



## **Similarities and Differences between the Credit Contract and the Loan Contract in the Banking Law**

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**Abstract:** In this paper we attempt to find the differences between the Credit Contract and the Loan Contract in the Banking Law. Banking business practices have played a role in conditioning the creation and amendment of a series of contracts that specifically regulate business relationships between the bank and its clients. As a result of these relationships, it appears that in the legal practice from the terminological context some contracts with the same designation are perceived contrarily. Such case has to do with the loan contract. We find the differences that characterize this contract in certain jobs relate to the subject of the loan. On the other hand, in banking business practice, the term loans and loans to loan contracts are not clearly distinguishable with clarity. The evidence also suggests that compiled legislation, including the national one, regulates this issue with a legal framework for the relationship of obligations, yet again, perhaps this is not sufficient. According to the analysis conducted we can conclude that since we are dealing not only with contracts with substantive differences but also with the same contract that differentiates in the part of the contracted object, the banking law doctrine should address these elements so that the differences between them are clear by including in terms of terminology.

**Keywords:** contract; credit; loan; law; bank; business

### **1. Introduction**

Despite the contracts that are regulating the flow of goods and services from certain areas of business, the banking contracts are increasingly represented in mass. Based on these contracts it is specifically regulated the money flow and some of the most specific banking services. These jobs are realized by the bank for its clients. The payment line as in the past is still considered as a separate and complex banking segment today. The work performed by the bank is considered a legal -

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business activity especially when in the capacity of the client is presented the legal person i.e the person with business subjectivity. (Krasniqi et al., 2017, p. 293)

The research method or review of the literature has included the process of collecting materials and forms of contracts from the area of Kosovo legislation. The main difficulty was the lack of similar workings and the differences in legislation on the topic of treatment in the comparative context. The research of elements for each contract has been a process that has accompanied the issue of bibliographic items in order to draft and write this paper. The legal analysis of loan and loan contracts is further supplemented by the descriptive method.

Through this method the aspects of the terminological contents of the contracts are reflected. Due to these circumstances the descriptive method study was a necessary tool for clarifying different terms and concepts, from legal to practical aspects, realizing the knowledge of the theoretical part and the approach to reality.

Banking contracts in most cases are concluded as formal contracts. This is due to the fact that their relationship requires a more written form. In practice there are countries such as France where these banking contracts can be considered consensual as well. Banking contracts by typology are also contract awards because they are contracted on the basis of general and familiar terms of banking business which are previously printed in special forms. In this way, the parties most often conclude the contract that it has been drafted - typed by the bank and it is considered bound when the contracting parties sign it. But even these contracts, such as contracts for the flow of goods, it is possible that, within the negotiations, they also introduce special provisions or clauses, which in certain cases exclude the responsibility of the bank or the customer – client (Cranston, 2002, p. 133).

Creating a bank contract is one of the most popular operations that the bank carries out as part of its activities. In the context of these relationships each time the bank is one of the parties in involvement within the contractual process. In Kosovo there is currently a relatively large number of banks and other financial institutions that carry out certain transactions by entering into banking contracts. The subject of banking contracts is usually the arrangement of money and securities flow and the performance of certain services related to payment transactions. They are complex, formal, linked to deadlines and should be bonded in writing (Helewitz, 2015).

The most widely used banking contracts are the credit contracts that the bank provides to its clients - bank customers. Clients - customers for their use pay interest and after returning the expiration of the utilization period to the bank. In

this global financial competition, the most important thing is the loan and the loan as the oldest form of financing.<sup>1</sup>

For the purpose of determining clear meanings between credit and loan, it is necessary to distinguish between them. This is because in practice, these two meanings are often used as synonyms. It is necessary to note that, although it is about similar meanings, however, they have certain changes. In particular, each loan is at the same time lending but, on the other hand, the loan, in certain cases, is not to be a credit.

### **1.1. Loan Contract (Mutum)**

The loan contract is a contract of the right to obligations on the basis of which legal relations between the lender and the borrower are established where the lender is obligated to the borrower to deliver the specified amount of money or the amount of other things the borrower is obliged to return this amount after the expiration of the set deadline, respectively to pay the same amount of money, respectively the same amount of items of the same type and quality.<sup>2</sup>

Borrowing and loan are often seen as the same although the word is for two different contractual relationships. Through a loan contract the lender undertakes to deliver to the borrower a specific sum of money or a specific quantity of other replaceable things, and the borrower undertakes to return the same sum of money or an equal quantity of things of the same type and quality thereto (Krasniqi, 2016, p. 112).

