

**RESIDENTIAL LOAN
RECOVERY AND
MANAGING RISK OF
DEFAULT:**

**THE FINAL REPORT OF
THE LOAN RECOVERY
WORKING GROUP**

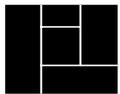
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Prepared by

Carol Rabenhorst
The Urban Institute



THE URBAN INSTITUTE

2100 M Street, NW
Washington, DC 20037
(202) 833-7200
www.urban.org

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RESIDENTIAL LOAN RECOVERY AND MANAGING RISK OF DEFAULT: THE FINAL REPORT OF THE LOAN RECOVERY WORKING GROUP

INTRODUCTION

Background

In the last several years, Hungary has adopted a number of progressive new laws to facilitate recovery of housing loans. As a result of recent changes in the legal framework, Hungary stands at the forefront of countries in Eastern and Central Europe in establishing the requisite legal tools for securing real estate loans and assuring expeditious access to collateral in the event of default in a mortgage loan. For example:

- Amendments to the Civil Code sections on mortgages and liens adopted in 1996 and a 1994 law on court procedures permit foreclosure and repossession without the lengthy judicial proceedings required under previous law.
- The Civil Code now permits the lender to sell the property itself without court intervention if the parties so agreed in the loan documents.
- Civil Code amendments provide that for residential real estate, the parties may agree that the borrower must deliver the property empty of occupants in the event of foreclosure.
- The 1997 Law on Mortgage Banks and Mortgage Bonds changed the priority for payment to a mortgage lender from the proceeds of a foreclosure sale from last place to fourth place, ahead of taxes, social security, and other public debt.
- The 1993 Law on Regulation of Rent and Sale of Housing exempts private landlords from the requirement of providing alternative housing to an evicted tenant.

Unfortunately, these significant developments toward a market-oriented legal framework for mortgage loans do not seem to have made a substantial difference in actual real estate lending practices used by Hungarian banks. Foreclosure and eviction still are rarely used in cases of residential loan default. Some bankers believe other remedies, such as renegotiating loan terms or seeking payment from guarantors, are preferable because they are less problematic, even if they are insufficiently effective. In addition, non-judicial foreclosure is available only if the loan documents are notarized, and this procedure is quite expensive.

In the meantime, the lack of competition among banks and the perception that residential lending is not profitable remain substantial impediments to the development of a more active residential mortgage market. Despite the facts that legislators and ministry officials have worked diligently to reform the legal framework for mortgage lending in Hungary. Heeding the advice of Western European and American advisors and following model laws recommended by the EU and EBRD, with banks generally not using the progressive remedies already available to them, it is uncertain whether additional changes in the legal framework in themselves would increase the amount of residential mortgage lending or the efficacy of loan recovery in the near future.

Summary of the Current Legal Framework

The following is a summary of the basic legal framework for execution and foreclosure, with emphasis on recent changes in the law. The practical effects of these changes remain largely untested, as noted above; recommendations for additional clarification together with a more detailed discussion of current execution procedures are included in Section I, below.

Law on Court Procedure (Law No. LIII/1994)

The Civil Code of Hungary provides that a lender's claim must be satisfied in accordance with other relevant laws, which would include the Law on Court Procedure. Prior to 1994, the rights of the borrower were strongly protected against the interests of the lender, particularly in the case of mortgage loans secured by residential real property. Foreclosure and execution of a mortgage were rarely effective means of collecting a debt, primarily because of the lengthy and expensive court proceedings required to obtain an order authorizing execution.

The Law on Court Procedure, Law No. LIII/1994, substantially improved a lender's prospects for an expeditious remedy for loan default by eliminating the long wait for the court order that must precede initiation of foreclosure and sale of the property. That law provides that if the parties have prepared the loan agreement using a public notary, in the case of borrower default the lender may simply go to court for an order certifying the default and authorizing execution to proceed. No trial is necessary. With the court order, the lender may go to the Office of Execution and initiate procedures to sell the collateral. (Execution procedures are described below.)

Under the 1994 procedures, a borrower who disputes the lender's claim has the burden of challenging the order in a court proceeding and proving the lender is wrong. The court may or may not stay the execution order pending resolution of a challenge by a borrower, presumably depending on the arguments and evidence the borrower presents when first challenging the claim.



Priority of Liens Under the Law on Mortgage Banks and Mortgage Bonds (Law No. XXX/1997)

The Law on Mortgage Banks and Mortgage Bonds strengthened the position of liens of mortgage lender vis-à-vis other liens in priority of payment from the proceeds of a foreclosure sale. The law moved the position of mortgage liens from sixth (and last) place to fourth place, ahead of taxes, social security, and other public debt. In contrast to other countries with new laws on mortgage banking that improve the position of mortgage loans, including Poland and Czech Republic, the law in Hungary makes the higher priority applicable to mortgage loans from all banks, not just licensed mortgage banks.

Prior to the passage of the Law on Mortgage Banks and Mortgage Bonds, the basic order of satisfaction of claims following a foreclosure, provided in §165 of the Law on Court Procedure (Law LIII/1994), was as follows:

- Child maintenance
- Other maintenance
- Employees' wages and other income coming from the same consideration
- The amount determined against the debtor in a criminal, penal, or minor offense proceeding, in a claim arising from the confiscation of wealth (with the exception of a civil claim) for the benefit of the state
- Tax, social security, and other public debt
- Other debt

Article 29 of the Mortgage Banks and Mortgage Bonds Law amended the Law on Court Procedure by adding the following section:

- Article 170(1). When a claim secured by a mortgage lien is to be satisfied from the sales proceeds of real property, or water or air vehicle, such claim should be satisfied prior to claims specified in paragraph d) - f) of Article 165.

Under the Law on Court Procedure, mortgage liens are satisfied in the order in which they are registered. Law LIII/1994, Article 170(2). With regard to claims of the government for taxes, social security, and other public debt, Article 170(1) has been interpreted to mean that when such debts are registered as liens, they are included in the category of mortgage liens. Described in that article; in other words, they are satisfied in fourth place, after categories a), b), and c). The Law on Court Procedure provides that within a category, debt is satisfied in the order in which it is filed.

Therefore, any previously registered contractual mortgage, such as a bank loan, would be satisfied before a government lien.

Amendments to the Civil Code (Law No. XXVI/1996)

In early 1996, the lien and mortgage provisions of the Civil Code of Hungary, Law No. IV of 1939, paragraphs 251-269, were revised by Law No. XXVI/1996. Substantive changes in the law that affect foreclosure procedures include the following:

- In the case of a lender who extends loans in the regular course of business, the lender itself may sell the collateral without foreclosure or enforcement by the court if the parties agree to this in writing before the loan is in default (presumably, when the loan documents are signed). Paragraph 262(2).
- For loans secured by occupied residential property, the contract must stipulate that the borrower will deliver the property empty of inhabitants in case the property is transferred to the lender in the course of enforcement of the lien. Paragraph 48.
- There is a provision for "independent" mortgages or liens for the first time in Hungarian law. Only the identified collateral encumbered by the lien secures these mortgages; other property of the borrower is not subject to seizure in case of default. Paragraph 269(1). This eliminates the former requirement that personal property must be sold before real property to satisfy a lien.
- When several liens encumber a single property, the priority of liens is established by the order in which they are registered, unless otherwise specialized by laws or regulations. The rights of the lender with first priority are not affected by subsequent liens. Paragraph 263(2).

The amendments were prepared after review of the laws of many other countries, particularly in Western Europe, and the EBRD model mortgage law.

Eviction Under Law on Rent and Sale of Housing (Law No. LXXVIII/1993)

Under ordinary mortgage loan procedures, the owner of the property (the mortgagor) gives the lender (the mortgagee) a lien or legal interest in the property as security for payment of the debt. The loan agreement provides that if the borrower defaults in payment, the lien is foreclosed and ownership of the property transfers to the lender, either by court order, if a court proceeding is required, or by declaration or operation of law, if no court proceeding is required. If the lender becomes the owner while the borrower remains in occupancy, a landlord-tenant relationship is established.



Prior to the Law on Rent and Sale of Housing, Law No. LXXVIII/1993, a landlord could not evict a tenant under most circumstances without providing an alternative dwelling. Under the 1993 law, a private landlord need not provide alternative housing if there is an agreement to that effect between the parties. Such a provision presumably could be routinely included in post-1993 mortgage loan agreements in Hungary. As in the case of non-judicial foreclosure, however, lenders report that they are reluctant to carry out evictions, even where loans are in default, because of social and "public relations" concerns, regardless of whether or not alternative housing is required.

This exemption from the alternative housing requirement becomes less important in light of the new requirement under the Civil Code. The parties must agree that the borrower will deliver the property without occupants in the event of foreclosure, but it could serve to assure that borrowers cannot argue that giving up occupancy of their home in event of foreclosure is tantamount to eviction, entitling them to alternative housing.

Execution Procedures

When court procedures are used to enforce execution of a lien, either after a trial or obtaining certification in the case of a notarized contract under the 1994 Law on Court Procedure), execution must begin within thirty (30) days after obtaining the court order. If no court order is required, as under Paragraph 264 of the amended Civil Code, foreclosure procedures can be initiated immediately upon default in a loan, after notice to the borrower of the method and date of the sale.

Execution can include seizure and sale of tangible assets (real and personal property) of the debtor and garnishment of wages or other income. Under the 1994 law, personal property must be seized and sold before execution can take place on real property. However, as noted above, this provision can be nullified in the case of an "independent mortgage" under the new Civil Code amendments, where only the real estate collateral securing the mortgage is subject to foreclosure. If there is a sale of personal property, certain types of property are exempt, such as household necessities and tools of trade.

It is not clear what, if any, effect the other Civil Code amendments will have on the execution procedures provided in the 1994 law. The basic procedures under that law are as follows:

- Receive extract from registry.
- Register right to execute in registry, upon which seizure becomes effective.
- Obtain official valuation or appraisal from local government and statement of any outstanding taxes.
- Determine asking price on basis of valuation.
- Inform debtor, creditors, and other registered parties.

- Publish public notice of sale (time, place, starting price, and property to be sold).
- Hold auction sale.

For the sale, bidders must qualify to participate by making a deposit of 10 percent of the starting price. The starting price is based on the public assessment or tax value maintained by the local government. The actual sales price can go down to a minimum of 50 percent of the starting price. The successful bidder must pay the executioner within 14 days, after which the executioner distributes the proceeds in accordance with the established priorities. If the proceeds are insufficient to cover the debt and the costs of the sale, the executioner continues to try to seize and sell more assets. Anyone may buy at an auction except the debtor or the executioner. Real property is sold "as is."

Under the 1994 law, if the property is occupied, it is up to the buyer to obtain possession by evicting the occupant. Alternatively, the buyer can negotiate an agreement with the occupant and allow the occupant to remain in the property as a tenant.

The Loan Recovery Working Group

In October 1997, USAID sponsored a Forum on Housing Loan Recovery in Budapest to provide an opportunity to discuss issues that are addressed in new laws but not clear in practice. Participants included representatives of individual banks and their real estate sales subsidiaries, the Ministry of Justice, the Supreme Court, the Association of Banks, the Hungarian Lawyers' Society, the Chamber of Executioners, and the Chamber of Notaries. The participants discussed the applicability of the new laws and implementing procedures, what additional changes in the laws or procedures might be beneficial, and what other action banks can take to increase loan recovery effectiveness.

At the conclusion of the Forum, the participants found there was still confusion and uncertainty about several important issues. They decided to form a Loan Recovery Working Group, a multi-disciplinary task force to study the current status of the legal framework, bank practices, and execution procedures applicable to residential loan recovery, and to identify and make recommendations for resolving problems remaining in management of default risk.

The Working Group divided into three subgroups, each of which focused on one of the following three topics:

- Actual experiences of banks with loan recovery procedures.
- The use of public documents for residential loans.
- The effectiveness of execution procedures.



After completing their research, the subgroups made findings and recommendations for improving the legal framework, court and execution procedures, and bank practices to assure maximum loan recovery in case of default. The results of this work were discussed by a panel comprised of members of the Loan Recovery Working Group at the USAID-sponsored Housing Finance Conference in November 1998 in Budapest, and are fully developed in this final report.

Summary of the Final Report of the Loan Recovery Working Group

This report is divided into several parts, in addition to this Introduction, as follows:

■ **Section I—Current Legal Framework for Execution Procedures, Its Effectiveness, and Recommendations for Additional Changes.** Lenders believe that current execution procedures are not efficient, and the relevant regulations do not encourage market operations based on competition. The Loan Recovery Working Group investigated the effectiveness of current execution procedures, including foreclosure, eviction, and recovery of monetary claims. The report describes how loan recovery procedures should work under the recently enacted laws, what practices lenders can adopt to make execution more expeditious, and whether additional modifications to the legal framework might make execution more effective.

In particular, the report recommends clarification of a lender's rights to foreclosure and eviction without judicial procedures. The new Civil Code amendments provide that if it is stipulated in the loan contract, a borrower in default must deliver the property empty of occupants. They also allow a lender to sell property directly if it has an established market price or if the lender grants mortgages as part of its ordinary business. These provisions are not self-executing, however, and further instructions are needed to clarify how they should work in practice.

In addition, this section includes a recommendation for changing the executions procedures, as submitted by the Chamber of Executioners, and recommendations for amendment of the Execution Law and wider use of public documents, as submitted by the Chamber of Public Notaries. The section also describes a judge's position with regard to the most significant legal issues.

■ **Section II—Benefits of Public Documents for Residential Loans and Experience with their Enforcement.** Lenders believe that foreclosure is not an efficient means of loan recovery because of the high cost and long time required. Under recent changes in the law, a court proceeding is not necessary to initiate foreclosure and execution if the loan contract is a public document. Banks do not routinely use this procedure for residential loans, apparently because they regard as too high the fees for preparing public documents.

The Working Group reports on the following: What are the actual costs of public documents in relation to the benefits of using them? Should use of public documents become standard procedure in residential loans? How should the costs be allocated? How do the costs and benefits of public documents in Hungary compare to those in other countries?

■ **Section III—Measures Taken by Various Banks before Terminating a Residential Loan Contract.** Several banks provided the Loan Recovery Working Group with a description of the procedures they use prior to initiating an actual execution when a residential loan is in default. Summaries of those procedures are provided in Section III.

■ **Section IV—Statistical Analysis of Past Experience with Real Estate Loans in Default and Current Lenders' Loan Recovery Procedures.** Up until now, available information about loan recovery practices and procedures has been anecdotal in nature. This may have caused lenders to perpetuate practices that are based on invalid or outdated assumptions.

Research was conducted to determine the following: What procedures are banks actually using to collect bad loans? Using data from actual cases of default, how long have various steps in the process taken? What problems or complications have been encountered, and how frequently? What might the results have been if procedures available under the news laws had been used? As a result of this work, specific recommendations can be made on how to expedite and increase the effectiveness of loan recovery procedures.

