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**Study on the feasibility of reducing obstacles to the transfer
of assets within a cross border banking group during a
financial crisis**

National Report
HUNGARY

By

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Part I - National regulation

1. Summary

1. Transfer of assets within a cross border banking group during a financial crisis -

1.1. Definition of Transfer of Asset

In the context of this study asset transfer is interpreted very broadly, including, among others, transfer of capital and collateral, assignment of receivables and any other possible kinds of asset transfer. In Hungary transfer of capital maybe implemented in two ways by capital increase or capital decrease. In the latter case the shareholders of a company get back some part of their previously invested money. However, both capital increase and capital decrease are seldom executed by transfer of assets agreement but typically by resolutions of the shareholder(s) and in this sense it belongs to the field of corporate law. On the other hand, various other types of asset transfer are governed basically by civil law (hereinafter: Civil Code).

1.2. Company Form of Banks

Act CXII. of 1996 on Credit Institutions and Financial Enterprises (hereinafter: "Bank Act") sets forth the special provisions on the establishment, operation, termination and supervision of credit institutions and financial enterprises. Banks qualify as such sort of credit institutions that pursue business like operations precisely enumerated by this Act. Banks may be established in the form of joint stock company, either as a private limited company or a public limited company or branch office. Bearing in mind that banks operating in Hungary are

mostly set up in the form of private limited company this Study focuses on the specialties of private limited companies.

Consequently, provisions of Act IV of 2006 on Business Associations (hereinafter: "Company Act") must also be taken into consideration because the ordinary running of business in the form of private limited companies is governed by the Company Act.

1.3. Crisis Situation

Neither the Bank Act nor the Company Act use the term crisis situation. Still, the Company Act describes such sort of circumstances when urgent or immediate actions are expected from the competent bodies of the company concerned. These sorts of circumstances can be interpreted as crisis situation:

- a) the company's equity capital has dropped to two-thirds of the share capital due to losses; or
- b) the equity of the company has dropped below HUF 5,000,000,- (in case of banks this amount is HUF 2 Billion, i.e. approx. EUR 8 Million); or
- c) the company is on the brink of insolvency; or
- d) the company has stopped making payments and its assets do not cover its debts.

In terms of Banking Law some other serious infringements of the provisions of Bank Act may lead to a situation when the supervisory bodies (hereinafter: "State Financial Institutions Commission" or briefly "Commission") shall take the major sanctions and exceptional measures necessary. Such situations can well be explained as crisis. This is the case, if a financial institution

- a) has own funds that is less than fifty per cent of the capital requirements specified in the Bank Act,

- b) wishes to pay or pays dividends in a situation where its own funds is below fifty per cent of the capital requirements specified in the Bank Act,
- c) fails to meet its obligation to create provisions or the obligation of value adjustment, has insufficient provisions and inadequate value adjustments, meaning that the evaluation of off-balance sheet items and assets was incorrect, as a consequence of which its solvency ratio falls below four per cent because the solvency margin were reduced by the amount of unaccounted accumulation of provisions and value adjustments,
- d) by non-observance of the regulations for ensuring liquidity and the approximation of maturities of assets and liabilities, severely endangers the maintenance of the liquidity of the credit institution,
- e) regularly or substantially violates the regulations on exposures and thus severely endangers the credit institution's liquidity, solvency or ability to produce income,
- f) regularly performs activities prohibited by law or for which it is not authorized,
- g) is unable to satisfy the requirements for authorization described in this Act during its operation,
- h) operates without the necessary accounting, management information or internal control system, or these systems are inefficient to indicate the credit institution's actual financial position,
- i) in the course of its resource collecting activities, determines an interest value significantly differing from the market value representing increased risks for the credit institution or the deposit-holders,

- j) enters into illicit or bogus contracts in order to gain pecuniary benefits or to alter its balance-sheet result capital requirement,
- k) employs an auditor who fails to inform the Commission, the board of directors and the supervisory board of the financial institution about any severe infringement, deficiencies and other problems found at the financial institution and endangering the prudent operation of the financial institution,
- l) repeatedly infringes the regulations specified in the Bank Act within five years of the operative date of the measure taken by the Commission or the resolution imposing a penalty,
- m) fails to fulfill the provisions of the supervisory measures taken for any severe violation of regulations.

1.4. Insolvency Law

Insolvency Law in Hungary is basically regulated by Act IL of 1991 (hereinafter: Insolvency Act). The Insolvency Act sets forth provisions for two types of insolvency proceedings:

1.4.1 Bankruptcy insolvency proceeding means when the debtor requests relief from its financial obligations in an attempt to seek composition agreement, or attempts to have a composition agreement concluded.

1.4.2. Winding up means the proceeding aimed to provide satisfaction, as laid down in this Act, to the creditors of an insolvent debtor upon its dissolution and termination of its corporate existence. Winding up proceedings are also called in Hungarian legal terminology liquidation proceedings.

Furthermore the Bank Act contains supplementary provisions for winding up of financial institutes.

2. Limitation of Asset Transfers in Going Concern Situations

The Civil Code does not contain limitations for asset transfer deals from parent to subsidiary or from subsidiary to parent or from subsidiary to another subsidiary. Of course, such transactions must comply with the general validity rules of civil law.

As regards corporate law, asset transfer is also allowed between parent and subsidiary or subsidiary and parent or subsidiary and another subsidiary provided that such transfer does not result in a crisis situation of the transferor or does not violate the legitimate interest of third persons. The same applies to capital increase or capital decrease which can be interpreted only in respect of a relationship of a parent and subsidiary. Capital increase is generally allowed in all situations but due care should be taken in order to avoid that a capital increase results in financial difficulties of the parent. If it still happens, adequate measures must be adopted on behalf of the shareholder of the parent. Capital decrease is also subject to matching the precisely described legal preconditions.

Nevertheless, a private limited company may effect any disbursement from its own funds to a shareholder, on account of his membership, during the company's existence solely in the cases defined in the Company Act and only if the conditions set out in the Accounting Act are satisfied, with the exception of the reduction of the share capital, from the taxed profit for the current year, or from the taxed profit from the current year supplemented with available profit reserves. No disbursement can be made if the company's equity capital - adjusted in accordance with the Accounting Act - is below its share capital or it would be reduced to drop below the share capital if the payment was made.

The Insolvency Act does not lay down restrictions. Nevertheless, it may happen that an asset transfer later on proves to be a transaction that

was not implemented in going concern situation. In other words, this transaction may retroactively be considered a doubtful one and be challenged by the liquidator or a creditor.

As regards Banking Law specific rules also prevail. A credit institution's exposure - that is to be taken into consideration for the calculation of capital requirement for credit risk using the standardized approach - to a single client or group of connected clients shall be considered a large exposure where its value is equal to or exceeds ten per cent of its own funds. The combined net value of a credit institution's exposures - calculated according to the above quoted provision - to a single client or a group of connected clients may not exceed twenty-five per cent of the credit institution's own funds. If the given client or group of connected clients is the subsidiary or parent company of the credit institution, the subsidiary of the given parent company, an owner with a qualifying participation in the credit institution, or an enterprise in which the credit institution or the owner of the credit institution is a member of the board of directors, a member of the supervisory board, an executive officer, or a close relative of one of these has a qualifying participation; the percentage specified above shall be twenty per cent. On the basis of the rules and regulations approved by the board of directors, the credit institution shall adopt decisions concerning the exposures referred to above with a two-thirds majority of the members of the board of directors attending. Credit institutions shall keep separate records on exposures.

The above quoted provisions shall not apply to exposures to the credit institution's parent company or any of its other subsidiaries, or the credit institution's own subsidiary, if the supervision on a consolidated basis to which the credit institution is subject applies to these companies as well. There are no specific regulations for crossborder transfer of assets.

3. Limitation of Asset Transfers in Crisis Situations

In the event of any imminent threat for the business association's insolvency, the executive officers shall conduct the management of the business association giving priority to the company's creditors. In the event that non-compliance with this obligation is verified and if the business association is deemed to be insolvent, the executive officers affected may be subject to financial liability under specific other legislation toward the company's creditors.

2. Scope

2.1. Notion of Company Group in Company Law

Two types of company groups exist in corporate law, namely recognized groups of companies and de facto groups of companies.

2.1.1. Definition, Conditions and Main Applications of Recognized Group of Companies

Any business association that is required to draw up consolidated annual reports according to the Accounting Act (dominant member) and any public or private limited company, or private limited-liability company over which the dominant member effectively exercises a dominant influence according to the Accounting Act (controlled company) may decide to enter into a control contract to join forces in pursuing their common business interests and continue operating in the form of a recognized group. The autonomy of the controlled companies of the recognized group may be restricted in the manner and to the extent specified in this Act and in the control contract, as it may be necessary with a view to the interest of the group as a whole. The control contract shall contain provisions for the protection of the rights of the members (shareholders) of controlled companies, and for the protection of

creditors' interests. Having a recognized group of companies registered in the register of companies shall not result in creating a separate legal entity from the business associations belonging to the group.

A decision for the preparation of the formation of a recognized group of companies and for the contents of the draft version of the control contract shall be adopted by simple majority of the votes of the supreme bodies of the business association involved, unless their memorandum of association provides otherwise. The dominant member and the controlled companies may install provisions in their memorandum of association to authorize their management to adopt decisions in the issues specified above. The control contract shall inter alia contain the following:

- a) the corporate names, registered offices and registration number of the business associations belonging to the group, indicting the company designated as the dominant member and the ones designated as the controlled companies of the group;
- b) the type of cooperation proposed for the business associations belonging to the group with a view to their common business strategy, and its essential elements, such as in particular the rights conferred upon the dominant member in adopting decisions at the group level and for the implementation of such decisions, and the related rights and obligations of the supreme body and management of the controlled company (companies);
- c) provisions to ensure the predictability and balanced allocation of the advantages and disadvantages stemming from operating in the form of a group, which are necessary for the protection of the rights of members (shareholders) of the controlled company (companies) and their creditors, such as the dominant member's commitment to cover any potential

- losses of a controlled company, to supplement the dividends of members (shareholders) or for the exchange of their shares (securities) or a commitment for the eventuality of insolvency of a controlled company on the part of the dominant member to participate in the reorganization of the controlled company;
- d) an indication as to whether the recognized group of companies is established for a limited period of time or for an indeterminate duration;
 - e) the legal consequences for any breach of contract.

The dominant member may supplement the dividends of members (shareholders) of the controlled company from its own taxed profits, or from the taxed profit supplemented with available profit reserves at the time when paying dividends to the members (shareholders) of the dominant member, provided that the dominant member is able to satisfy the statutory conditions for the payment of dividends.

The duration of the control contract shall be determined in consideration of what is contained above.

The draft version of the control contract shall be approved by the supreme bodies of the business associations participating in setting up the recognized group subject to a three-quarters majority of the votes. The dominant member of the recognized groups of companies shall send the control contract to the competent court of registry within fifteen days of approval for reasons of registration and publication in the Cégközlöny (Company Gazette). The court of registry shall register the recognized group by way of an entry in the records of the business associations involved, if the control contract and the proceedings for its approval are found to be in compliance with the provisions of the Company Act. The provisions of the Company Act pertaining to recognized groups of companies shall apply as of the date of registration in the register of companies.

The dominant member of the recognized group, or its management, may instruct the management of the controlled company according to the provisions laid down in the control contract, or in the memorandum of association within the meaning of the control contract, and may adopt resolutions binding upon the operation of the controlled company. In this case, the provisions of the Company Act on the exclusive competence of members' meetings (general meetings) shall not apply concerning the powers and operation of the supreme body of the controlled company, and the dominant member may not be declared liable if having acted in accordance with the provisions of the control contract. Where so prescribed in the control contract of the recognized group, from the powers conferred upon the business association's supreme body - in addition to what is contained above - the dominant member of the recognized group shall have powers to exercise the right for the appointment and removal of the executive officers and supervisory board members of the controlled company, and for establishing their remuneration. The control contract may also provide facilities to permit the appointment of an employee of the dominant member as director of the controlled company, in which case the appointment shall be fixed in a resolution adopted by the supreme body of the dominant member. An executive officer and/or supervisory board member of the dominant member of a recognized group may also be elected to the same position at a controlled company, whereupon the consent shall be considered granted upon the registration of the recognized group in question.

2.1.2. Definition, Conditions and Main Applications of De Facto Groups of Companies

The provisions concerning recognized group of companies may be applied in the absence of a control contract and registration as a recognized group, if the business associations belonging to the group are

engaged in operations under a common business strategy for at least three consecutive years based on collaboration between the dominant member and the controlled company (companies), and they demonstrate the kind of conduct to ensure the predictability and balanced allocation of the advantages and disadvantages stemming from operating in the form of a group. In the event of doubt, the burden of proof lies with the dominant member to demonstrate that the criteria set out above are satisfied as regards the business associations belonging to the group, and that the provisions contained above are applied legitimately in the collaboration between the dominant member and the controlled company (companies). The dominant member of the group shall be held liable for any unlawful application of the provisions set out above according to the regulations governing the making of unfavorable business decisions. At the request of the dominant member and any other person who is able to verify his lawful interest, the court may declare the genuine collaboration between the dominant member and the controlled company (companies) to be in compliance with the requirements set out above. Such court ruling precludes the establishment of unlimited liability of the dominant member - on the grounds of its history of the making of unfavorable business decisions - for the outstanding debts of the controlled company in the event of the controlled company's insolvency stemming from reasons that may have occurred during the period to which the said court ruling pertains, or in the course of such period. If, within ninety days of the operative date of the court ruling, the dominant member and the controlled company (companies) enter into a control contract drafted in compliance with the court ruling, the court of registry shall register the recognized group in the register of companies.