Borrowing is always a non-remunerated contract because the borrowed thing should be returned to the lender, where it is not important whether this item is consumable or un-consumable. Borrowing is also a real contract, because it is created only after the item is delivered to the borrower, not at the moment of reaching the agreement. If neither the duration nor the purpose of the use is contracted, the borrower is obliged to return the item to the borrower when he so requests (Alishani, 1986, p. 78).

The loan contract is a consensual contract, as it is considered binding at the time the parties are agreed to its essential elements, not the delivery of the thing to the borrower. Delivery of the item is important for the fulfillment of the obligation

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<sup>1</sup> Law of Banking Contracts and Credit Securities, Chapter 2, source: <http://www.nwir.de/archiv/NWIR15/Chapter%202.pdf>.

<sup>2</sup> Law no. 04/L-077 on Obligational Relationships, Article 567, <https://gzk.rks-gov.net/ActDetail.aspx?ActID=2828>.

towards the borrower, not for the conclusion of the contract. Essential elements of the loan contract are the object, the duration and, in the case of a remunerated loan, the loan remuneration.

The loan is a two-way binding contract because the lender is obliged to hand over the money to the borrower or the asset, and the borrower is obliged to return the same sum of money, or the same amount of items of the same type and quality. The Borrower may vouch for the principal to pay the interest, so the loan may be rewarded and without reward. In the commercial contract the borrower pays interest even though it is not contracted, which means that between the subjects of the commercial law the loan is a contract with a reward (Alishani, 1986, p. 78).

The loan may be in cash or on goods (in nature). On the occasion of the repayment of the money loan, the nominal value principle applies in our favor, which means that the loan is returned only to the amount of monetary units in which it has been expressed. When it comes to a loan in commodities, we always have to do with replaceable items the obligation for the return of which does not consist in the return of the thing received but of the other item of the same kind, quantity and quality (money, fuel, wheat, tomatoes, etc.) (Lummer & McConnell, 1989).

The loan is an informal contract, because the lawmaker has not determined its form. The contract may be unaccounted for when the borrower can use it for any purpose and destined when the contract specifies in advance the purpose for which the borrower will use the asset or the borrowed money. If the borrower uses the defaulted loan in cash for purposes other than those provided for by contract, the borrower may terminate the contract (Lummer & McConnell, 1989).

**Lender's Liabilities:** The lender's basic obligations are constituted on the return of the promised item and the eventual liability for the disadvantages.

**Delivery of Promised Items:** The lender is obligated to deliver the contracted items at the appointed time. If the deadline for submitting items is not set, the borrower has the right to demand that the items be delivered within three months from the delay of the lender in delay (subject to the deadline), and in any case within one year from the date of signing the contract. The borrower is delayed if the borrower fails to deliver the promised item at the time of the contract, if the time of delivery is not contracted if the lender has not delivered the item where this has been requested by the borrower (Lummer & McConnell, 1989).

**Liability for damages/errors:** If because the buyer is in delay the risk is transferred thereto before the thing is delivered thereto, the seller must keep the thing safe with

the diligence (Article 503, paragraph 1 of the LOR). As the law does not provide for liability for the loan, the provisions on seller's liability for material misconduct in the case of a sale (Article 357 of the LOR and articles 400-412 of the LOR) apply to the liability of the lender. Foreign liabilities are not liable for legal deficiencies because the object of the loan is substitute items that the borrower must return (of the same type, quantity and quality) and especially does not consider the hedge of the eviction if the subject of the loan is the money, which also excludes liability for material deficiencies (Alishani, 1986, p. 122).

If it comes to a remunerated loan (in principle, these are a commercial loan contract), the lender's liability exists regardless of the fact that he has been known or should have known the flaws of the borrowed object (objective liability). However, if the loan is interest-free, the lender is liable for the material flaws of the thing only if it has been known or could have been known to them, but for them it has not notified the borrower (Alishani, 1986, p. 122).

**Obligations of the borrower:** It is a basic obligation of the lender to return the goods or the money received, and if it is a remunerated loan, the payment of the compensation.

**Loan Returns:** The borrower is obliged to return within the agreed term the same amount of money, respectively the same amount of items of the same type and quality. If the loan repayment term has not been contracted, nor can he be appointed due to the circumstances of the concrete contract on the loan (e.g. the size of the loan, whose interest the contract was concluded, with or without compensation etc.), the borrower is obliged to repay the loan after a reasonable deadline that cannot be shorter than two months from the day the lender requested the repayment of the loan.

Foreign items and borrowed money are often returned by installments, and this is what the parties have contracted. If there are no clear provisions for this, the LOR provisions on performance of the contract and the debtor's delay apply to the loan.

The Borrower also replies to the flaws of returned items under the same criteria as the lender.

