GIDE

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newsletter

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BANKING LAW

New developments in relation to foreign currency loans

The problems surrounding foreign currency denominated loans have been a "hot topic" in Hungary in the recent months. In our January 2014 issue, we mentioned that proceedings concerning foreign currency loans were on-going. In its latest decision, the Hungarian Supreme Court (Curia) left several questions open, notably concerning the unilateral modification of contracts by financial institutions.

In its legal uniformity decision dated 16 June 2014, the Civil Chamber of the Supreme Court pronounced itself on issues of (i) the practice of "rated-spread", (ii) the validity of an exchange rate risk borne exclusively by the consumer, and (iii) the unilateral modification of a consumer loan contract by the financial institution. The decisions are now binding to all lower courts.

Firstly, the Curia declared the practice known as "rate spreads" unfair. This practice, applied to foreign currency loans, meant that banks were converting the amount of credit disbursed at the buying exchange rate while the amount of repayment instalments was calculated at the selling exchange rate. The difference between the buying and selling exchange rates was pocketed by the financial institutions.

The Supreme Court declared that the economic reason for using different exchange rates was "not clear, not understandable, and not transparent". The application of the rate spread was unfair because it was not compensated by any additional service from the bank to account for the additional cost borne by the consumers. It was therefore an undue cost for them. Consequently, the Court held that, instead of using a different exchange rate for each calculation, the official exchange rate quoted and published by the Hungarian National Bank must be applied as the conversion rate, in line with the Civil Code.

Secondly, concerning consumer loan agreements, the Supreme Court declared that the provision which sets out that the exchange rate risk is borne exclusively by the consumer is not unfair by nature, because it falls under the scope of main service provision. To be qualified as unfair, it must meet three conditions: the consumer must prove that a) the part of the contract relative to the exchange rate risk was not understandable, b) to a generally informed average consumer acting with reasonable thoughtfulness and prudence, c) because of insufficient information or lack thereof. Examination of circumstances would advance on a case-by-case basis.

Thirdly, the Hungarian Supreme Court reaffirmed that the unilateral modification of a consumer loan contract by the financial institution was subject to very strict conditions. Those strict conditions were already listed in one of the previous opinions published by the Supreme Court.

If the unilateral modification is qualified as unfair, the amounts determined by the contract must be recalculated without applying the unfair modification.

The decision, however, has not solved the problems related to the exchange rate risk borne by the consumer, which represent approximately 80% of all burdens upon the debtors of foreign currency loans. The President of the Civil Chamber opined that legislation should remedy remaining issues, for it was "*not up to the Supreme Court to give ideas to Parliament*".

As the legal uniformity decision of the Hungarian Supreme Court is only applicable to courts, in other words does not create any legal obligation to the banks and the borrowers, the Hungarian parliament was quick to react and passed a new Act on 4 July 2014 in an attempt to help borrowers to enforce their right towards banks.

The law stipulates that banks will be obliged to compensate borrowers for what the government says were "unfair" conditions applied to mostly foreign-exchange denominated loans granted previously.

The new law compels banks to repay borrowers for imposing unilateral increases in interest rates on the loans and for charging a margin between the different exchange rates applied at the disbursement and during the repayment of the loan.

Banks have 90 days to repay revenues arising from unilateral "unfair" contract modifications, unjustified increase of interest rates and revenues gained from using exchange rate margins. Banks have a deadline of 30 days to turn to court and request the court to establish that the unilateral contract modifications, amendment of interest rates, and the application of different exchange rates were fair and transparent according to the terms of the contract.

Government officials confirmed that this might be the first step in a legislative process, with the aim of terminating foreign currency loans and/or converting them to HUF loans.

Nullity of fiduciary collaterals

The new Civil Code, which entered into force on 15 March 2014, institutes the nullity of the practice of so-called “fiduciary collaterals”. This term refers to legal constructions where the property - of goods or claims - is transferred, or an option right is granted to the creditor to secure their claim, but the exercise of the newly acquired rights by creditor is subject to contractual provisions.

This mechanism affected the unity of the legal and economic property - the creditor was entitled to an absolute right, but could only exercise it within certain limitations - and led to widespread abuses in practice. For example, creditors regularly attempted to enforce their claims outside the framework of their debtor’s insolvency or liquidation proceedings, thus putting other creditors at a disadvantage and the debtor in a more vulnerable position.

The new Civil Code expressly states that such fiduciary collaterals are null. The official explanation for this sanction is that these practices were “aimed at circumventing mandatory mortgage rules”.

However, the new Civil Code did allow certain types of contractual practices containing elements of fiduciary collaterals, but were considered to be regulated adequately to prevent future misuses. Thus, retention of title as a previously existing contractual form, and financial leasing and factoring as recently codified contractual forms, continue to be legal in the new Civil Code. In addition, the new Civil Code also exempts from the legal consequence of nullity the collateral arrangements defined in Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements.

CONSUMER LAW

Consumer protection rules becoming more stringent

The deadline for the transposition of the European Directive 2011/83/UE on consumer rights (the “**Directive**”) elapsed on 13 June 2014. Hungary transposed the Directive through a decree “on the detailed conditions of contracts between business and consumer” that entered into force on 14 June 2014 (the “**Decree**”).

