RESIDENTIAL LOAN RECOVERY: MANAGING RISK OF DEFAULT
Report of the Loan Recovery Working Group
for the Conference on Housing Finance in Hungary
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INTRODUCTION

Background

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

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

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

In the meantime, the lack of competition among banks and the perception that residential lending is not profitable remain substantial impediments to the development of a more active residential mortgage market. Despite the fact that legislators and ministry officials have worked diligently to reform the legal framework for mortgage lending in Hungary, heeding the advice of Western European and American advisors and following model laws recommended by the EU and EBRD, with banks generally not using the progressive remedies already available to

them, it is not clear whether additional changes in the legal framework in themselves would increase the amount of residential mortgage lending or the efficacy of loan recovery in the near future.

The Loan Recovery Working Group

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

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

The Working Group divided into three subgroups, each of which focused on one of the following three topics: (1) actual experiences of banks with loan recovery procedures; (2) the use of public documents for residential loans; and (3) the effectiveness of execution procedures. After completing their research, the subgroups made findings and recommendations for improving the legal framework, court and execution procedures, and bank practices to assure maximum loan recovery in case of default. The results of this work will be discussed at the Housing Finance Conference by a panel comprised of members of the Loan Recovery Working Group, and are fully developed in this report.

Summary of the Report of the Loan Recovery Working Group

This report is divided into several parts, as follows:

1. Current Legal Framework for Execution Procedures, Its Effectiveness, and Recommendations for Additional Changes

Lenders believe that current execution procedures are not efficient, and the relevant regulations do not encourage market operations based on competition. The Loan Recovery Working Group investigated the effectiveness of current execution procedures, including foreclosure, eviction, and recovery of monetary claims. The report describes how loan recovery procedures should work under the recently enacted laws, what practices lenders can adopt to make execution more expeditious, and whether additional modifications to the legal framework might make execution more effective.

In particular, the report recommends clarification of a lender's rights to foreclosure and eviction without judicial procedures. The new Civil Code amendments provide that if it is stipulated in the loan contract, a borrower in default must deliver the

property empty of occupants. They also allow a lender to sell property directly if it has an established market price or if the lender grants mortgages as part of its ordinary business. These provisions are not self-executing, however, and further instructions are needed to clarify how they should work in practice.

On addition, this section includes a recommendation for changing the execution procedures submitted by the Chamber of Executioners.

2. Benefits of Public Documents for Residential Loans and Experience with their Enforcement

Lenders believe that foreclosure is not an efficient means of loan recovery because of the high cost and long time required. Under recent changes in the law, a court proceeding is not necessary to initiate foreclosure and execution if the loan contract is a public document. Banks do not routinely use this procedure for residential loans, apparently because they regard as too high the fees for preparing public documents.

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

3. A Description of Loan Recovery Procedures Used by Various Banks before Terminating the Loan Contract

4.A Preliminary Statistical Analysis of Past Experience with Real Estate Loans in Default and Current Lenders' Loan Recovery Procedures

Up until now, available information about loan recovery practices and procedures has been anecdotal in nature. This may have caused lenders to perpetuate practices that are based on invalid or outdated assumptions.

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

The first results of this statistical analysis will be presented at the Housing Finance Conference in the panel discussion "Are Default Risk are Manageable?"

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SECTION I.

Present Regulations Concerning the Foreclosure of Mortgage and the Possible Ways of Solving the Arising Problems

In the course of housing crediting with a mortgage collateral, how can the mortgaging bank assert its claim if the debtor of the loan continues not to pay for a longer period of time?

The crediting bank has two titles for the assertion of a claim secured by a mortgage.

1. On the basis of its mortgage, it may demand from the court to oblige the obligor of the mortgage to tolerate for the bank to satisfy its claim through the auctioning of the mortgaged real estate in a judicial process, from the price paid at the auction [CC subs. (1), Sect. 251]. Thus the obligation is not aimed at the payment of the money. It is another question that, in the case of the larger part of housing loans, the real debtor (mortgage obligor) and the personal debtor (the debtor of the borrowing agreement) are usually one person.