If it comes to a loan in nature, which consists of giving items, the parties may agree that the lender will repay the loan (Alishani, 1986, p. 123). Nevertheless, the existence of this provision of the contract, the borrower is authorized to return, at his/her choice, to return the amount of money corresponding to the value of those items at the time and place specified in the contract. If the borrower has decided

that instead of the borrowed thing to repay the amount of money, the question arises as to whether it is a sale, however the lawmaker also considers this legal relationship as a loan contract considering the intention of the parties to conclude the contract the loan, as well as the possibility that the borrower instead of the money will return the loan item, which in case of sale is not possible.

All this applies even when there is no possibility of returning the same amount of item of the same kind and quality. The borrower may also repay the loan before the deadline for its return. He is obliged to inform the lender for his purpose, and if he has suffered any damage, he is obliged to compensate (Alishani, 1986, p. 122).

Remuneration for the use of the loan: The borrower is obliged to pay the lender a certain amount of money for the use of the loan. The rate of interest may be determined, an ordinary or a contracted one (Alishani, 1986, p. 122).

## **2. Credit Contract**

With the credit contract, the banking institution (the Bank) vows to make available to the borrower a certain amount of money for a fixed or indefinite period of time for the foreseen or unforeseen destination and the user vows that the bank pays the contracted interest and refunds the amount of money received at the time and in the manner prescribed by the contract. The credit contract has its starting point in the loan contract, but economically and legally - it has technically gone further by developing into a special banking law contract with the characteristics that the modern economy requires (Helewitz, 2015).

Credit contract differs essentially from the loan contract, the loan contract a lender may be any natural and legal person, whereas for the credit contract, as a rule, the bank, an object of the contract may be the money or other substitute items, whereas the object of the loan contract may be only money, the contract for the loan may be rewarded and without reward, depending on whether the interest payment is contracted (between the subjects of the commercial law the loan is in reward even if interest is not contracted), whereas the credit contract is always rewarded, the contract for the loan is an informal contract whereas the credit contract should be concluded in writing (Huerta de Soto, 2002).

The credit contract is not only a name but also a formal and consensual one, because it is created not only by giving money but also by the obligation of the bank to make the money available to the user. This contract is two-way binding

because apart from the bank there is also the obligation of the user to pay the interest and to return the principal as well as to fulfill the other obligations for which he is contractually pledged. Usually it is about contract of adhesion, because it is related based on bank forms previously prepared that the user, as a rule, has to accept without the possibility of change and completion (Alishani, 1986).

**Content of the Loan Contract:** The main elements of the credit contract are: loan amount, terms of loan delivery, terms of use, terms of loan repayment, etc. When concluding a credit contract, the bank must adhere to banking patterns and good business habits. For this reason, the laws and all other provisions, business habits, practices and general practice constitute the system of bank credit contracts (Alishani, 1986).

When concluding a specific contract, all sources of the right for a loan contract should be considered, so besides the main elements of the law, the overall financial structure of the work must be taken into account.

What will be the content of the loan contract depends largely on the type of loan. In addition to certain types of credits mentioned by lawmakers, business practices have created different kinds of loans, depending on the needs of the participants and the circumstances affecting the domestic and international market.

Contracts for sale, replacement, loan (credit) and donation are contracts that as business purpose have the passing and acquisition of the property right in the object.

### **2.1. Types of Credit Contracts**

In the legal literature there are several criteria by which are divided bank loans and consequently also the contracts governing the bank-to-client relationship. According to the following criteria we distinguish the contracts as follows:

Based on the criteria of the duration of the relationship between the issuer (depending on the loan repayment period) we have: short-term, mid-term and long-term loans;

Based on the criteria of who is presented in creditor quality, they can be: public loans (which are approved by state authorities) and external loans (approved by foreign banks or external financial organizations);

According to the debtor's activity, they may be industrial, crafts, agricultural, hotel, tourist, etc., loans;

Under the credit granting criteria, they may be: commercial or commodity credit (when divided for goods and money) and money credit (which are returned in cash);

According to the business purpose criteria, the contract for the credit may be: manufacturing and consumer as well as loans for basic and floating assets or investment loans;

According to the credit repayment criterion, they can be divided into: personal loans, since it is important to trust in the debtor and his solvency and overlapping credit. Covered loans are also available in other ways, such as through billboards, mortgage loans or pledge for movable property. These loans may also be secured through the insurance policy of the so-called *welter* policy (in case the borrower carries out the insurance of the goods that is purchased through the loan and if the secured goods are destroyed then the insurer will receive the compensation on the basis of this insurance compensation is paid to the bank that has secured the loan of the insured);

Depending on the criterion of whether interest-bearing or interest-bearing loans are we have a contract for interest-free loans and interest-rate contracts;

Depending on the purpose and purpose of the credit, the credit contracts may be general and specific (of these contracts the financial assets received should be exclusively used for the contracted purpose);

Under the credit repayment criteria, there are: the contract for the repayment of the simultaneous credit, the credit contract for the repayment of installments and the credit contract with amortization. Receivables are returned simultaneously, loans are returned at certain time periods, whereas amortized loans or annuity loans are returned uniformly (annually or semi-annually). The annuities consist of returns and interest rates;

Depending on the credit function and the purpose it may have, the contract for investment, short-term loans and consumer credit contracts.