2.2. Group Interest

The definition of "group interest" that specifically allows or facilitates intra-group transfer of assets does not exist in Hungarian law. Still, the term group interest appears in connection with the operations of

recognized company groups. Under Company Act the executive officer of the controlled company shall conduct - in accordance with the control contract - the management of the business association by giving priority to the interests of the recognized group as a whole. The executive officer shall be exempt from the general provisions if his conduct is found to be in compliance with the relevant provisions set out in legal regulation and in the control contract.

Furthermore, some other definitions are worth taking into consideration.

2.2.1. Majority Control under Civil Code

Majority Control means a relationship where a natural or legal person or unincorporated business association (hereinafter referred to collectively as "holder of a participating interest") controls over fifty per cent of the voting rights in a legal person or in which it has a dominant influence.

A holder of a participating interest is deemed to have dominant influence over a legal person if it is a member of or shareholder in that company and:

- a) it has the entitlement to appoint and recall the majority of the executive officers or supervisory board members of the legal person; or
- b) it controls more than fifty per cent of the votes by virtue of an agreement with other members or shareholders of the legal person.

Dominant influence is also deemed to exist if the entitlements referred to above are ensured indirectly to the holder of a participating interest. The indirect control by a holder of a participating interest of over fifty per cent of the votes in a legal person or dominant influence exercised indirectly by a holder of a participating interest shall be determined by multiplying the number of votes held by another legal person in that legal person (intermediary company) by the number of votes held by the holder of a participating interest in the intermediary company or

companies. If the number of votes controlled by the holder of a participating interest in the intermediary company is greater than fifty per cent, it shall be treated as a whole.

2.2.2. Priority of the Business Interest of the Recognized Group

The provisions already mentioned above in connection with definition of recognized group of companies must be emphasized in connection with this issue. Namely, the dominant member of the recognized group, or its management, may instruct the management of the controlled company and may adopt resolutions binding upon the operation of the controlled company. Consequently, the executive officer of the controlled company shall conduct - in accordance with the control contract - the management of the business association by giving priority to the interests of the recognized group as a whole.

2.2.3. Dominant Influence under Bank Act

Dominant influence means the controlling influence referred to under the definition of parent company in the Accounting Act, or a relationship between a person and a company:

- a) under which the person with control has the capacity to decide on the distribution of the company's profits, the diversification of profit or losses to another company or the company's strategy, business or sales policies, or
- b) that permits coordination of the management of the company with that of another company for the purposes of a mutual objective, regardless of whether the agreement is fixed in the bylaws (deed of foundation) of the company or in another written contract, or
- c) under which joint management is effected through the board of directors, the supervisory board or the management comprised of all or some of the same persons (who provide the necessary decision-making majority), or

- d) under which the person with control is able to exercise substantial influence in the operation of another company without any capital involvement.

2.3. Specific Tax Issues

Act No. **XCII** of 2003 on the Rules of Taxation uses the term „affiliated company“.

Affiliated company shall mean:

- a) the taxpayer and the person in which the taxpayer has majority control - whether directly or indirectly - according to the provisions of the Civil Code;
- b) the taxpayer and the person that has majority control in the taxpayer - whether directly or indirectly - according to the provisions of the Civil Code;
- c) the taxpayer and another person if a third party has majority control in both the taxpayer and such other person - whether directly or indirectly - according to the provisions of the Civil Code;
- d) a foreign enterprise and its domestic place of business and the business establishments of the foreign enterprise, furthermore, the domestic place of business of a foreign enterprise and the person who is in the relationship defined under Paragraphs a)-c) with the foreign enterprise, whereby:
 - da) majority control shall also mean when any party has the right to appoint or dismiss the majority of executive officers and supervisory board members;
 - db) in terms of majority interest, the voting rights of close relatives shall be taken into account concurrently.

2.4. Specific Regulations for Banking Groups

Banking groups are defined in Bank Act in a very sophisticated way. The following types of bank groups can be identified:

2.4.1. Financial Conglomerate

Financial Conglomerate is a group that meets the following conditions:

- a) at the head of the group:
 - 1. is a credit institution; or
 - 2. is a non-regulated entity, and the group's activities mainly occur in the financial sector within the meaning of Subsection (3); and
- b) at least one of the entities in the group is within the insurance sector and at least one is within the banking or investment services sector; and
- c) the consolidated and/or aggregated activities of the entities in the group within the insurance sector and the consolidated and/or aggregated activities of the entities within the banking and investment services sector are both significant within the meaning of Subsection (4) or (5).

Subsections (3), (4) and (5) set forth that:

- (3) The activities of a group in different financial sectors shall be deemed significant if the balance sheet total of the regulated and non-regulated financial sector entities in the group as a whole exceeds forty per cent of the combined balance sheet total of the group.
- (4) Activities within a financial sector shall be deemed significant, if:
 - a) the average of the ratio of the balance sheet total of that financial sector to the balance sheet total of the financial sector entities in the group and
 - b) the average of the ratio of the solvency requirements of the same financial sector to the total solvency requirements of the financial sector entities in the group

exceeds ten per cent within the insurance sector and within the banking and investment services sector as well. For the purposes of these calculations the banking sector and the investment services sector shall be treated as a single sector.

- (5) Cross-sectoral activities within the financial sector shall be deemed significant within the meaning of Subsection (4) if the balance sheet total of the smallest financial sector in the group exceeds one thousand six hundred billion forints.

2.4.2. Group

In the context of financial conglomerates a group means a group of companies which consists of a parent company, its subsidiaries and the entities in which the parent company or its subsidiaries exercise dominant influence or hold a participating share.

2.4.3. Credit Institutions Subject to Supervision on Consolidated Basis

Such credit institution fall under this type

- a) that has at least one credit institution, financial institution or investment company as a subsidiary or that holds a participation in such an institution or
- b) whose parent company is a financial holding company

2.4.4. Other Relevant Terms

- a) Financial holding company means a financial institution, other than a mixed financial holding company, whose subsidiary companies are either exclusively or mainly credit institutions, financial institutions or investment firms with at least one of such subsidiaries being a credit institution or an investment firm.
- b) Mixed-activity holding company means a parent company other than a credit institution, investment firm, a financial

holding company or a mixed financial holding company, the subsidiaries of which include at least one credit institution.

- c) Mixed financial holding company means a parent company, other than a regulated entity, which together with its subsidiaries, at least one of which is a regulated entity which has its head office in the European Union, and other entities, constitutes a financial conglomerate.
- d) EU parent credit institution means a parent credit institution in a Member State in which another credit institution authorized in any Member State, or an investment firm or a financial holding company set up in any Member State does not have a dominant influence.
- e) EU parent financial holding company means a parent financial holding company in a Member State in which another credit institution authorized in any Member State, or an investment firm or a financial holding company set up in any Member State does not have a dominant influence.

3. Conditions and Sanctions

a) Authorization

3.1. Internal Approval Procedures

Pursuant to Company Act certain decisions are subject to specific approval procedures of the shareholders meeting, such as decisions to increase the share capital, unless the Company Act contains provisions to the contrary; or decisions to reduce the share capital, unless the Company Act contains provisions to the contrary. In addition, the articles of association may stipulate certain topics decisions on which are

assigned to the competence of the general meeting. These topics may vary depending on the size of the deal or the subject issue thereof.

The Bank Act sets forth that on the basis of the rules and regulations approved by the board of directors, the credit institution shall adopt decisions concerning the exposures referred to in Subsection (7) with a two-thirds majority of the members of the board of directors attending. Credit institutions shall keep separate records on exposures.

3.2. External Approval Procedures

Pursuant to the Bank Act the Commission's permission is required for the transfer of the account portfolio and the contracts for repayment of monetary instruments (hereinafter referred to as "assignment of customer accounts"). The same applies to financial institutions operating in the form of a branch office. However, no permission is needed in case of such branch office whose registered office is located in another member state of the European Union

3.3. Notification and Publishment Obligations

Under Company Act special notification and publishment obligations arise if capital increase or decrease take place.

At public limited companies the general meeting shall be convened by way of a public notice published in accordance with the articles of association at least thirty days in advance. The articles of association may contain provisions to stipulate that the notice for calling the general meeting may be posted on the company's official website instead of being published by means of the printed press. In addition to being posted on the website, the articles of association may require the notice to be published in the press as well, and that it shall be sent by way of electronic means to the shareholders who specifically requested it, in addition to being posted on the website or published in the press. In the event of any deviation between the public notice and the notice sent to

the shareholders by way of electronic means, the public notice shall prevail.

Once a resolution has been rendered on capital increase or decrease it must be published in the official gazette. Furthermore, capital decrease is subject to additional publication requirements. The management board shall take measures to have the decision on the capital reduction published in two consecutive volumes of the Cégközlöny (Company Gazette) within thirty days after the date of the resolution of the general meeting for the reduction of share capital or from the delivery of the final court decision, leaving at least thirty days between the two publications. The notice shall specify as to whether the conditional reduction of share capital is carried out by decision of the general meeting or the court, it shall contain the subject of the decision, and shall advise the company's creditors of their right to demand collateral security for their claims originating from before the first publication of the notice that did not fall due by this time. Known creditors must be informed directly as well.

3.4. Specific Agreement Incorporating the Terms and Conditions of the Transfer

Pursuant to Bank Act financial institutions, other than financial holding companies, must adopt internal rules and regulations, subject to approval by the board of directors, to provide sufficient facilities to establish the substantiality and transparency of placements and exposures as well as to control the assessment of risks and to reduce them. The same applies, *mutatis mutandis*, in other types of asset transfer deals whereby written agreement is always required.

3.5. Differences between Transfers in Going Concern Situations / Transfers in Crisis Situations

There are no differences as regards the formal requirements of transfers in going concern situations or in crisis situations.

b) Counterpart for the Asset Transfer

3.6. Arm's Length

The term "arm's length" although not with the same words, commonly applied in areas of taxation when there are dealings between related corporations, e.g. parent and subsidiary. It covers the standard under which unrelated parties, each acting in their own best interests, would carry out a particular transaction. In Hungarian legal terminology it corresponds to fair market price.

The transactions of affiliated companies shall be accounted at fair market prices for taxation purposes irrespective of whether or not the underlying contracts are concluded at fair market prices. This provision shall not apply if the conduct of the affiliated companies is consistent with market practices that could reasonably be expected from independent parties under the given circumstances.

The state tax authority shall declare by resolution, upon request, the procedure for determining the fair market value to be used in a forecasted transaction to be concluded between affiliated companies, the facts and circumstances based on which it is determined, and, if possible, the fair market price or price range (fair market value). The resolution shall be considered valid only upon the consent of all affiliated companies involved in the transaction, or in bilateral and multilateral proceedings, upon the agreement of the state tax authority and the competent foreign authorities for conducting the proceedings. Before lodging the application the applicant may request prior consultation for the applicant and the competent authority to discuss in advance the conditions under which to conduct the proceedings, to make arrangements for the timetable and disposition of discussions, and any

possible ways for cooperation. The outcome of such prior negotiations shall not be binding upon the applicant or upon the competent authority in the proceedings for determining fair market value. Proceedings for establishing fair market value may be unilateral, bilateral or multilateral. Where the laws of another country relating to income taxes also apply to the transaction in question, the affiliated company shall indicate in the application its intention to use unilateral, bilateral or multilateral proceedings for establishing fair market value.

However, bank groups must comply with special banking law provisions and take care of the solvency of all members of the group. Therefore in crisis situations special rules apply. The Bank Act sets forth that credit institutions subject to supervision on a consolidated basis and financial holding companies shall be responsible for ensuring the prudent operation of the companies they control, including compliance with the risk exposure and capital adequacy regulations. The boards of directors of credit institutions or financial holding companies that are subject to supervision on a consolidated basis may instruct the boards of directors of credit institutions, financial institutions, investment companies and associated companies in which they have a dominant influence to observe and enforce the regulations pertaining to supervision on a consolidated basis, and the boards of directors must follow these instructions.

c) Compulsory Counterparts and Guarantees

3.7. Compulsory Counterparts and Guarantees

Depending on the type of asset transfer counterpart is never laid down, it may or may not be stipulated or must be fixed.

3.7.1. Counterpart is never paid in the following asset transfers:

- capital increase

- capital decrease
- donation (under Civil Code a donation contract one of the parties shall be obliged to grant his own property to the other party as a gratuitous material bequest. Contracts for the donation of real properties shall only be valid if concluded in writing.)

3.7.2. Counterpart may or may not be stipulated in the following asset transfers:

- assignment of receivables
- transfer of independent liens (under Civil Code independent liens are negotiable. The obligor shall enforce his rights and complaints from the legal relationship serving as the basis for the independent lien solely in respect of the person or the successor of such person who has directly acquired the independent lien without consideration and who was aware of the legal relationship on which it was based.)

3.7.3. Counterpart must be fixed in the following asset transfers:

- sale and purchase contract (under Civil Code by concluding a sale contract the seller shall be obliged to transfer title of ownership and cede possession of a thing to the buyer, and the buyer shall be obliged to pay the purchase price and take possession of the thing. All things that are not withdrawn from circulation can be subject to sale. Real property sale contracts shall only be valid if concluded in writing.

3.7.4. Other Relevant Information

A credit institution may not acquire or hold investments that constitute a qualifying holding in a company and whose net value is in excess of fifteen percent of its own funds, with the exception of other financial institutions, investment enterprises, commodities brokers, bodies

providing clearing and settlement services under the CMA, investment fund managers, exchange market operators, insurance and reinsurance companies or ancillary services companies.

In terms of the restrictions described above, ownership shares, acquired by the credit institution for a temporary period of not more than three years of the date of execution of the contract, for reducing losses deriving from financial services or acquired as a result of swap transactions for partial share in loans or of a liquidation - registered and managed separately and rated regularly - must not be taken into consideration. Furthermore, the ownership shares recorded in the trading book need not be taken into consideration.