2. The other title is that the creditor may lay a claim for a pecuniary claim. If the obligor fails to meet the extended time limit set in the request for payment, the creditor may abandon the borrowing agreement [CC subs. (1) and (2), Sect. 300] or may terminate the borrowing agreement with immediate effect [CC point e), subs. (1), Sect. 525] - because of the serious breach of contract of the debtor.

The Civil Code lists a rather broad scope of reasons for termination, in the case of which the crediting bank may terminate the legal relationship unilaterally, immediately if the financial situation of the debtor deteriorates to an extent which endangers repayment.

It is the judicial proceedings which usually serve for the foreclosure of mortgages and the assertion of pecuniary claims. As an exception, Act LIII of 1994 on Judicial Execution (in the following: AEx) makes the direct judicial execution of claims contained in public notary documents possible even without a non-appealable court decision stating the lawfulness of the claim - be it a mortgage claim or a pecuniary claim - (with a payment warrant in the case of the latter). However, this exceptional procedure only saves the action at law, or the payment warrant, the judicial execution procedure is still necessary in these cases for the assertion of the right (in the lack of voluntary performance).

However, foreclosure of mortgage has ways through which the party entitled may completely evade the long and costly procedures (implying especially large losses for the debtor) of the assertion of his right in front of the authorities, including both the court procedure establishing the lawfulness of the claim (and the above public notary procedure), and the judicial execution procedure. Today the amended regulations of the right of lien chapter of the Civil Code already make it possible for the party entitled to the mortgage - in case of the existence of certain conditions - to ensure for himself in advance the utilization of a specific way of the assertion of his

right - resulting from the security character of the mortgage - in the case of the termination of the borrowing agreement.

This legal possibility - in the case of the existence of other non-legal conditions - may play a great role in the foreclosure of mortgage securing housing loans, in the faster and thus more advantageous arrangement of these (for the creditor and the debtor as well).

We shall present the official ways of the assertion of rights in the following Chapter I, while showing the special way of the foreclosure of mortgages outside of the official procedures in Chapter II.

The Foreclosure of Mortgage and the Assertion of Pecuniary Claims through the Different Official Procedures (Judicial, Public Notary and Judicial Execution Proceedings)

A) The Procedures Preceding the Execution

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

The executory page is usually (as well as from the point of view of our theme) issued by the court on the basis of the condemning resolution of the court in the civil matter. This resolution, thus, is a court ruling; in the case of a mortgage: for the toleration of the auction of the real estate and the satisfaction of the claim from the auction purchasing price; while in the case of a pecuniary claim: the court ruling for its payment; or it is - only in the case of the latter, pecuniary, claims a non-appealable payment warrant. Thus the party entitled shall obtain these for the court to issue an executory page.

An executory clause is issued by the court on the basis of a special public notary document, which document shall contain:

- the assumption of a responsibility,
- the name of the party entitled and the obligee,
- the subject of the obligation, the quantity (amount) and the title,
- the way and the due date of performance (AEx subs. (1), Sect. 21).

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

In the course of marking the documents to which a clause may be added, the AEx also contains a provision specially for the foreclosure of mortgages [point c),

Sect. 22]. Basically both places of the Act designate an identical public document, there is no difference in content between them.

We can summarize the official procedures preceding the executory procedure as follows.

1. In the payment warrant procedure, the payment of the pecuniary debt may be demanded. The foreclosure of mortgages is not possible in this procedure. This is so as according to the Civil Procedure [subs. (1), Sect. 313 of Act III of 1952] only pecuniary claims and claims for the delivery of chattels may be asserted in this procedure. The assertion of pecuniary claims through a payment warrant may take place

- on the basis of the declaration of the payment warrant as non-appealable (if the obligor does not contradict this) or
- in the case of the contradiction of the obligor, on the basis of a non-appealable resolution in the procedure thus transformed into a lawsuit.

2. In legal proceedings, the mortgagor, on the basis of his action, may assert his claim both on the basis of

- pecuniary claims and
- mortgages. On the basis of the non-appealable court verdict, on the demand of the creditor bank, the judicial execution may be initiated.