The first results of this statistical analysis were presented at the Housing Finance Conference in November 1998, in the panel discussion "Are Default Risk are Manageable?"

SUMMARY AND RECOMMENDATIONS

The housing finance system in Hungary is at a critical point. The volume of housing loans has dropped, both in comparison to other developed European countries, and to the level of loans made in Hungary several years ago. Other than high interest rates that make loans unattractive to borrowers, the principal reason for the low volume of housing loans is that financial institutions do not regard such loans as secure. Profitable investments due to perceived high credit risk and the need to tie up financial resources for long terms ordinarily associated with residential mortgage lending.

One purpose of the Loan Recovery Working Group was to find ways to help assure that financial institutions can recover their claims more quickly and efficiently,



with the ultimate goal of increasing the likelihood that more banks will provide housing credits on a larger scale.

Problems with housing loans need to be treated differently in different phases of a transaction. Certain measures are appropriate before signing the contract, others during the phase of amicable negotiation between the beginning of a delinquency and termination of the loan agreement, and still others during legal procedures following the amicable phase. The recommendations of the Working Group mainly concern the legal procedures; however, some suggestions deal with the amicable period as well. Recommendations relating to delinquent loans include legal and regulatory modifications and suggestions for addressing specific procedures in the overall financing system.

One of the main tasks for the future will be to modify the legal environment to assure that lengthy court procedures can be avoided in ordinary cases. In cases where the borrower and the financial institution enter into a clearly stipulated public document signed by a notary, the lender can use expedited procedures to obtain a warranty for payment phase and to conduct an auction of the mortgaged property. In addition, if the agreement is properly drafted, the lender can get greater assurance that it will be vacant when sold rather than still occupied by the borrower.

For lenders to be able to implement the expedited procedures, the Execution Law must be amended. Equally important, lenders must develop new attitudes, become familiar with the legal results of their actions and the means of enforcing regulations concerning delinquent loans. The agreement between the borrower and the lender must meet strict conditions supervised by a notary. Otherwise, use of the public document will not be sufficient to carry out its intended purpose: the ability of the lender to commence an auction of vacant property without a lawsuit in the event of intractable default.

Recommendations for Amending the Execution Law

Enforcement of the mortgage during the foreclosure process

Current regulations fail to place mortgage lien holders in a sufficiently strong legal position. The legal power of a mortgage lien should be increased, primarily in order to solve problems arising when a party other than the lien-holder launches a foreclosure procedure against the mortgaged property. Basically, the mortgage lien-holder cannot join the procedure unless it has an enforceable document as well. New regulations can enable a mortgage lien-holder to join a foreclosure procedure simply by virtue of holding a lien on the subject property. To accomplish this, modification must be made to the Execution Law concerning the foreclosure of real property and movable assets and the order of priority of payment to creditors. With the proceeds of a sale, in harmony with the new foreclosure regulations of the Civil Code and to regulate enforcement of a real estate mortgage and a mortgage on movable assets consistently,

in accordance with Section 1, Paragraph 251 and Section 2, Paragraph 263 of the Civil Code. Which assures priority to a claim based on a mortgage. When a third party starts a foreclosure process, the law should provide that claims of the mortgagee cleared by the court in a non-judicial procedure are satisfied as well. In addition, regulations should stipulate clearly which party may start a legal procedure in case the claims are not recognized.

Section 1, Paragraph 151 of the Foreclosure Law should also be modified and should stipulate that the portion of the purchase price required to cover mortgage claims can be withheld from the auction proceeds distributed to other creditors.

At the present time, a bank may lose the collateral for its claim, even when it has a registered foreclosure right on the property, if the borrower sells the property during the term of the loan. In such a case, it is not clear whether foreclosure may proceed on the original property or on new property bought by the borrower, or whether a foreclosure action may be launched against the new owner of the original property used as collateral for the loan. The latter solution would have a very adverse effect on the mortgage lien-holder. Therefore, there is a need to permit lenders to register a prohibition on sale or encumbrance of the property as well as the lien. It may be possible to accomplish this under the existing Execution Law, Section 1, and Paragraph 39, obviating the need to modify the Civil Code. However, the regulations should be adopted to clarify this possibility under the current law.

Vacating the property prior to an auction

A key issue concerning a successful foreclosure is the ability to deliver vacant property to the auction buyer. This also comports with the requirements in the regulations concerning material rights in the Civil Code, Paragraph 251, Section 1, and Paragraph 263, Section 2, that stipulate the “security feature” of a mortgage. The regulations relating to foreclosure should assure the enforcement of these rights, by clarifying the following:

- If the court authorizes the enforcement of rights under a mortgagee, it should at the same time order that eviction from the property can be enforced in the foreclosure process, on the theory that the former owner (the borrower) no longer has title to the property.
- The “security feature” of the mortgage should be enforceable in a foreclosure started by a third party as well. Accordingly, a mortgage could terminate during the foreclosure process but the mortgagee would be compensated from the sales proceeds through a non-judicial procedure.



- In general, the parties to a foreclosure must assure that the buyer receives a vacant property vacated after the auction. They should determine whether there are other interests or claims against the property.
- The need to transfer vacant property to the buyer may require reconsideration of Paragraph 48 of the Civil Code. As a general proposition, it is not advisable to maintain two different sets of mortgage enforcement regulations. However, first it is necessary to establish the constitutional basis for unification of the laws. If a loan contract signed after Paragraph 48 of the Civil Code went into effect does not stipulate that the borrower is required to deliver the property vacant this situation cannot be changed by subsequently adding language to Paragraph 48, since it cannot place requirements on the borrower retroactively.

Increasing the Efficiency of Auctions

The territorial competence of an execution officer should be increased in cases where the debtor's property of the debtor lies outside the jurisdiction of the officer or in more than one jurisdiction.

An expert should establish the value of the subject property, both in a vacant state and an occupied state, if appropriate, before the auction. This may incur additional expense for the bank, but it assures that the fair market value has been established if the sale is subsequently challenged in court.

To achieve greater public participation and transparency, auctions should be organized in large auction halls or courthouses, or regulations should require publication of sales in Action News, or the official newsletter of the Chamber of Executioners.

Once there is certainty that property will become vacant at auction and auctions gain broader publicity, regulations should be stipulate that the bidding price cannot be lowered at the first auction.

Extending the use of the public document

Financial institutions do not routinely use public document for housing loan contracts, reportedly because of the extra cost. To extend the use of public documents, preparation fees should be lowered, at least in the case of smaller transactions, and, if a financial institution develops and uses a standardized form, notaries should charge lower fees. It may also be possible to expedite court procedures for claims based on contracts without public documents. Court procedures concerning defenses in foreclosures need to be updated, and implementation of judicial decisions regarding foreclosure should be accelerated.

Recommendation for increasing the efficiency of foreclosures

Analysis of available data shows that the amicable phase between the beginning of a delinquency and termination of a loan agreement lasts too long. In most cases, delinquency is the result of “structural” changes (unemployment, economic crisis in the region, etc.), that are likely to make it very difficult for the debtor to cure the delinquency. Financial institutions should be able to differentiate these cases from those where the problem is less severe or temporary (enlargement of the family, divorce, change of job, etc.), and the chances to remedy the delinquency are higher. In the first scenario, the lender should terminate the loan, as quickly as possible; in the second, it should attempt amicable settlement for a longer time or renegotiations of the loan terms.

Where there is little likelihood of recovering a delinquent loan, for example, if the property did not get built, government guarantee could be helpful in enabling financial institutions to write off delinquent loans and shorten the period during which arrears continue to accumulate.

Efficient treatment of delinquencies requires thorough knowledge and prompt enforcement of legal options; therefore, it is essential to strengthen the legal departments of financial institutions. At the beginning of a transaction, financial institutions should make sure that they enter into an agreement that fulfills the strict conditions and qualifies the lender to use the available expedited foreclosure procedures. One precondition is the use of public documents. By modifying the Execution Law and increasing the force of the public document, banks will have a stake in requiring such documents. Since their widespread use is in the interest of notaries as well, notaries should decrease their fees in routine cases.

Executioners play a key role in the success of foreclosures, especially in assuring that the property is vacated before the auction and the procedure receives a high level of publicity, assuring the maximum level of recovery.

SECTION I

The Effectiveness of Regulations on Foreclosure Procedures and Recommended Changes

The use of mortgage liens to secure housing loans has been a widely used practice in Hungary, even before the change of regime. From the period during and just after World War II until 1994, it was very difficult, if not impossible to assure that the property used as collateral would be vacate if there were a foreclosure auction. Primarily because no eviction could be ordered against an occupant who lost title to the residence after default unless an alternative dwelling of regulated quality was made



available by the lender¹. Based on authorization regulations of the Civil Code in effect at the time², courts came to the interpretation that the alternative dwelling rules should be applied. Not only for rental flats but also in relation to occupancy of a dwelling under title registered in the Real Property Register, including ownership and usufruct.

OTP, the state savings bank, enjoyed a monopoly in the housing finance market. Due to that factor and the underdevelopment of the housing market, the mortgage lien as a legal institution was rarely used; even for loans with a loan-to-value ratio of 1 to 3 guarantors had to be provided as secondary collateral.

The rules on eviction from rental dwellings substantially changed in 1994 with the adoption of the Law on Rent and Sale of Housing, which provided that a person who loses title to a property could be evicted under an execution procedure without being provided with alternative housing. The new Law on Execution confirmed this rule as well³. As a result of changes in law, the Supreme Court withdrew its former Policy No. PK 70⁴.

Options for Asserting Claims Against Defaulting Borrowers

In making housing loans with mortgage collateral, the lender has two basic options for asserting a claim if the borrower does not pay:

- On the basis of a claim against the property secured by the mortgage, the bank may satisfy its claim through auctioning the mortgaged real estate in a judicial process for a price set within the parameters of the law [Civil Code subs. (1), Section 251]. Or through non-judicial foreclosure in accordance with procedures established in the Civil Code and the Law on Court Procedure [Law No. LIII/1994]. These procedures are not aimed at the collection of money but at the seizure and sale of the mortgaged asset to satisfy the debt.
- On the basis of a pecuniary claim (a claim for money owed), the lender may terminate the loan agreement [under Civil Code subs. (1) and (2), Section 300], with the result that the entire sum outstanding becomes due [CC point e), subs. (1), Section 525]. The Civil Code provides a number of justifications for termination, in which case the lender may end the legal relationship unilaterally and immediately, if the financial situation of the debtor deteriorates

¹ Such rules were legally based on the provisions (Article 114-126) of Section 15 of the former Housing Decree on offering alternative housing to persons that have lost title to their houses. This Decree was intended to regulate rental flats only, but one of its provisions [Article 151. (1)] Expanded the scope of the rules to "usage of housing under titles other than renting" as well.

² Article 450. (2): "In relation to issues related to rental flats and not regulated in this law, the provisions of separate laws and the rules on renting things shall govern."

³ Article 181-184 of Law LIII of 1994 on Court Execution

⁴ Withdrawn by Policy PK 288 dated April 11, 1994

to an extent which endangers repayment or if other terms of the loan agreement are not met.

Usually, judicial proceedings serve as the basis for foreclosure of mortgages or assertion of pecuniary claims. The Law on Court Procedure permits direct execution of either kind of claim, if the loan agreement is prepared as a public document, as long as the lender makes a payment warrant in the case of a pecuniary claim. Until clearer regulations or practices are established for use of these procedures, however, it appears likely that lenders can avoid an action at law (and the payment warrant) only in the cases of voluntary compliance by the borrower.

The law provides ways for foreclosure of mortgages through which the lender may completely evade the long and costly procedures (including large losses for the debtor) through assertion of rights in both a court procedure establishing the lawfulness of the claim in conjunction with the use of public documents, and the judicial execution procedure. This legal possibility can be expected to play a greater role in the foreclosure of mortgages securing housing loans, in procedures that are not only expeditious but also advantageous to the debtor as well as the creditor.

Assertion of rights through official procedures is discussed below in Part I. Procedures for foreclosure of mortgages outside of official procedures are discussed in Part 2.

Foreclosure of Mortgages and the Assertion of Pecuniary Claims through Official Procedures (Judicial, Public Notary and Judicial Execution Proceedings).

Procedures Before Execution

For the assertion of a claim through judicial execution, the entitled party needs an executory document on the basis of which the judicial execution may begin. The AEx (Section 10) establishes the types of such documents. From the point of view of the foreclosure of a mortgage securing a housing loan or the assertion of a pecuniary claim based on a loan agreement, it is the executory page (AEx, Section 15) and the judicial executory clause, which may be relevant.

An executory page is usually issued by the court on the basis of the condemning resolution of the court in the civil matter. In the case of a mortgage, it allows the auction of the real estate and the satisfaction of the claim from the auction purchasing price; for a pecuniary claim, it is a ruling for payment (a non-appealable payment warrant).

The court on the basis of a special public notary document, which document must contain, issues an executory clause:

- The assumption of a responsibility



- The name of the party entitled and the obligee
- The subject of the obligation, the amount, and the title
- The terms and due date of performance (AEx subs. (1), Section 21)

On the basis of this, both types of claims may be asserted, if the due date of performance has passed [subs. (3), Section 21].

In the course of marking the documents to which a clause may be added, the AEx also contains a provision especially for foreclosure of mortgages [point c), Section 22]. Basically, both sections of the Act designate an identical public document; there is no difference in content between them.

To summarize, the official procedures preceding the executory procedure are as follows:

- In the payment warrant procedure, the payment of the pecuniary debt may be demanded. The foreclosure of mortgages is not possible in this procedure. The assertion of pecuniary claims through a payment warrant may take place on the basis of a declaration of a payment warrant as non-appealable (if the obligor does not dispute this) or, in the case of the contradiction of the obligor, on the basis of a non-appealable resolution in the procedure thus transformed into a lawsuit.
- In legal proceedings, the mortgagor may assert his claim both on the basis of pecuniary claims and mortgages. On the basis of a non-appealable court order and the demand of a creditor bank, judicial execution may be initiated.
- If the contract concerning the loan was prepared in a public notary document, then both the payment warrant procedure or the legal proceedings may be avoided. If the obligor has not fulfilled his obligation and the party entitled so demands this, the court may add a clause to the public document on the basis of which the execution may be initiated.
- The inclusion of the mortgage contracts in a public document. In practice, this is not a provision in force as inclusion in public documents is entrusted to the public notaries and to other authorities (e.g., courts, administrative bodies) which presently do not have as their task the preparation of contracts, thus, the public notary document form is the relevant form.