### **3. The Difference between Credit Contract and Loan Contract**

Credit contract is a contract by which a bank is obliged to make available to a credit user a certain amount of money for a particular purpose or unintended purpose, and the user is obliged to pay the bank interest contracted and the amount



of money received returned in a timely manner and in a manner determined by contract.<sup>1</sup>

Loan contract is a contract by which a lender subject to the right is obliged to subordinate to another party - the borrower a certain amount of money or other substitutable item and on this occasion the borrower respectively the borrower is obliged to return the lender after a certain deadline the same amount of money to the same amount of replaceable items of the same quality with compensation or without compensation.<sup>2</sup>

From the definitions noted above it can be stated that:

- we are dealing with contracts of great similarity. Viewed in the historical context, the credit contract originates from the loan contract and today as such appears as a fairly frequent job than for the loan;
- these two contracts, despite the similarities, are different and distinguish between them.

Credit Loans have the option of exclusively developing banks or licensed financial institutions for banking, while the loan contract can be concluded regardless of whether it is a natural person or a legal person. The subject of the credit contract is exclusively the money whereas the contract of the loan, except the money, the subject of the contract may be other replaceable items;

Within the credit contract the interest is an essential element whereas the loan contract is likely to be contracted but is not meant to be contracted (as in the case of loans between legal persons it is considered that the borrower is obliged to pay the interest even if it is not contracted) (Krasniqi et al., 2017).

The fact that these two contracts differ from one another is also related to the term credit and lender. In the case of credit, it is always about banking institutions or other financial institutions, which is not the case with the loan. As far as the loan is concerned in addition to the bank or other licensed financial institutions, non-bank and non-financial institutions (natural and legal persons) may also be a contracting party.

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<sup>1</sup> Law on Obligations of the Republic of Kosovo Nr. 04 / L-077 in the provision of Article 1058 has regulated the interruption and validity and implementation of other laws. Within this provision in paragraph 3 of the credit contract it states that it will continue to apply appropriately as long as the national legislation does not enforce laws or other sub-legal acts for regulating the same. Therefore, in relation to the credit contract the current law refers to the Law on Obligations of the former SFRY no. 30 of 1978, namely Articles 1065 to 1068.

<sup>2</sup> Law no. 04/L-077 on Obligational Relationships Article 567

Therefore, from this concept is practically the answer to the many-year dilemma whether or not the legal entities are able to enter into contracts for the loan. Simply, the answer comes out of what was emphasized above, the conclusion of loan contracts between them is legal and permissible work which differs from the loan because the latter can only be tied to the banks.

#### **4. Conclusion**

In banking business practice and in contract law, the terms of the loan and credit terms are usually perceived as synonymous or exactly the same. Meanwhile, despite the similarities, in reality between these two contracts there are substantial differences. From this it emerges that the need for the theoretical plan to clarify these terms in their essence to show differences and similarities.

A legal transaction by which the creditor makes the debtor available a certain amount of money or anything else that can be exchanged and the borrower of a certain day or several days must return the goods received by type, quality and quantity, often of interest.

Credit is an agreement in which a lender, in the most frequent cases, gives the bank money or assets to a borrower and the borrower is obliged to reimburse the money or property, usually of interest, at a time and in the future. Generally, the lender takes the risk that the borrower will not repay the loan or return it in time.

Each credit at the same time is a loan while the loan should not be a credit. Credit is defined as a sum of money that the financial institution - the bank and others as a creditor (lender,) transfers to another person (lender, borrower) with the obligation to return them within the specified period and pay the fee corresponding or interest. Unlike a credit, a loan is defined as the one being given or an obligation is taken to be returned; the economic relationship in which the lender gives the borrower a sum of money or a certain amount of goods. The difference between these two terms is the creditor or lender.

In the case of a credit, it is always a bank or other financial institution, which is not the case with a lender, which may be a bank or a financial institution, but also non-bank and non-financial institutions, legal or natural person.

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\*\*\* Law no. 04/L-077 on Obligational Relationships, Nocioni, Article 567, <https://gzk.rks-gov.net/ActDetail.aspx?ActID=2828>.

\*\*\* Law of Banking Contracts and Credit Securities, Chapter 2, Retrieved from: <http://www.nwir.de/archiv/NWIR15/Chapter%202.pdf>.