3. The inclusion of the obligation in a public notary document. If the contract concerning the loan was included in a public notary document, then both the payment warrant procedure or the legal proceedings may be spared. After such antecedents, if the obligor has not fulfilled his obligation and the party entitled demands this, then the court may add a clause to the public document. On the basis of this, the judicial execution may already be initiated. A separate working group deals with the regulations concerning the content and the issuing of the public document, therefore we do not discuss this here.

4. The inclusion of the mortgage contract in a public document. In practice, this is not a provision in force as inclusion in public documents is entrusted to the public notaries and to other authorities (e.g. courts, administrative bodies) which presently do not have as their task the preparation of contracts, thus, actually, the public notary document form remains.

B)
The Judicial Executory Procedure

The foreclosure of mortgage, as the assertion of the right of lien, usually takes place in a judicial executory procedure [CC Sect. 262].

The judicial execution of the non-appealable judgment of the mortgage claim or the pecuniary claim (in the latter case the payment warrant declared non-appealable) takes places in a different way, though in the end it leads to the same result. We shall add that principally - because of the outstanding role of the mortgage claim as a security - the mortgage obligee shall be much more protected by execution law, enforcing the relevant prescriptions of substantive law [CC sentence 1, subs (1), Sect. 251; sentence 1, subs (2), Sect. 263]. The legal exemptions, phrased here, from

the exclusive possibility of asserting the mortgage obligee's right are limited only to really justified cases - e.g. the assertion of the claim for maintenance - and may not injure the interests of the mortgage obligee substantially.

The judicial foreclosure of the mortgage demand, according to regulations, is concentrated on the seizure and the auctioning of the mortgaged real estate, omitting the seizure of other chattels and the income of the debtor. This is favorable from the point of view of the timespan of the procedure, and it is worth choosing this when the income and other chattels of the debtor do not ensure sufficient coverage, but the value of the pledged property is certainly sufficient for this purpose.

In the course of the judicial execution of pecuniary claims, the principle of gradualism is effectuated. The seizure is first made concerning the wage, other incomes and chattels of the obligor, and if these do not prove or foreseeably do not prove sufficient, then the bailiff extends this to the other assets constituting the property of the obligor (in our case to the mortgaged real estate).

In order to support the enforcement of the security character of the right of lien, judicial execution shall enforce two substantive law regulations in the course of the foreclosure of the mortgage claim:

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

These regulations naturally mean a further advantage in the course of the assertion of the mortgage claim, as compared to the assertion of the simple - not founded - pecuniary claim.

- Examining Act LIII of 1994 on Judicial Execution (in the following: AEx) from these aspects, we have to take a look at the procedures initiated upon the demand of
  - the mortgage obligee and
  - a third person outside of the borrowing agreement.

  The judicial executory procedure and other administrative procedures - especially the tax collecting procedures - initiated by third persons belong to the latter, that is we shall examine what the situation of the mortgage obligee - namely the mortgage obligee of the real estate - is in these procedures.
- The other important aspect is how the right of the real estate mortgage obligee is effected by the rights of the obligees of the registered and non-registered real rights and contractual obligations.
- Finally, the regulations of the order of satisfaction also effect the effectiveness of the above substantive law regulation.

The Procedure Initiated upon the Demand of the Mortgage Obligee

In this procedure we shall examine the effects of the rights of other parties concerned.

a) Proprietary Rights

Usually the subject-matter of the mortgage is the condition of the real estate, as usually it is the proprietary right which is contracted as the collateral. Thus the execution is aimed at the proprietary right. Therefore in the course of the auction the auction buyer usually acquires unencumbered property, as the encumbrances remaining concerning the real estate are listed specially with a taxative character (Sect. 137) and this right - naturally - does not figure among these.

Still, it is a quite debated question whether the owner - who is at the same time the mortgage obligee - may keep the real estate occupied after the auction as well, and how the auction buyer may obtain the vacation of the real estate, and whether he has to tolerate at all that the former owner remain in the real estate.