A credit institution may exceed the limits prescribed in the Bank Act if it is able to meet the capital requirement described in Subsections (1)-(2) of Section 76, less any loan amounts in excess of such limits, and if it is able to comply with other restricting requirements.

d) Financial Capacities of the Transferor and the Transferee

3.8. Compliance with conditions relating to the financial capacities/health of the transferor/transferee

3.8.1. Liquidity

A credit institution must maintain liquidity (hereinafter "liquidity") at all times. It shall execute the collection of resources and placement of assets so as to maintain continuous liquidity.

A credit institution shall provide for its obligations described above by close approximation of the dates of maturity and the sums of its receivables and payables, with due consideration of the type, extent and risks of the activities it performs.

A credit institution shall prepare internal rules and regulations and a plan to ensure the liquidity described above.

Branch offices of third-country credit institutions must maintain a capital maintenance ratio of at least one hundred per cent at all times.

3.8.2. Consequences if conditions have not been respected

Consequences from two directions may come in this situation.

3.8.2.1. Consequences under Civil Code

Third parties might challenge the asset transfer if the conditions have not been respected in three major forms:

- challenging for invalidity under voidness
- challenging for invalidity under nullity
- challenging for concealment of assets serving as collateral

3.8.2.2. Consequences under Bank Law

The Commission may intervene and take the adequate measures depending on the seriousness of violating the conditions. The following main types of measures are acknowledged:

- The Commission shall review the strategies, policies, processes and methods relating to the capital adequacy of credit institutions, and shall evaluate the exposures of credit institutions.
- In the event of any serious infringement of the provisions of this Act, legal regulations pertaining to prudent operation, the NBH Act, legal regulations on financial transactions and foreign exchange, the Commission shall take the major sanctions and exceptional measures necessary, if a financial institution

- a) has own funds that is less than fifty per cent of the capital requirements,
- b) wishes to pay or pays dividends in a situation where its own funds is below fifty per cent of the capital requirements,
- c) fails to meet its obligation to create provisions or the obligation of value adjustment, has insufficient provisions and inadequate value adjustments, meaning that the evaluation of off-balance sheet items and assets was incorrect, as a consequence of which its solvency ratio falls below four per cent because the solvency margin were reduced by the amount of unaccounted accumulation of provisions and value adjustments,
- d) by non-observance of the regulations for ensuring liquidity and the approximation of maturities of assets and liabilities, severely endangers the maintenance of the liquidity of the credit institution,
- e) regularly or substantially violates the regulations on exposures and thus severely endangers the credit institution's liquidity, solvency or ability to produce income,
- f) regularly performs activities prohibited by law or for which it is not authorized,
- g) is unable to satisfy the requirements for authorization described in the Bank Act during its operation,
- h) operates without the necessary accounting, management information or internal control system, or these systems are inefficient to indicate the credit institution's actual financial position,
- i) in the course of its resource collecting activities, determines an interest value significantly differing from the market value representing increased risks for the credit institution or the deposit-holders,

- j) enters into illicit or bogus contracts in order to gain pecuniary benefits or to alter its balance-sheet result capital requirement,
- k) employs an auditor who fails to inform the Commission, the board of directors and the supervisory board of the financial institution about any severe infringement, deficiencies and other problems found at the financial institution and endangering the prudent operation of the financial institution,
- l) repeatedly infringes the regulations within five years of the operative date of the measure taken by the Commission or the resolution imposing a penalty,
- m) fails to fulfill the provisions of the supervisory measures taken for any severe violation of regulations.

- The Commission shall, in addition to the provisions, take the necessary regular or extraordinary measures, also if
 - a) the capital maintenance ratio of a branch office of a third-country credit institution falls below one-hundred per cent,
 - b) a branch office of the foreign credit institution in another country has become insolvent.

- The Commission may also take measures if the supervisory authority with jurisdiction over the registered office of the third-country credit institution has taken measures against or penalized the given credit institution or one of its branch offices operating in any country for a reason that affects the safe operation of the branch office.

- The Commission shall take the aforementioned major sanctions or exceptional measures if, according to the findings of the supervisory review and evaluation:

- a) the own funds held by credit institutions is insufficient to ensure sound management and coverage of their risks; or
 - b) the credit institutions' internal control mechanism, corporate governance functions and risk management procedures, internal models for the assessment of capital adequacy, and management of large exposures fail to comply with the requirements set out in this Act and other legal regulations implemented by authorization of the Bank Act.
-
- Prior to taking exceptional measures with respect to a credit institution that is subject to supervision on a consolidated basis, the Commission shall consult the competent supervisory authority of the Member State where a credit institution to which supervision on a consolidated basis applies jointly with the credit institution in question is established.
 - Before adopting a resolution for taking the exceptional measures the Commission shall not be required to consult with the competent supervisory authority of the other Member State, if the time required for consultation may jeopardize the effectiveness of the decisions. In this case, the Commission shall, without delay, inform the other competent supervisory authority.

The necessary regular or extraordinary measures as quoted above are detailed in Chapter d) "Sanctions".

3.8.3. Rank of Claim of the Transferor in case of Insolvency Proceedings of the Transferee

The Insolvency Act precisely sets forth the rank of claims of various creditors if the debtor goes under winding up proceedings. The debts

shall be satisfied from its assets that are subject to winding up in the following order:

- a) liquidation expenses,
- b) claims secured by lien on financial assets prior to the time of the opening of liquidation proceedings, up to the value of the pledged property and in consideration of the sums already paid; if there is more than one lien on the pledged property they shall be satisfied in the sequence laid down in Subsection (1) of Section 256 of the Civil Code,
- c) alimony and life-annuity payments, compensation benefits, income supplement to miners, which are payable by the economic operator, furthermore, monetary aid granted to members of agricultural cooperatives in lieu of household land or produce, for which the beneficiary is entitled for his/her lifetime,
- d) with the exception of claims based on bonds, other claims of private individuals not originating from economic activities (in particular claims resulting from insufficient performance or compensation for damages, also including the amount of the guarantee obligations ordinarily expected in the given trade, as calculated by the liquidator), claims of small and micro companies as well as small-scale agricultural producers,
- e) social insurance debts and overdue private pension fund membership dues, taxes - with the exception of the tax arrears - and public debts collectable as taxes, repayable government subsidies, as well as water and sewage utility charges,
- f) other liabilities,
- g) irrespective of the time and grounds of occurrence, default interests and late charges, as well as surcharges and penalty and similar debts.

- h) claims held by any executive officer or executive employee of the economic operator, or their close relative [Civil Code, Paragraph *b*) of Section 685], or their domestic partner, or an economic operator under the debtor's majority control (Civil Code, Section 685/B), and the claims resulting from the debtor's gratuitous commitment, furthermore, claims held by any member (shareholder) of the economic operator (Civil Code, Section 685/B) with majority control, that were filed before the occurrence of a situation constituting potential danger of insolvency.

It comes from the foregoing that the transferor's claim does not enjoy a preferential ranking.

3.8.4. Differences between Transfers in Going Concern situations and transfers in crisis situations

Under ordinary provisions of the Insolvency Act, where a lien was filed prior to the opening of liquidation proceedings, the liquidator shall be allowed to deduct from the proceeds from the sale of the property pledged as security only the costs of safeguarding - including maintenance - and costs of the sale of the pledged property, and the liquidator's fee specified in specific other legislation, and shall use the remainder to satisfy the claims for which such property was pledged - immediately upon completion of the transaction. In the case of any lien on financial assets, by way of derogation from the above regulation, fifty per cent of the proceeds from the sale of a property pledged as security, less the costs of sale, shall be used exclusively to satisfy the claims for which such property was pledged up to the amount covered by the lien, provided that the lien was established prior to the time of the opening of liquidation proceedings.

However, the above rules shall not apply where the holder of the lien is the business association or its executive officer or executive employee, or their close relative, or their domestic partner, or a business association under the debtor's majority control. The above rules shall not apply either if the lien holder is a member (shareholder) of the business association with majority control, and the claim secured by the lien was filed before the occurrence of a situation carrying potential danger of insolvency. A situation is considered to constitute potential danger of insolvency as of the day when the member (shareholder) of the business association was or should have been able to predict that the business association will not be able to satisfy its liabilities when due.

e) Information and Transparency

3.9. Specific Information to be communicated on the Transfer

Communication to the Commission is generally not required, except for the transfer of the account portfolio and the contracts for repayment of monetary instruments (hereinafter "assignment of customer accounts"). In this case validity of the assignment of customer accounts is subject to the Commission's permission. The same relates for the assignment of customer accounts, in case of a financial institution operating in the form of a branch office. Nevertheless, such permission is still not necessary in case of such a branch office whose registered office is located in another member state of the European Union.

Pursuant to Company Act, among others, the following shall fall within the exclusive competence of the general meeting:

- a) decisions to increase the share capital, unless this Act contains provisions to the contrary;
- b) decisions to reduce the share capital, unless this Act contains provisions to the contrary;

- c) decisions on all issues which are assigned to the competence of the general meeting by law or the articles of association.

Unless otherwise provided by the Company Act, the general meeting shall be called by the management board. The general meeting shall be called according to the procedure set out in the articles of association, by means of an invitation sent to the shareholders at least fifteen days prior to the first day of the general meeting. The articles of association may contain provisions for sending the invitation to the general meeting by way of electronic means to the shareholders who specifically requested it. The invitation shall contain, among others, the agenda of the general meeting. Consequently, if an asset transfer is contemplated by way of capital increase or capital reduction or under the terms and conditions of the articles of association the deal is subject to the resolution by the general meeting, information must be communicated to the shareholders.

Employees may be interested in asset transfers in two positions. They may be simply employees of the transferor/transferee or they may also be shareholders. If they qualify as shareholders, the above provisions automatically prevail. In this sense it is to be noted that according to the provisions of the articles of association, private limited companies may issue employee shares and provide them to full-time and part-time employees free of charge or at a preferential price (employee shares). Public or private limited companies may issue a type of employee shares with entitlement to preferential dividends - after the shares carrying dividend preference - from the after-tax profits to be distributed among shareholders prior to shares belonging to other categories or classes of shares. The articles of association may also provide for the issue of employee shares carrying entitlement to appoint executive officers.

In accordance with the Labor Code the employer shall inform the employees, workers' councils and trade unions concerning all facts and conditions, and any changes therein, which are important from the point of view of exercising rights and fulfilling obligations. Therefore such a question should be put whether the targeted transaction qualifies as important in this sense. Depending on all circumstances of the contemplated asset transfer the transaction may or many not prove to be important from point of view of employees. If the answer is not, then there is no mandatory obligation to inform them prior to adopting the transaction. However, even if it is not mandatory to cooperate with the worker's council prior to adopting the targeted transaction, i.e. providing information to the employees is voluntary, it is still advisable. Such an information would constitute a symbol of utmost cooperation between the employer and the worker' council or/and the employees.

If the asset transfer has an impact on the corporate data of the transferor and/or the transferee it must be published in the official gazette. This way third parties may have access to information on the transaction. Furthermore, in case of public limited companies the general meeting shall be convened by way of a public notice published in accordance with the articles of association at least thirty days in advance. The articles of association may contain provisions to stipulate that the notice for calling the general meeting may be posted on the company's official website instead of being published by means of the printed press. In addition to being posted on the website, the articles of association may require the notice to be published in the press as well, and that it shall be sent by way of electronic means to the shareholders who specifically requested it, in addition to being posted on the website or published in the press. In the event of any deviation between the public notice and the notice sent to the shareholders by way of electronic means, the public notice shall prevail.

In addition, special rules apply if the asset transfer is performed through capital reduction. In this case creditors enjoy particular treatment. The management board shall take measures to have the decision on the capital reduction published in two consecutive volumes of the Cégközlöny (Company Gazette) within thirty days after the date of the resolution of the general meeting for the reduction of share capital or from the delivery of the final court decision, leaving at least thirty days between the two publications. The notice shall specify as to whether the conditional reduction of share capital is carried out by decision of the general meeting or the court, it shall contain the subject of the decision, and shall advise the company's creditors of their right to demand collateral security for their claims originating from before the first publication of the notice that did not fall due by this time. Known creditors must be informed directly as well. The company's creditors may file any request for collateral security in connection with the reduction of the private limited company's share capital within a thirty-day forfeit deadline following the last publication of the notice.

Coming from the foregoing Commission as supervisor must be communicated before the transfer. Shareholders must be communicated by way of the invitation to the general meeting also before the transfer, provided the transfer constitutes a capital increase, a capital reduction or a transaction falling under the exclusive competence of the general meeting. Otherwise, such communication can be done at the next general meeting when the management board renders a general overview of the company's operations. Employees, in their capacity as ordinary employees and not shareholders, should be informed before the transfer, provided the same would have important impact on them. Third parties, unless they are qualified as creditors, and a capital reduction is envisaged can have access to information only after the transfer.

f) Sanctions

3.10. Sanctions under Insolvency Law

3.10.1. The creditor, and on behalf of the debtor, the liquidator may file for legal action before the court within 90 days from the time of gaining knowledge or within one year from the date of publication of the notice of liquidation to contest concerning:

- a) contracts concluded by the debtor within five years preceding the date when the court received the petition for opening liquidation proceedings or thereafter, or his other commitments, if intended to conceal the debtor's assets or to defraud any one creditor or the creditors, and the other party had or should have had knowledge of such intent;
- b) contracts concluded by the debtor within two years preceding the date when the court received the petition for opening liquidation proceedings or thereafter, or his other commitments, if intended to transfer the debtor's assets without any compensation or to undertake any commitment for the encumbrance of any part of debtor's assets, or if the stipulated consideration constitutes unreasonable and extensive benefits to a third party;
- c) contracts concluded by the debtor within ninety days preceding the date when the court received the petition for opening liquidation proceedings or thereafter, or his other commitments, if intended to give preference and privileges to any one creditor, such as the amendment of an existing contract to the benefit of a creditor, or to provide financial collateral to a creditor that does not have any.

