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Goodbye Interest Cap Premiums

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Following recent judgements of the German Federal Court of Justice ("FCJ") on the invalidity of handling fees (see our newsletter of October 2017), the FCJ recently held that pre-formulated interest cap premiums or interest hedging fees agreed in consumer loans are invalid. The ruling raises questions as to (i) whether consumers may reclaim any fees already paid, (ii) whether prospectively this decision will be extended to loan agreements with entrepreneurs, and (iii) the possibility of alternative structures.

On 5 June 2018, the FCJ held that pre-formulated clauses of so-called interest rate cap premiums ("*Zinscap-Prämie*") or interest hedging fees ("*Zinssicherungsgebühr*") in variable-interest consumer loans are invalid. This decision is in line with FCJ's recent jurisprudence of July 2017 on the invalidity of handling fees set out in pre-formulated clauses. As in the past, the FCJ based its ruling on a deviation of the respective fee clauses from the principal ideas of the German Civil Code, according to which, only (term-dependent) interest may be charged as the price of a loan.

Background

In the decision, a consumer association brought an action for an injunction against the use of interest cap clauses by a German bank. In these clauses, the bank had charged its customers an interest cap premium or interest hedging fee so that in return interest rates could not rise above a certain level. The fee was due immediately upon conclusion of the contract without a pro rata refund in the event of a loan prepayment.

According to the FCJ, the respective fee provisions are pre-formulated clauses (and not individually negotiated provisions), and thus considered to be general terms and conditions; irrespective of the fact that the respective fee amount was only agreed by completing a gap text.

The FCJ held that the clauses do not constitute a permissible agreement on the price of the loan since such an agreement on the price would have to be term-dependent. Neither do the clauses contain a valid fee for a special service of the bank since — from the point of view of the average customer — the clauses aim to ensure that the bank is compensated for any loss of additional income in the event that the variable interest rate exceeds the agreed interest cap. In this function, the clauses form an integral part of the interest calculation of the bank so that the respective fees are incurred in relation to the granting of the loan, and not for a special service by the bank. In consequence, the FCJ interpreted the clauses to contain an additional fee independent of the term for the granting of the loan. This conflicts with the principal ideas of the German Civil Code, according to which, only (term-dependent) interest may be charged as the price of a loan.

Within the context of a concluding comprehensive balancing of interests, the FCJ held that there were no circumstances apparent, which would rebut the presumed effect of the clauses to unreasonably disadvantage the consumer.

Extension to loans with entrepreneurs

It is currently unclear as to whether this decision will, in future, be extended to loans between entrepreneurs. The likelihood of an extension is supported by the fact that the FCJ extended case law on consumer loans to corporate loans in the past, and by the fact that the decision was not based on specific aspects of consumer law. It is, however, also possible that the FCJ might give greater consideration to the private autonomy of entrepreneurs in the context of a comprehensive balancing of interests.

Repayment claims

Following this judgement, borrowers that are consumers may be entitled to claim the repayment of interest rate cap premiums or interest hedging fees if the underlying obligation was contained in the lender's standard terms and conditions. Any claims of premiums or fees paid until the end of the year 2014 are, in general, time-barred and can no longer be made. A claim for repayment of such premiums or fees paid in 2015 will become time-barred by the end of 2018.

Alternative structures?

In order to make effective interest rate cap agreements, it is possible to agree these individually, to submit the fees and expenses to a foreign jurisdiction (which requires a certain nexus of the transaction to such jurisdiction) or to an arbitration tribunal, or to calculate and charge an additional interest that corresponds with such fees and expenses. In line with the legally recognised practice of disagio, it would also be possible to provide for a pro rata refund of the interest cap premium or interest hedging fee paid. Another possibility would be to charge the interest-hedging fee as a fee for a special service, which, of course, requires that the fee is solely incurred for interest rate hedging.

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