Neither the AEx, nor any other substantive law regulation ensures such a title. The judicial practice (PK. standpoint 70) was developed with the observance of the previous housing regulations, and consists in that the former owner may continue to occupy the flat after the auction as well, as a utilizer, a quasi tenant.

When this approach is utilized in the course of the execution, the real estate is designated as inhabited in the auction conditions, and the auction price is also set by the court according to this (as the half of the vacant possession value), thus with regard to this, the auction buyer may not demand the vacation of the flat, as he has only paid the inhabited value in the purchasing price. However, this does not create a title of inhabitation for the former owner, thus the auction buyer tries to "put him out", as there are many sad examples of this.

Usually it can be stated that it is the interest of both parties, if the real estate falls under execution, to have the auction fast, and to sell it at the highest price possible. The time span of the sale - including the time span of the foreclosure - increases the time during which the unpaid - presently rather high, 29% - transaction interest and the interest on default (a further 6%) unnecessarily burden the real estate. This also has the effect that it is not possible to grant loans to a high proportion with respect to the value of the real estate as in the process of the foreclosure procedure the interest accrued usually totals to a very high amount, to three times the value of the capital debt, as the experiences of the banking working group have showed. In the course of the average complete period - ca. 4 years - of the procedure for the assertion of the claim, the arrears of interest reach the total value of the real estate, therefore the owner does not receive any part of the auction purchasing price. He may only trust the presently still general practice that the real estate is not delivered vacant to the auction buyer.

Today, however, such speculators also appear at the auctions who purchase the real estate with the intention of obtaining its possession through illegal means later on. We find numerous pieces of information - and even primary information from a legal advisor of a bank - showing that by now these methods are used not only by the "real estate sharks". These illegal placements result in a situation where the former owner has no possibility of habitation, while the auction buyer acquires the

difference between the vacant possession value and the inhabited value of the real estate, which is usually one half of the value of the real estate.

As an amendment we may propose that the auction of the real estate shall be advertised at vacant possession value and the executor shall hand the real estate over to the auction buyer vacantly, within a time limit after the termination of the auction determined in rules of law.

Legal proceedings prolong the time of satisfaction from the collateral extremely. Therefore, the possibilities of satisfaction outside of the legal proceedings shall be examined.

The revision of Section 48 of the Civil Code shall be raised, as it was created, or more precisely prepared, based on information which is contradictory to the present AEx. The gradualism which was basic for it was not introduced into the provisions of neither the Act on Flat Rental (Act LXXVIII of 1993) nor the AEx. As opposed to these latter two laws, the mentioned provision of the Civil Code maintained the previously prevailing uncertainty, for contracts concluded before its coming into effect, concerning by what title the owner losing his legal title may remain in the real estate. While for contracts concluded later on, this provision prescribed - with a cogent character - that the real estate may be auctioned as vacant only in the case of a special clause for this in the contract.

It would be reasonable, therefore, to state expressis verbis in the AEx that the debtor cannot keep the real estate (and thus the flat as well) occupied after the auction.

A further reason for this is that, according to the general provisions concerning real estate execution, there is no provision which requires the auction of the real estate as inhabited. And in the case of a mortgage operating as a security, it is even less reasonable to establish auctioning in an inhabited form as a general rule.

Neither is maintaining gradualism justified by the fact that borrowing agreements concluded earlier are also involved. The danger of non-payment may also arise much later, within consolidated conditions, as these loans may have a maturity extending over several decades, and it is definitely unjustifiable, in the by then completely changed conditions, to maintain the regulation favoring the owner.

Finally, we have to underline a non-legal type of question which on the other hand greatly influences the effectiveness of the executory regulations. And this is the social dimension of the flat, that is that the placement on the street implies the subsequent impossibility of the debtor's family. The debtor no longer receives an amount, from the executory auction purchasing price, from which he could, even within more modest conditions, solve his habitation (because of the interest on default, the transaction interests and the costs).