- 3.10.2. The liquidator, on behalf of the debtor, shall be entitled to reclaim within 90 days from the time of gaining knowledge or within one year from the date of publication of the notice of liquidation any service the debtor has provided within a sixty-day period preceding the date when the court received the petition for opening liquidation proceedings or thereafter, if it was provided to give preference to any one creditor and if such service is not usually provided under normal circumstances. Prepayment of a debt is, in particular, considered as giving preference or privileges to any one creditor.
- 3.10.3. The liquidator shall have powers to terminate, with immediate effect, the contracts concluded by the debtor, or if none of the parties rendered any services, the liquidator may rescind from the contract. The claim due to the other party owing to the above may be enforced by notifying the liquidator within 40 days from the date when the rescission or termination was communicated.
- 3.10.4. The liquidator shall act with due diligence under the given circumstances at all times during the liquidation procedure. The liquidator shall be held liable in accordance with the general provisions of civil law for damages caused by any breach of his obligations. The liquidator's liability shall cover the assets of the debtor existing at the time of the opening of liquidation proceedings, or acquired in the course of liquidation. It falls within the sphere of due diligence of the liquidator that, in the event that any property is fraudulently depleted before the court's declaration of insolvency, and the liquidator is of the opinion that, by contesting such fraudulent conduct, the assets of liquidation can be increased, he shall be obliged to initiate the necessary procedures and shall notify the creditors' select committee thereof.

3.11. Sanctions under Civil Law

3.11.1. Contracts in violation of legal regulations and contracts concluded by evading a legal regulation shall be null and void, unless the legal regulation stipulates another legal consequence. A contract shall also be null and void if it is manifestly in contradiction to good morals. Unless otherwise provided by law, anybody shall be entitled to plead the invalidity of an annulled contract without a time limit. No special procedure is required for the establishment of invalidity.

3.11.2. If the consent of a third party or official approval is required for the validity of a contract, the contract shall not be concluded until this has been given; however, the parties shall be bound by their statements. Either party shall be relieved from obligation if the third party fails to give its consent or the authority fails to grant its approval before the applicable deadline as communicated by one party to the other. Once consent and/or approval has been received, the contract shall become effective as of date on which it is signed, unless otherwise prescribed in legal regulation.

3.11.3. An avoidable contract shall, in consequence of being avoided, become invalid as of the date on which it is concluded. The aggrieved party and persons with a legitimate interest in the avoidance of a contract shall be entitled to do so.

3.11.4. With regard to invalid contracts, the state of affairs having existed prior to the conclusion of the contract shall be restored. If the state of affairs having existed prior to the conclusion of the contract cannot be restored, the court shall declare the contract valid for the period up to the date of judgment. An invalid contract may be declared valid if the cause of invalidity can be abolished, in

particular by eliminating the excessive benefit in the case of a usurious contract or the unreasonable advantage between the services of the parties. In such cases, it shall be necessary to provide for the return of any services that might remain without consideration.

3.11.5. A contract by which the basis for satisfying a third person's claim has been deprived entirely or in part shall have no legal force in respect of such third person if the other party acted in bad faith or had a gratuitous advantage originating from the contract.

3.12. Sanctions under Company Law

3.12.1. The business association shall be liable for damages caused to third parties by its executive officer when acting in an official capacity.

3.12.2. Executive officers shall conduct the management of the business association with due care and diligence as generally expected from persons in such positions and - unless otherwise provided in this Act - give priority to the interests of the business association. Executive officers shall be liable to the business association in accordance with the general rules of civil law for damages caused by any infringement of the law or any breach of the memorandum of association, the resolutions of the business association's supreme body, or their management obligations.

3.12.3. The Company Act admits the category of wrongful trading. In the event of any imminent threat for the business association's insolvency, the executive officers shall conduct the management of the business association giving priority to the company's creditors. In the event that non-compliance with this obligation is

verified and if the business association is deemed to be insolvent, the executive officers affected may be subject to financial liability under specific other legislation toward the company's creditors. This specific other legislation, namely the Insolvency Act sets forth that any creditor or the liquidator may bring action during the liquidation proceedings for the court to establish that the former executives of the economic operator failed to properly represent the preferential rights of creditors in the span of three years prior to the opening of liquidation proceedings in the wake of any situation carrying potential danger of insolvency (including the cleaning up of environmental damages), in consequence of which the company's assets diminished to the extent specified. A situation is considered to carry potential danger of insolvency as of the day when the executives of the economic operator were or should have been able to predict that the economic operator will not be able to satisfy its liabilities when due. If damage is caused by several persons together their liability shall be joint and several.

3.12.4. Where executive officers are vested with joint right of representation or where the company is managed by a body, the liability of executive officers for damages to the business association shall be joint and several according to the provisions of the Civil Code pertaining to joint negligence. If the damage results from a decision of the management body, any member who did not take part in the decision-making process or voted against it shall be exempt from liability.

3.12.5. Following termination of the business association without succession, claims for damages may be brought against the executive officers by the members (shareholders) with membership at the time of the cancellation of the business

association by the court of registry, within a period of one year following such cancellation by a final ruling. If, during the existence of the business association, the liability of the member (shareholder) for the obligations of the business association was limited, the member (shareholder) may enforce such claim up to rightful share due to him from the assets distributed upon termination of the business association.

3.12.6. The articles of association of a private limited company may contain provisions to require the management board to issue a written statement declaring that any disbursement made in favor of a shareholder from the own capital of the company shall not jeopardize the company's solvency or creditors' interests. The management board shall be held liable for any payment made due to its failure to make the statement or to making a false statement according to the general provisions pertaining to executive officers.

3.13. Sanctions under Banking Law

3.13.1. Responsibility of the Board Members and the Supervisory Board Members

The members of the executive board and of the supervisory board of a financial institution and the executive officers of a financial institution operating as a branch office shall be responsible for the financial institution to perform the authorized activities in accordance with the provisions set forth in the Banking Act and in other legal regulations.

3.13.2. Sanctions levied by the Commission

Sanctions levied by the Commission have a wide range of variety depending on the irregularities committed by the bank. Such

sanctions sometimes rather qualify as measures or instructions taken by the Commission therefore the details described herein partly overlaps the contents of the Chapter e) "third parties" of this Study. The following sanctions can be imposed:

A/ Ordinary Measures

Aa/ In the event if any violation of regulations or deficiencies are established - if these do not severely endanger the prudent operation of the financial institution -, the Commission shall take the following measures:

- a) it may call upon the financial institution within the framework of negotiations held with an executive officer to take the necessary steps
 - 1) in order to eliminate the revealed deficiencies to comply with the regulations of this Act and the provisions of legal regulations on prudent operation,
 - 2) to maintain or improve its financial position;
- b) it may advise the financial institution
 - 1) to provide further training to its employees (managers) or to hire employees (managers) with the appropriate professional skills,
 - 2) to draw up its standard service agreement and/or internal rules and regulations before the prescribed deadline, or to adapt it according to specific criteria,
 - 3) to change its business management concept;
- c) it may stipulate the fulfillment of obligation for extraordinary supply of data;
- d) it may oblige the financial institution to draw up and execute an action plan;
- e) issue a disciplinary warning to the executive officer of the financial institution.

- f) adopt a resolution to declare the fact of infringement, and shall order the cessation of the infringement or prohibit any further infringement;
- g) require the credit institution to take measures for the reinforcement of the arrangements, processes, mechanisms and strategies relating to its internal control mechanism, corporate governance functions, risk management procedures and internal models for the assessment of capital adequacy.

Ab/ In the event if a financial institution

- a) performs any activities prohibited by law or for which it is not authorized,
- b) is unable to continuously satisfy the requirements for authorization described in this Act during its operation,
- c) has own funds that is less than seventy-five per cent of the capital requirements,
- d) wishes to pay or pays dividends in a situation when its own funds is below the capital requirements, or has failed to set aside general reserves during the year,
- e) does not have sufficient provisions and the valuation of its assets is inadequate, as a consequence of which its solvency margin must be reduced by the amount of unaccounted accumulation of provisions and adjustments,
- f) regularly or severely violates regulations on exposures (such as to undertake any exposure without due care and diligence),
- g) employs an auditor whose activities are not in compliance with statutory provisions and who fails to inform the board of directors and the supervisory board of the credit institution and the Commission about any violation of law, deficiencies and other problems found at the credit institution endangering the prudent operation of the credit institution,

- h) is unable to fulfill or - repeatedly - fails to fulfil by the deadline its obligation to disclose data, to report or to provide information to the Commission, the NBH, its shareholders or the Fund,
- i) hinders the Commission or the auditor in performing their tasks,
- j) operates without the stipulated and necessary regulations, records, information technology and controlling systems,
- k) fails to comply with supervisory measures taken in respect of its non-compliance with the regulations,
- l) repeatedly infringes the regulations specified above within two years of the operative date of the measure taken by the Commission or the resolution imposing a penalty,
- m) can only comply with the relevant capital adequacy requirement in such a way that it cannot repay a junior subordinated loan on time.
- n) holds own funds which is insufficient to ensure sound management and coverage of their risks; or
- o) conducts such internal control mechanism, corporate governance functions and risk management procedures, internal models for the assessment of capital adequacy, and management of large exposures that fail to comply with the requirements set out in Bank Act and other legal regulations implemented by authorization of Bank Act.

Then the Commission shall apply the following measures:

- a) delegate - one or more - on-site inspectors to the financial institution;
- b) oblige the financial institution
 - 1) to adopt internal rules and regulations, or to adapt and apply these regulations according to specific criteria,

- 2) to provide professional training for employees (managers) or to hire employees (managers) with the appropriate professional skills,
 - 3) to conduct an investigation in the interest of determining responsibilities for the damages caused and to initiate proceedings against the responsible person,
 - 4) to reduce operating costs,
 - 5) to accumulate sufficient reserves,
 - 6) to convene the board of directors or the supervisory board and advise these bodies to discuss specific items on the agenda and to the necessity of making specific decisions,
 - 7) to draw up and implement a restoration plan,
 - 8) to elect another auditor;
 - 9) to comply with the additional capital requirement prescribed under Subsection (2) of Section 76, however, the additional capital charge of the credit institution may not be higher than the capital requirement specified in Subsection (1) of Section 76.
- c) it may prohibit, limit or make subject to conditions
- 1) payment of dividends,
 - 2) payment of remuneration of executive officers,
 - 3) raising of loans by the owners of financial institutions, or rendering services to them by credit institutions which involve any exposure,
 - 4) extension of loans by financial institutions to enterprises belonging to the sphere of interests of the owners or executive officers,
 - 5) extension (prolongation) of deadlines specified in loan or credit agreements,
 - 6) performing certain financial service activities or activities auxiliary to financial services,

- 7) opening new branches, starting new financial services as well as starting up new activities (business lines) within a financial service.

Ac/ If the asset retention index of a credit institution operating as a branch office falls below one hundred per cent, the Commission shall order the parent foreign credit institution to bring the branch office into compliance with the provisions on capital maintenance ratio.

B/ Extraordinary Measures

B/a In the cases described in Subsection (3) of Section 151, the Commission shall apply the following extraordinary measures - in addition to the ordinary measures - in lieu of bankruptcy proceedings:

- a) it may stipulate
 - 1) to sell the credit institution's assets used for purposes other than banking operations,
 - 2) for the financial institution to settle its capital structure within the deadline and in compliance with the requirements prescribed by the Commission,
 - 3) compliance with the capital requirement above the limit specified in Subsections (1)-(2) of Section 76, which may not be higher than the capital requirement specified in Subsection (1) of Section 76, in respect of the financial services performed by the financial institution and the exposures of the financial institution;
- b) it may limit or prohibit the credit institution
 - 1) to conclude transactions between the owners and the credit institution,

- 2) to effect payment of deposits and other repayable resources,
- 3) to undertake commitments;
- c) it may determine the highest rate of interest that may be charged by the credit institution;
- d) it may compel the board of directors to convene the general meeting, and furthermore, it may advise these bodies to discuss specific items on the agenda and to the necessity of making specific decisions; as well as
- e) it may delegate a supervisory commissioner to the credit institution.

Subsection (3) of Section 151. lists the following irregularities:

The financial institute:

- a) has own funds that is less than fifty per cent of the capital requirements,
- b) wishes to pay or pays dividends in a situation where its own funds is below fifty per cent of the capital requirements,
- c) fails to meet its obligation to create provisions or the obligation of value adjustment, has insufficient provisions and inadequate value adjustments, meaning that the evaluation of off-balance sheet items and assets was incorrect, as a consequence of which its solvency ratio falls below four per cent because the solvency margin were reduced by the amount of unaccounted accumulation of provisions and value adjustments,
- d) by non-observance of the regulations for ensuring liquidity and the approximation of maturities of assets and liabilities, severely endangers the maintenance of the liquidity of the credit institution,

- e) regularly or substantially violates the regulations on exposures and thus severely endangers the credit institution's liquidity, solvency or ability to produce income,
- f) regularly performs activities prohibited by law or for which it is not authorized,
- g) is unable to satisfy the requirements for authorization described in this Act during its operation,
- h) operates without the necessary accounting, management information or internal control system, or these systems are inefficient to indicate the credit institution's actual financial position,
- i) in the course of its resource collecting activities, determines an interest value significantly differing from the market value representing increased risks for the credit institution or the deposit-holders,
- j) enters into illicit or bogus contracts in order to gain pecuniary benefits or to alter its balance-sheet result capital requirement,
- k) employs an auditor who fails to inform the Commission, the board of directors and the supervisory board of the financial institution about any severe infringement, deficiencies and other problems found at the financial institution and endangering the prudent operation of the financial institution,
- l) repeatedly infringes the regulations within five years of the operative date of the measure taken by the Commission or the resolution imposing a penalty,
- m) fails to fulfill the provisions of the supervisory measures taken for any severe violation of regulations.

