

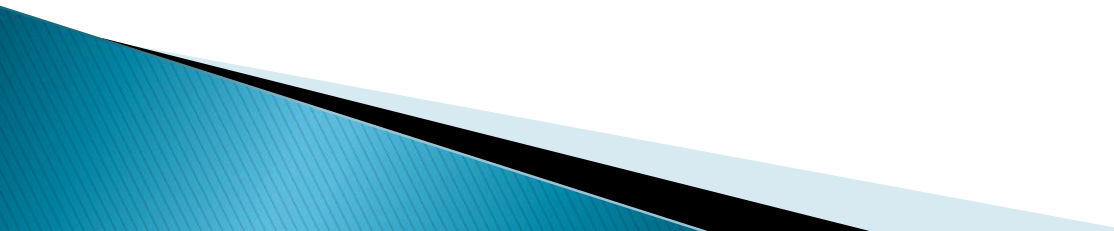
Monetary Law and Monetary Policy

14. Money in the law of obligations. Foreign exchange under Polish law

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Issues covered

- ▶ principle of nominalism – reference to a particular currency and application of the *lex monetae*
 - ▶ use of foreign currencies in monetary obligations
 - ▶ foreign exchange law (*Prawo dewizowe*)
 - ▶ regulation of moneychanging activity (*działalność kantorowa*)
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Principle of nominalism

- ▶ Reference to a currency and the unit of account in which it is expressed
- ▶ A debt expressed in currency of a country involves an obligation to pay the nominal amount of the debt in whatever is the legal tender at the time of payment according to the law of the country in whose currency the debt is expressed (*lex monetae*)
- ▶ Any fluctuations in the value of that currency in terms of exchange rate or purchasing power (inflation) between the time when the debt was incurred and the time of payment do not affect this obligation

Principle of nominalism

- ▶ Relation to the State theory of money → the State defines a currency and a unit of account; payment of a specified amount expressed in this currency discharges an obligation under the laws of this State
- ▶ There is no general possibility of post-contractual adjustment of the amount of an obligation expressed in money.
- ▶ Risk for creditors resulting from the possibility of loss of value resulting from inflation or depreciation of currency.
- ▶ The usual way of reflecting such risk in a contractual relationship: applying an **interest rate** to the amount of the obligation (contractual interest rate, not to be confused with statutory interest rate applicable to overdue payments)

Principle of nominalism – a specific example

- ▶ Capital gains tax is charged on the nominal amount of the income, regardless of the inflation.
- ▶ Example: a fixed term deposit of 10.000 PLN for 1 year with 6% interest rate. After 1 year the nominal income will be 600 PLN.
- ▶ If the inflation in the same period will be 10%, the interest rate will not even offset the loss of the purchasing power of the amount in question (equalling 1000 PLN).
Correspondingly, the income in real terms will be negative (loss in real terms).
- ▶ Nevertheless, capital gains tax is charged on full nominal amount earned as interest (under Polish law $19\% \times 600 \text{ PLN} = 114 \text{ PLN}$).
- ▶ Over decades, lawsuits were brought by taxpayers in the U.S., the U.K., Germany and Austria but lost due to courts upholding the principle of nominalism.

Principle of nominalism – the problem of inflation

- ▶ The application of the principle of nominalism may lead to manifestly unjust results in case of high inflation, in particular of hyperinflation → the creditor is effectively deprived of the value of his/her claim in real terms.
- ▶ Example: ECHR case Rudzinska vs. Poland (1999), 45223/99. In 1984–87 the applicant saved money on a specific banking account („*książeczka mieszkaniowa*”) at a State-run bank with a purpose of financing the purchase of an apartment. Her savings subsequently lost their effective value during the hyperinflation of 1989–90. The ECHR ruled that the right to protection of property does not extend to the protection of purchasing power of money on a banking account. Correspondingly, there was no infringement against the rights of the applicant as long as she could access the nominal amount of her savings, even though she has lost all their value in real terms.

Exceptions to nominalism

- ▶ *rebus sic stantibus* clause – a statutory right to have an obligation adjusted by a court in case of extraordinary circumstances, specifically applied in times of monetary collapse
- ▶ early cases decided on the basis of general clauses, e.g. Art. 242 of the German Civil Code (BGB) providing for the principle of equity and good faith (*Treu und Glauben*) applied to readjust debts in the period of German hyperinflation in early 1920s.
- ▶ Specific statutory provisions introduced later, e.g. current Art. 358¹ § 3 of the Polish Civil Code allowing for an adjustment of a monetary obligation in case of a significant change in the purchasing power of money
- ▶ extraordinary circumstances usually defined narrowly
- ▶ Obligations adjusted individually on a case-by-case basis – *rebus sic stantibus* clauses do not provide for a general rule of revalorization

Exceptions to nominalism

- ▶ **contractual** indexation (valorization) clauses – adjustment of the obligation according to a contractually pre-defined criterion (e.g. inflation rate, exchange rate of a foreign currency) (e.g. Art. 358¹ § 2 of the Polish Civil Code – the parties may agree to set the value of a monetary performance according to a measure of value different from money)
- ▶ in the past: „gold clauses”
- ▶ defining a performance by reference to a specific commodity
- ▶ unit of account clauses, e.g. reference to the SDR
- ▶ clauses allowing for periodic price reviews in long-term contracts

Interest rate as protection against effects of nominalism

- ▶ Main objective of interest rate: reflecting the price of borrowing (use of capital/external financing)
- ▶ Secondary objective: protection against gradual loss of value of money resulting from low or moderate („creeping”) inflation
- ▶ Third objective: penalization of payment delays
- ▶ Fixed or variable interest rate
- ▶ Contractual interest rate – set by the parties in the contract, subject to interest rate caps in some countries under anti-usury laws (e.g. Poland: under Art. 359(2¹) of the Civil Code maximum interest rate is set as double the statutory default rate applicable for obligations = currently (as of 16 Jan 2024) 18,5%; under Art. 481(2¹) of the Civil Code maximum contractual interest rate for overdue payments is set as double statutory interest rate for overdue payments, currently 22,5%).