Therefore it is definitely necessary to examine the possibility of the establishment of a system which ensures the sale of the real estate outside judicial executory procedure, and, more than that, ensures a flat in exchange - naturally a more modest one - for the owner, with more easy loan conditions.

b) Usufruct and other personal and land easement

Here, the AEx does not assert the rule of sentence 1, subs. (2), Sect. 263 of the Civil Code providing that the rights originating later shall not effect the mortgage.

It may be suggested that in this question as well, the prevailing rule shall be the date of the registration, or, in the case of legal usufruct, the date of the originating of the usufruct, and any rights thereafter shall be null and void after the auction. It seems reasonable, however to accept that, as a countervalue for the rights "swept off" in the real estate execution, the party entitled shall be ensured some kind of satisfaction. Thus, the party entitled to this right shall be enlisted in the distribution plan, and shall receive satisfaction on the basis of expert estimation.

Further studies are necessary concerning land easement, whether they shall definitely continue to exist on the basis of the provision of the law, regardless of the date of their origination.

c) Lease

The act on flat rental regulates this question adequately, the change of the owner does not effect the right of the tenant. This question, that is to say the exercise of the right of disposal of the new owner shall be regulated by the regulations on the right of notice. Presently, free notice to quit also exists, but notice may be given without ensuring an exchange flat only if this has been stipulated in the flat rental contract. This is obviously a disadvantage if the owner later on - after the conclusion of the mortgage contract - lets his flat which is mortgaged.

2. Executory procedure
launched by another person against the loan debtor

Two kinds of such procedures are possible:
a) judicial execution
b) administrative, typically tax collecting procedure

a) In the course of the judicial execution initiated upon the demand of a third person, the security character of the mortgage debiting the real estate breaks. The mortgage ceases to exist - on the basis of the referred Section 137 of the Civil Code - , and the demand of the obligee of the mortgage is not even included in the distribution plan, contrary to the preferential claim of the obligee of the chattel mortgage (AEx Sect. 114).

If, in the course of the execution, the obligee of the mortgage does not dispose of a non-appealable document, according to which the debtor is obliged to tolerate the satisfaction of the obligee from the auction purchasing price, the mortgage is lost, and the mortgage obligee does not receive any security, satisfaction in exchange.

As against this obviously inequitable measure, the judicial practice grants the possibility for a mortgage obligee to await for the court to back this document only in the case of a mortgage contract included in a public document. (Here, actually, the lending credit institution cancels the borrowing agreement with immediate effect with regard to the deterioration of the financial situation of the debtor, and on the basis of

this there is a possibility for the condemnation of the complete amount of the loan in arrears.)

This discrimination is conflicting with the general security character of the right of lien, relating to all its cases. It is difficult to accept as a general argument, it may be expected only from a mortgage contract included in a public document to serve as an exclusive security for satisfaction [CC subs (1), Sect. 251]. It is so as this limitation is not contained by the substantive law regulation, as it would reverse the relation of the general rule and the exception and it would establish the effectiveness of the general rule only exceptionally. And the procedural law regulation shall not lead to a result just contrary to the substantive title: contrarily the ways for the effectiveness of the substantive law regulation shall be created.

This kind of arrangement is also contrary to the regulation of the substantive law declaring the protection of right of lien, and in which it is stated that the vested rights acquired later concerning the real estate do not effect this security [CC sentence I, subs (2), Sect. 263].

Undoubtedly, both mentioned substantive law regulations allow for legal exceptions. However, these may be only really justified exceptions, as, concerning the order of satisfaction, e.g. the allowance or the costs of the execution are well founded.

Proposals for Solution

It is correct that in the course of the executory procedure, before the preparation of the distribution plan, the mortgage obligee - and other registered, or known though not registered obligees - shall be notified according to the regulations. The problem is how the mortgage obligee may join the course of the execution if he does not dispose of a non-appealable document. In this respect the requirements included in Resolution No. 46/1991. (IX. 10.) AB of the Constitutional Court shall be taken into consideration, without keeping these the procedure cannot be regulated constitutionally. According to the resolution of the Constitutional Court, generally executory procedure may only be started if the demand of the party requesting the execution has been adjudged by the court, and in the course of the procedure the debtor was informed about the claim against him, and he has had the adequate possibility for defending himself (Reasons, Chapter II).

