



## Amendments to the Civil Code and the REIT Act

Deloitte Legal Newsletter

**Both the amendments to Act V of 2013 on the Civil Code (hereinafter: "Civil Code") and the tax law changes for 2017 will be promulgated in the next few days. One such change is the amendment to Act CII of 2011 on Real Estate Investment Trusts (hereinafter: "REIT Act").**

## Amendments to the regulations of the Civil Code

The draft amendment to the new Civil Code (hereinafter: "Amendment") was passed by the Parliament on 13 June 2016. The changes will become effective in phases, i.e. on 1 July 2016, 1 October 2016 and 1 January 2017.

The objective and purpose of the Amendment is to address the economic needs that have arisen or become more prominent since the entry into force of the Civil Code, as well as the requirements of harmonization with the transformed regulatory environment of the EU.

The Amendment affects several areas of the Civil Code, including significant changes to the regulations concerning liens, the prohibition of fiduciary collateral arrangements, securities and the liabilities of senior executives. These topics are addressed in our June newsletter.

### External liability of senior executives

Under the current regulations of the Civil Code, **in certain cases, senior executives of legal persons have joint and several liability with the legal person for any damage caused to third parties when acting in their capacity as a senior executive.** The Amendment eases this liability and eliminates the uncertainty caused by the currently effective regulation. **Under the Amendment, senior executives shall be liable** (have joint and several liability with the legal person) **for any damage caused to third parties when acting in their capacity as a senior executive only if the damage is caused by them on purpose.** The current regulation will be applicable in the future only if the damage occurred before 1 July 2016 and is caused by an act committed after the entry into force of the Civil Code.

**The Amendment does not affect the senior executive's liability towards the legal person (internal liability).**

### Changes in the regulations on liens

The changes to liens and collateral security resulting from the Amendment **will enter into force on 1 October 2016.**

#### Independent liens

A number of rules pertaining to liens in the Civil Code's book on rights *in rem* will be subject to change. The most crucial change is that **the concept of independent liens will be reintroduced to the Civil Code to replace separated liens.**

The currently effective concept of seceded liens has not become widespread in the business world and, as a result, maintaining it has become unreasonable. In order to aid the efforts aimed at the development of a



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prospering mortgage bond market and to boost the bank refinancing market, **the Amendment reintroduces the concept of independent liens.**

While a separated lien allows the lien holder "to transfer the lien — under contract, to guarantee his debt — without having to transfer the secured claim to the holder of his debt", the Amendment contains revised regulations on the concept of independent liens compared to the previous version of the Civil Code. Under the rules of the Amendment regarding independent liens, mortgages can also be established in a way that **the mortgage is registered on the pledged property for a specific amount, regardless of the secured claim.** A new rule compared to the previous Civil Code is that, under the Amendment, **such independent liens may only be registered in favour of financial institutions and only on real property.**

By introducing independent liens, the Amendment creates the opportunity for financial institutions to transform their real property mortgage into an independent lien (transformed independent lien). Such transformation may not cause the situation of the mortgagor to become more burdensome. The transformed independent liens differ from reintroduced independent liens in several aspects. The key difference is that a transformed independent lien may only be used for its original purpose, i.e. no other guarantee purpose may replace that original purpose, however in case of the reintroduced independent liens the original purpose can be changed.

### Lien holder's agent

The provisions on lien holder's agents are amended in order to ensure their clarity. A practical problem was that the regulation effective until now allowed a lien holder's agent to be designated only in the pledge agreement or thereafter. As a result, the lien holder's agent could sign the pledge agreement only as a representative of the lien holders. **The Amendment allows a lien holder's agent to be designated even before the pledge agreement is signed, and this also permits the lien holder's agent to sign the pledge agreement in his own name on behalf of the lien holder.**

### Collateral security

The rules for collateral security (regulated by the Civil Code under the rules of liens) are also subject to change.

A new element in the regulation is that **collateral security may now be arranged not only on payment account balances, but also on claims based on a deposit contract and, in addition, on any claim registered on behalf of the party(ies) by an institution acting as an account manager authorized based on the Amendment.**

## Easing of the prohibition of fiduciary collateral arrangements

The Amendment also introduces changes in connection with the nullity of fiduciary collateral arrangements. The currently effective Civil Code provides that any clause on the transfer of ownership, other right or claim for the purpose of security of a pecuniary claim, or on the right to purchase shall be null and void.