B/b In addition to the exceptional measures described above, the Commission may simultaneously call upon the owner of the

financial institution, or the founders of the financial enterprise operating as a foundation:

- a) entered into the register of shareholders - in the case of financial institutions operating as cooperatives, into the register of members - having a direct ownership interest reaching or exceeding five percent,
- b) having a qualifying holding, to take the necessary measures.

B/c In the case of a branch office of a third-country credit institution, the Commission shall notify the third-country credit institution and its supervisory authority at the same time that it takes the extraordinary measures specified above.

B/d Simultaneously with the notice described above, the Commission shall notify the financial institution's board of directors, supervisory board and auditor and shall call upon the board of directors to immediately take the measures instructed.

B/e If the financial institution fails to comply with the supervisory measures ordering convening the general meeting, the Commission may initiate the convening of the financial institution's general meeting at the court of registry.

B/f In addition to the measures listed in B/a above, the Commission may suspend the voting rights of the owners of the financial institutions belonging into its sphere of authority for a specific period of time, but not more than for a period of one year if the owner's activity or influence exercised on the financial institution, based on the available facts, endangers the financial institution's reliable and prudent operation; in

such cases, when determining the quorum, the votes effected by such restriction must be ignored.

B/g The Commission may appoint a supervisory commissioner particularly if

- a) suspension of payments is imminent,
- b) the credit institution falls in a situation to impose potential and imminent jeopardy for the credit institution's failure to fulfill its obligations,
- c) the credit institution's board of directors is unable to perform its tasks and thus the interests of the deposit-holders are endangered,
- d) the deficiencies revealed in respect of the credit institution's accounting or internal control system are of the extent that it has become impossible to evaluate the credit institution's actual financial position.

C/ Other Sanctions

C/a The Commission may impose fines and penalties for any violation of the provisions stipulated in the legal regulations pertaining to financial services and activities auxiliary to financial services.

C/b The Commission shall have powers to order the proceedings for final settlement of financial institutions if the preconditions are fulfilled.

C/c The Commission may initiate liquidation proceedings against a financial institution or the branch office of a third-country financial institution in the cases listed precisely by the Bank Act.

3.13.3. Responsibility of the Supervisory Commissioner

The supervisory commissioner shall be held responsible for damages caused in his such capacity according to Section 348 of the Civil Code if he is employed by the Commission, and according to Section 350 of the Civil Code if he is appointed thereby. Both cases mean that instead of the supervisory commissioner the Commission itself should bear the responsibility towards third persons.

3.14. Sanctions under Criminal Law

Subject to all the circumstances criminal proceedings may be initiated against the officers and/or the employees of the bank or perhaps even third persons may be involved. Criminal offenses to be taken into consideration are especially the following under Hungarian Criminal Code:

- Violation of Accounting Regulations
- Criminal Bankruptcy
- Concealment of Assets for Avoiding a Liability
- Credit Fraud
- Impairment of Equity Capital
- Failure to Comply with the Obligation to Supply Economic Data
- Capital Investment Fraud
- Money Laundering
- Failure to Comply with the Reporting Obligation Related to Money Laundering
- Embezzlement
- Fraud
- Misappropriation of Funds
- Defalcation

g) Third Parties

3.20. Supervisory Authorities

3.20.1. Legal Status of Supervisory Authority

Supervision of financial institutes in Hungary is supplied by the State Financial Institutions Commission (the Commission) which is a government agency. The Commission shall attend to all duties conferred under its competence by an act or other legal regulation adopted under authorization of an act. In the course of carrying out its functions, the Commission shall work in league with the National Bank of Hungary, with the Office of Economic Competition, and with other authorities vested with powers to exercise supervision over the bodies and persons specified separately.

3.20.2. Cooperation with Foreign Authorities and EU Bodies

3.20.2.1. The Commission may enter into collaboration agreements and exchange information with foreign financial supervisory authorities so as to improve facilities to carry out its duties, to exercise supervision on a consolidated basis and supplementary supervision, and to promote and facilitate integration programs. The Commission shall hold membership in the Committee of European Securities Regulators, established by Commission Decision 2001/527/EC, in the Committee of European Banking Supervisors set up by Commission Decision 2004/5/EC and in the Committee of European Insurance and Occupational Pensions Supervisors, established by Commission Decision 2004/6/EC.

3.20.2.2. The Commission shall provide the European Commission with written notification, among others, of the following:

- a) authorizations issued to credit institutions, investment firms, insurance companies or reinsurance companies, and the withdrawal of such authorizations;

- b) authorizations issued to the Hungarian branches of third-country credit institutions, investment firms, insurance companies or reinsurance companies, and the withdrawal of such authorizations;
- c) authorization issued to an investment service provider that manages a European investment fund and that is a subsidiary, whether directly or indirectly, of a company established in a third country;
- d) acquisition of holdings in a Hungarian-registered credit institution by a third-country credit institution as a consequence of which the credit institution becomes a subsidiary of the third-country credit institution, and the termination of such holdings;
- e) acquisition of holdings in a Hungarian-registered insurance company by a third-country insurance company as a consequence of which the insurance company becomes a subsidiary of the third-country insurance company, and the termination of such holdings;
- f) acquisition of holdings in a Hungarian-registered reinsurance company by a third-country reinsurance company as a consequence of which the reinsurance company becomes a subsidiary of the third-country reinsurance company, and the termination of such holdings;
- g) any financial holding company that is subject to supervision on a consolidated basis, and when such supervision no longer applies;
- h) the proceedings opened in connection with supervision on a consolidated basis;
- i) when identifying a group as a financial conglomerate and of the appointment of a coordinator;
- j) any restrictions on the freedom of establishment creating barriers for Hungarian insurance companies or reinsurance

companies in establishing themselves and operating in a third country or carrying on activities in a third country;

- k) a list of the regulated markets that have a registered office in Hungary, and any changes therein;
- l) the statutory provisions prescribing mandatory insurance and any amendments therein.

3.20.2.3. The Commission shall cooperate closely with the competent authorities concerned for supplementary supervision of entities in a financial conglomerate. The Commission shall provide data and information which is essential or relevant for the exercise of supplementary supervision to the other competent authorities. Cooperation with the competent authorities concerned shall cover the following items:

- a) identification of the group structure of the financial conglomerate, as well as of the competent authority exercising supervision of the regulated entities in the group;
- b) monitoring the financial conglomerate's strategic policies and objectives;
- c) monitoring the financial situation of the financial conglomerate, in particular on capital adequacy, intra-group transactions, risk concentration and profitability;
- d) identification of the major shareholders with qualifying participation and executive employees of the entities in the financial conglomerate;
- e) monitoring the organization of the financial conglomerate, risk management and internal control systems at the financial conglomerate level;
- f) procedures for the collection of information from the entities in a financial conglomerate, and the verification of that information;

- g) monitoring adverse developments in regulated entities of the financial conglomerate which could seriously affect the regulated entities;
- h) information on major sanctions and exceptional measures taken by the competent authorities.

3.20.2.4. The Commission may also exchange information as may be needed for the performance of supplementary supervision with the central banks of Member States of the European Union, the European Central Bank and the European System of Central Banks. The Commission shall, prior to its decision, consult the competent authorities concerned with regard to the following items, where these decisions are of importance for other competent authorities' supervisory tasks:

- a) changes in the shareholders and/or executive employees, which require the authorization of the Commission;
- b) major sanctions or exceptional measures.

By way of derogation from what is contained above, the Commission may decide not to consult in cases of urgency or where such consultation may jeopardize the effectiveness of the decisions. In this case, the Commission shall, without delay, inform the other competent authorities concerned. The Commission, in its capacity as the coordinator, may contact the competent authority of the country where the entity that is at the head of the financial conglomerate is established to exchange data and information concerning such entity.

3.20.3. Duties of the Commission

3.20.3.1. The Commission shall have powers to take the action and exceptional measures, and may impose the fines in the relevant acts for any violation or circumvention of or non-compliance with the provisions:

- a) of the relevant acts, other legal regulations adopted by authorization of these acts, and other statutory provisions governing the operations of the bodies and persons of financial institutions;
- b) contained in the Commission's resolutions;
- c) set out in the own internal regulations of the bodies and persons of financial institutions.

3.20.3.2. The Commission may impose sanctions initiated by the National Bank of Hungary, or by a foreign financial supervisory authority on the strength of law.

3.20.3.3. If a branch office of a financial institution authorized in another Member State of the European Union or the cross-border services provided in Hungary by such financial institution violates the regulations in force in Hungary or if insufficiencies are detected in the operation of the branch office or the financial institution, the Commission shall call upon the branch office or the financial institution to rectify the situation that is in contravention of the rules. In the event of the failure of the branch office or financial institution to comply with the above-specified request, the Commission shall notify the supervisory authority of the other Member State of the European Union with regard to the anomalous situation and request that the supervisory authority take appropriate action. The Commission may act directly if it determines that the continuance of the anomalous situation presents a serious threat to the stability of the financial system or the interests of customers. The European Commission shall review the measures of this type that are taken by the Commission and subsequently determine their legality.

3.20.4. The Commission's International Cooperation with the Regulatory Agencies of Other Countries Regarding Supervision on a Consolidated Basis

At the request of the supervisory authority of a third country, the Commission, having considered the availability of reciprocity or on the basis of a valid supervision cooperation agreement, may supply reports, data and information that may be necessary for exercising supervision on a consolidated basis to the third-country supervisory authority if it is able to guarantee legal protection for the processing of such information that is equivalent to or better than the protection afforded under Hungarian law. At the request of the supervisory authority of a third country, the Commission, having considered the availability of reciprocity, may conduct the inspections, or, if there is a valid supervision cooperation agreement, it may give its consent to the supervisory authority of the third country requesting consent, to an auditor or to another expert designated by it to conduct the inspections. If the parent company of a credit institution is a third-country credit institution or financial holding company, the Commission shall examine - with a view to exercising supervision on a consolidated basis - as to whether the laws of that third country are in conformity with the provisions laid down in Directive 2006/48/EC of the European Parliament and of the Council concerning supervision on a consolidated basis. The Commission shall consult with the European Banking Committee, following which it shall make a decision regarding conformity. If the laws of a third country are not in conformity with the provisions laid down in Directive 2006/48/EC of the European Parliament and of the Council concerning supervision on a consolidated basis, the Commission shall take over supervision on a consolidated basis, and shall take all appropriate measures at its disposal. Where necessary, the Commission shall consult with the competent supervisory authority of the third country where the credit institution or financial holding company in question is established.

3.20.5. Supervision of Financial Conglomerates as Supplementary Supervision

The objective of supplementary supervision is to exercise prudential supervision of entities at the level of the financial conglomerate. Accordingly, the Commission, in exercising supplementary supervision, shall oversee the exposures, intra-group transactions, solvency position, internal control mechanisms and risk management processes of financial conglomerates at the group level.

Supplementary supervision shall include:

- a) every entity in the financial conglomerate;
- b) every credit institution in the financial conglomerate, the parent company of which is a regulated entity that has its head office in a third country;
- c) every credit institution in the financial conglomerate, the parent company of which is a mixed financial holding company that has its head office in a third country.

The Commission may verify, on site or otherwise, the data and information supplied by the entities in a financial conglomerate to the extent necessary for the purposes of supplementary supervision. The Commission may ask the competent authorities of other Member States of the European Union to have the verification carried out.

The Commission, if serving as coordinator according to Subsection (1), shall examine as to whether the laws of that third country are in conformity with the provisions laid down in Directive 2002/87/EC of the European Parliament and of the Council. The Commission shall consult the competent authorities concerned, taking into account any applicable guidance prepared by the Financial Conglomerates Committee. Following consultations the Commission, in its capacity as the coordinator, shall make a decision regarding conformity.

If the laws of the third country are in conformity with the provisions laid down in Directive 2002/87/EC of the European Parliament and of the Council, supplementary supervision of the financial conglomerate that is headed by the third country parent company of a credit institution referred to in Paragraphs *b)* and *c)* of Subsection (3) of Section 96/E shall not be exercised by the Commission. If the laws of a third country are not in conformity with the provisions laid down in Directive 2002/87/EC of the European Parliament and of the Council, the Commission, in its capacity as the appointed coordinator, shall take over to exercise supplementary supervision, and shall take all appropriate measures at its disposal.

3.20.6. The Commission as Coordinator

The Commission, as the competent authority, shall cooperate with the competent authorities of other Member States of the European Union in selecting a competent supervisory authority to coordinate and exercise supplementary supervision of entities of financial conglomerates (hereinafter referred to as "coordinator").

The Commission shall exercise the tasks of the coordinator if authorization to the credit institution that is at the head of the financial conglomerate was granted by the Commission.

The Commission shall exercise the tasks of the coordinator if the financial conglomerate is not headed by a regulated entity and:

- a) the parent company of the credit institution authorized by the Commission is a mixed financial holding company; or
- b) where more than one regulated entity with a head office in the Community have as their parent the same mixed financial holding company with a head office in Hungary, and one of the

credit institutions in the financial conglomerate has its head office in Hungary; or

- c) the financial conglomerate does not include a credit institution that has been authorized in the Member State where the head office of the mixed financial holding company is located, the most important financial sector in the financial conglomerate is the banking sector and the investment services sector considered together, and the credit institution with a head office in Hungary has the largest balance sheet total.