However, the body also found a constitutional possibility e.g. for the distraining decree of the public notary to be an enforceable document, if the debtor can get to know this claim before the start of the execution and if he can resort to a legal remedy against the decree, on the basis of which legal remedy the court - adjudging his objection on the merits - may even change the public notary's decree (Reasons, para. 3-4, Chapter III).

Though the present AEx does not regulate this executory form, still, the possibility of the mortgage obligee to join into the procedure shall be sought in this direction, with the introduction of the court decision.

The existence of the mortgage and the lawfulness of the claim have to be clarified in the procedure.

The existence of the mortgage may, in principal, be certified securely by the real estate registration of public authenticity. However, we have to mention that up to date registration and an apparatus disposing of adequate legal expertise are necessary for this.

The justifiedness of the claim may be clarified in an abridged procedure in a way that the court (possibly the executory court, as the real estate probably lies in its area of competence) hears the debtor, the parti(es) demanding execution.

- If the debtor acknowledges the debt, then the involvement of the mortgage obligee's demand into the execution is without problems. If, in such a case, one of the obligees, e.g. one of the creditors, in the case of several mortgagees, objects to the existence of the claim - fearing that this would effect the satisfaction of his claim detrimentally - then another creditor presenting this objection is to be ordered to initiate a lawsuit.

- If the debtor does not acknowledge the claim, then the mortgage obligee is to be ordered to initiate a lawsuit.

It shall also be examined whether the bailment of one of the securities may be demanded for the objecting declaration of the debtor to become effective, as the obligee may lose the part of the difference between the contractual interest and the court bailment interest falling on the enforcement procedure. Furthermore, the seriousness of the declaration shall also be helped. The bailment of a security of the amount required by old Hungarian law (going for a two year period) may also be raised. It may be raised, as against this latter, that this claim reached the path of execution just because the debtor could not pay. Naturally the amount of the security shall not go near the amount of the debt.

It was also raised among the proposals, how it could be reached for the mortgage to continue to remain in the executory procedure initiated by another party, and thus for the debtor, who otherwise is regularly paying his debt, not to go bankrupt. It shall be remarked that in this matter we do not have a concrete proposal for solution.

b) The relation of other types of executory procedures, decisively the administrative procedure, with judicial execution.

According to the *AEx's* general rule on the scope of its authority, the AEx's prescriptions shall be used in the course of real estate executions effected in administrative executions as well, except if the law provides otherwise. And if the real estate was seized in both procedures, then the procedure shall be continued according to the rules of the AEx.

A real problem arises if only the administrative procedure has started, and the mortgaged real estate was seized only there, typically for the collection of tax arrears. In these cases, it would be reasonable to proceed similarly as we have signaled in the case of the judicial proceedings initiated by third persons.

Concerning the proposals phrased both in point a) and point b), we have to stress that further studies are necessary in order to make these consistent with the

AEx. In the course of this, the cognition of the relevant solutions of foreign execution laws would also be necessary, to select the appropriate regulation.

3. The Order of Satisfaction in the Course of the Judicial Execution

A problem of definition arose concerning whether if the claims or one of the claims figuring in a different satisfaction order or identical satisfaction order are or is secured by a mortgage, then shall the order of satisfaction change with regard to this - on the basis of subsection (2), Section 170 of the AEx.

The order of satisfaction is determined by AEx Section 165. Compared to this, Section 170 lists the claims secured by mortgages on the more favorable 4th place. From this we may conclude that claims, which otherwise have to be satisfied in the 4th place or later on, or presently on the 5th place or later on, if these are secured by a mortgage, shall be satisfied on the 4th place.

Subsection (2) of Section 170 determines what shall be the order of satisfaction if all of these claims are founded with mortgages. In this respect, the amendment takes as its basis the regulation of the mortgage law, that is the time sequence of the establishment of the mortgage [CC sentence II, subs. (2), Sect 263]. It does not take into consideration the character of the claim which founds the mortgage.