Judicial Execution Procedures

The foreclosure of mortgage, as the assertion of a right of lien usually takes place in a judicial executory procedure [CC Section 262]. The judicial execution of a non-appealable judgment on a mortgage claim or a pecuniary claim (in the latter case,

the payment warrant declared non-appealable) takes places in a different way, although in the end it leads to the same result. Because of the special role of the mortgage claim as security, the mortgage obligee is much more protected by execution law, through enforcing the relevant prescriptions of substantive law [CC sentence 1, subs (1), Section 251; sentence 1, subs (2), Section 263]. The legal defenses against assertion of a mortgage claim are limited only to strongly justified cases, such as a claim for maintenance, and may not substantially injure the interests of the mortgage obligee.

Judicial foreclosure of a mortgage is focussed on the seizure and the auctioning of the mortgaged real estate, omitting the seizure of other chattels and the income of the debtor. This is favorable from the point of view of the timeliness of the procedure, and it is worth choosing this when the income and other chattels of the debtor do not provide sufficient coverage but the value of the pledged real property is sufficient.

In judicial execution of pecuniary claims, the principle of gradualism is applied. The seizure is made first, then other income and chattels of the debtor. Only if these do not prove or foreseeably will not prove sufficient, can the bailiff extend execution to other assets of the debtor, such as the mortgaged real estate.

Security under the right of lien derives from judicial execution of two substantive laws in the course of the foreclosure of the mortgage claim:

- The right of lien shall ensure satisfaction preceding other claims in order [CC sentence 1, subs (1), Section 251].
- Rights originating after the mortgaging shall not effect the right of satisfaction of the mortgage obligee [sentence 1, subs (2), Section 263].

These regulations naturally confer a greater advantage in assertion of the mortgage claim, as compared to the assertion of the pecuniary claim.

Act LIII/1994 on Judicial Execution (in the following: AEx) shows the procedures initiated upon the demand either of a mortgage obligee or a third person outside of the borrowing agreement. The judicial executory procedure and other administrative procedures (especially the tax collecting procedures) initiated by third persons belong to the latter, that is we shall examine what the situation of the mortgage obligee - namely the mortgage obligee of the real estate - is in these procedures.

Another important aspect is how the rights of the obligees of the registered and non-registered real rights and contractual obligations affect the right of the real estate mortgage obligee. And finally, the regulations of the order of satisfaction also affect the effectiveness of the substantive law.



Execution Procedures Initiated by the Mortgage Lender

Proprietary Rights

Execution of a mortgage is aimed at transferring proprietary rights in the subject property. In the course of an auction, the buyer ordinarily acquires unencumbered property. Remaining encumbrances concerning the property are listed with a tax character (Section 137).

There remains substantial controversy, however, about whether the debtor may occupy the property after the auction, and how the auction buyer can obtain the property in a vacant state. Neither the AEx, nor any other substantive law, ensures such a result. Judicial practice (PK. standpoint 70) was developed in line with previous housing regulations, in that the former owner (the defaulting debtor) may continue to occupy the property after the auction, as a user or tenant.

When this occurs in the course of mortgage foreclosure, the real estate is designated as inhabited in the auction conditions, and the auction price is set accordingly at half the value of the vacant property. Thus, the auction buyer may not demand the vacation of the property, since he has only paid the value of inhabited property. Nevertheless, the former owner no longer has title and often the auction buyer tries to "put him out," usually with less than satisfactory results for all concerned.

It is the interest of both parties, if the real estate falls under execution, to have the auction quickly, and to sell it at the highest price possible. The time span of the foreclosure and sale increases the mounting debt of the debtor, through transaction costs (29 percent) and interest on default (a further 6 percent according to bankers, debt on property to be auctioned often reached three times the amount of capital debt. In the course of the average complete period of the assertion of the claim (about 4 years), the arrears of interest reach the total value of the real estate; therefore, the owner does not receive any part of the auction purchase price.

Sometimes, speculators appear at auctions that purchase the real estate with the intention of obtaining possession later on through illegal means. These illegal actions result in the auction buyer unfairly acquiring the difference between the vacant value and the auction price based on the inhabited value of the real estate, which is usually one half of the vacant value.

It would be advisable to advertise auctions of real estate at vacant value, and provide the executor with the legal means to hand over the property empty of inhabitants. Or guarantee that it will be empty within a time limit after the termination of the auction according to the legal rules.

Because legal proceedings substantially prolong the time of satisfaction through the collateral, it is necessary to understand the procedures through which satisfaction can be obtained without formal legal proceedings.

Section 48 of the Civil Code, as revised, maintained the previously prevailing uncertainty for loan agreements concluded before its coming into effect concerning the nature of the title the former owner has following foreclosure. For loans concluded after its effective date, this provision clearly provides that former owner must deliver the property vacant for foreclosure if there is a specific clause to that effect in the loan agreement. It would be preferable, therefore, to state *expressis verbis* in the Law on Execution that the debtor may not continue to occupy the property after the auction. It may be argued that it is not reasonable to exclude loan agreement made before the amendment to the law from the requirement that the debtor vacate the premises.

It is important to remember, however, that there are non-legal considerations, which greatly influences the effectiveness of the executory regulations, such as the social aspect of the premises and the effect of eviction on the debtor's family. Because of the interest on default, the transaction interests and the costs, the debtor is unlikely to receive any funds from an executory auction with which he could solve his own housing problems by leasing or buying a more modest dwelling. So it is necessary to examine the possibility of establishing a system to ensure sales outside judicial executory procedures, and perhaps provides a modest flat in exchange for the debtor, with easier loan or lease conditions.

Usufruct and Other Land Easements

For this issue, the Law on Execution does not assert the rule of sentence 1, subs. (2), Section 263 of the Civil Code, providing that rights arising later shall not effect the terms of the mortgage. The prevailing rule should be the date of registration, or the date of origination of the usufruct, and any rights thereafter shall be null and void after the auction. It seems reasonable, however, to accept as a counter value for the rights eliminated in the course of execution, that the formerly entitled party be ensured some kind of satisfaction. Perhaps through inclusion in the distribution plan, and should receive satisfaction on the basis of expert appraisal of the value of the right.

Further study is necessary concerning land easements and whether they continue to exist on the basis of the provision of the revised law, regardless of the date of their origination.

Lease

The Law on Regulation of Rent and Sale of housing (1993) regulates this question adequately. Basically, change of ownership does not effect the rights of a tenant. Exercise of the right of disposal by a new owner after foreclosure is controlled by



the regulations on the right of notice. Presently, free notice to quit exists, but such notice may be given without providing an alternative dwelling only if this has been stipulated in the lease contract. This is obviously a disadvantage if a borrower rents a mortgaged dwelling after the conclusion of the loan agreement.

Execution Procedures Initiated by a Third Party against a Debtor

Two kinds of such procedures are possible when execution is initiated by a party other than the mortgage lender: judicial execution, and administrative execution (typically, a tax collecting procedure).

In the case of judicial execution, a lien on the property securing a mortgage ceases to have effect. On the basis of Section 137 of the Civil Code, the lender with real estate as security is not even included in the distribution plan. This is contrary to the preferential claim of the lender with a chattel mortgage (AEx Section 114). If the mortgage lender does not dispose of a non-appealable document, under which the debtor is required allow the satisfaction of the lender from the auction purchase price, its mortgage rights are lost and the lender does not receive any security or satisfaction in exchange. This is possible, however, only if the loan agreement is included in a public document.

On the other hand, the judicial procedure allows the possibility for a mortgage lender to await for the court to back this document only in the case of a mortgage contract included in a public document. Then the lender may cancel the agreement on the basis of the financial condition of the debtor, proceed to try to collect the entire amount of the loan balance.

Proposals for Solution

Judicial Execution. In the course of an execution procedure, before the preparation of the distribution plan, a mortgage lender and registered and known obligees receive notice of the pending action. The problem is how the mortgage lender may join the course of the execution if he does not dispose of a non-appealable document. In this regard, the requirements included in Resolution No. 46/1991. (IX. 10.) AB of the Constitutional Court should be taken into consideration, so that the procedure can be regulated constitutionally. The resolution of the Constitutional Court provides that an execution procedure may begin only if the demand of the party requesting the execution has been adjudged by the court, and in the course of the procedure the debtor was informed about the claim against him and has had adequate opportunity to present a defense. (Reasons, Chapter II).

However, under the Constitution there are other possible enforceable documents, such as a distraining decree of a public notary, if the debtor has knowledge of the claim before the start of the execution and if he has recourse to defenses against

the decree on the basis of which the court, after adjudging his objection on the merits, may nullify the public notary's decree (Reasons, paragraph 3-4, Chapter III). Though the present AEx does not regulate this executory form, the opportunity for a mortgage lender to join into the procedure should be considered, with the introduction of a court decision. The existence of the mortgage and the validity of the claim would have to be demonstrated in the procedure. Theoretically, the property registration system should be adequate evidence of the authenticity of the claim, but in practical terms the administrative delay in registration could make other form of proof necessary, at least at the present time.

The validity of the claim may be clarified in an expedited procedure so the court (possibly the executory court, as the real estate probably lies in its area of competence) hears the debtor, the party(ies) demanding execution. Then, if the debtor acknowledges the debt, the lender's participation in the execution would proceed. If there are several creditors and one objects to the validity of the claim because it might affect the satisfaction of his claim detrimentally, that creditor would be ordered to initiate a lawsuit. If the debtor does not acknowledge the claim, then the lender would be ordered to initiate a lawsuit.

It should also be considered whether the bailment of one of the securities should be demanded for the objection of the debtor to take effect, since the lender may lose part of the difference between the contractual interest and the court bailment interest during the enforcement procedure.

An important question is how to retain the effectiveness of a mortgage during an execution procedure initiated by another party, for the benefit of the lender and also for the debtor, who may be regularly paying his debt and wants to avoid bankruptcy. At this point, the working group was unable to propose a concrete solution to this problem.

Administrative Execution. The AEx's provisions are used for real estate foreclosures in administrative executions as well, unless the law provides otherwise. a problem arises if the administrative procedure has begun and the mortgaged real estate has been seized, typically for the collection of tax arrears. In these cases, it would be reasonable to proceed as proposed for the case of judicial proceedings initiated by third persons.

Further study is necessary to make proposals for a remedy consistent with the AEx, including the study of execution laws of other countries.

The Order of Satisfaction in Judicial Execution

Claims secured by a mortgage, in accordance with subsection (2), Section 170 of the AEx (as revised), are satisfied in fourth place. If there are multiple mortgage claims, satisfied in order of registration.



Mortgage claims do not affect the order of satisfaction of claims for the first three categories. An example: it is not possible to amend the allowance obligation determined for several children to secure the allowance of one child with a mortgage if this would decrease the amount of property available to secure the allowance for the other children.

Other Problems Considered by the Working Group

With regard to the AEx regulation, questions have arisen concerning the lawful time period for executory measures, including: the mailing of the notice of payment for the expenses advanced, which is a precondition of the executory measures; the first executory action after the arrival of the expenses advanced, and the transfer of the purchasing price received from the successful sale.

The regulation of the lawful period of the demand for the payment of expenses advanced is expected to be resolved. However, there is little expectation for a more specific regulation on the first executory event after the receiving of payments advanced, because this may not be increased in accordance with the law. Instead, the problem must be adjudged in the course of supervision in a specific execution procedure.

Methods of Satisfaction Outside Judicial Execution Procedures

Cases of foreclosure involving a dwelling occupied by the debtor present problems, which require solution outside of judicial execution.

The Civil Code contains three cases for assertion of rights of lien claim outside the administrative procedures, as adaptations of the private sale figuring in Anglo-Saxon law, when the sale may take place outside the judicial execution.

The parties may agree in the loan agreement that the lender itself may sell the real estate if the lender engages in mortgage lending on a business basis [CC subs. (2), Section 264]. Under a more narrow interpretation, this may include only specialized credit institutions; the more common interpretation is that this includes any credit institution, which grants credit with mortgage collateral.

The new rights of lien regulations of the Civil Code offer further possibilities in this direction. The lender may also stipulate in the loan agreement that at the time of default, the debtor must turn over the pledged real estate to an entity that handles auctions or makes mortgage loans in the regular course of business [subs. (3), Section 264]. Even if the creditor itself does not satisfy either one of these two conditions, all administrative procedures may be avoided by giving a commission for sale.

The Civil Code provides a further possibility of sale by the lender in the cases where the pledged property has an officially quoted market price. However, the current level of development of the real estate market probably does not yet provide a sufficient base for this.

The effectiveness of these new rights of lien would be greater if it were possible to establish a system under which, at the time of the first payment arrears, temporary payment difficulties could be differentiated from permanent or at least long lasting payment difficulties. In the latter, the debtor could be offered a flat burdened by a smaller loan and a smaller monthly obligation. If the debtor can successfully be retained within the housing loan system, he can be relocated without great hardship and his initial dwelling can be sold much more advantageously than through the utilization of judicial foreclosure and execution. Rapid placement also prevents the accumulation of interest and thus the accumulation of additional debt against the real estate during the long period of the court procedure for the assertion of the claim.

However, a system of non-judicial foreclosure can work only clear regulation of the judicial procedure also exists, as a deterrent to delay and to assure that the property can be sold vacant (and therefore at highest value) in a relatively short time. Within developed market economies, The United States is the shortest: 8 months on average; France is the longest: one and a half years⁵. This period includes the entire procedure from default in payment through auction.

Knowing that the official procedure is efficient, a debtor cannot expect that the lender will not be able to assert a claim expeditiously, or that he may remain in the dwelling after the auction. He is more likely to weigh which procedure would be most advantageous to him in terms of future housing possibilities. A debtor with long-term payment difficulties ordinarily would choose not to impede the free market sale of a vacant property⁶.

When there is predictable certainty and speed in foreclosure procedures, one of the impediments to granting a higher ratio of credit may also be overcome. For example, OTP Bank now grants credit up to one third of the value of the real estate. With inflation under control and decreasing, the opportunity to grant a higher ratio of credit goes up with the level of security of the collateral. In the developed economies, this ratio often reaches 75 or 80 percent or even more of the value of the real estate. Studying the operation of this system in other countries, and its potential applicability to Hungary, seems justified at this time.

⁵Data from the housing loan return conference held in the Gellért Hotel in Budapest in December 1996.

⁶According to the practice of the Uniform Commercial Code of the United States as well, the pledge acquiring the proprietary rights can only utilize sale outside of the judicial procedure successfully if it is "possible without the upsetting of the peace" (article 9-503; quoted by part IV, page 7, paragraph 1 of the studies prepared concerning the amendment of the right of lien regulations of the Civil Code).



RECOMMENDATIONS OF THE CHAMBER OF EXECUTIONERS

This chapter is based on the practical experiences of real estate executioners and their recommendations for solving problems remaining in current execution procedures. At the outset, it should be stated that the available statistical data reflect only a small portion of actual real estate executions because executioners are not required to compile this information.