The Commission shall exercise the tasks of the coordinator, if:

- a) the financial conglomerate is headed by more than one mixed financial holding company with a head office in different Member States of the European Union and there is a regulated entity of the financial conglomerate in each of these States; or
- b) the financial conglomerate is not headed by a parent company, the most important financial sector in the financial conglomerate is the banking sector and the investment services sector considered together, and the credit institution with a head office in Hungary has the largest balance sheet total within the financial conglomerate.

By way of derogation from the above rules, the Commission may exercise the tasks of the coordinator by common agreement with the competent authorities concerned, and appoint a different competent authority as coordinator, taking into account the structure of the conglomerate and the relative importance of its activities in different countries. Before taking its decision, the Commission shall give the conglomerate an opportunity to state its opinion on that decision.

The tasks to be carried out by the Commission in the capacity of the coordinator shall include:

- a) supervisory overview and assessment of the financial situation of a financial conglomerate;
- b) gathering of data and information pertaining to the entities in a financial conglomerate and forwarding them to the competent authorities concerned;
- c) assessment of compliance with the rules on capital adequacy and of risk concentration and intra-group transactions within the financial conglomerate;
- d) assessment of the financial conglomerate's structure, organization and internal control system as set out separately;
- e) planning and coordination of supervisory activities in cooperation with the relevant competent authorities involved;
- f) other tasks, measures and decisions assigned to the coordinator and which are necessary in order to achieve the objectives of supervision;
- g) notification of the entity that is at the head of the financial conglomerate, the competent authorities concerned, the supervisory authority of the Member State where the mixed financial holding company is established and the European Commission when identifying a group as a financial conglomerate and of the appointment of a coordinator.

In order to facilitate and establish supplementary supervision, the Commission, in its capacity as the coordinator, and the other relevant competent authorities, and where necessary other competent authorities concerned, shall have coordination arrangements in place.

Beyond the foregoing the Commission's permission is required specifically for the transfer of the account portfolio and the contracts for repayment of monetary instruments.

3.21. Minority Shareholders

Minority shareholders enjoy various rights in connection with a contemplated or executed transfer. As a matter of fact, these rights do not belong only to transfers but overall activities of the company. The major rights are the following:

3.21.1. Those members (shareholders) controlling at least five per cent of the voting rights may, at any time, request that the business association's supreme body be convened, indicating the reason and the purpose thereof. The memorandum of association may also grant this right to members (shareholders) controlling a lesser percentage of the votes. If the management fails to comply with such request within thirty days, upon the request of the members making the proposal, the court of registry shall convene the meeting of the business association's supreme body within thirty days after the submission of a request to this effect, or shall empower the requesting members to convene the meeting. The ruling of the court of registry in favor of the request may not be appealed.

3.21.2. If the business association's supreme body has refused a proposal that the last annual report prepared pursuant to the Accounting Act, or any event which has occurred in the management during the last two years - including the policy dictated by a person having obtained a qualifying holding and having a history of making unfavorable business decisions - be examined by an auditor, or, if the decision on a regularly announced proposal to this effect has been ignored by the supreme body, such examination shall be ordered by the court of registry upon a request by members (shareholders) controlling at least five per cent of the votes. Under penalty of forfeiture of rights, the request specified above shall be submitted within a period of thirty days after the date of the meeting of the business association's supreme body. In the event of a judgment in favor of the request, an auditor shall be appointed by the

court of registry, and the costs thereof shall be advanced by the business association. The business association's supreme body shall decide whether the costs incurred in connection with the activity of the auditor be borne by the business association or the persons requesting the examination.

3.21.3. Upon request by the shareholders, executive officers shall provide information concerning the affairs of the business association, and allow inspection of its books and documents. In the event of any executive officer's failure to comply with such request, upon request of the member concerned, the court of registry may instruct the business association affected to provide the information in question and/or to provide for inspection. Exercise of the right pursuant to the foregoing by the shareholders may not infringe upon the business interests or business secrets of the business association.

3.21.4. Shareholders shall have the right to participate, to request information within the limits specified in the Company Act, and to make remarks and proposals at the general meeting. Shareholders are entitled, if holding shares with voting rights, to vote.

3.21.5. The management board shall provide the necessary information to all shareholders in connection with the items placed on the agenda of the general meeting. The management board shall disclose the key data of the annual report prepared pursuant to the Accounting Act and key data of the report of the management board and the supervisory board to the shareholders at least fifteen days before the general meeting.

3.21.6. A group of shareholders controlling at least five per cent of the voting rights may request in writing the management board to place an issue of their choosing on the agenda, indicating the reason and the purpose thereof. The articles of association may contain provisions to

afford this right to a group of shareholders controlling a lesser percentage.

3.21.7. Any shareholder of a business association may request the judicial review of resolutions adopted by the organs of the business association on the grounds that such resolution violates the provisions of the Company Act, other legal regulations, or the memorandum of association.

3.22. Creditors

In special cases of transfer, i.e. capital reduction, creditors have the right to get knowledge about the contemplated transfer.

The management board shall take measures to have the decision on the capital reduction published in two consecutive volumes of the Cégközlöny (Company Gazette) within thirty days after the date of the resolution of the general meeting for the reduction of share capital or from the delivery of the final court decision, leaving at least thirty days between the two publications. The notice shall advise the company's creditors of their right to demand collateral security for their claims originating from before the first publication of the notice that did not fall due by this time. Known creditors must be informed directly as well.

The company's creditors shall file any request for collateral security in connection with the reduction of the private limited company's share capital within a thirty-day forfeit deadline following the last publication of the notice. Any creditor whose claim is already secured - pursuant to legal regulation or contract - consistent with the risk related to the reduction of the share capital shall not be entitled to demand such security, nor if it is not justified in light of the private limited company's assets and liabilities, financial position and profit or loss. However, the

above provisions shall not apply where the private limited company's share capital is reduced:

- a) to cover the company's losses; or
- b) for the purpose of redistribution, in the manner specified in the Accounting Act, in favor of an appropriated reserve over and above the private limited company's share capital.

After the transfer the creditors have a special right to challenge a transfer. In the event of the termination of a private limited-liability company or a public or private limited company without a legal successor, any member (shareholder) who has abused his limited liability may not rely on his limited liability. Any members (shareholders) of private limited-liability companies and public or private limited companies, who has abused their limited liability or the company's legal personality to the detriment of creditors, shall bear unlimited and joint and several liability for the unsatisfied obligations of the defunct business association. The liability of the members (shareholders) as specified above shall apply in particular if such members disposed over the assets of the business association as if they had been their own, or if they reduced the assets of the business association for the benefit of others or their own such that they knew or should have known with due care that the business association would not be able to satisfy its obligations towards third parties as a result thereof.

In addition, in the course of winding up proceedings, creditors enjoy a particular right to attack the deals of the business association. The creditor may file for legal action before the court within 90 days from the time of gaining knowledge or within one year from the date of publication of the notice of liquidation to contest concerning:

- a) contracts concluded by the debtor within five years preceding the date when the court received the petition for opening liquidation proceedings or thereafter, or his other commitments, if intended to

conceal the debtor's assets or to defraud any one creditor or the creditors, and the other party had or should have had knowledge of such intent;

b) contracts concluded by the debtor within two years preceding the date when the court received the petition for opening liquidation proceedings or thereafter, or his other commitments, if intended to transfer the debtor's assets without any compensation or to undertake any commitment for the encumbrance of any part of debtor's assets, or if the stipulated consideration constitutes unreasonable and extensive benefits to a third party;

c) contracts concluded by the debtor within ninety days preceding the date when the court received the petition for opening liquidation proceedings or thereafter, or his other commitments, if intended to give preference and privileges to any one creditor, such as the amendment of an existing contract to the benefit of a creditor, or to provide financial collateral to a creditor that does not have any.

3.23. Employees

Pursuant to Hungarian Labor Code the employer shall inform the employees, workers' councils and trade unions concerning all facts and conditions, and any changes therein, which are important from the point of view of exercising rights and fulfilling obligations. If a transfer does not have an influence to exercising rights and fulfilling obligations of the employees, no such obligation exists. Nevertheless, employees do not have the right of opposition, acceleration rights, or right of approval, right to have the transfer annulled.

3.24. Deposit Holders

In the spirit of the directive 94/19 the deposit guarantee is provided by the banks. Two types of fees exist. A credit institution that has been authorized by the Commission to collect deposits shall, upon joining the

Deposit Guarantee Fund, pay a one-time affiliation fee equal to half percent of its subscribed capital to the Fund within thirty days of receiving the authorization.

The obligation of the Fund's members to pay annual fees shall be determined by taking into account the total amount of deposits kept by the credit institution insured by the Fund on 31 December of the previous year, the credit institution's membership in voluntary deposit insurance and institutional funds, and other aspects stipulated in the Fund's rules and regulations. When providing supplementary cover, the amount of the deposits for which supplementary cover is provided shall be taken into consideration when determining the annual fee, along with the cover afforded by the deposit-guarantee scheme of the country in which the branch office's home office is located. When determining the annual fee, the Fund may consider the ratings determined for the credit institutions and their obligations by the rating organization prescribed by specific other legislation. The amount of the annual fee to be paid as determined pursuant to the above rules may not be higher than two thousandths of the aggregate total interest holdings indicated under accrued and deferred liabilities on deposits insured by the Fund and kept with the member institution on the 31st of December of the previous year and the deposits insured by the Fund as stipulated by statutory provisions on credit institutions' obligation to prepare annual reports and to keep books.

There is no specific regulation concerning the deposit guarantee in case of a transfer of assets in another Member State.

If a transfer of assets including deposited funds occurs, the deposit insurer or guarantor does not have to be notified.

Deposit holders of the transferor do not enjoy any right concerning the transfer, either before the transfer or the decision to transfer or after it.

3.25. Member State

In case of transfer of assets to/from a transferee/transferor located in another Member State, neither the host nor the home Member State has any right or obligation. In exceptional case the Hungarian State still have the right to intervene. When the Hungarian State brings about a share capital increase by subscribing new shares, it may ultimately bring about a share capital increase by issuing government securities where the failure of a credit institution would seriously endanger the economic interests of the country or some of the larger regions or threaten the prudent functioning of the banking system and insolvency and/or liquidation can only be averted by Government intervention.

h) Private International Law

3.26. Under Hungarian law asset transfers between two Hungarian entities may only be governed by the Hungarian law unless a special international element can be discovered in the transaction.

If the asset transfer is implemented between entities belonging to various jurisdictions, the parties are free to stipulate the governing law that can be either the law of one of the parties or even the law of a third country.

If no prevailing law is specified, the law of the transferor shall prevail. However, if the asset transfer can be interpreted as a contract aiming at a banking or credit transaction, then the law of the bank providing the banking service shall prevail.

Part II -Evaluation of potential solutions

1. Transfers from the parent company to the subsidiary or from the subsidiary to the parent at arm's length:

- **Proposal No. 1**

We understand that community legislation allows:

- any kind of transfer from the parent company to the subsidiary and
- transfers from the subsidiary to the parent at arm's length.

Possible consequences or conditions:

- Any restriction to those transfers have to be removed by Members States
- After the transfer, specific information about the transfer have to be communicated to supervisors and shareholders

Answers to questions in connection with proposal No. 1.

- i) The Hungarian legislation has adopted the adequate national measures in order to comply with the relevant community legislation with special regard to Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) and Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast). Therefore in order to reach the desired result no major measures should be revised. Perhaps the only exception is Section 14. § (1) k) of the Bank Law pursuant to which the Commission's permission is required, except for the cases described in Subsections (2)-(4) of this Section, for the transfer of the account portfolio and the contracts for repayment of monetary instruments (hereinafter referred to as "assignment of customer accounts"). Pursuant to Subsection (2) the same permission is required for the assignment of customer accounts in favour of a branch office. However, this permission is still not required for the branch offices of credit institutions that are registered in another Member State of the European Union.
- ii) Consequently, potential modification of the above provision would entail merely minor changes.
- iii) The Hungarian Bank Law focuses on the maintenance of capital adequacy and prudential activity of financial institutions. The Bank Act expressly sets forth that credit institutions subject to supervision on a consolidated basis and financial holding companies shall be responsible for ensuring the prudent operation of the companies they control, including compliance with the risk exposure and capital adequacy regulations. Therefore, in my view,

this solution satisfactorily takes into account interests of parent companies, subsidiaries, minority shareholders, creditors, deposit holders, employees, supervisory authorities or Member States as a whole.

- iv) No legal obstacles remain by adopting this solution.

2. Transfers from the subsidiary to the parent company (in preferential conditions)

a) Prior and overall agreements

- **Proposal No. 2:**

Proposal:

Under this proposal, we consider that an EU instrument has been adopted, which provides that a group agreement under which the parent company and some of the entities of the group can mutually commit themselves to transfer assets in a crisis situation has to be allowed by the Member States. This agreement is endorsed by each legal entity being a party to the agreement. This agreement guarantees financial support from the parent to the subsidiary and from the subsidiary to the parent. This agreement could only be voluntary because of the freedom of contracts, the limited liabilities of companies and minority shareholder rights. This agreement is submitted to the supervisory authorities. A group-wide view of solvency and liquidity would be a useful part of the supervisory assessment of an intra-group transfer. This group-

wide approach will be required as part of the review of the CRD on 'colleges'.

The agreement may already be submitted when the subsidiary asks for authorization to take up and pursue the business of credit institutions. This agreement may also be submitted when the subsidiary asks for authorization and will be considered as a modification to the conditions of the authorization to take up and pursue the business of credit institutions.