According to the reasoning of the Amendment, the prohibition provided in the Civil Code represents an excessive limitation affecting real-life business contracts; therefore, **based on the new rule under the Amendment, clauses violating the above prohibition of fiduciary collateral arrangements will qualify as null and void only if a consumer assumes such a liability in order to secure a claim.** This means that companies will be able to conclude fiduciary collateral arrangements, such as a call option right, with other companies, but not with consumers.

## Changes in the transfer of contracts

Under the current regulation, the guarantees of a contract shall cease to exist upon the transfer of the contract. According to the reasoning of the Amendment, practical experience does not justify that guarantees should cease to exist as the situation of the obligor of the guarantee will not become more burdensome as a result of the transfer of the contract, while the opposite is true for the party entering into the contract. **The Amendment provides that "The guarantee of a right transferred to the party entering into the contract shall continue to exist. The guarantee of an obligation transferred to the party entering into the contract shall cease to exist, except if the obligor of the guarantee consents to the transfer of the contract."**

## Rules on securities

Revising the rules on securities of the Civil Code has become necessary due to the fact that certain provisions need to be integrated in industry regulations in order to ensure the effectiveness and consistency of the regulation of this field of law. Accordingly, the Amendment harmonizes the Civil Code and Act CXX of 2001 on the Capital Market (hereinafter: 'Capital Market Act').

Under the Amendment, the Civil Code will contain the definition of and basic rules pertaining to securities, but will no longer include procedural rules regarding securities and provisions specifically subject to capital market regulation (e.g. rules regarding the production, transformation or transfer of dematerialized securities) which will be regulated by the Capital Market Act in the future.

The changes affecting securities under the Amendment **will enter into force as of 1 January 2017.**

In addition to the above, **the Amendment introduces changes regarding the transfer of the secured claim, exercising the lien**

**holder's right to satisfaction, as well as the enforcement and termination of the lien.**

## Positive changes in REIT regulations

The REIT Act entered into force in July 2011 and a few days ago the Parliament enacted the Act on Amendments to Certain Tax Laws and Other Related Laws, as well as Act CXXII of 2010 on the National Tax and Customs Administration (hereinafter: "REIT Amendment") which addresses the objections of entities in the real estate market concerning the establishment and operation of REITs, thus facilitating the application of the law. The REIT Amendment modifies several provisions of the REIT Act, thereby potentially encouraging the foundation of REITs and so the revival of the capital market. The information below is based on the final version of the regulation and includes updates to our previous communication regarding this topic.

The REIT Amendment includes the following major changes:

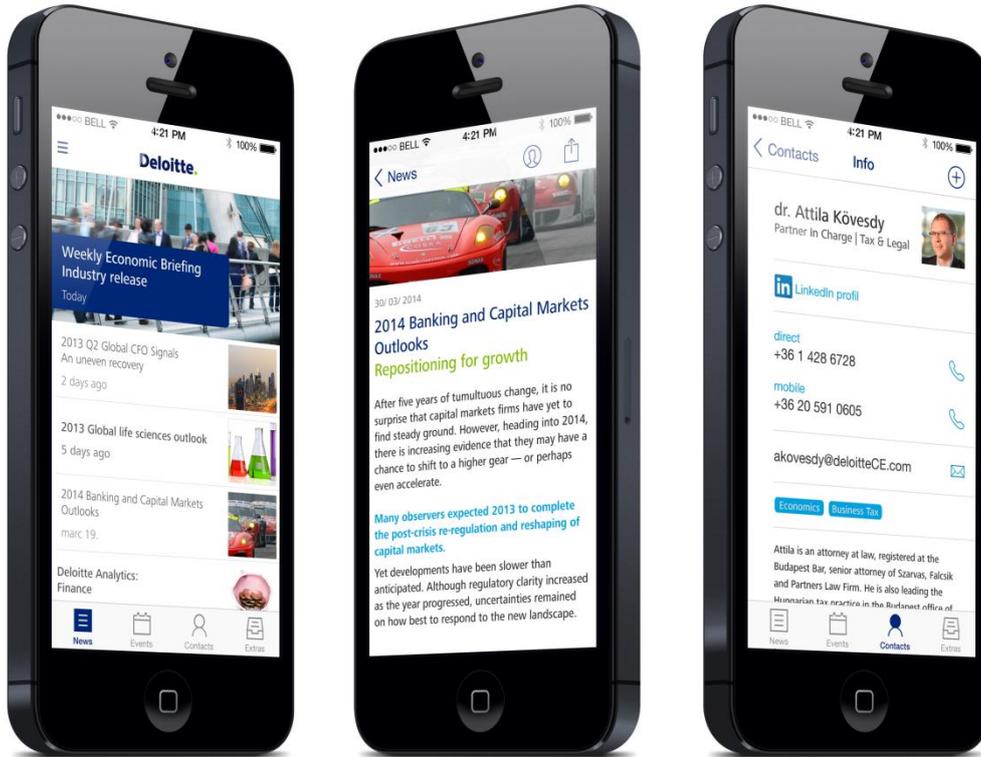
- **The minimum initial capital requirement for REITs will be reduced.** Instead of the current minimum capital requirement of HUF 10 billion, the new regulation allows REITs to be founded with an initial capital of only HUF 5 billion.
- **Free float restrictions have also changed.** Pursuant to the previous regulations, REITs must possess one series of shares representing 25% of the total capital where no individual shareholder owns more than 5% of the series (free float). **Although the new regulation maintains the above 25% and 5% limits, it allows the REIT status to be kept even in the case of ownership shares of over 5%; however, the reporting procedure detailed below must be applied and the voting right that may be exercised by each small shareholder through the share series may not be higher than 5%.** This amendment would make it possible for real estate investment trusts to restrict the voting rights of small shareholders of free-float share series and thus avoid losing the REIT status in cases where the 5% threshold applying to small shareholders is exceeded. With respect to this provision and to those below restricting voting rights concerning insurance companies and credit institutions, the REIT Amendment sets forth that the rule defined in the Civil Code providing that shares ensure voting rights proportional to their nominal value shall not apply in this context. Furthermore, the amendment clarifies that the free-float share series defined in this section is subject to the same treatment as other ordinary share series of REITs.
- In addition to the above, the REIT Amendment also regulates the above-mentioned reporting procedure and sets forth that **the shareholders must submit to the REIT's directorate a statement on the number of shares that they hold each quarter.** If the number of shares a shareholder holds exceeds the free-float limit, then the directorate must request the shareholder to sell some of its shares in order to meet with the free-float limit and **the shareholder must comply with such request within 3**

**months.** If the shareholder fails to do so, the REIT will be entitled to sell the shares which are in excess of the limit on behalf and in the name of the shareholder.

- **According to the REIT Amendment, the limitation that insurance companies and credit institutions may not possess an ownership share of more than 10% has been abolished; however, such entities may hold no more than 10% of the total voting rights.**
- The rules on dividend payment and on establishing call option right have also changed. Under the REIT Amendment, REITs may not enter into contracts **(with the exception of contracts with financial institutions regarding loans or credits)** and may not assume unilateral liabilities which would limit the payment of dividends or would grant a call option right to another person in connection with a piece of real estate in the real estate portfolio.
- The REIT Amendment also sets forth that **the asset portfolio of REITs may, in addition to the types previously allowed, include further types of assets that are reasonably required for conducting the core activity that may be carried out by the REIT.**
- **Under the REIT Amendment, REITs must distribute dividends within 15 trading days** (as defined in the Act on Capital Markets) **from the approval of the financial statements.** As a result, the amendment ensures that the deadline is met in practice, taking into account the restrictions stipulated by KELER's terms of business as well as official holidays. In addition to the above, if the disposable funds of an REITs is less than the after-tax profit for the current year which can be paid out as dividends, then at least 90% of the disposable funds must be paid out as dividends.

**At the same time, the favourable rules currently applying to REITs, in particular the favourable tax rules, will not change:** the property transfer tax payable by REITs and their special purpose vehicles must be calculated using the 2% rate, while REITs are not subject to corporate income tax or local business tax.

We believe that this amendment properly addresses the most criticized provisions of the REIT Act and, as a result, will facilitate the foundation of REITs.



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