The regulation of the mortgage law ensuring a listing more close to the beginning does not effect, however, the claims which are listed anyway in one of the first three places. Respecting these first three claims, the mortgage law does not change their order, as the general rule of Section 170 - the provision of subsection (1) - only makes possible listing on the 4th place, before that no claim may be listed on this title. From the relation of the general rule and the part rule (the provision determining the exception) it follows that the part rule may only provide within the limits set by the general rule, with respect to the claim mentioned there, thus it may refer only to the order, among each other, of the claims listed on the 4th place.

Among claims which otherwise would be satisfied on the 5th place or after, naturally securing by mortgage shall be an influencing factor. This is so as the right of lien aims just at this, that the claims secured by a mortgage shall be priority claims among the claims listed in point f), Section 165 of the AEx.

Securing by mortgage, following from the above, does not effect the order of satisfaction of the claims selected on the first three places. This may also be justified with a concrete example: it is obviously not possible to amend the allowance obligation determined for several children so that they secure the allowance of one child with a mortgage if this would decrease the amount of the collateral for the allowance for the other children.

4. Other Problems Which Arose

a) A problem of interpretation arose concerning the inclusion of the mortgage contract and the borrowing agreement into a public document, concerning the designation of certain of its content elements. This question may be a theme for the working group dealing with this theme, we shall forward this to them.

b) With regard to the AEx regulation, proposals have arrived concerning the lawful period of the executory measures: concerning the lawful period of

- the mailing of the notice of payment for the expenses advanced, which is a precondition of the executory measures;
- the first executory action after the arrival of the expenses advanced, and
- the transfer of the purchasing price received from the successful sale.

The regulation of the lawful period of the demand for the payment of expenses advanced will expectedly be solved.

However, there is no hope for the more concrete regulation, as compared to the present one, of the first executory event after the receiving of payments advanced, because this may not be increased at the level of the law. Instead of this, the complaint shall be adjudged in the course of a supervision in the given executory procedure.

II
Ways of Satisfaction Outside the Judicial Executory Procedure

The ejectment of the owner inhabiting the flat involves problems which definitely make it justified to seek solutions outside of the judicial execution.

The Civil Code contains three cases for the extension of the assertion of the right of lien claim outside the administrative procedures - as an adaptation of the private sale figuring in Anglo-Saxon laws - , when the sale may take place outside the judicial execution.

Before the opening of the satisfaction law - thus before the default - the parties may agree in that the mortgage obligee himself may sell the pledged property (in our case the real estate), if he himself deals with mortgage lending on a business basis [CC subs. (2), Sect. 264]. According to a more narrow interpretation, this circle may only involve specialized credit institutions, while according to broader interpretation this may mean any credit institution which also grants credit with a mortgage collateral.

The new right of lien regulations of the Civil Code offer further possibilities in this direction. The mortgage obligee may also stipulate in the borrowing agreement that at the time of the opening of his mortgage claim (that is e.g. in the case of the cancellation of the borrowing agreement) he hands over the pledged real estate to a person (company) which deals with the organization of auctions or the granting of mortgage loans in a businesslike way [subs. (3), Sect. 264]. Therefore, even if the creditor does not satisfy either one of these two conditions, all administrative procedures may be evaded through the giving of a commission for sale.

The Civil Code mentions as a further possibility of sale by the obligee the cases where the pledged property has an officially quoted market price. The present practice of the real estate exchange, however, probably does not yet provide a sufficient base for this.

For the utilization of these authorizations, it is necessary to clarify the notion of the entrepreneur "dealing with the granting of mortgage loans in a businesslike way"; whether it is the narrower or the broader definition which is adequate. It depends on this whether the bank granting the mortgage loan may sell the real estate itself or by commission, and what type of company, in the latter case, it shall give commission to.