From 1995-1997, actual forced sales of real estate were as follows: Independent court executioners (187 and 195 persons, respectively) effected 3,499 successful public real estate sales. In 1,736 cases, the actual price reached one half of the advertised minimum price. In 2,328 cases, the properties being auctioned were occupied. In the course of these cases, there were 12 evictions; in other cases, where the properties were not sold, there were 1,397 such cases. Thus, it can be inferred that in forced sales of occupied properties, evictions occurred in a very small percentage of cases. The number of properties sold well below their market value due to the fact that they were occupied was significantly higher. A right of usufruct over the subject real estate has the same price-reducing effect. This is especially unfavorable for the creditor if the bearer of the right of usufruct is the same person as the debtor.

Two factors are of major importance with regard to more efficient managing of real estate executions and auction sales:

- First, there must be the widest possible publicity for the sale. This can be achieved through diversifying the methods of publishing public sales. A decisive step in accomplishing this objective was taken by the Executive Chamber of Hungarian Courts when it established the paper called Public Sales News, which has a weekly circulation of several thousand.
- Second, there must be a proper legal framework for providing guarantees to the creditor and the purchaser of the property as well as to the debtor. Current regulations are inadequate for this purpose. They do not provide participants in the process with clear-cut rights of occupancy or methods of assuming possession of property occupied by the debtor. This discourages the majority of potential purchasers from participating in auction sales, and encourages speculators, who may be unscrupulous, which has an unfavorable influence upon both the executioner and the interested parties.

The Chamber of Executioners proposes to resolve the situation by the following legal regulations:

- Paragraph No. 137 of the Law No. LIII of 1994 should be amended to include the same content as Article (1), by adding the following attachment as Article (2):

- "Article (2): the right of usufruction is lost in case its bearer is responsible as debtor or with the same rank for the claim as that being prosecuted."
- The content of Paragraph No. 143, Article (1), remains unchanged. The following should be added as Article (2):
 - "Article (2): the property may be regarded as occupied if:
 - It is occupied by a person or organization with a valid lease contract;
 - It is occupied by the usufructuror;
 - It is occupied by a non-debtor co-owner, in cases of undivided jointly owned real estate.
- (3) A real estate occupied by the debtor or his/her family cannot be regarded as being occupied."
 - Paragraph No. 154 should be amended with the following Article (4):
 - The debtor and his/her family is obliged to leave the premises and remove all their belongings within 30 days following the public sale of the property, thus to assure that the executioner can hand over unoccupied property to the purchaser.
 - In case the debtor does not comply, the executioner shall take the measures indicated in article (3) of Paragraph No. 183.
 - At the request of the purchaser, the executioner shall submit the case to the court. The court shall take the measures indicated in Paragraph No. 183.

If these regulations were put to effect, legal security would be universal with respect to the debtor, the creditor, and the purchaser; such guarantees would eliminate uncertainties encountered at public sales. Advantages would include the following:

- Because the purchaser would be assured that he/she could take possession of the real estate, the property would be auctioned at the highest possible price.
- The creditor would enjoy greater security with regard to payment of sums due from the debtor.
- The debtor would receive the highest possible price for his property and could thus achieve the greatest reduction in his debt to the lender or possibly even the balance of funds left from the auction after all creditors are paid.



- These provisions would end rumors about possible links between the "Housing Mafia" and the justice system.
- Legal security would be universally and fairly applied.

RECOMMENDATIONS OF THE CHAMBER OF NOTARIES FOR AMENDMENTS TO THE EXECUTION LAW AND FOR MORE EXTENSIVE USE OF PUBLIC DOCUMENTS

The Chamber of Notaries fully supports increasing the security of housing credits and the likelihood of recovery in case of default. That objective would be served by modification of legislation on foreclosure, discussed in Part I, below, and by the wider use of public documents, as discussed in Part II, below.

Modification of legislation on foreclosure

Amendment of relevant provisions of Act LIII of 1994 (the Law on Execution):

An important issue is the delay in registration of title to property in the land register. The rules on foreclosure, as specified in Articles 110-113 of Law on Execution, provide a solution only in cases when there is a claim for money, security or physical chattel on the basis of nonpayment of a loan. These articles of the law offer no solution in a case where there is an assertion of rights to ownership of the property itself because of the obligor's default in a legal obligation. The contract to obtain ownership of the property is executed by the transfer of title. Such a contract can be executed neither by depositing the sum in the foreclosure escrow account nor by using the subject of the receivable as a judicial deposit.

A solution is presented in Article 132 of Act LX of 1881, which could be adapted in modernized form. Thus, if an executioner confiscates the existing claim of a debtor in relation to a property owned by a third person -- an obligatory right -- the executioner may register ownership of the property in the land register when the obligatory right becomes due. Then, when the debtor takes title to the property, the executioner could confiscate the property.

Another solution could be for the executioner to submit an application for confiscation to the court and the court to authorize the applicant for confiscation to assert the debtor's ownership right or other right in REM available to the debtor, register the property in the name of the debtor, and assume the right to act on the debtor's behalf. That would make it possible to prevent the situation when properties on which the debtor has valid obligatory rights are excluded from foreclosure for lack of registration of ownership in the land register.

The justification for Articles 110-113 indicates that rules on confiscation of property also cover the right to the value of the property if it becomes subject to foreclosure, but the regulations do not contain provisions under which the applicant for foreclosure could realize the obligatory rights of the debtor in relation to ownership of the property and could have the debtor's ownership rights registered in the land register and proceed to foreclosure. If the subject of foreclosure is the right to enter the ownership rights of debtor into the land register, the property compulsion will have the objective of limiting, then withdrawing such rights by the person requesting foreclosure, and as a result the performance of the obligations of the debtor.

It was unfortunate to replace Article 55, Section (1) of Law No. 14/1979. (IX. 17.) by Article 150, Section (1) of the Law on Execution. The justification for Article 150 does not explain the change. The text for the former permits the buyer at auction to retain all or part of the purchase price in case there was a "receivable" registered in the land register on the subject property. These regulations would permit a mortgage lender, if the buyer at auction, to retain the portion of the sales price covered by the mortgage. On the other hand, Article 150, Section (1) of the Law on Execution leads to a different result; it provides the right of retention only in the case when the buyer at auction has a claim against the debtor in relation to which the "foreclosure right" is registered in the land register for the property sold at auction. It is not sufficient to have receivables covered by a lien registered in the land register; a right to foreclosure should also be registered. The lender's security would be much better served by return to the original text.

The Law on Execution is not consistent with changes in mortgage rights contained in the amended Civil Code. In the case of the foreclosure of chattels, it does not take into consideration that chattels can be encumbered not only by pledge but also by mortgage; because the law speaks about mortgagees in a uniform way, mortgagees have unconditional indemnity priority. This priority is realized in the case of chattels, while this rule is not applied to real estate foreclosures. In the case of chattels, the executioner is ex officio obliged to invite the presentation of claims by other parties who have priority rights, while in the case of real estate there is no such possibility. The mortgagee does not receive compensation from the purchase price on the basis of the mortgage alone, only if it participates itself as the applicant for foreclosure.

According to the provision of Article 268, Section (1) of the Civil Code the mortgage terminates when the property is sold in the course of foreclosure. In this case the mortgagee can realize its indemnification right in relation to the collected purchase price.

The provision of AEx however was not fit to the provision of Civil Code referred to. According to AEx the mortgagee has no possibility to realize its indemnification right in relation to the purchase price obtained in the course of the foreclosure procedure, although its mortgage right will terminate with the sale of the property at the auction,



while, concurrently according to the provision of Article 268, Section (1) of the Civil Code its indemnity right opens. The lien thus terminates, the indemnity right opens by law, while in actual fact it cannot obtain from the purchase price its receivable covered by mortgage. It can obtain its due share in the exceptional case if not later than the preparation of the distribution plan such mortgagee is in the position to obtain a document which can be subject to foreclosure and thus join the foreclosure procedure.

Thus for failure to have updated the relevant provisions of AEx withdraws from the mortgagee the collateral of its receivable despite of the provisions of Article 268 of the Civil Code.

Thus it is necessary to amend AEx- to permit the realization of the provision of Article 268, Section (1) of the Civil Code so that from the purchase price obtained at the auction those mortgagee lenders should also be indemnified whose mortgage has terminated by the sale and could not participate in the foreclosure procedure in the quality of applicant for foreclosure. As the receivable covered by lien - whether the receivable covered by mortgage was or was not overdue - and as under the provision of Article 268 Section (1) of the Civil Code the indemnification right of the mortgage lender opens with the sale of the property at the auction, whether the receivable covered by the mortgage was otherwise overdue or not, on these basis of these provisions no differentiation should take place among the mortgage lender whose receivable covered by the mortgage was due and were in the position to initiate foreclosure and those lender, whose indemnification right simply opened due to the sale at auction.

Just as the law article LX of 1881 does not differentiate, AEx must also not differentiate between liens covering overdue and not overdue receivables. "Thus the act does not differentiate when establishing the indemnification sequence between overdue and non-overdue mortgage debts, every real mortgage covered receivable must be paid in the sequence, and that is made obvious also by the fact that law article LX of 1881 , Articles 192 and 193 provides separate provisions on how to indemnify receivables which are not due yet on the day when the price is distributed " (K. 14th of January 1932- P.V. 136/1931).

Thus the modification of AEx is necessary in relation to liens covering chattels as well as property so that out of the sums obtained on them in the course of foreclosure the mortgage lenders are paid in the sequence of the date of mortgage registration, and they should be considered for the purposes of distributing the revenue whether or not they participate in the procedure as applicants for foreclosure.

To solve possible disputes, in an updated form Article 190 and the articles following it in law article LX 1881 should be adopted to clarify the scope of indemnification right and the disputes over the distribution of purchase price. Namely: if the validity or sum of the mortgage covered receivable is objected to be the debtor: the lender - if not certified in the course of the negotiations on the sequence that its

receivable had been established by absolute decision or court compromise should be executed by law without preliminary litigation in case the document states such execution or litigation is under way- in which case it should be instructed to go to court. Similarly the lender can be instructed to turn to court in case its claim is objected to by the debtor or by some other mortgage lender. Apart from such cases, if some other lender submits objection against a receivable certified by some resolution with legal force or compromise and not objected to by the debtor the objecting lender should be instructed to litigate the case.

If the receivable is based on resolution of legal force or some document to be executed without preliminary litigation, objections can only be considered if the objecting party has made it likely in the course of objecting that after the date of the resolution to be implemented, compromise or the date of the document some facts arose which made them invalid. In such a case, whether the debtor or the creditor raises the objection the objecting party should be instructed to turn to court.

The party instructed to go to court should launch a case within 30 days after the resolution becomes absolute and should report to the land register authority (according Hungarian legislation in effect to the proceeding executioner) within the same deadline to have performed the action. Should some record in the land register be objected to, the objecting party should be instructed to turn to the court.

Only such party can object to the record in the land register who is authorized to make objection according to the provisions of the decrees on the land register.

The lender shall be instructed to carry on a lawsuit also if the mortgage is registered to secure a conditional or future receivable and some other mortgage lender or the subject of foreclosure makes objection under the title of the realization or non-realization of the condition or because the receivable did not emerge, and in the case of the security lien (in current Hungarian legislation simple lien - with the exception of independent lien- every lien is of security type, including possible head mortgage, and there is no differentiation between simple mortgage and security mortgage) the receivable charged is objected to be some other mortgage lender or the subject of foreclosure.

If on the ranking place of an countermanded mortgage repayment receivable is charged on the basis of the payment of the receivable, in case the repayment receivable is objected to the party charging the receivable should be instructed to carry out a lawsuit.

Thus the solution to be employed is known and thus the lien can be realized, of the sum collected in the course of mortgage foreclosure the mortgagees can be indemnified and the lien reaches its objective.



Naturally the regulation can be updated, in the course of the approval of the distribution plan the court can decide in extra-judicial procedure on the issues Act LX of 1881 qualified as being subject to lawsuit. The possibility of indemnification of the claims of the mortgagees out of the collected sum, the validity of the mortgage covered receivables, their actual sum can be decided on - on the analogy of the liquidation procedure in extra-judicial procedure also, in the form of resolutions, by the court executing the foreclosure in the form of procedure as per Article 171 of AEx.

The costs of the agreement composed in public document

If the contract was prepared in the form of public document, for the contract the parties shall pay the legislative fee (of fixed, maximum price, as stated in decree 14/1991. (XI.26.), in the case of unilateral recognition of the debt, half of that fee. If the party (bank) submits a draft, that fee can be further reduced by 50 percent (R.7 Section). The concrete rate of public notary fees ranges - depending on the value- between 0.1 percent and 1.6 percent. IF for the purposes of establishing the standard credit fees or commissions the Bank takes into consideration and undertakes the payment of the notary fee, that will not mean extra expenditure for the beneficiary clients.

Those who believe that the form of contract of the private document form with full probative force does not involve cost, are wrong. It is most risky to have such type of contract prepared by a lay person, so that could not be done. If prepared by an advocate legal cost - based on free agreement- is to be paid, and if prepared by a legal consultant on the bank's staff the proportionate part of the employment costs (salary and salary taxes, overhead costs) are to be covered by the bank.

It follows, that taken together, the least costly solution is if the contract is prepared in the form of public document. In relation to the costs it should be remembered that savings occur from the possibility for direct foreclosure and the probative force of the public document when the lien is realized. The full responsibility of the public notary under the Civil Code, supported by liability insurance provides for the recovery of losses in case of probable mistakes.

Court Practices in Relation to the Recovery of Delinquent Loans

I will make an attempt to briefly summarize the experiences of courts in relation to problems in loan recovery of housing loans, and to give some recommendations for amending regulations. The problem areas can be grouped several ways from the perspective of courts:

- The contract in question has already been entered into or to be concluded later.

- Within the above two groups, whether the parties have made the agreement as a private document or as a public document.
- The bank wants to enforce its claim under judicial or non-judicial procedure.

In relation to contracts already made, it has been a practice only in the past few years that the parties notarize the loan contract, and it is typically done for corporate loans rather than housing loans. Declarations to recognize debt are more frequently notarized, however, as it is known, it is subject to a number of uncertain factors.

In the case of contracts made as private documents, banks must pursue either a judicial or a non-judicial procedure to recover their claims that result from non-performance of contracts, unless the other party makes a declaration to recognize debt. The features of that case have been summarized by you under the empirical assessment, and the result is identical to court experiences.

In the phase called “amicable”, court experiences show that, though banks object to the inherent contradictions of social market economy, nevertheless social considerations play an important role in drawing the conclusions from breaching contracts and making a decision to enforce claims. In my opinion, this is primarily an economic, political, and social issue, and the role of law starts only after the decision has been made.

At this point, it becomes important that the termination of contract, and the statements on delinquencies should be accurate. The lawsuit submitted should be complete, so that no time is wasted by submission of missing documents, or by searching for the address of the defendant in several “acts”, or by filing claims a second time to make figure accurate about principle, interest, costs, etc. Courts have an important role here in terms of effecting non-judicial procedures as fast as possible, and, when it comes to judicial procedure, to thoroughly prepare trials.