One of the most significant innovations concerns the duty to inform the consumer. The Decree set out an exhaustive list of information that should be communicated in a clear and intelligible way, prior to the conclusion of the contract, such as the essential properties of the product, the full price (with added taxes) and all associated costs of the transaction, the availability of after-sales services and the conditions of the consumer’s right to withdrawal - which was extended from 8 working days to 14 calendar days. According to the new Hungarian Civil Code, consumers can only be natural persons acting outside their professional capacity.

In addition, businesses must clarify whether they offer a “*szavatosság*” (i.e. a provision which grants that if a consumer purchases a defective product, they can ask for its reparation or replacement from the manufacturer) or a “*jótállás*” (i.e. term of a contract, or legal provision, which defines how the manufacturer must honour its obligation in case of delivery of a defective product), two terms which are often used and confused as synonyms in commercial vocabulary.

The Decree also contains measures regulating consumer contracts signed “remotely” between parties, i.e. over the Internet, telephone, through mail-order services, or implying that the parties are not in face-to-face contact at the time the contract is entered into. It also regulates contracts concluded “outside of the premises of the business”, covering for instance the practice of organizing trips for the purpose of presenting and advertising products or services. However, its scope does not extend to all consumer-business relationships, such as financial transactions, transactions concerning immovable property, or travel contracts.

The Decree expressly states that silence on behalf of the consumer can never be assimilated to given consent, and that it is only possible to derogate contractually from these rules in favour of the consumer.

TAX LAW

New advertising tax approved by Parliament

A new advertising tax bill has been passed in a fast-track procedure on 11 June 2014 and entered into force on 12 July 2014. This new tax applies to service providers of media content established in Hungary such as publishers, outdoor advertisement firms and online advertisers, advertisement in media services, predominantly Hungarian press products published and distributed in the country, and for online and outdoor advertisement.

The tax is progressive and is calculated on the basis of consolidated annual advertising revenues: the rates range from 1% for a tax base of HUF 0.5-5 billion (EUR 1.6-16 million), to 40% for a tax base exceeding HUF 20 billion (EUR 63.5 million). The law also provides a detailed account of how tax rates for affiliated companies should be calculated.

The first economic policy measure of the new cabinet was met by strong opposition from the Hungarian media, the majority of which joined forces to protest with blank pages and black screens. The Hungarian Advertising Association (“**MRSz**”) and the Association of Hungarian Journalists (“**MÚOSz**”) phrased concerns as well. MRSz claimed that the new tax would make it difficult, if not impossible, for the majority of Hungarian media companies to operate, which could potentially endanger freedom of the press in the country. Several parties affected by the new measure also challenged its necessity, since, according to them, revenues collected from advertising would only represent a minor portion of the budget, while placing a disproportionate burden on its payers.

Members of conservative governing party Fidesz dismissed such claims, asserting that revenue raised from the advertising tax will be spent on modernizing schools.

EU LAW

The Hungarian licence procedure for retail establishments may violate EC law

On 16 April, the European Commission (“**EC**”) launched an infringement procedure against Hungary after holding that the legislation concerning retail establishments is not in compliance with EU law.

Currently, with the stated purpose of protecting small- and medium-sized retail outlets from the increasing development of shopping centres, a retail establishment exceeding 300 m^2 in Hungary requires a special licence. The final decision to grant a licence is made by the Ministry

of National Economy, who may reject the licence if, in its view, the geographical area in question already contains a certain number of shopping centres.
In its letter of formal notice sent on 16 April 2014, the EC questions the fact that the decision on licences is not subject to the judgment of an independent authority, but rather to the Hungarian government, which may reject the licence on the grounds of "economic need" based on its discretionary right. The test known as "economic need" is clearly forbidden by the Services Directive. The Hungarian government had two months from receipt of the notification to answer the EC. The Commission will then decide whether to push the case further.

Hungarian meal voucher system to be judged by the European Court of Justice

While the food vouchers market was previously shared by three main foreign companies (Sodexo, Chèque Déjeuner and Edenred), in 2011 the government adopted a decree creating the Erzsébet voucher – offered by employers to their staff as a benefit to subsidise meals – and the SZÉP Card – which can be used to pay for food, as well as leisure and hotel services.

Financial institutions must comply with very strict rules in order to issue the SZÉP Card, there can therefore be only a few active market players. For its part, Hungarian National Recreational Foundation (*Magyar Nemzeti Üdülési Alapítvány*) has the monopoly over the Erzsébet voucher, as it is the only actor authorised to issue such vouchers.

On 20 June 2013, the European Commission ("**EC**") announced that it was bringing a case against Hungary before the Court of Justice, contesting the restrictive conditions surrounding the issuance of meal vouchers in consideration of the fact that the new legislation could prevent the free provision of service. After almost a year of silence, the EC claim concerning the Erzsébet-voucher and SZÉP Card has now come before the European Court of Justice ("**ECJ**").

The EC alleges that the state monopoly created by the Erzsébet voucher and the SZÉP Card excluded operators who had been present in the market for several years and effectively hampered the arrival of new operators in the country, making the free provision of services impossible.

Hungary claims that restructuring the market was required to raise cash to fund social projects without putting a further tax burden on citizens, and argues that finding resources for social projects is up to individual Member States rather than the European Union.

Nevertheless, while the EC does not question Hungary's ability to define its own social policy, it has an obligation to ensure the good performance of the internal market and therefore, the provision of social expenditure cannot be a valid reason justifying the restrictions in place.

However, the ECJ may only consider the applicable EU legislation when ruling on the case. If it confirms the EC's position, Hungary must comply with the judgment or expect high financial penalties.

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