The following possible consequences or conditions can be driven from the above proposal:

- The capital adequacy rules is still respected after the transfer
- The transfer does not endanger the transferor's solvency
- The amount of the transfer is to be reimbursed by the transferee to the transferor. In case of insolvency, the creditors of the transferor will be reimbursed *before* the creditors of the transferor up to the amount of transfers that occurred.
- After each transfer, the transferor informs supervisors and the shareholders during the ordinary General Assembly meeting following the transfer.- If the good faith, competence and prudence of the transferor's management is not in question and if the transfer fulfils all the conditions specified above, then the transfer cannot be challenged under Insolvency Law.

Answer to Questions

- i) The third and fourth possible consequence or condition as described above would require revision of Hungarian measures. Preferential ranking in case of insolvency, i.e. that the creditors of the transferor will be reimbursed *before* the creditors of the transferor up to the amount of transfers that occurred should be

granted by an amendment to the Insolvency Act. On the other hand, pursuant to the general provisions of Company Act, ordinary General Assembly Meeting of a private limited company must be convened only once a year. Otherwise, if conditions precedent set forth by law or by the articles of association occur, extraordinary General Assembly Meeting must be convoked. Anyhow, it is not a material issue whether a General Assembly Meeting is called ordinary or extraordinary.

Otherwise, I do not really see significant loop-holes in Hungarian legislation. Capital adequacy requirement stands in the centre of banking law. A bank – for the purpose of maintaining solvency and the ability to fulfil liabilities – must always have sufficient own funds to cover the risks of its activities. If the own funds is less than one hundred twenty per cent of the combined total of the capital requirement specified heref Bank Act and the additional capital requirement the Commission has prescribed, the Commission must be notified of all payments made in connection with the junior subordinated loan capital.

In addition, credit institutions subject to supplementary supervision and mixed financial holding companies must comply with the following regulations:

- They shall be responsible for ensuring the prudent operation of the entities they control, including compliance with the provisions on exposures and capital requirements.
- They may instruct the entities in the financial sector in which they have a dominant influence to observe and enforce the regulations pertaining to supplementary supervision, and they must follow these instructions.
- They are required to ensure that own funds are available at the level of the financial conglomerate which are always at

least equal to the capital adequacy requirements and to have adequate capital adequacy policies at the level of the financial conglomerate.

- The type of data and information for risk concentration and intra-group transactions shall be defined and calculations for supplementary capital adequacy requirements shall be carried out at least once a year.
- The results of the calculation and the relevant data for the calculation shall be submitted to the coordinator by the credit institution which is at the head of the financial conglomerate or by the mixed financial holding company.

As regards publication obligations of banks Section 137/A. of the Bank Act sets forth the following provisions:

(1) Credit institutions, and the subsidiary credit institutions of parent credit institutions in a Member State or parent financial holding companies in a Member State that are subject to supervision on a consolidated basis and the subsidiary credit institutions of EU parent credit institutions and EU parent financial holding companies that are subject to supervision on a consolidated basis shall disclose information specified in specific other legislation on an individual and consolidated basis together with the companies referred to in Subsection (2) of Section 90.

(2) Credit institutions shall have formal policies in place, approved by the board of directors, to determine the principles of disclosure. These policies shall specify the procedures for assessing the appropriateness of their disclosures, including their verification and frequency.

(3) The obligation of credit institutions prescribed in specific other legislation to disclose information shall not include:

- a) information deemed immaterial, and
- b) proprietary and confidential information.

(4) Within the meaning of Subsection (3):

a) information shall be regarded as material in disclosures if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions;

b) information shall be regarded as proprietary to a credit institution if sharing that information with the public would undermine its competitive position. It may include information on products or systems which, if shared with competitors, would render a credit institution's investments therein less valuable;

c) information shall be regarded as confidential if there are obligations to customers or other counterparty relationships binding a credit institution to confidentiality.

(5) Credit institutions shall state in their disclosures the fact that the items of information specified in Paragraph b) of Subsection (3) are not disclosed, the reason for non-disclosure, and publish more general information about the subject matter, except where these are to be classified as proprietary or confidential under the criteria.

(6) Credit institutions shall publish the disclosures required under Subsection (1) on an annual basis at a minimum, within fifteen days of the approval of their annual accounts. Credit institutions shall also determine whether more frequent publication is necessary in the light of the relevant characteristics of their business such as scale of operations, range of activities, and shall post a notice hereof on their official website. Furthermore, credit institutions, if they become aware of certain facts which – according to their internal policies – are liable to have a serious effect on their financial situation or the administrative and accounting organization shall publish such information within thirty days. Credit institution shall disclose such information on their official website or publish them in the official journal of the Commission, if the Commission provides such service with a view to compliance with the statutory obligation of disclosure.

(7) Credit institution shall simultaneously forward the information published according to Subsection (6) to the Commission, and the Commission shall have the right to display such information on its official website.

(8) Upon request, the Commission may waive the requirement of disclosure with respect to a credit institution if:

- a) it agrees to publish information relating to accounting, exchange markets and issuers and other information prescribed by law in accordance with Subsection (6); and
- b) the information referred to in Paragraph a) as specified by the credit institution is in compliance with the obligation of disclosure in terms of content.

(9) Where it is required on account of the credit institution's activities and the need for disclosure, the Commission shall order the credit institution:

- a) to disclose the information specified in Subsection (3) in due observation of the regulations relating to personal data, bank and trade secrets;
- b) to publish one or more disclosures more frequently than annually;
- c) to use specific media and locations for disclosures other than the financial statements;
- d) to use specific means of verification for the disclosures not covered by statutory audit.

(10) Credit institutions should, if requested, explain their rating decisions to economic operators and other corporate applicants for loans, providing an explanation in writing. The administrative costs of the explanation have to be at an appropriate rate to the size of the loan.

- ii) Consequently, the necessary modifications would entail merely minor changes.

- iii) We think that this solution would satisfactorily take into account interests of parent companies, subsidiaries, minority shareholders, creditors, deposit holders, employees, supervisory authorities or Member States as a whole.
- iv) No material legal obstacles would remain.

b) Strong Guarantees Covering the Risk of Outstanding Payment

- **Proposal No. 3**

For the purposes of this proposal, we consider that:

- If:
 - o There is a security financial collateral arrangement between the parent company and the subsidiary. The transferee provides financial collateral by way of security in favour of the transferor within the framework of the 2002/47/EC directive. The required proportion of the value of the financial collateral/value of the transfer of assets has been published by the supervisory authorities (especially when the collateral is a debt due by a third party).
- Then:
 - o Any restriction to transfers of assets from the subsidiary to the parent company have to be removed by Members States

Bearing in mind the adoption of the foregoing, the possible consequences or conditions are the following:

- Compulsory ratios are still respected after the transfer
- The transfer does not endanger the transferor's compulsory ratios
- The amount of the transfer is to be reimbursed by the transferee to the transferor.
- Definition by central banks of common criteria in the area of collateral eligibility and greater acceptance of the cross-border use of collateral.

Answers to Questions

- i) Only a few Hungarian legislative measures should be revised in order to reach this result because major provisions of Directive 2002/47. of the European Parliament and of the Council of 6 June 2002 on Financial Collateral Arrangements have been incorporated into Hungarian law. It is true, however, that this harmonization was made into the Civil Code, the Insolvency Act and the Act No. CXX. of 2001 on Capital Market. Therefore, the Bank Act would deserve some transformation, too. In addition, the National Bank of Hungary should be granted the power to define common criteria in the area of collateral eligibility.

The Civil Code sets for that financial collateral may be provided under a financial collateral arrangement to secure a claim in the form of cash, money on account, security and other financial instruments specified in specific other legislation, upon delivery of the collateral. If the financial collateral pledged is some other thing, the regulations on liens shall apply. Delivery shall mean any procedure upon which the financial collateral is transferred from the possession or from under the control of the collateral provider to the possession or control of the collateral taker or otherwise designated so as to be in the possession or under the control of

the collateral taker, such as when credited to the bank account, securities account or securities deposit account of the collateral taker or of a person acting on the collateral taker's behalf. If the collateral is not delivered the regulations on liens shall apply. Parties may agree to grant the right of the collateral taker to use and dispose of the financial collateral as the owner. Where a collateral taker exercises a right of use, he thereby incurs an obligation to transfer equivalent collateral to replace the original financial collateral at the latest on the due date for the performance of the relevant financial obligations covered by the financial collateral arrangement. The equivalent collateral shall replace the original financial collateral.

“Equivalent collateral” in relation to money on account, means a payment of the same amount and in the same currency. In relation to securities and other financial instruments, it means securities and financial instruments of the same issuer or debtor, forming part of the same issue or class and of the same nominal amount, currency and description or, where a financial collateral arrangement provides for the transfer of other assets following the occurrence of any event relating to or affecting any security or financial instruments provided as financial collateral, those other assets.

By way of derogation from the above rules, parties may agree that the collateral provider may, on the due date for the performance of the relevant financial obligations, set off the value of the equivalent collateral against or apply it in discharge of the relevant financial obligations.

Parties may agree to stipulate the right for the collateral provider to replace the original financial collateral with other equivalent collateral at the latest on the due date for the performance of the relevant financial

obligations. The equivalent collateral shall be treated the same as the original financial collateral.

Parties may stipulate an obligation to provide additional financial collateral in order to take account of changes in the value of the financial collateral or in the amount of the relevant financial obligations, and that the collateral taker is required to release any excess collateral to the collateral provider. The additional collateral shall be treated the same as the original financial collateral.

Upon the due date for the performance of the relevant financial obligations the collateral taker shall be able to realize the financial collateral if it is cash, money on account, security or other financial instrument whose market price is listed publicly or can be determined at that time independent from the parties. The collateral taker shall be able to realize the financial collateral provided in other forms of security or financial instruments if the parties have so agreed in the financial collateral arrangement and have stipulated the method of valuation of the financial instruments.

If the financial collateral arrangement contains an agreement for the valuation of the securities and other financial instruments, sale and appropriation shall be subject to the terms of the financial collateral arrangement.

The collateral taker shall settle all accounts with the collateral provider within reasonable time, and shall surrender any proceeds exceeding the amount of the claim and any interest, and the costs of sale where applicable, to the collateral provider.

If the agreement between the parties contains any clause for realization that is considered commercially unreasonable, it may be contested by the party whose right or lawful interest is injured thereby.

Any party whose right or lawful interest is injured by the manner of realization, particularly any failure to abide by the obligation referred to above, shall be able to demand compensation for damages from the collateral taker. The collateral taker shall be relieved if able to evidence that he has acted in a commercially reasonable manner.

As regards the Bank Act it also contains some important provisions. Section 78/A § (7), (8) and (10) lay down that:

(7) The Commission shall approve the assignment of zero risk weight to exposures to the parent company or subsidiary of a credit institution, or the subsidiary of the parent company - which may be taken into consideration for the calculation of own funds and which do not give rise to any liabilities - if the aforesaid parent company, subsidiary or company:

- a) is a credit institution, investment firm, financial enterprise, investment fund manager or ancillary services company;
- b) is included in the same consolidation as the credit institution on a full basis;
- c) is subject to the same risk evaluation, measurement and control procedures as the credit institution;
- d) is established in Hungary;
- e) and there is no impediment to the prompt transfer of own funds or repayment of liabilities to the credit institution.

(8) The Commission shall approve the assignment of zero risk weight to exposures to members of the same institutional protection scheme as the lending credit institution - which may be taken into consideration for

the calculation of own funds and which do not give rise to any liabilities - provided that the following conditions are met:

- a) the member is able to satisfy the requirements set out Paragraphs a) and d) of Subsection (7), and there is no obstacle in the transfer of own funds between the credit institution and the member, or for the repayment of the obligation;
- b) the credit institution and the member have entered into a contractual or statutory liability arrangement which ensures their liquidity and solvency;
- c) the arrangements ensure that the institutional protection scheme will be able to grant support necessary under its commitment from funds readily available to it;
- d) the institutional protection scheme disposes of suitable and uniformly stipulated systems for the monitoring and classification of risk, which are to be approved by the Commission;
- e) the institutional protection scheme conducts its own risk review which is communicated to the individual members;
- f) the institutional protection scheme draws up and publishes once in a year either:
 - 1. a consolidated report comprising the balance sheet, the profit-and-loss account, the situation report and the risk report, concerning the institutional protection scheme as a whole, or
 - 2. a report comprising the aggregated balance sheet, the aggregated profit-and-loss account, the situation report and the risk report, concerning the institutional protection scheme as a whole;
- g) members of the institutional protection scheme are obliged to give advance notice of at least twenty-four months if they wish to end the arrangements;
- h) the multiple use of elements eligible for the calculation of own funds as well as any inappropriate creation of own funds between the members of the institutional protection scheme shall be eliminated; and

i) the institutional protection scheme shall be based on the membership of at least ten credit institutions, ninety per cent of which shall be cooperative credit institutions.

(10) For the purposes of Subsections (7) and (8), transfer of own funds shall include:

- a) the granting of subordinated loan capital;
- b) supplementary capital contributions to cover losses;
- c) any increase of the subscribed capital;
- d) any non-repayable transfer of assets to the debit of the capital or accumulated profit reserve;
- e) the granting of core and subsidiary loan capital.

ii) The above modifications would entail merely minor changes.

iii) This solution would satisfactorily take into account interests of all players of the capital market, including parent companies, subsidiaries, minority shareholders, creditors, deposit holders, employees, supervisory authorities or Member States as a whole.

iv) After introduction of the foregoing measures no legal obstacles remain.

c) Liability of the Parent Company for the Subsidiary's Debts

Answers to prior question

The parent company can be held jointly and severally liable for the subsidiary's debts only in exceptional circumstances but the same have nothing to do with the specific legal form of the subsidiary where the

shareholders are systematically liable for all decisions or due to preferred shares under which the shareholder is systematically liable for some or all decisions of the company.