Undoubtedly, as for all types of cases, more warrants for payment becomes absolute than the ones that are turned into litigation. However, that statistical figure is “deteriorated” by the fact that there are a number of cases where the case is reopened, thereby also lengthening the recovery period, because, depending on its subject, a request for reopening a case may result in stay of execution by court until an absolute judgement is made. In relation to requests for reopening cases, court practices are clear regarding the fact that a late objection can, and should, be interpreted as a request to reopen the case when it is required so by the party filing an objection. However, the court should examine whether the extremely strict conditions for reopening the case are present or not, similarly to any other cases when a lawsuit is requested to be reopened.

A larger proportion of applications for reopening cases are rejected by courts, and only a lower proportion is put to a second trial. I can see from my own experiences



that the number of cases reopened has considerably increased in the past few years, however, only relatively few of them are actually tried before court.

It is an increasing practice by judges that courts do not “automatically” stay execution when the date of a trial to reopen a case is fixed, unless the reopening of the case seems very likely to be successful. We tend to reject requests for stay of execution more and more frequently, after which the parties, many times, will not even respond to the written requests to provide some missing documents, and the statement of claim must be rejected without issuing a summons, i.e., the warranty for payment, or the judgement of condemnation remains in effect, and execution is going on.

Even when it comes to reopening a case, it is extremely important that the procedure in the basic case should be lawful and accurate as far as amounts are concerned, because when a case is actually tried by court under reopening the case, then a judgement can be made relatively fast, usually at one trial, provided there is nothing to overrule or change.

It is an overall experience that banks fail to use all possible options provided by law in relation to cases that have been turned into litigation procedures. The number of the cases is insignificant where banks require to take temporary actions as per Article 156 of the Civil Procedure (Polgári perrendtartás) or to take security measures as per Article 185 of the Execution Act. When the relevant legal conditions are met, both legal institutions may be applicable to shorten the procedure, and to effect the execution procedure in parallel with court procedures. Thus, when an absolute judgement of condemnation is in hand, only satisfaction procedures should be requested in relation to items of personal and real property that have already been seized, and the actions of execution and seizure do not have to be started all over again. The advantage of temporary measures is that the court must make a decision about the application as a first priority, and the order can be enforced in advance. Whereas security measures may result in seizure before a final judgement is made in the lawsuit, thus, for instance, it may result in registration of the right to foreclose on the real property encumbered with the bank’s mortgage lien. At a possible auction, an foreclosure right that has been registered earlier may represent an advantage.

Let me make a practical recommendation as well. It is an honor for the Pest Central District Court (Pesti Központi Kerületi Bíróság – PKKB for short) that the court enjoys clients’ trust, since clients tend to stipulate an exclusive competence of that court in loan contracts. However, it is publicly known that PKKB Court has been the most overloaded court in Budapest for years, since many laws put the burden of sole competency on that court as well. Several thousand court cases have been waiting for assigning them to judges for years, and it is especially true for the Property Law Group, which deals with housing loan cases. Fluctuation in the positions of judges is the highest, therefore the likelihood that a case is reassigned several times is very high.

Though one cannot forecast five, ten, fifteen years ahead which court will be less overloaded, nevertheless the experiences of the past couple of years show that PKKB Court will not likely to be one of them. Therefore, merely for practical reasons, we can recommend clients to specify other district courts in Budapest with less overload as the solely competent court, when clients do not want to expose themselves to the “whims” of general rules on competency.

Based the above, the conclusion that can be drawn from the courts’ perspective is that procedures could be accelerated by more effective and precise use of the possibilities provided by law.

Undoubtedly, banks will have to advance costs, but, I think, they will be compensated for costs by accelerated and more secure recovery procedures.

Facts such as lengthy lawsuits and foreclosure procedures, inflation, decreasing likelihood of recovery as debts are accumulating and the bank may be deprived of collateral all suggest that notarizing loan contracts is still a cheaper solution.

From the court’s perspective, and knowing the types of court procedures on private documents, and the unreliability and uncertainty of documents, the role of public documents should be preferred and strengthened. It increases lawfulness that only such kind of document can be directly enforced without court procedure and attestation, and also increase contractual security for both parties. It is because it is rather difficult to prove anything against notarized documents under a possible lawsuit to prove invalidity of the contract. Of course it is also required that the contents of public documents should be as precise as possible and in compliance with laws.

Considering that banks usually use form contracts for housing loans, I find it possible that, under amendment of some laws, such forms could be registered with the Chamber of Public Notaries, after they have accepted them, and Public Notaries should use such forms on-request, and charge a fee that would be better even than the current favorable fees of Public Notaries.

Thus the fee transferred on to the borrower would be less burdensome, and would not repel borrowers from using public documents. The fact that the form is registered would represent a guarantee for both parties, and would almost exclude the possibility to challenge the contract for legal error, or deceit. Therefore public documents would become a more widely used form of document, which would enhance both contractual security and the security of recovery, and would reduce the period of recovery.

Based on court experiences it is clear that there was a substantial and positive change in the contents of public documents after the Execution Act had taken effect. Public documents are increasingly precise, accurate, therefore lend themselves more



easily to enforcement. It is a requirement by all means, that a notarized contract or unilateral declaration should meet the requirements contained in Article 21 of the Execution Act. It is applicable to mortgage lien contracts as well, which is typically important for housing loans. It is still a practice that the parties notarize the contract on the mortgage obligation only, by referring only to the contract made between them under a private document. However, the mortgage lien contract fails to contain the items required by Article 21 of the Execution Act.

Though it happens less frequently for housing loans, but it should be mentioned what happens when the mortgagor is not the borrower himself. That is the situation where it happens most frequently that the contents of the notarized contract fail to meet the requirements of the law, moreover, sometimes it even fails to include a reference to the fact that the person who has undertaken to be mortgagor has proven his ownership by presenting a “fresh” extract from the Land Register to a Public Notary and the other contractual party. The presentation of that document and also inclusion of the fact that it has been presented are indispensable securities.

Fortunately, we come across less and less notarized contracts, where the Public Notary fails to warn the party undertaking the obligation to the possibility of direct foreclosure as a legal consequence.

In my view, the regulation could be made more precise if legislators added a provision about such requirements for content to Art 21 of the Execution Act. Court practices are the same in relation to the fact that direct foreclosure as a legal consequence can be applied only when the obligor has been warned about it. An explicit provision in laws to that effect would also enhance lawfulness and security.

Under the current practice, even when the contract or the declaration to recognize debt is notarized, the termination of contract, and the statement of delinquencies are usually communicated not only in private documents. No doubt, when those documents are also notarized, it will make the recovery of the claim even more costly, however, in my view, based on a proper interpretation of Article 21/2/ of the Execution Act, the use of public documents should be indispensable for enforceability. Maybe the parties do not tend to use it, because the wording of the law is not unambiguous, and it needs interpretation by the person applying the law.

Anyway, using the said provision of law, after a possible change by legislators to make it more straightforward, would solve the problem that even a notarized contract reflects only the status of the time when the contract was made, and fails to prove the bank’s claim at the time of the borrower’s breaching the contract. By notarizing proper statements on delinquencies and termination of contracts, the institution of direct foreclosure could be made complete, would ensure lawfulness, and would accelerate recovery.

It is also the experience of the past one or two years that there has been a sharp increase in the number of execution lawsuits. Lawsuits are more and more frequently based on Article 369 a./ of the Civil Procedure, where the client says that the claim included in a notarized document has not come to existence officially. This is a direct consequence of the increased use of adding clause to public documents. However, these lawsuits would extremely be accelerated if documents to contain information on delinquencies, and the fact of termination would be notarized. The existence of such notarized documents would many times result in justified rejection of requests for stay of execution. Thus launching a lawsuit would not necessarily mean a stay of execution. From experiences it is clear that more and more lawsuits are launched intentionally and exclusively with the purpose of stay of execution even when it is very likely that the party launching the lawsuit will lose it. However, as we all know, time is money and life, thus it may help releasing the collateral from the burden of foreclosure. And a special lawsuit has to be launched in order to sanction that such cases are of a nature to deprive collateral.

The complex issue of securing collateral to the claim belongs to the realm of enforcement rather than court practices.

In relation to that, I can confirm a statement that says that the rules of the Civil Code and the Execution Act on liens fail to comply with each other to the extent that it can cause serious legal grievance to a person requesting execution.

Amendments to laws should be made to the effect, on one hand, that deprivation of collateral can be prevented, and, on the other hand, it should be ensured during foreclosure that mortgage lien holders without a right to foreclose should also be satisfied in full or in part.

With regards to that, it is also very important that the basic contract should be notarized, because thereby it can be terminated more faster (encumbering some collateral with a right to foreclose qualifies as deprivation of collateral, which is a serious breach of contract), and thereby the mortgage lien-holder's right to foreclose is more readily available.

However, for contracts in private document, a substantial reform of rules on foreclosure is necessary, including the rules of the Civil Code as well. Such change could be made to ensure for the bank a prohibition to sell and encumber the property that is offered as collateral under a mortgage lien to secure a loan made and already disbursed against the collateral. Though it limits the owner's right to dispose over the property, there is an important reason of legal policy that in these exceptional cases the prohibition to sell or encumber the property is allowed. Legislators themselves allowed that possibility under Article 114./1/ of the Civil Code.



It would be a possible solution to allow that a demand for first option can be announced for foreclosures as well. If proper guarantees are created around it, the announcement of demanding first option could be used to make a claim due that serves as a basis to a mortgage lien that has not been secured as yet by a right to execute. The obligation of third persons or persons with opposite interests to make declarations that is ensured under execution procedures and under Art 41 of the Execution Act could be used in an analogous way. When the announcement by the executioner complies with those contained in Article 21 of the Execution Act, in the case the declaration is not made, considering also Article 195 of the Civil Procedure, the announcement of the executioner, as a public document, could be completed with a clause. Thus, under a relatively fast and completely lawful procedure, the mortgage lien holder would also get the right to foreclose. Should the mortgagor reject to recognize the claim, he could be ordered to start a lawsuit, and therefore he can also get the appropriate guarantees by law.

It could serve as a legal guarantee, that when a real property encumbered with a right to foreclose is sold, the Land Registry would not register the ownership of the buyer without the consent by the holder of the right to foreclose. In reality, however, due to the lengthy Land Registry procedures, a situation may arise that the buyer takes possession of the property, then his application to register his ownership is rejected, however the parties cannot or do not want to reinstate the original status. It would be a rather dramatic issue, but one that is worth considering, that in such a case the occupant without title could be evicted outside litigation procedure in the course of the foreclosure procedure. Since there is no enforceable document against him, it is a task for legislators to solve that problem lawfully. That should be ensured against those persons, who make contracts after the right to foreclose has been registered, but the situation is different where the right to foreclose was not registered in the Land Register at the time of making the contract. In that case it is still a possibility without any change to start a lawsuit by referring to a contract to deprive collateral as per Art. 203 of the Civil Code.

I think Article 39 of the Execution Act could be applied in relation to those persons who buy some real property that is encumbered with a right to foreclose. Either when the executioner realized the situation as part of his activities or on request by the person to demand foreclosure, it could be possible to establish a certain, limited legal succession. No doubt, the buyer is no legal successor to the borrower in relation to the claim of the person to demand foreclosure. However his property is encumbered with a right to foreclose. Thus the court of execution may declare that he is liable for the claim up to the amount of the claim secured by the property, but only by using the property. Thus there would be no need to start a special lawsuit to obligate to tolerate, however, there judgement of the court of execution can be challenged, thus there is a legal remedy secured for the buyer as well.

The estimated value at real property auction is a complex issue. From the perspective of lawfulness, it would be justified that in each case the appraiser that has been designated by the court of execution should set the estimated value, however it would clearly make the procedure more expensive and lengthier to some extent as well, knowing how overloaded appraisers are.

At the same time, it would be more secure and lawful procedure, and would diminish objections due to estimated value.

No doubt, the effectiveness and “clientele” of auctions would be enhanced if real property could be put to auction in an occupiable status, so that the buyer can expect that the executioner will transfer him the vacated property within a defined period of time.

The situation is relatively simple when the borrower himself occupies the property, and undertakes under a public document to vacate the property in case it is foreclosed. In that case, “only” the court of execution should ensure the right and possibility, that when the foreclosure is ordered the court should give reference to that as well in the court order, should order the borrower to vacate the property, or authorize the executioner to switch from executing the claim in cash to implement the defined action, in order that he can transfer the property to the auction buyer in a vacated status. All this can only happen when the auction is successful.

In those cases where there is public document to declare voluntary obligation to vacate the property, I think the only solution could be for the court to declare the obligation to vacate the property in its judgement of condemnation about the debt claim, or would oblige the borrower to tolerate vacation under a possible foreclosure. When the mortgage lien holder is not identical to the borrower, that solution is used by court, however, it is a valid need that the same solution could be used for situations where the borrower and the mortgagor are the same persons.

The situation is completely different, when a tenant lives in the property to be put to auction. In that case as well, a distinction could be made between tenants whom made the contract before or after registration of the right to foreclose. Actions could be taken against the first group of tenants in the course of execution, and the second group could be ensured to have a first buyer option under regulations of material law. However, we should keep in mind that, in a basic situation, we are talking about persons who have nothing to do with the debt, and acted bona fide when making the lease contract. If their lease contract ceased to exist as the result of the announcement of auction, and could be sued to vacate the property just because of the auction, I think tenants’ rights would be seriously violated. A tenant would suffer damage that could not be claimed from either the auction buyer or the person to demand foreclosure, and the tenant would not be able to collect anything from the borrower either most probably.



No doubt, there are substantial disadvantages to auctioning at the price of the occupied property as well.

Therefore I find a solution acceptable whereby when the first option is ensured for the tenant, the executioner would solicit the tenant to exercise it. When the tenant does not want to use it, the lease contract could be terminated by virtue of law by setting an appropriate deadline. In that respect, the court of execution should again ensure the legal option to add a clause to the executioner's announcement made in compliance with Article 21 of the Execution Act, and based on that to vacate the tenant.

Another alternative solution can be to enhance the possibilities for selling the property outside auction, but by no means ignoring the foreclosure procedures by court. In my view, Article 264/2/ of the Civil Code is not part of that situation, since pawn lending is primarily related to general pledges. Those who do that as their regular business make loans against pawns, whereas the objective of loans under housing finance is different, namely to buy or build the collateral, and the collateral serves as a pledge to make loan payments.

I find it not feasible from a legal point of view that banks would sell directly some real property that is in the ownership and possession of someone else. That solution would raise several problems, which would further complicate the situation, and would bring the borrower in an extremely defenseless situation.

I want to emphasize again that the recommendations for amendment explained in this paper can be made only when there are appropriate legal guarantees present as well, by enhancing the competence of the court of execution, and by ensuring the appropriate legal remedies, including lawsuits.

