

Analysis of Corporate Restructuring and Insolvency
in Hungary – Presentation for key stakeholders

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European Bank
for Reconstruction and Development

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WHITE & CASE

Objective

The objective of the exercise was to analyse the current framework for **CORPORATE** restructuring and insolvency to identify ways to deal more efficiently with NPLs in the corporate sector and suggest potential remedies, as well as incentives to promote NPL resolution.

Timeline

Started in June 2014 and the report was presented to various stakeholders during February 2015 and has since been revised following these discussions and discussions are ongoing. This version of the report has not been signed off by the Ministries.

Meetings were conducted with the following stakeholders:

Initial meetings:

- **Six** large commercial banks
- Hungarian Association of Insolvency Office Holders
(*Felszámolók és Vagyonfelügyelők Országos Egyesülete*)
- Hungarian Chamber of Commerce and Industry
(*Magyar Kereskedelmi és Iparkamara*)
- Hungarian Chamber of Court Bailiffs (*Magyar Bírósági Végrehajtói Kamara*)
- A number of high-profile insolvency judges.

Follow-up meetings:

- Ministry of Justice (*Igazságügy Minisztérium*)
- Ministry for National Economy (*Nemzetgazdasági Minisztérium*)
- Ministry of National Development (*Nemzeti Fejlesztési Minisztérium*)
- The Central Bank of Hungary (*Magyar Nemzeti Bank*)

Tax considerations / 1

➤ Issue regarding tax authority as creditor:

- Tax authorities can only accept 100% recovery on tax claims
- UK, Spain – tax authorities can waive tax claim on conversion

➤ Proposal:

- Tax authorities should be granted the possibility of reducing their tax claims
- Guidance could be issued on how waivers should be granted, or legislation should specify scenarios when waiver is automatic (e.g. insolvency)

➤ Issue regarding the cancellation of receivables from the balance sheet:

- Receivables can only be cancelled from the balance sheet if certain specific requirements are met
- IFRS requires the write off of receivables for which there is no reasonable expectation of recovery

➤ Proposal:

- As Hungary is moving towards IFRS, it should be made possible to write off debt in line with principles used by IFRS

Regulatory considerations

➤ Issue:

- Strict **licensing** requirements on secondary investors
- Licensing takes a long time (90 + 90 days)

➤ Proposal:

- Easing regulation and practice in terms of the purchase of corporate NPLs:
 - Abolish licensing requirements to encourage institutional investors
 - Several EU jurisdictions do not require licensing for trading corporate debt, e.g. the UK, Ireland, Poland, Spain and Romania
 - If licensing is maintained in general, streamline and speed up application process or even have a pre-screening procedure
 - Introduce easier conditions on corporate form, statutory capital, personnel, etc.

Tax considerations / 2

- **Issue regarding cancellation of debt in the context of restructurings:**
 - A full or partial cancellation of debt in a pre-insolvency situation is recognised as taxable revenue of the debtor
 - Tax losses from previous years may only partially offset the tax liability
- **Proposal:**
 - A tax exemption may be granted to debtors whose debts are fully or partly cancelled due to threatened or actual insolvency
 - E.g. the UK, Greece and Poland exempts gains upon cancellation in a pre-insolvency situation
 - Allowing tax losses carried forward from previous years to offset the resulting gains without any limitations
- **Issue regarding debt to equity conversion in the context of restructurings:**
 - Debt to equity conversion may result in taxable income to the debtor
- **Proposal:**
 - A tax exemption may be granted to debtors for debt to equity conversion gains in a pre-insolvency scenario

Tax considerations / 3

➤ Issue regarding real property as collateral

- The acquisition of real property by a bank through security enforcement is subject to real estate transfer tax (the rate is lower if the bank sells the real estate within three years, but this benefit only applies to banks and not to financial enterprises)

➤ Proposal:

- The period available for banks to utilize the reduced tax rate could be extended to at least six years – in line with holding restrictions in banking legislation
- The benefit can be extended to financial enterprises

➤ Issue regarding lack of tax incentives

- Hungarian legislation does not contain any tax incentives facilitating the resolution of NPLs

➤ Proposal:

- Tax incentives may be introduced by e.g. reducing the Bank Tax in case the bank sells or writes off a certain amount of NPLs

Overview of the legal aspects

- Report was prepared after thorough review of legislation in all affected areas and considering market practice after discussions with stakeholders
- „Big Picture” solutions proposed – details to be elaborated (after further discussions with stakeholders)