Interest rate as protection against effects of nominalism

- ▶ Statutory interest rate – set in some jurisdictions by law as default interest rate for obligations and/or for overdue payments
 - default interest rate for obligations (applicable if the interest rate is not set in the contract) – in Poland under Art. 359(2) of the Civil Code set as a sum of the NBP reference rate and 3,5% = currently (as of 16 Jan 2024) 9.25%;
 - statutory interest rate for overdue payments – in Poland under Art. 481(2) of the Civil Code set as a sum of the NBP reference rate and 5,5% = currently 11.25%.

Obligations in foreign currency

Reference to foreign currency can be used as a sort of indexation mechanism (→ contractual exception to the principle of nominalism). In such cases the actual payment takes place or can take place in an amount of national currency calculated according to the exchange rate of the foreign currency at the time of payment.

- ▶ Example – the general rule of Art. 358(1) of the PL Civil Code: obligation for payment of an amount of money expressed in a foreign currency can be satisfied by payment of the amount of corresponding value in Polish currency, unless actual payment in specific foreign currency is expressly required by statute, court decision or the contract.
- ▶ Principles of European Contract Law, Art. 7:108 (2): In the absence of such agreement, a sum of money expressed in a currency other than that of the place where payment is due may be paid in the currency of that place according to the rate of exchange prevailing there at the time when payment is due.

Obligations in foreign currency 2

If payment in a specific foreign currency is expressly required – the principle of nominalism according to the *lex monetae* of that specific currency applies.

- ▶ Example: Principles of European Contract Law, Art. 7.108 (1): The parties may agree that payment shall be made only in a specified currency.

Private international law: *lex monetae* refers only to the currency of the obligation and can differ from the law applicable to the contract.

Example: a contract, subject to Polish law, provides for payment of 1000 USD. Polish law applies to the contract, but US law applies to the currency of payment (to what is legal tender according to the *lex monetae*).

Nominalism and *lex monetae*

- ▶ If a contract refers to obligation in a currency, the law of the State issuing that currency (*lex monetae*) determines what constitutes legal tender and what is its nominal value.
- ▶ Relevance:
 - cases of monetary reform, such as redenomination (e.g. Poland in 1995, Turkey in 2005); euro adoption;
 - demonetisation (withdrawal of banknotes or coins), e.g. India in 2016;
 - introduction of new banknote series and withdrawal of old series, e.g. Norway in 2017–2020.

Polish foreign exchange law

- ▶ Law of 27 July 2002 on foreign exchange (*Prawo dewizowe*)
- ▶ Used to restrict and regulate the use of foreign currencies and the exchange thereof → element of exchange controls
- ▶ Exchange controls gradually abolished since 1990
- ▶ since 2008/2009 no limitations on the use of foreign currency in obligations subject to private law
- ▶ Very limited restrictions remain in place for moving funds by Polish residents to non-EU Member States for the purposes of investment → in some cases a general or specific foreign exchange permit is required

Moneychanging activity (*działalność kantorowa*)

- ▶ Economic activity consisting of sale and purchase of foreign currency
- ▶ A regulated activity subject to the requirement of entry into the register of moneychanging activity (Art. 11 ForEx Law), maintained by the NBP
- ▶ Regulations applicable only to exchanging cash on physical premises; do not apply to online currency exchanges
- ▶ Specific personal requirements (no criminal record) and requirements regarding premises (e.g. display of the exchange rates)
- ▶ Further technical requirements specified in a regulation of the Minister of Finance
- ▶ Subject to control by the NBP (Art. 33(1)(2) ForEx Law)

Attention: there are no legal limits as regards exchange rates and exchange rate spreads applied by specific moneychangers. In some cases rates in some exchange points may vary from mid-market rates even by 20–30%. Polish authorities have been largely unsuccessful in curbing misleading practices of some providers → *caveat emptor* (customer beware!)

Online currency exchanges (*kantory internetowe*)

- ▶ Dynamic growth in Poland since ca. 2010
- ▶ Operate on the basis of bank transfers in different currencies (e.g. a transfer in PLN from a customer's banking account in PLN vs. a transfer in EUR to a banking account in EUR)
- ▶ Some offer also additional services and allow to keep funds on 'currency wallet' accounts
- ▶ **Not subject to the regulation of moneychanging activity under the ForEx Law** → just an unregulated economic activity on the basis of general provisions of law [→ anachronic regulation of the ForEx Law]
- ▶ Funds held at such institutions are **not protected by the deposit guarantee scheme** (exception: currency exchanges operated by banks)
- ▶ In general not subject to supervision of any kind, in particular not included in the competences of the Financial Supervision Commission (KNF).
- ▶ Some of them hold licenses to provide payment services – subject to relevant licensing and supervision requirements.