Preparations for the Amendment of the Execution Act

The procedural instructions of Law LIII/1994 on execution by court (the Execution Act) took effect as of September 1, 1994, whereas changes in relation to organizations started as of January 1, 1995.

The experiences of the past four years revealed that the new procedural rules of the Execution Act and the new forms of organization – such as the introduction of the legal institution of independent court executioners and execution officers – have basically fulfilled the hopes attached to them. The new law, unlike the former execution law of communist type, is more relevant to the changed societal system, is less protective to borrowers, and, by creating an interest for independent court executioners, makes execution procedures more effective. To date, most of the huge back-log of former cases has been processed successfully.

However, it should also be mentioned with some self-criticism that speed and effectiveness of execution procedures are still behind expectations in a constitutional state. In recent years, it has caused some tensions that execution procedures (which used to be financed from the state budget, i.e., from tax payers' money) are much more costly for users of execution procedures, i.e., for persons demanding execution, or borrowers now, compared with the past when they had to pay only 3 percent in dues for the procedure and some nominal fee against costs for on-the-spot actions. Now, high fees have to be paid to independent executioners, who have to maintain their offices, pay the salaries of employees, if any, make a living for themselves and cover additional costs. What that situation means for persons demanding execution is that, after a lengthy and costly court procedure, they also have to pay substantial amounts in advance for execution costs in order that the execution procedure can start at all, whereas, there is no guarantee for the success of the execution procedure.

One of the most frequent causes to unsuccessfulness of execution procedures is that many borrowers have become impoverished, and some of them make their property disappear by the time it comes to execution.

In relation to a substantial part of execution procedures, i.e., in cases of housing loans – especially in relation to loans made before 1989 – what has caused almost political tension is the fact that impoverished, unemployed people are not able to make loan payments. And the auctioning of real property will go together with masses of people's losing their homes and being put to the streets. As a result of an initiative by the Ombudsman, such procedures had to be suspended with a "consent" by the largest lender, OTP. The system developed by the Government - I mean Government Decree 96/1998. (V.13.) -, under which subsidy can be used by borrowers in order to settle debts, does represent an assistance in most of the cases, or it would mean assistance if borrowers used that opportunity. However the system cannot eliminate the problem completely.

After the new lien provisions of the Civil Code had taken effect, the enforceability of liens under execution procedure became more important, especially when a third person launches the execution procedure, because if the person demanding execution did not manage to obtain an enforceable document during the procedure, then the real property encumbered with mortgage lien will be sold, and the claim that is secured by the mortgage lien will cease to exist without the claim being satisfied. It has caused a legal uncertainty that it is not clear either from the material laws or the Execution Act that when the borrower's house is put to auction, then the new owner can have possession of the house in an occupied or a vacated status. Court practices have developed to a direction, under which the former owner, i.e., the borrower, can stay in residence as a quasi tenant in the house. The effectiveness of auctions and the purchase prices that can be achieved at auctions also cause problems, since it happens very rarely that the purchase price achieved is higher than the starting price, and houses are regularly sold at half of the starting price. Such low purchase price is



especially detrimental for the impacted persons when the starting price is set for an occupied status. The question raises whether it is justified to reduce the purchase price to half of the starting price, and whether it is justified that it can happen even at the first auction. The lack of auction halls causes a problem as well, since primarily the so called “auction hyenas” (bargain hunters) go to venues other than auction halls. Their appearance at auctions naturally has to do with low purchase prices.

The Ministry of Justice is aware of the above problems. In the past couple of years, comments have been received continually regarding the Execution Act, or the implementation decrees, primarily in relation to regulations on fees. The experiences gathered as a result of controlling the operations of court executioners, and the signals sent by those applying the law both revealed the fact that some provisions of the Execution Act will need to be amended in order to increase the speed and effectiveness of execution procedures. Some of the provisions will need to be made more explicit only, but additional language will need to be given to many of the provisions. The document issued on the tasks for the Ministry of Justice during the period between 1998 and 2002 specifies that “experiences show that the Execution Act must be reviewed. The execution of judgements is not effective, thereby causing problems in economy, and leading to private persons’ taking justice in their own hands. The Act should be revised in a way that makes execution fast and reliable.”

With an objective to solve the above problem, among others, last fall preparations have been started with the purpose of drafting the amendment of the Execution Act. As a first step, the Ministry sent letters and made announcements in technical periodicals to those applying the law, business organizations, and citizens, soliciting them to make comments and recommendations as to the execution procedure. More than 50 organizations, and a few private persons have sent their recommendations or positions to the Ministry, which represents almost 1,000 comments or recommendations. After grouping and processing the recommendations received, the Ministry prepared the first document on the problems of the Execution Act a few days ago, summarizing the reasons for and directions of amendments to the Execution Act and associated regulations. According to the nature of the document, it cannot contain full-fledged recommendations to solutions, but can serve as a starting point for discussions. The Ministry is making plans to send out the document in a few days to entities to apply the law who are especially affected by the recommendations, to other Ministries, banks, and Chambers. According to our plans, a Codification Committee will make preparations for the amendment of the Act, and the Draft Bill for the amendment will be submitted to Parliament at the end of the first half of year 2000.

According to my personal opinion, that effort will not be easy, or free of battles, since there are a number of recommendations among those received, which interpret the same issue the opposite way and intend to solve the issue in ways that exclude each other.

Some of the controversial issues

The Issue of Fees

The persons requesting execution procedures find the execution procedure too costly, and the fees charged and recovery commissions taken by independent court executioners very high. However, an independent court executioner has to use his income to make a living, finance his office, and all expenditures arising in relation to execution procedures. The recommendations received suggest the idea that the way fees are charged should be changed to the effect that the executioner has a right to demand a much lower advance payment only at the beginning of the procedure, and can charge fees by individual execution actions. Most of the executioner's income should come from a commission that would be linked to the effectiveness of execution.

Undoubtedly, the current fee structure, that is composed of a fee that is a function of the value of the execution case, plus advance payment, plus reimbursement of associated costs incurred, has been found insufficient in creating an incentive for executioners, because, in most of the cases, the fee does not reflect the work actually done by the executioner. What I mean is that the executioner always receives the advance payment, or, "in theory", is entitled to the full fee even when the execution is suspended due to the lack of property that could be seized. The reasons why I am saying "in theory" is that, as far as I know, it is no practice that persons demanding execution would pay the full fee to the executioner in addition to the advance payment, or executioners would enforce their entitlement to the full fee. However, there is a disadvantage to the proposed structure to charge fees for individual execution actions, namely that the process would be too bureaucratic, may lead to many disputes, which would result in an increased number of objections to execution procedures, which, in turn, would mean increased work for courts. On the other hand, the proposal of a dramatic reduction in advance payment and some reduction of the fee and the reimbursement of costs would raise the most serious problem, namely "being bribable". Therefore, I think that one must act very cautiously when changing the fee structure, and interests of all actors should be "handled" properly.

Several recommendations have been made to the effect that the number of documents that can be completed with a clause of enforcement should be increased. However, attention must be drawn to the fact that according to the legal principle, that is also used in member states of the European Union, court execution should be used, as a major rule, only in order to collect a claim that previously has been sanctioned by court as a result of prior legal discussion. In some cases, a resolution by some other organization to make judgement on legal dispute can be executed as well, provided the organization's procedure is supported by guarantees similar to those in court procedures. In exceptional cases, a lien-holder may get immediate right to execution based on a document or resolution, however, in that case, the document must meet stricter requirements, for instance, must be a public document prepared by a Public



Notary. On the basis of Resolutions 46/1991. (IX.10.), 52/1991. (X.22.), and 50/1991. (X.3.) of the Constitutional Court, it can be stated that such cases must be very limited, therefore special care must be taken when expanding on the cases when a clause of execution can be added to a document. Those few cases that have meanwhile been included in the Execution Act (resolutions by wine-growing communities to obligate someone to make payment of a fine and costs of procedures, or allowing the addition of clause of execution to resolutions by the Reconciliation Board in customer protection procedures) fail to meet the above expectations. Considering the above, I do not find it likely that loan contracts made by banks under private documents of full probative force could be included in the group of documents that can be completed with a clause of execution.

A solution must be found for mortgage lien-holders to enforce their demands, in compliance with the lien related rules of the Civil Code. Several issues must be considered here.

One of the issues is that, in the lack of a document that can be completed with a clause of execution, claims should be able to be enforced under court procedures more rapidly. That is not an issue of execution procedure, but requires the development of new Civil Procedure rules, which will result in a reduced time requirement for court procedures. As it is publicly known, as a result of the postponement of the start of the operations of High Courts of Justice, and under OGY Resolution No. 80/1998. (XII.16.), the Ministry of Justice should perform certain additional tasks until June 30, this year, in order to accelerate court procedures, and as part of that effort, some provisions of the Civil Procedure may be required to be amended as well.

The other issue is how a mortgage lien-holder can join an execution procedure started by a third person. In my view, and also according to the position published by courts, the lien-holder can only join the procedure when he has got an enforceable document. However, it is not easy to obtain an enforceable document due to the lengthy court procedures (unless the document is a notarized document to which a clause of execution can be added), and by the time the document is obtained the execution procedure might have ended. The situation can be solved by the shortening of court procedures, however, in my view, an institutional possibility should be developed as part of the Execution Act that a person demanding execution can join the execution procedure, and his demand must be taken into consideration and satisfied under the execution procedure. That solution is justified to use, this is my opinion and also that of other persons dealing with execution, however, the implementation thereof requires the participation of court, with special regards to the above mentioned resolutions of the Constitutional Court.

The third issue seems to me the most difficult to solve. Namely the occupied or vacated status of real property seized under foreclosure procedure, and many times encumbered with mortgage lien, and the issue of accommodation for the borrower. Out

of the recommendations received, the ones that comes from lenders suggest that the real property should always be sold in an vacant status, and the borrower should be obligated to vacate it. However, the Ombudsman has drafted a proposal, under which, when the foreclosure is on some residential property that is occupied by the borrower and his family in circumstances that require exceptional equity considerations, it should be made possible to limit the foreclosure, and to release the property from under the burden of foreclosure. That would represent a special lawsuit to limit foreclosure, and not only the debtor but also the court of guardians would be entitled to launch such lawsuit for the benefit of the family. It should also be made possible that the borrower can stay in the property as a tenant for a period of 6 moths or longer under a court decision. And when a borrower vacates a property that has been sold at a value reflecting vacant status, then the borrower should get a defined sum out of the sale proceeds, so that he can satisfy his need for a minimum accommodation. In all other cases, the Ombudsman is supportive of auctioning houses at a value reflecting vacant status.

Some other recommendations have also been made, e.g., the Execution Act should define a specific deadline for execution actions to be effected by executioners. However, in my view, that recommendation is difficult to implement in practice considering the nature of execution procedure, since even currently there are some defined deadlines in it, however deadlines are not met due to negligence by the executioner or some other party, or a delay in court procedures.

With regards to auctions, there are some recommendations that seem to be acceptable, namely the ones that are about a little reduction of starting prices, and the ones about the fact that auctions should be organized in auction halls for the sake of higher publicity.

In my view, special attention should be given to providing a better definition in the amended Execution Act of the activities of actors in the execution procedures. Experiences show that citizens, state institutions, and business organizations all many times fail to meet their obligations under the Execution Act. They sometimes fail to provide proper information for launching or continuing the execution procedure, or to meet obligations associated with the seizure of claims, sometimes registration procedures in the Land Registry get delayed, sometimes the seizure of business spaces is not entered in the register of the Court of Registration, etc. Court executioners to implement execution are not always up to the situation either, and by neglecting some of their obligations or performing them inaccurately they contribute to a lengthened or unsuccessful execution procedure. The competence level of executioners must be raised, and their liability should be increased as well, by making them accountable more frequently for their negligence, even under disciplinary action. In my view, the authorizations of the Chamber of Hungarian Court Executioners should be expanded, and they should receive a more important say in the nomination of executioners, and in launching disciplinary actions. As a solution to ensuring and educating new supply of



executioners, it should be considered that persons whom have passed their exam as executioners could be involved in some execution actions as deputy executioners under the supervision of practitioner executioners. The number of executioners is planned to be 300, and all positions should be filled in in the near future. It should be made possible that executioners can act at least within the county, even if the property to be seized is not located in their respective areas of operation. That solution is more practical and less costly for executioners and persons demanding execution alike than to hire another executioner.

Of course a lot of other recommendations have been received and are waiting for consideration, however, I found the above recommendations to be most relevant to the conference.

In summary, I want to emphasize that though the Execution Act has brought a favorable change in relation to execution, and the signs of further development are clearly seen, nevertheless the Act and the associated decrees must be amended to the effect that the objective for drafting the law should be to ensure a faster and more effective legal enforcement. It is my hope that the efforts of the Housing Finance Group will be manifested in a way that, as a result of the amendment of the Execution Act, housing finance secured by mortgage lien will be a secure business in Hungary as well, and delinquent housing loans can be recovered over a short period of time.

SECTION II. BENEFITS OF NOTARIZED DOCUMENTS

Mortgage Lending and Public Documents

The first major change in laws that contributed to the evolvement of the current situation was the elimination of direct garnishment by financial institutions in 1991.

After that change, banks have pursued court procedures in relation to a vast number of cases in order to recover their claims. Many procedures regarding warrant of payment and litigation procedures were started, while courts had a tremendous workload.

In the initial period, in some of the cases, warrants of payment became absolute in the lack of objection, later, however, the number of such cases decreased, and the fact was realized that in the cases where the bank needs to turn to court in order to recover claims, when the borrower, for whatever reason, objects to the existence of the claim, lengthy court procedures, even of several years, can be expected before banks can receive the document to enforce.

Meanwhile, substantial changes happened in court execution procedures as well. In addition to organizational changes, substantial procedural changes happened as well, leading to a number of legal interpretation issues.

Amendments to Civil Code Rules on Liens

All the above changes have raised many practical and theoretical issues in the past 2 to 3 years. Creditors found as one of their most important task to find out how a claim can be successfully recovered at lower costs upon the borrower's default and failure of "amicable" negotiations.

The simplest solution to expedite the process seems to be to notarize the loan contract or a unilateral statement to recognize debt, since by having such document, the creditor can launch a foreclosure procedure outside litigation.

We have tried to find an answer to the question what causes banks not use notarization as a general practice in mortgage lending, and what solutions are used in this area to improve security of lending and effectiveness of recovery.

First, let us summarize the benefits that come from using public documents.

Advantages

Evidence

The notarial document is a full evidence of the fact that in the contract concluded by the contracting parties indicated in it the parties made the legal declaration at that date and time and with the content contained in it as it is indicated by the notarial document.

In case of an occasional legal dispute the contracting party can not dispute the facts referred to above as the notarial document serves as full evidence of all these and – though contrary proof is permitted, it not at all promising.