Affected areas identified

- The environment: lenders approach, interbank cooperation and general contractual framework
- Licensing/regulatory
- Enforcement (by court) outside insolvency
- Insolvency-related issues:
 - Bankruptcy/moratorium
 - Liquidation

Out-of-Court restructurings

Diverse in practice, less regulated

➤ **Issue:**

- The „Budapest Approach” is not applied: little evidence of multi-creditor out-of-court cooperation on restructuring in practice

➤ **Proposal:**

- Greater cooperation encouraged with banks via NBH and Banking Association

General legal environment: the new Civil Code & old Bankruptcy Act

➤ **Issues:**

- Ambiguous provisions of the new Civil Code in terms of the survival of the security interests upon the transfer of entire contractual positions;
- Less motivation to purchase NPLs due to legal/financial risks, i.e. re-establishment of security interests, re-triggered hardening periods

➤ **Proposal:**

- Relevant provision of the new Civil Code to be amended

Court enforcement

➤ **Issue**

- Court bailiffs appointment system is not merit-based;
- Lack of influence by creditors

➤ **Proposal:**

- Stronger creditor rights to select/object bailiffs;
- Stronger financial incentives

➤ **Issue**

- Communication between bailiffs and creditors

➤ **Proposal:**

- Regular reporting obligations;
- Information flow even before initiating process (to avoid starting expensive, but fruitless processes)

Greater Creditor Rights to Resolve NPLs in Bankruptcy and Liquidation / 1

➤ **Issue:**

- Existing (electronic random) appointment system of Trustee/Liquidator (IOHs) is rigid and not merit-based;
- Lack of influence by creditors in appointment, and, to some extent, replacement

➤ **Proposal:**

- Replacement of current system to be considered;
- Greater role to creditors in IOH's appointment (and remuneration);
- Stronger creditor rights to provide feedback and replace the acting trustee/liquidator;
- More active (combination of both external (state) and internal) regulation to facilitate better performance (and thereby market appreciation):
 - especially in liquidation (not a debtor in possession procedure);
 - transformation of the Hungarian Association of Insolvency Office Holders to a chamber with mandatory membership (legally binding guidelines, code of ethics etc.) + creating a dedicated State agency

Greater Creditor Rights to Resolve NPLs in Bankruptcy and Liquidation / 2

➤ **Issue:**

- Limited settlement options and lack of creditor influence

➤ **Proposal:**

- Creditors to be given wider right to propose restructuring measures;
- Legislation to better facilitate the implementation of such measures, (e.g., debt to equity swaps, change of management);
- Encouraging (and facilitating easier formation of) creditor committees (representatives);
- Adjusting deadlines for all affected courts (e.g. for objection and exclusion matters)

➤ **Issue:**

- Easy to challenge liquidation filings

➤ **Proposal:**

- Courts to be given wider right to right to assess situation, rely on expert opinions and scrutinize debtor objections

Greater Creditor Rights to Resolve NPLs in Bankruptcy and Liquidation / 3

➤ **Issue:**

- Lack of transparency and control for creditors during the liquidation proceedings, particularly in relation to the sale of assets by the liquidator;
- Special status of secured creditors is not reflected in terms of sales

➤ **Proposal:**

- More detailed obligations by liquidators to manage the proceedings and inform creditors;
- Secured creditors to be given specific rights regarding the sale of the collateral (e.g., prior approval of such sale: timing and price, right to stipulate further conditions) – N.B. post-sale objection rights not sufficient;
- Right to sell the secured asset themselves (outside the liquidation proceeding);
- Wider rights for secured creditors to ,credit-bid'

Effective Bankruptcy Proceedings

➤ **Issue**

- Debtors and shareholders not properly prepared for the financial and operational restructuring, no reorganization or business plan is required from the debtor for filing

➤ **Proposal:**

- Requirement to file, together with the initial filing for bankruptcy, at least a preliminary reorganization or business plan by debtor;
- „Fast-track” procedure to be considered: filing with plan, as pre-agreed with major creditors

➤ **Issue:**

- Only a formal review of the settlement agreement and the reorganization plan by courts;
- Lack of powerful tools for the courts and trustees against bad faith debtors, especially regarding:
 - (i) fictitious claims (usually of „friendly” third parties); and
 - (ii) wrongful exclusion of „real” creditors from voting

➤ **Proposal:**

- Specific education/trainings and right to rely on expert opinions (for scrutinizing claims);
- Rights (and responsibilities) of trustees to be strengthened to better protect creditors’ rights

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