risks arising from the transaction on the consumer, i.e. the weaker party.

The fact that a contract type that placed all the risks arising from a transaction exclusively on one party, i.e. the consumer, could take root and become widely popular points to the shortcomings of the Hungarian legal and regulatory environment. The most important of these risks is that related to the exchange rate. According to a view published in legal literature, banks did not pass exchange rate risk onto debtors because formally it is always borne by the debtor.[24]

In my opinion, the principle of expectable behaviour should have been considered even in this case, as it is a fundamental principle of civil law. Pursuant to Section 1:4, Sub-section (1) of the new CC "Unless otherwise provided for by this Act, in civil law any reference to what can be expected of or by a person, or in a particular situation, is a reference to what can reasonably be expected". The question arises what could be expected of consumers in connection with the exchange rate risk. Were they expected to foresee, in light of the exchange rate fluctuations in the preceding ten years, an approximately 20 to 30% weakening of the forint? Were they expected to anticipate a shift of unprecedented magnitude in the HUF/CHF exchange rate? If experts did not reckon with exchange rate fluctuations of that size, should consumers have been expected to foresee that movement? Answers to these questions will have to be given by the Court in pending litigation about, *inter alia*, the passing of exchange rate risk exclusively onto consumers.

On the other hand, the issues to be covered by the information to be provided by financial institutions should also be taken into account. In this respect, the Advocate General's Opinion of 27 April 2017, already referred to above, points out that the information provided to the consumer should enable that consumer to assess the potentially significant economic consequences of such a term. That requirement cannot, however, go so far as to oblige the seller or supplier to anticipate and inform the consumer of subsequent changes which were not foreseeable, such as those manifested in the fluctuations of the exchange rates of the currencies at issue in the main proceedings of Case C–186/16, or to bear the consequences of such changes (see Paragraph 72 of the Opinion of the Advocate General).

A further problem is that neither judicial practice nor jurisprudence seems to be fully aware of the legal consequences of the full or partial invalidity of foreign

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[24] István Gárdos – András Nagy: Fundamental Legal Principles of Foreign Currency Lending. Hitelintézeti Szemle (Credit Institutions Review), Volume 2013/5, p. 376.

currency-denominated loan agreements. Although a group established by the Curia in 2015 to analyse legal practice reviewed this issue thoroughly and with circumspection, no majority view evolved.[25]

Therefore, it is still a moot question whether a situation that existed before the contract date can be restored once the entire invalidity of a foreign currency-denominated loan agreement has been established *(in integrum restitutio)*. Views published in legal literature reject this, and argue that the declaration of effectivity in accordance with the Former CC is the only reasonable solution.[26] Another problem is what exactly declaring a contract effective means and what the exact difference is between the declaration of effectivity and that of validity.[27]

In spite of the fact that Section 37 of Act XL of 2014 on the Resolution of the Curia Concerning the Uniformity of Law Regarding Consumer Loan Agreements of Financial Institutions and on Certain Other Provisions is clear about the legal consequences of the invalidity of consumer loan agreements, there is still legal uncertainty surrounding this issue. In this respect the law confines itself to the declaration of contracts as valid and declaring them effective while pending a decision. From the legislator's perspective, it follows from the above that the original status cannot be restored in the event that a consumer loan agreement is entirely invalid. However, practitioners still challenge the currency of this view of the legislator.

6. Summary

The spread of foreign exchange lending and the imbalance evolving in the related agreements in the wake of the 2008 crisis have given rise to an unprecedented social problem in Hungary, to which the legislator had to respond as it also posed a threat to economic growth. Legislation was enacted in 2014 aimed at relieving Hungarian society of the predicament caused by foreign currency lending. However, it is clear today that neither the settlement of accounts nor HUF conversion brought genuine help for certain social groups, for those groups had accumulated credit-related debt, which surpassed significantly the collateral value of the resi-

25 See The Applicability of Invalidity to Loan Contracts (a summary opinion). Available at http://www.lb.hu/sites/default/files/joggyak/osszefoglalo_velemeny_i.pdf

26 Péter Gárdos: The Legal Implications of the Invalidity of Loan Contracts. Jogtudományi Közlöny (Bulletin of Legal Sciences), Volume 2014/11 pp. 509–510.

27 For the European legal context of the declaration of validity, see Balázs Bodzási: The Impact of European Law on the civil code of the member states, with special regard to the most recent ruling by the European Court. Jogtudományi Közlöny (Bulletin of Legal Sciences), Volume 2013/9, pp. 426–435.

dential property they pledged as collateral, and had fallen long overdue with such debts well before the entry into force of the legislation discussed above. The government will have to work out for them a different solution, also including social policy measures. Substantially simplified personal bankruptcy proceedings seem to be the most appropriate tool.

One can only hope that both the enforcers of law and the Hungarian financial sector will draw conclusions that will help prevent the occurrence of similar situations in the future. Hopefully, all of this will contribute to the improvement of financial literacy in Hungary, to the development of responsible lending and responsible borrowing and ultimately, to greater transparency in Hungary's banking system.