

At a glance

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Securitisation in Hungary: Some Legal Issues

Overview

According to a study of the National Bank of Hungary published in 2004, the following factors are the major obstacles to securitisation transactions in Hungary: (i) sufficient liquidity is available to commercial banks through classic funding channels (parent funding, corporate & consumer deposits, capital markets); (ii) plain vanilla products generate profitability comparable to matured markets; (iii) typical securitizable homogenous banking portfolios (e.g., car lease, mortgage and credit card portfolios) have only recently built up to a significant volume; and (iv) tax issues (sale of receivables constitutes non-VATable income for the originator and its VAT-reclaims must be pro-rated).

However, a need for diversifying funding sources, or the ability to raise off-balance sheet financing or to transfer specified portfolio-associated risks, will drive the market forward. It is likely that Hungarian-based local and foreign banks will make use of securitisation programmes. Securitisation would also appeal to Hungarian-based local and foreign corporations which manage their Eastern European expansion from Hungary. Additionally, foreign companies producing goods in Hungary and exporting these to other parts of the European Union can be expected to make use of securitisation. Furthermore, it can be anticipated that well-structured first deals will encourage the perception of securitisation not only as a tool for transfer of credit risk, but also as a source of funding.

In order to encourage investors and originators and alleviate current legal and commercial obstacles, new securitisation legislation is intended to be enacted in Hungary in early 2007.

Legal considerations

(1) Choice of law

To the extent that a foreign element determines the contractual relationship, the counterparties are free to choose foreign law to govern their contract. In the case where a foreign-based SPV (special purpose vehicle) purchases receivables from a Hungarian originator, notwithstanding that the assignment agreement is governed by foreign law, issues relating to the underlying receivable such as assignability, set-off and enforcement against a debtor (the underlying obligor in a securitisation transaction), will continue to be governed by Hungarian law.

(2) True sale

Under Hungarian law, an assignment agreement is valid upon the conclusion of an agreement between the assignor (normally the originator in a securitisation transaction) and the assignee (the purchaser or an SPV in a securitisation transaction), unless there

is a statutory or contractual prohibition. By virtue of the Hungarian Civil Code, monetary claims are generally freely assignable. Hence, a prohibition on assignment should not be effective but may cause a breach of the terms of the underlying contract.

The debtor's right to discharge or to set-off or counter-claim against the assignor may be determined by giving notice to the debtor, prior to or post assignment, preferably in writing. A notification provided by the assignor perfects the assignment. Should such notification incorporate the assignor's order that the debtor pays all amounts due and payable under the underlying contract to the assignee, the debtor can only discharge his payment obligation by paying to the assignee. The debtor will not be entitled to set-off or counter-claim of those obligations which arose following the notification of the assignor's obligations. Hungarian law does not expressly stipulate that the assignor is obliged to notify the debtor. Thus, the assignee may also disclose the assignment, in which case it is likely that the debtor may require proof of the assignment (e.g. a copy of the agreement).

The receivables must be sufficiently identified when assigning, which means that at least the debtor and the amount owed are specified. Hungarian law allows assignment of future receivables to the extent that these are identifiable at the time of the assignment.

In this context, it can be assumed that a true sale is achieved when the assignment agreement is valid, perfected and concluded "at arm's length" (see below section (4)).

(3) Transfer of collateral

Ancillary rights, such as mortgages and pledges, are transferred to the assignee automatically with the assignment of the underlying receivables, provided that they are related to the assigned receivables. It is advisable however, that the assignee as new mortgagee re-registers his title to the receivables and the collateral.

In Hungary the re-registration of mortgages is a relatively fast process taking only a few days.

(4) Claw-back and "suspect periods"

Under Hungarian law, transactions defrauding creditors made within five years prior to the commencement of insolvency proceedings in respect of the assignor may be challenged by an insolvency administrator. An insolvency administrator is also entitled to claw-back transfers at an undervalue concluded within two years of the initiation of insolvency proceedings. A three-month "suspect period" applies for transactions preferring creditors.

The insolvency administrator is entitled to challenge any of the above transactions within 90 days of becoming aware of such transaction, but in any event within 1 year of the bankruptcy order of the assignor.

(5) Data protection

According to the Hungarian data protection legal framework, the disclosure of personal data is prohibited without the prior consent of the respective individual. The personal data provided to the assignee by the assignor would also be subject to bank secrecy provisions under Hungarian law. The transfer of personal data to countries outside the European Union (third countries) is restricted, unless the individual has consented and the relevant third country provides an adequate level of protection to the personal data. Hungarian law allows the transfer of personal data to another European Union Member State with the consent of the personal data subject.

(6) Regulatory

Under Hungarian Law, the servicing of receivables does not require any authorisation. Purchasing receivables, however, might fall into the category of providing financial services if such activity is carried out in a "business-like manner". Under Hungarian law, a transaction constitutes an activity carried out in a "business-like manner" if (i) due consideration was provided; (ii) the services in such transaction were continuously supplied; and (iii) the identity of the customers in multiple transactions was not specified. Therefore, the SPV might need to obtain an appropriate authorisation issued by the Hungarian Financial Supervisory Authority (the "HFSA").

"Passporting" of banking services is allowed pursuant to Hungarian law.

There are no restrictions on money transfers and currency exchanges.

(7) Taxation

As most of the true sale securitisation transactions in developed markets are channelled through offshore SPVs which are registered in low taxation jurisdictions (such as Ireland, The Netherlands, Luxembourg and the Channel Islands), the double taxation treaties between these jurisdictions and Hungary should be analyzed in order to determine the tax consequences of a transaction. Thus, it is possible to reduce the withholding tax to zero provided that certain procedural requirements are met.

Under Hungarian tax law, there are no stamp duties or other taxes when assigning receivables, other than registration fees when mortgages have to be re-registered.

Pursuant to Hungarian tax law, no VAT should be levied on the sale and transfer of receivables, other than transactions in which the purchaser assumes any credit or default risk.

The servicing of receivables is VAT taxable when it is performed in Hungary unless it qualifies as a "financial-intermediation service", which is tax exempted.

In any case, it is recommended to obtain a tax-related opinion from local counsel.

(8) Draft securitisation legislation

Summary of the main provisions of the draft legislation:

- the draft legislation only applies to Hungarian originators, onshore SPVs registered in Hungary and local ancillary service providers;
- SPVs may issue special bonds where the repayment of principal is not mandatory;
- funds may issue special investment units;
- SPVs may not be the subject of a bankruptcy moratorium;
- only its investors may wind up an SPV;
- the winding up procedure must be completed within one year; and
- in conduit SPVs, the separate tranches of financing must be liquidated individually.

Further amendments in other legislation in order to facilitate securitisation transactions are as follow:

- assignment of future or conditional receivables would be available;
- claw-back concerns: the liquidator's rights to challenge the receivables sale (assignment) transactions will be limited in respect of securitisation transactions;
- supervision by the HFSA: no need for licenses on stand-alone transactions; although conduit SPVs may be subject to license requirements;
- taxation: securitisation is an exception to VAT pro-rating restrictions; local tax (revenue-based) exemptions introduced; and
- SPV corporate forms: the draft securitisation legislation will rely on existing corporate forms rather than introducing new ones or granting relief in respect of corporate management requirements.

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