The joint and several liabilities may be rooted on the connection between the parent and subsidiary, namely that the subsidiary is under direct control of the parent or both belong to the same group of companies either as a recognised group of companies or de facto group of companies.

The Hungarian Company Law acknowledges the concept of issuing various types of shares, such as preference shares. Even within the group of preference shares several subtypes exist. For the purposes of this Study the shares allowing preferential right to any liquidation surplus might first be taken into consideration. The articles of association may define classes of shares to afford, upon termination of the private limited company without succession, priority for a share from the assets to be distributed.

In addition, the general meeting may adopt a decision to issue registered shares (in an amount that does not exceed ten per cent of the share capital) that, according to the rules laid down in the articles of association, gives the limited company a purchase option or the shareholders a sale option (redeemable shares). Redeemable shares may also be issued of the type in which both the purchase option and the sale option is embodied simultaneously. This kind of share may be so issued that the shareholders enjoy a sale option once the parent company renders decisions unfavourable to the shareholders or causes damages.

- **Proposal No. 4.**

Under proposal 4. we consider that a EU instrument has been adopted and creates an automatic liability:

- by means of a specific type of company where the shareholders are systematically liable for all decisions that are disadvantageous for the company
- or by means of a preferred shares under which the shareholder is systematically liable for some or all decisions of the company

Answers to Questions

i) In order to reach this result several national measures should be revised.

A/ Pursuant to the basic principles of Hungarian Company Law in case of two types of business associations the liability of the shareholders is limited. These company types are the limited liability companies and the private or public limited liability companies. Banks typically belong to the category of private or a minority thereof to public limited liability companies.

According to Section 171. § (1) of Company Act public (private) limited companies are business associations founded with a share capital (subscribed capital) consisting of shares of a pre-determined number and face value, in the case of which the obligation of members (shareholders) to the public limited company extends to the provision of the face value or the issue price of shares. With the exceptions defined in this Act, shareholders shall not bear liability for the obligations of a public (private) limited company. Shareholders shall be required to pay up and make available to the private limited company the cash and in-kind contributions covering the face value or issue price of

the shares they have received. With the exception of a reduction of share capital, shareholders may not be exempted from this obligation and they shall not, during the company's existence, be able to reclaim the contributions they have made.

On the other hand, a private limited company may effect any disbursement from its own funds to a shareholder, on account of his membership, during the company's existence solely in the cases defined in this Act and only if the conditions set out in the Accounting Act are satisfied, with the exception of the reduction of the share capital, from the taxed profit for the current year, or from the taxed profit from the current year supplemented with available profit reserves. No disbursement can be made if the company's equity capital - adjusted in accordance with the Accounting Act - is below its share capital or it would be reduced to drop below the share capital if the payment was made. Any disbursement made in contradiction of the said rules shall be repaid to the company if it is able to prove that the shareholder involved has acted in bad faith. The above provisions also applies where a shareholder receives any payment for reasons other than his membership, which are not permitted, and which are otherwise incompatible with the principle of prudent management.

It comes from the foregoing that shareholders usually do not have other obligations than to provide the cash or in kind contribution. However, reference is also made to potential exceptions set forth by law when this limited liability is broken through. Such exceptions are the following:

1. Those shareholders who have supported a resolution, in respect of which they knew, or should have known given reasonable care that such resolution was clearly contrary to

the significant interests of the business association, shall bear unlimited and joint and several liability toward the business association for resulting damages, unless otherwise prescribed by law.

2. In the event of the termination of a private limited company without a legal successor, any shareholder who has abused his limited liability may not rely on his limited liability. Any shareholders of private limited companies, who has abused their limited liability or the company's legal personality to the detriment of creditors, shall bear unlimited and joint and several liability for the unsatisfied obligations of the defunct business association. The liability of the shareholders as specified above shall apply in particular if such members disposed over the assets of the business association as if they had been their own, or if they reduced the assets of the business association for the benefit of others or their own such that they knew or should have known with due care that the business association would not be able to satisfy its obligations towards third parties as a result thereof.

3. If the shareholder of a qualifying holding makes a series of poor business decisions on behalf of the controlled company, hence imposing substantial strain on the controlled company in meeting its liabilities, the competent court of registry may - at the request of any creditor of the controlled company - instruct the shareholder of a qualifying holding to provide collateral security, or may impose the judicial supervisory sanctions specified in the Company Registration Act upon him. If the controlled company is going into liquidation, the shareholder of a qualifying holding shall bear unlimited liability for all liabilities of the company for which the debtor controlled

company is lacking sufficient cover in the process of liquidation proceedings, if the court has declared - in an action filed by the creditors during the liquidation proceedings - the unlimited and full liability of the shareholder of a qualifying holding responsible due to its history of making unfavourable business decisions in the debtor company.

4. The provisions relating to the liability of any shareholder with a qualifying holding applies to the liability of the shareholder of a single-member limited company.

Consequently, the foregoing provisions create the joint and several liability of shareholders for the controlled company but this liability does not occur automatically when a decision proves to be disadvantageous for the company. In order to reach the joint and several liability, some other element is always required, which can be summarized with the negative attitude committed wilfully or with gross negligence. According to Hungarian court practice the expression "making a series of poor business decisions" as quoted in point 3. above, covers unambiguously a wilful or gross negligence behaviour.

Therefore the automatic liability could be achieved only by adopting new legislative actions.

- B/ As explained above by enabling the private limited companies to issue redeemable shares, the germs of such preferred shares can already be discovered in Hungarian law under which the shareholder can be held systematically liable for some or all decisions of the company. However, additional legislation would be needed to elaborate the precise terms and conditions and characteristics of such redeemable shares. Besides enacting another type of shares may also be taken into account.

- ii) The modifications outlined in points i) A/ and B/ above would entail substantial modifications but no major frictions with established legal principles. In my view the concept of breaking through the limited liability should be extended and the preconditions for holding a shareholder automatically liable for disadvantageous for the company decisions should be accurately specified.
- iii) This solution would satisfactorily take into account interests of subsidiaries, minority shareholders, creditors, deposit holders and employees of the subsidiaries, supervisory authorities or Member States as a whole. However, this solution might be harmful to the interests of parent companies, as well as minority shareholders, creditors, deposit holders and employees of the parent companies. A very sensitive balance should be established for finding out a fine solution.
- iv) Not only the provisions of Hungarian company law should be revised but in line with it adequate provisions of banking and insolvency law ought to be amended, as well. Series of sophisticated legislative measures would be necessary to achieve this goal.

d) Improving Transferability Transfer through the Introduction of a New Concept of "Banking Group"

- **Proposal No. 5.**

Pursuant this proposal, we consider that the idea of “group company” has been adopted by an EU instrument. The managers of the subsidiaries will be obliged to follow instructions even if the subsidiaries will thereby incur financial losses. These managers must therefore not be held liable vis-à-vis their own companies. This power of management is accompanied by the right to use the financial resources of the subsidiary, since the economic advantage of the group can be maximized only where there is a complete integration of the two entities. Once the agreement is concluded, transfers of assets are allowed between the members of the group.

The following consequences or conditions can be drawn or performed as a result of the proposal:

- The constitution of the group is submitted to the supervisory authorities.
- In case of insolvency, there is a possibility for creditors to file their claims with any of the companies of the group.
- In case of Insolvency, the creditors of the transferor will be reimbursed before creditors of the transferor up to the amount of transfers that occurred and the possibility for creditors to file their claims to any of the companies concerned by the transfer.

Answers to Questions

- i) Only a limited number of national measures should be revised in order to reach this result, especially in insolvency law.

The Hungarian Company Act already adopted the concept of recognized group of companies, as well as de facto group of companies.

The dominant member of the recognized group, or its management, may instruct the management of the controlled company according to the provisions laid down in the control contract, or in the memorandum of association (hereinafter referred to collectively as "control contract"), and may adopt resolutions binding upon the operation of the controlled company. In this case, the provisions on the exclusive competence of general meetings do not apply concerning the powers and operation of the supreme body of the controlled company, and the dominant member may not be declared jointly and severally liable if having acted in accordance with the provisions of the control contract.

The executive officer of the controlled company shall conduct - in accordance with the control contract - the management of the business association by giving priority to the interests of the recognized group as a whole. The executive officer shall be exempt from the liability if his conduct is found to be in compliance with the relevant provisions set out in legal regulation and in the control contract.

The autonomy of the controlled companies of the recognized group may be restricted in the manner and to the extent specified in the Company Act and in the control contract, as it may be necessary with a view to the interest of the group as a whole. The control contract shall contain provisions for the protection of the rights of the shareholders of controlled companies, and for the protection of creditors' interests. Having a recognized group of companies registered in the register of companies shall not result in creating a separate legal entity from the business associations belonging to the group.

Similar provisions apply to de facto group of companies. Consequently, the constitution of a group is allowed under Hungarian law and it can also be acknowledged by supervisory authorities through its registration at Hungarian courts for registration acting in their capacities as company registers.

However, the Insolvency Act provides a strict ranking of claims submitted by the creditors against a company under liquidation proceedings. Claims can only be filed in the proceedings conducted versus the insolvent company and not against the subsidiaries, parents of the insolvent company or member companies of the group where the insolvent company belongs to.

- ii) The modifications required to reach the desired result would entail merely minor changes in the text of Insolvency Act but bearing in mind their effect they would be considered substantial amendments. On the other hand, modifications would have impact on Bank Act, too, because the Bank Act contains specific provisions on winding up (liquidation) proceedings against banks. Therefore, qualification of this sort of modifications would be on the edge of substantial modifications and merely minor changes.

Pursuant to the Insolvency Act the business associations' debts shall be satisfied from its assets that are subject to liquidation in the following order:

- a) liquidation expenses,
- b) claims secured by lien on financial assets prior to the time of the opening of liquidation proceedings, up to the value of the pledged property and in consideration of the sums already paid; if there is more than one lien on the pledged property they shall be satisfied in the sequence laid down in Subsection (1) of Section 256 of the Civil Code,

- c) alimony and life-annuity payments, compensation benefits, income supplement to miners, which are payable by the business association, furthermore, monetary aid granted to members of agricultural cooperatives in lieu of household land or produce, for which the beneficiary is entitled for his/her lifetime,
- d) with the exception of claims based on bonds, other claims of private individuals not originating from economic activities (in particular claims resulting from insufficient performance or compensation for damages, also including the amount of the guarantee obligations ordinarily expected in the given trade, as calculated by the liquidator), claims of small and micro companies as well as small-scale agricultural producers,
- e) social insurance debts and overdue private pension fund membership dues, taxes and public debts collectable as taxes, repayable government subsidies, as well as water and sewage utility charges,
- f) other liabilities,
- g) irrespective of the time and grounds of occurrence, default interests and late charges, as well as surcharges and penalty and similar debts.
- h) claims held by any executive officer or executive employee of the economic operator, or their close relative, or their domestic partner, or an business association under the debtor's majority control, and the claims resulting from the debtor's gratuitous commitment, furthermore, claims held by any shareholder of the business association with majority control, that were filed before the occurrence of a situation constituting potential danger of insolvency.

The above provisions prevail in case of liquidation of "ordinary" business associations. Banks are subject to specific regulations, too. As a major difference liquidation proceedings cannot be instituted by creditors just by the Commission or the banks themselves. Furthermore the Bank Act sets forth qualification of certain claims as follows:

- any claims deriving from placement of deposits must be listed according to above Paragraph d), these claims have equal status;
 - debts from the core loan capital, subsidiary loan capital or subordinated loan capital and from the junior subordinated loan capital shall be satisfied after the liability referred to in the above Paragraph g) has been satisfied.
- iii) This solution would satisfactorily take into account interests of parent companies, subsidiaries, minority shareholders, creditors, deposit holders, employees, supervisory authorities or Member States as a whole.
- iv) In our opinion some legal obstacles would still remain in connection with the definition of various terms. The Company Act admits the terms recognized group of companies and de facto group of companies. Banks, of course, qualify as business associations and therefore the provisions of the Company Act apply to them. However, the Bank Act uses some additional terms, as well, such as "group", "banking group" and "financial conglomerate". Of these three terms the key term is financial conglomerate in accordance with the relevant EC directives. Nevertheless, harmonization or approximation of definitions in Company Act and Bank Act should be achieved. In our view, these legal obstacles could be removed relatively easily by enacting some cross reference provisions in one or another or both acts.

e) Other Solutions

We think that the European Union and the Member States cannot afford to see the events of the USA financial sector neutrally. It would be

essential to draw the lessons of the collapse of major financial institutes and the difficulties investors, banks, employees and the government have to face. I am afraid that the consequences of the crisis in the USA will not stop within the American borders and can have worldwide and global impact. Therefore, some measures should be adopted by the European Union and the Member States strengthening the possibility of intervention of the national central banks, national governments or even the European Central Bank and the European Commission if signs of financial crisis in capital and/or money market can be discovered. As regards Hungarian legislation, some provisions still allow the Hungarian Central Bank to make some actions in this sense. Pursuant to Section 14. of Act No. LVIII. on the National Bank of Hungary the NBH may extend an emergency loan - subject to the prohibition of monetary financing - to a credit institution whose operation jeopardizes the stability of the financial system in consequence of specific circumstances. The NBH may render such a loan subject to the actions of the State Financial Institutions Commission (hereinafter referred to as the 'Commission') or performance of actions by the credit institution as initiated by the Commission.

I wish to emphasize that extraordinary actions can, of course, be allowed only in exceptional circumstances without violating the principles of free movement of goods, capital and without harmful effects to the freedom of business competition.