The notarial document is lasting and reproducible evidence as its original copy remains at the custody of the notary public and further attested copies of it can be requested without limitation in time.



■ **The document is an evidence of the circumstance that the parties were not in legal mistake in the course of concluding the contract.** The notary public that is independent and impartial by the law should inform the parties on their rights and liabilities relating to the contract. The notary reads out and explains the document in the presence of the party and then the party should assure him on its approval. Therefore, in the course of a legal dispute nobody can assert that he was in legal mistake in concluding the contract.

■ **The document is evidence that the parties involved in the contract were in possession of competence and authorization for contracting.** The notary is liable to get assurance on the personal identity of the parties, on the competence and authorization for contracting, on the veritable intent of the parties and should certify all these in an authentic document.

Direct execution power

On the base of the Public Notary Act and its Implementation Clause, on the ground of assumption of liability contained in notarial document direct Court foreclosure shall prevail when the claim falls due. By this, the party involved can spare the time required for an executable court judgement and the costs of the court procedure. A further advantage related with the executable nature is that – with view to this – the chance and ratio of voluntary adherence to law.

Responsibility of the notary public

The notary public bears unlimited responsibility with all his property for the damages caused to the parties involved in the range of his operation. The responsibility of the notary is supported by the compulsory liability insurance.

Disadvantages

The arguments mentioned against the contribution by the notary public are that this arises a feeling of distrust in the client, extension of the implementation period, the complicated procedure is and the price.

Feeling of distrust

In the course of providing a loan the bank places out other persons' money (depositors, shareholders) and is obliged to ensure the reimbursement of the loan in all possible and necessary means. One of these sureties can be that the bank relies on the power of the executable notarial document. As the executives of the bank risk not they're own but other people's money, in such a business transaction the emotional questions like the feeling of distrust can not play any role. Scrutinizing the procedure

from other side, the involvement of a guarantor does not reflect higher or lower degree of distrust than the relying on the tool of a notarial document.

Complicated procedure

If the loan contract is written in the notarial document:

■ **Unitas actus.** The parties involved should be jointly present at the notary public, the reading out of the authentic document must not be overlooked as the transgression of these provisions would endanger the authenticity of the document and this way its executable power. Maybe the reading out and explaining the notarial document can be time-consuming and cumbersome, however from the aspect of the debtor it is indeed very important. In several instances, the debtor realizes for the first time in the course of reading or from the questions asked subsequently what obligation the contract imposes on him and what the consequences of default are. The obligation of the notary of reading out the document is an efficient implement of client protection providing for the bank the numerically incalculable but still existing psychological benefit that the probability of the debtor's compliance conduct increases.

■ **Place of compiling the document.** The notaries prefer to indicate their own offices as the place of concluding the document as the conditions of efficient work (staff practiced in the notarial format of work, copier, computer link to the registration of firms, etc.) are more available in these offices. However, in justified cases, with good organization it can be solved that the notary carries out the work, not in his own office, but instead in the premises of the bank. However, it should be taken into consideration that in these cases the co-operation of the notary would be more expensive.

■ **Checking the personal identity, the ability and authorization for transaction.** In the course of the procedure, the notary public should check whether the parties appearing are in possession of the preconditions indicated in the title. This means that he can not be satisfied on the declaration in this sense by the parties themselves, but he should get assured on the existence of preconditions.

In case of natural entities this only involves the presentation of the personal identification card or another official document having a signature and photograph in it. If the client is a legal personality, the contract will be signed by its representative. In such a case the task of the notary public extends – in addition to the investigation of the personal identity of the representative – to the checking of the existence of the legal personality client, its identifier data and the manner of representation.

In case of economic associations, both the firm registration certificate and the personal identification card(s) of the representative(s) are necessary. I would like to note here that the signature certificate is not sufficient for the attesting of the authorization to sign, its purpose is quite different.



From the aspect of executable power, it is very important that it should become unequivocally clear from the text of the contract that the subject of the legal transaction is not the representative but the economic association or other organization represented by him. Frequently, it is necessary to determine on the base of the deed of association whether the economic association has not delimited the authorization of the representative, is not a special approval by the members' assembly (or a resolution by the general assembly) is required.

For the interest of subsequent executable power of the document, the above outlined procedure should be carried out both for the bank and the debtor. To avoid causing an excessive burden to the bank, appropriate preparations are essential. Several notaries public are directly connected with their computers to the IM Company [by the Ministry of Industry], these colleagues can get assured on the authorization of the representatives of the bank and the client by a simple visual check. In case of those for whom this facility is not available, the presentation of the incorporation certificate is required. If the employees signing on behalf of the bank are not indicated in the certificate, they should have appropriate (authenticated) authorization. Such an authorization can be provided for several occasions and for several persons at the same time. In co-operation with the notary public that is in relation with the bank, the order of procedure can be so arranged as to avoid the occurrence of delay or stoppage.

In summary: it is doubtless that the committing the contract to notarial document causes substantial loss of time for the representatives acting on behalf of the bank and this burden hinders the performance of their other tasks, however, with a good co-operation and reasonable organization this delay can be largely reduced.

If the debtor acknowledges his debt in the presence of the notary:

- The above outlined circumstances that are adverse for the bank staff (loss of time, difficulties of authentication of authorization) do not prevail if the bank makes the disbursement of the loan dependent on signing a debt acknowledgement committed to notarial deed.
- In this case only the debtor's side should be present at the notary public. The notary should commit to notarial deed all those conditions of the contract that are relevant from the aspect of implementation and in such a solution the charge of the notary will be 50 percent less as compared to the bilateral contract.

Charges

The fee charged by the notary public is an amount determined in a legal regulation; adherence to this is compulsory for the notary public. In case of loan contracts, the value of the transaction should be taken into consideration in determining

the amount of charge. The notary public is entitled to reduce to half or increase to double also in the cases determined in the legal regulation. In case of loan contracts, the most frequent reason of reduction is that the notary prepares the document on the base of the draft provided by the party (the bank). The typical reason of increasing the charge is when the document should be prepared not at the site (in the notarial offices) or if it should be compiled in a foreign language.

If the notary public commits in the document the loan contract, then the full amount is charged. If the party issues a commission for the preparation of a so-called loan acknowledgement declaration document, only half of the amount will be charged as compared to the charge according to the transaction value.

In addition to the charge according to the transaction value and the lump sum covering the cost related with the former, the notary charges also his cash expenses, which are regulated – instead of the transaction value – according to the actually implied expenditures (typing fee by pages, attestation by the number of pages attested, telephone, fax and travel expenses whenever and in which extent these are necessary).

In transactions charged according to value is not progressive but degressive, that is, with the increase in the transaction value the rate of charge is reduced and, above a given limit, it does not change any more (maximum price).

2.3 Examples of calculating the charges

■ The Bank provides a loan for the client for purchasing a flat in an amount of HUF 1,000,000. The parties commit to notarial deed the loan contract of 3-page volume in the official premises of the notary public and they request the issue of two authenticated copies of the document. The list fee of the notary is as follows:

Notarial work fee according to transaction value:	HUF 16,700
Lump-sum for expenses:	HUF 6,680
Attestation of document issued (6 pages):	HUF 1,680
Typing fee (9 pages):	HUF 540
Total (2.5 percent):	HUF 25,600

■ The Bank provides a loan for the client in an amount of HUF 1,000,000. The parties commit to notarial deed the loan contract of 3-page volume in the premises of the Bank and they request the issue of two authenticated copies of the document.



List of charges:

Notarial work fee according to transaction value (increased):	HUF 33,400
Lump sum for expenses:	HUF 13,360
Attestation of document issued (6 pages):	HUF 1,680
Typing fee (9 pages):	HUF 540
Travel expenses:	HUF 500
Total (4.9 percent)	HUF 49,480

■ The Bank provides a loan for the client in an amount of HUF 1,000,000. The parties commit the contract of 3 pages to notarial deed on the base of the draft provided by the Bank the loan in the official premises of the notary public and they request the issue of two authenticated copies of the document.

List of charges:

Notarial work fee according to transaction value (reduced):	HUF 8,350
Lump-sum for expenses:	HUF 3,340
Attestation of document issued (6 pages):	HUF 1,680
Typing fee (9 pages):	HUF 540
Total (1.3 percent)	HUF 13,910

(The calculation of charge is made similarly if the notary commit a loan acknowledgement declaration to a notarial document.)

■ The Bank provides a loan for the client in an amount of HUF 3,000,000. The calculation of the charge is done with view to the draft, no reason occurred which would justify an increase.

Notarial work fee:	HUF 18,350
Lump-sum for expenses:	HUF 7,340
Attestation of document issued (6 pages):	HUF 1,680
Typing fee (9 pages):	HUF 540
Total (0.9 percent)	HUF 27,910

■ The Bank provides a loan for its clients in an amount of HUF 5,000,000. The calculation of the charge is done similar to the previous example:

Notarial work fee:	HUF 28,350
Lump-sum for expenses:	HUF 11,340
Attestation of document issued:	HUF 1,680
Typing fee (9 pages):	HUF 540
Total (0.8 percent)	HUF 41,910

■ **Is the notarial fee too high or too low?** The examples given above appropriately represent the extent of the notarial work fee, its ratio to the transaction value and its degressive grading.

In judging the extent of the notarial work fee (too high or too low) can not be determined considering a single aspect, the working hours. Also the following factors should be considered: the responsibility of the notary public (occasional indemnities), the compulsory participation (the notary can not choose between small and large cases), the maintenance of the notarial office (personal and material expenditures), the general overhead costs, proportional part of maintenance of this establishment and also the social welfare function of the work fees. Therefore, the notarial charge is not identical with the work proceeds of the notary public but it includes also the costs of maintaining the institution as a whole.

If in this area the dramatic reduction of notarial work fees would occur, this would reduce in direct proportion the interest of the notary in the quick, high-standard, flexible manner also for the reason that the risk of carrying out the task increases in the same manner (small work fee – high risk of damage indemnity disbursement).

Proposals for the solution

Price-to-value ratio

In which case is it worth to commit the loan contract to a notarial deed and file this document together with other items of security? In this question the bank can freely decide and for this decision it carries itself the responsibility.

A numerical answer can not be given unless as a result of economic viability calculations if the bank is in possession of reliable data on the ratio of non-reimbursed loans to the amount of placements. In addition to the fee charged by the notary public, also the imposed court procedure costs and the adverse effects attributed to the loss in time.

It should not be overlooked that the cost of the notarial deed appears at the debtor while the bank will enjoy the advantage of direct executing power. While this does not change, for the bank it is always worth to apply the tool of notarial deed.

Security contracts

If the debtor itself provides the security, the debt acknowledgement declaration provides sufficient security to make it possible to lead a foreclosure procedure against the property items offered by the debtor as surety.



If the surety is provided not be the debtor but the so-called substantive debtor, then it is necessary to edit the mortgage contract in the form of a notarial deed.

Other problems

The question whether in the notarial deed only the debtors or also the guarantors (etc.) are included as parties thereto, should be decided by the bank and the notary public will compile the document according to this commission.

If the court refuses at the first instance the claim for attaching a clause, it is worth in each case to exhaust all legal remedies as it can not be excluded that there are differences between the practice of the different courts.

Two characteristic examples concerning this issue:

- In a specific case, the court rejected the issuance of the execution clause because, in the court's position, "no execution can be issued over some real property that belongs to the obligor of the mortgage when the mortgagor is no debtor to the debt under any title, since, under Article 136(1) of the Execution Act, foreclosure is applicable to real property that is in the ownership of the borrower only."

Based on the appeal by the person requesting foreclosure, the court of second instance declared the writ to be no longer in effect, and instructed the court of first instance to make a new resolution under the following reasons:

"Based on a lien contract, the obligee ensures the right for him-/herself that in the case where the obligor fails to perform, the obligee can seek satisfaction from the collateral that secures the claim. It is possible that a third person pledges an item of property as a collateral to the debt of another person. In that case, this latter person - the obligor of the debt - is the personal obligor, and the third person is the obligor in rem.

When the personal obligor and the obligor in rem are different persons, then the obligee may chose which one to turn against. The obligee may seek satisfaction from the item of property that secures his/her claim, when the obligor fails to perform (Article 251 of the Civil Code). Therefore the right of satisfaction will open upon maturity date and not upon non-performance on the debt.

The court of first instance had misinterpreted Article 136 (1) of the Execution Act when they had drawn the conclusion from it that no execution can occur over the real property of the mortgagor.

The document of appeal contained valid argument when saying that Art 136 (1) of the Execution Act uses the term "borrower" in a general sense, which also covers a mortgagor who is obligor in rem."

In a similar case, a declaration on recognizing debt contained the obligations as undertaken by the mortgagors.

The court of first instance rejected the issuance of the execution clause saying that in their view the debtor in rem in no debtor or guarantor to the loan contract but only a mortgagor to it, thus a person requesting execution may enforce claim against him under litigation only.

The court of second instance found the appeal by the person requesting execution justified, and changed the verdict by the court of first instance.

In their justification, the court pointed out that the public document that contains an obligation undertaken unilaterally meets the requirements of Article 21(1) of the Execution Act with regards to the mortgagor who signed the document, thus the requirements of the issue of an execution clause are applicable to him/her as well.

■ As per the content of the public document the obligors “are aware that, upon a one moth delinquency in loan repayment, the Bank, pursuant to its internal procedures, may launch execution over the full amount of the remaining loan balance when an execution clause is added to this public document.”

The debtors failed to make loan payments, therefore the full outstanding amount became due, and the debtors received a written notification about that.

The application for the issue of an execution clause was rejected by a court order. In justification, the court established that, under Art 21(2) of the EA, when an obligation is subject to the existence of a condition or a point in time, the existence of the condition or the point in time should also be proven in a public document before execution can be started. According the position of the court, a public document should prove the fact that a monthly payment has not been made, or the fact why the claim is of the specific amount as contained in the form.

Such orders containing rejection are not rare nowadays either, though individual decision no. BH 1997/348 of the Highest Court (Highest Court Pfv* 1. 22.934/1996) contains guidelines as to the case described as well:

“According to the certified copy of the public document containing the obligation undertaken, the obligor has recognized his/her outstanding debt, therefore his/her obligation was not subject to the existence of any other conditions or point in time. The fact that the obligor should have met his/her payment obligation before December 31, 1995 is a circumstance that does not need any special evidence by a separate public document.



The deadline for performance defined in the public document, or the fact that the deadline has passed is enough that enforceability can be established, since the person requesting execution stated that the obligor had failed to perform.”

We think that the interpretation of Art 21 (2) will cause further problems in the application of the law.

The said individual decision by the Highest Court found it possible to issue the execution clause in that given case, because the obligor had recognized his/her debt in the public document, thus there was no need to prove the existence of any other conditions or point in time in a special public document.

However, it may still cause uncertainty if the contract is notarized.

It is self-evident that, where the deadline for performance had been defined by calendar days, there is no need to prove that a certain date has passed, therefore the said individual decision is also applicable where the contract is notarized.

If that is the case, the question can be raised in what cases the provision contained in Art 21 (2) of the EA is applicable, and whether it is necessary - relevant in real life - to have a provision like that.

In all cases I regard it important that the bank should make available to the notary in writing the exact consignment relating to the subject and the substantial content of the contract. In the notarial practice we have frequently seen confused people whom the bank sent to the notary and they can not specify its reason. It would anyway raise the feeling of distrust if the client is compelled to shuttle between the bank and the notary public.

The other side of this problem is when the bank employee requires from the notary to implement the literal, identical version of the form sheet contract, he would like to recognize even those parts in the notarial document which were excluded from the blank form by deletion.

The notary public is a jurist and though the bank contracts are similar, however there are no identical cases. If the notary bears responsibility for the damages caused in his range of operation, then it should be made possible for him to discuss certain conditions which he considers incorrect from legal aspect with such an official of the bank who has right for decision and not only for authorization for signing. In some banks this works well, in other cases not.

Examples from Abroad

Austria

Committing the credit contract directly to notarial deed occurs but rarely – in spite of its direct executable power of this document.

Attributable to the differences in substantive law, the Austrian bank remits an offer to the client and the client approves the offer. The loan transaction is implemented by the disbursement of the amount of loan. Of the sureties (thanks to the bomb-proof cadastral registry) most frequently the mortgage on real estate is applied. In such cases the Austrian bank makes the disbursement of the loan on the registration of the mortgage. Its method of implementation is that the bank transfers the amount of the loan, parallel with remitting the offer to the “other people’s account” of the notary public (custody in trust), then the bank provides a commission to the notary to compile the approving declaration of the debtor, to have the mortgage right registered and after its completion, to disburse the amount of loan to the debtor. In case of paying the amount contrary to the commission received, the responsibility is imposed upon the notary, even to the full amount of the loan. The fee due to the notary public is determined according to the transaction value, in a degressive manner, similar to the Hungarian regulation.

France

Committing the loan contract to notarial deed is a usual and generally approved practice. The bank remits the necessary data to the notary public and, in most cases, one of the staff members of the notarial office is given authorization to sign the notarial deed on behalf of the bank. Such contracts make up approximately one half of the work of notaries (of a total number of 7000). The fee charged by the notary public is based upon the transaction value: it is the 0.5 to 1 percent of the amount of loan.

Poland

Relying on the notarial deed is a generally pursued practice. The fee charged by the notary public is based upon the transaction value: it is the 3 to 5 percent of the amount of loan.

Italy

Also in Italy, the mortgage on real estate is the most frequent kind of surety and, because of this, it is compulsory to employ a notary. The work fee is calculated according to the transaction value.



Summary

In case of providing housing loans the reliance on notarial deed does not involve any drawback to the bank, its benefit is that the possibility of avoiding the costly litigation procedure, the increase of probability of the contract-keeping behavior of the client and, finally, the responsibility of the notary.

For the client of the bank the cost of committing to notarial deed is only one and not the heaviest one of the expenditures and the clients usually consider it as a further surety. For the bank's client it is a further advantage that he will be informed by a jurist who is impartial and independent by profession.

Instead of the currently prevailing multi-front struggle the improvement of co-operation of the banks and the notaries is anyway justified for the sake of reducing the elements evaluated as adverse as compared to the advantages. For this it is necessary for the parties to bury the hatchet and to sit down beside a table for the joint solution of their problems.

SECTION III. BANK PROCEDURES BEFORE TERMINATION OF LOAN CONTRACTS

Administration of Qualified Residential Housing Loans at Kereskedelmi és Hitelbank

Measures taken by the Bank before terminating the loan contract

Due to the fact that K&H Bank has a relatively short record of housing loans (since May, 1996, a total of 6000 to 7000 housing loans were granted) and credit-rating methods were established in a period when the Bank was already over the debt and banking consolidation which means the introduction of compulsory precaution and strict scoring, there have been two housing loans in all when legal steps had to be taken in the administration of the housing loan (both cases occurred fairly recently), that is, when all the necessary measures proceeding the termination of the contract were taken.

One cannot speak of established policy in housing loans because of the low number of cases involved

There is, however, a certain type of residential loan granted by the bank (inherited from the IBUSZ Bank) which was delivered for thousands of people since 1992. This is the automobile credit which has a number of identical features with housing loans: it is a targeted loan covered by lien (though not by mortgage) and it is a residential mass loan.

Since many of these loans became overdue in the course of the last two years, the bank has established a fairly efficient policy to manage them.

The policy elaborated for housing loans (which is not yet being applied) will follow fundamentally the same guidelines, although bearing in mind the obvious differences between the two types of loans.

It is important to know that the maturity of the paying installments constitutes a very strict limit in the computer system applied by the bank. At the making of the contract the client himself may decide which day of the month he/she wishes to pay the installments, but once it had been established, the system regards that day as the date of maturity, that is, if the installment arrives just one day later, the system will add a default interest (that is, it cannot happen that even though the date of maturity is the Xth day of the month, no default interest is added till the end of the month)

In case of overdueness (the paying installment does not arrive) the system prints a notice at the 10th day after the date of maturity, which is delivered by the office that grants the loan to the client.

In case the first notice yields no result, that is, the installment does not arrive to the credit account, after 30 days (40th day of overdueness) the system prints a notice (in the case of automobile loans) which is delivered to the client centrally (of course, the office receives a copy of this notice, too) and which refers to the possible termination of the loan contract. At the same time, the guarantors are informed about the possible termination of the loan contract.

Although this procedure sounds extremely strict, it does not directly imply the immediate taking of legal steps. In case the client presents himself at the bank office within 30 days, the contract may be restored with the original or with renegotiated conditions.

Within 30 days after the delivery of the second notice the bank must take the following measures:

- It must contact the client by phone at his/her home or at his/her workplace;
- It must send the client a telegraph;
- It must send a notice with an acknowledgment of receipt to the address of the client;
- It must contact the client personally (the help of the banking security service is available for this purpose. This method is usually very efficient);
- If necessary, it may contact local authorities or offices (police, security company etc.) in writing or personally.

All these measures must be properly administered by the bank office.



In case the client presents himself/herself after receiving the notices, he/she must be dealt with out of turn personally by the office director if possible. The director may decide within his/her own competence which of the following courses to take:

- Suspension of payment amortization;
- Prolongation;
- Realization of the automobile;
- Realization of the automobile combined with a loan granted for purchasing a less expensive automobile (or change of the automobile with the continuation of the original loan).

In case for whatever reasons the office cannot resolve the problem within 30 days after the delivery of the second notice but the resolution of the problem is under way or it will presumably be resolved then on the basis of the written presentation of the office the regional director may give permission to manage the case at office level for a further 30 days at maximum.

In case no agreement is reached with the client during this period or the content of the contract is not duly performed by the client in the followings, and he/she shows no inclination for cooperation with the bank, the office is entitled and obliged to terminate the contract. Within 15 days after receiving the notice on termination the client must repay his/her debt or submit the automobile at the appropriate brand shop for purposes of realization.

In case the problem remains unresolved after the termination of the contract (the client does not pay or submit the automobile), the whole documentation of the loan contract must be handed over to the legal branch which initiates the court procedure.

The course of managing housing loans must be similar. Naturally, in these cases not cheaper automobiles but cheaper housing units are offered and there is no need for the mediation of the brand shop at the realization of the unit. The legal procedure (warrant, termination etc.), too, has a different course in case of a claim covered by mortgage than in automobile loans where the Bank usually has an optional contract.

The Management of Default Housing Loans up to Starting Legal Procedures at the Vértés Savings Cooperative

The Vértés Savings Cooperative currently holds 518 loans for housing construction or purchase. Of them 60 are regarded as default or bad loans. In 7 of the 60 a legal procedure has been initiated.

A borrower is in default if the monthly amortization payment is not paid until the deadline day in the month.

In this case the computer loans registration system prints out an invoice letter that is mailed by the branch office that has issued the loan.

In case the payment is still not made a repeated letter is mailed in the next month (i.e., on the 30th day following the first letter) in which the client is warned that if payments are not made the loan will be managed centrally.

If the second warning has no effect, the branch office defers the loan file to the center and central collection procedures starts.

As a first step, the center requests the client to pay the arrears in one sum. If this request is not met, both the borrower and guarantors are called to a personal meeting in the center.

If the borrower appears at the meeting, payments of arrears, rescheduling amortization within the maturity period and, as a final resort, prolonging the maturity period is discussed. The decision is always made by the authorized decision making forum B. Upon special agreements and modification of the loan contract most of the arrears are paid. In the agreement it is included that in case of accumulating arrears, legal procedures will be started without warning.

If the client does not appear, a procedure is started in which the court issues an order to pay the invoice. When the invoice is ordered by the court, foreclosure procedures are started. Of course, if the client pays the total amount or large part of the arrears while the procedure goes on, the savings bank is willing to stop procedures.

Measures Taken by the OTP Bank before Terminating the Loan Contract

After some major changes in enforcement law in 1996, new internal regulations were issued for the area of lending in our bank.

Based on the experiences that had been gathered by that time, we realized that court recovery procedures were extremely lengthy, costly and their effectiveness is reciprocally proportional to the time elapsed.

The internal regulations set the aim that in order to improve the situation with the delinquent portfolio, and to reduce costs of recovery, any intent or request by the borrower to mitigate or repay his/her debt should be met and supported. Of course when the intent or request is not followed by payments made or the observance of the modification agreement, the recovery procedure must continue consistently.



General procedure for housing loans

The first reminder letter is sent when the delinquent amount exceeds HUF 200 but is less than one month's payment. This reminder letter can be sent several times if applicable.

The second reminder is sent when the delinquent amount exceeds one month's payment but is less than the amount of three months' payment, and the borrower has already received a first or second reminder.

The third letter, that will contain last warning before acceleration, will be sent when the borrower's delinquency exceeds three months' payments and the second reminder has already been sent.

For loans that undergo automated processing, these letters are prepared and mailed by the computer system automatically, but the loan officer has the opportunity, in any case, to set the automated letter generation and undo it, if necessary.

At the same time when reminders are sent, notification is sent to all the other obligors to the loan about the delinquency and the reminder sent to the borrower.

For a long time, the bank had not wanted to issue any general internal procedures in relation to termination of loan contracts because of the specific nature of housing loans.

Branches had rarely used this option in the course of individual qualification of loans, and court procedures had been launched to recover the delinquent amount only.

Decision-makers had been told, as a general recommendation, to first take measures in order to recover the delinquent amount, and the total amount of the loan contract should only be terminated, and therefore the full claim be accelerated, when the bank cannot expect a voluntary payment even in response to a solicitation letter to pay the delinquency, and therefore another solicitation letter demanding payment should be sent.

As delinquencies arise, the obligors should be persuaded to contact the branch in person in order to settle the delinquency. Under a personal discussion, reduced payment, forbearance, term extension or payment in one sum on a definite date can be offered and agreed to.

The modification agreement made with the obligors should be committed to writing, and monitored continuously for performance. Any collateral specified in the contract should be checked for existence, and the income to support payment should

also be verified along with whether the requirements regarding any other security is met.

Before commencement of recovery procedure by court, it is worthwhile to inspect the property in order to see whether the procedure has been successful. After that check, considerations can be made whether it is worthwhile to incur additional costs or it is reasonable to prepare for writing off and start making the necessary calculations in relation to claims qualified as uneconomic, and recommend writing off the loan.

In the case of loans that are deemed of large sum and delinquent, and having no state guarantee, and for which no court procedure has been launched, it is advisable that, when forbearance or term extension is agreed to, the borrower and any other obligors involved should be required to provide a notarized statement to recognize the debt in order to expedite recovery procedures by court, if, any, and to substantially reduce costs.

When the delinquency is of large sum and/or the delinquency is the result of more than one payments missed, notarization of the agreement on rescheduling the delinquent amount should be considered.

Special procedures for individual loan types

Loans approved under terms in effect as of January 1, 1994. It is possible for these loans to grant forbearance at the start of or during the payment period without adjusting the term under a loan contract modification.

Term extension can also be agreed to under contract modification. For deferred payment loans, the bank will agree to forbearance and term extension in exceptional cases only, and the main reason for that lies in the resulting substantial increases in payment obligations.

Credits with new conditions - with payment subsidy. Payment of loans made under terms prevailing from January 1, 1989 through December 31, 1993 is subsidized from the state budget. In the case of these loans, it is especially important to individually assess each situation in communication with the borrower. During that communication the borrower should be made understood that non-payment will result in withdrawal of subsidy and delinquency in an according sum, which will substantially increase borrower's financial burdens, and the loan will truly become impossible to repay for the obligor.

Considering the substantial differences in amount that can be received in payment subsidy in the different subsidy cycles, and the related legal regulations, efforts should be made to settle the delinquent debt within a cycle.



No payment subsidy can be posted for these loans after three monthly payments have been missed. When the borrower requests a temporary reduction or suspension of the payment amount, it can be agreed to if he/she undertakes to pay the missed payments, whose full amount is higher than three months' payments, within the subsidy cycle.

It can happen that the borrower is unable to pay the higher payments during a shortened term specified in the contract, therefore a high delinquent debt accumulates, which the borrower is unable to pay. In such cases the solution can be to extend the term, which can be effected during or after the cycle.

The borrower should be informed that a term extension, forbearance or reduced payment will mean reduced payment subsidies, however, this option is still more favorable for the borrower than subsidy withdrawal and the resulting additional interest and late fee.

Loans with - so called - old conditions. In the case of housing loans made under laws in effect up until December 31, 1988, in order to recover overdue delinquent debts on them, borrowers who, based on their income situation, undertake to pay their delinquent debt in installments, should be approved to do so.

A special situation is created for these loans by the fact that under Article 64-68 of Law CIII/1990, guarantors are not effected by the rate changes in 1991-1992. However, when a contract modification is signed, their obligations will change in accordance with the changed conditions.

It is possible for the bank to reduce or suspend payments for borrowers in temporary hardships, down to the interest amount or even below.

The term of 30-35 years, that has earlier been common, in many cases even mandated by law, cannot be lengthened. Due to high interest rates, no substantial reduction could be achieved for most of these loans even by extending terms. Term extension can represent a solution for shorter-term loans only, when a large delinquent sum accumulates in the final phase of the term, and together with extending the term, the borrower opts for payment in installments rather than payment of full delinquent amount in one sum.

When term extension, forbearance, or payment reduction is agreed to, the recovery procedure will be suspended. Should the borrower fail again to meet the new obligations that he/she agreed to, the bank will continue the recovery procedure, and terminate the modification agreement or the loan contract.

The above is naturally only a brief outline of the "amicable phase", that has been developed by the Bank in order to recover housing loans outside court procedures.