The utilization of the new right of lien regulations may have effect if it is possible to set up a system in which, at the time of the first payment arrears, transitory payment difficulties would be divided from lasting payment barriers. In the case of the latter, the debtor would be offered a flat which is burdened by a smaller loan, and thus by a smaller monthly amortization obligation. If the debtor can successfully be held within the limits of the housing loan system, he can be placed much more advantageously and his flat can be sold much more advantageously than through the utilization of judicial foreclosure and judicial execution. Such a system of placement is more humane, as it can offer several levels of solution for the debtor in arrears and in a difficult situation, and it maintains the possibility of keeping the family together, and the keeps up the precondition of the employment of the parents.

A rapid placement also prevents the accumulation of interest and thus the accumulation of debts debiting the real estate. This way it can also be prevented for the interest on default, during the long period of the court procedure for the assertion of the claim, to augment the amount of the debt to an extent where the part of the auction purchasing price remaining after the deduction of this amount will no longer be sufficient to purchase another flat.

However, the system outside of the official procedure can only work if, beside it, the clear system of regulations of the official procedure also exists, the utilization of which certainly gives the mortgage obligee the right that the real estate secured will be sold vacant within a relatively not too long period of time (this time, within the developed countries, is the shortest in the United States: 8 months on the average, while being the longest in France: one and a half years[1]). This period includes the complete assertion of the right procedure, from the default in payment to the auction.

Knowing that the official procedure is efficient, the debtor cannot hope that the mortgage obligee will not be able to assert his claim in the foreseeable future, or even that he may remain in the flat even after the auction. However, he may weigh which procedure will give him the least detrimental possibilities for further habitation. In case of an obvious difference, it can be expected that the debtor with long-term payment difficulties will choose the free market sale of the flat, giving a better perspective, and does not impede that by sticking to the possession of the flat[2].

With this, one of the impediments of granting a higher ratio of credit may also be overcome. Namely, presently OTP Bank only grants credit up to one third of the value of the real estate. Naturally, one of the causes of this was the previously rather

[1]Data from the housing loan return conference held in the Gellért Hotel in Budapest in December 1996.
[2]According to the practice of the Uniform Commercial Code of the United States as well, the pledgee acquiring the proprietary rights can only utilize sale outside of the judicial procedure successfully if it is "possible without the upsetting of the peace" (article 9-503; quoted by part IV, page 7, paragraph 1 of the studies prepared concerning the amendment of the right of lien regulations of the Civil Code).

high inflation. The decrease of the rate of inflation and its expectable controling, presently already expectable in the foreseeable future, raises the possibility of granting credit to a higher proportion. If, however, the period of the official procedure does not change, then, together with the interest on default, even in the case of the utilization of a transaction interest rate lower than 29%, the amount of the debt may increase excessively, and the collateral may be excessively used. And this danger moves the creditor to continue to keep the ratio of the crediting low. (In the developed countries this ratio generally reaches 90-100% of the value of the real estate.) Therefore, the studying of the operation of this system in the Netherlands, and the examination of the possibilities for its establishment seems justified.

Summarizing, we may state that the examination of the problems which arose concerning the foreclosure of mortgages was correct, and consequently we find it justified to initiate the amendment of the rules of law.

János Pesta, Ministry of Justice

Proposal of the Chamber of Executioners

In the followings the practical experiences of real estate prosecutions and our proposals to solve the problems that have occured are described.

My account of the problem begins with the enumeration of certain statistical data but it must be in advance stated that these data reflect but a small portion of the real situation due to the fact that prosecutors did not and do not have obligations to present these kinds of data.

To sum up, it has to be added that the data shown bellow indicate the minimum number of actual forced sales of real estates between 1995 and 1997. The details are as follows: independent court prosecutors (187 and 195 persons, respectively) effected 3499 succesful public real estate sales in the examined period and in 1736 cases the actual price reached one half of the put-up price. In 2328 cases the real estates under sale were occupied. In the course of these cases there were 12 evictions and in other cases, where the real estates were not sold, there were 1397 such cases. It can be inferred that in cases of public sale of occupied real estates evictions amounted to but a tiny proportion of all cases. The number of real estates that were sold well bellow their market price due to the fact that they were occupied was significantly higher. Right of usufruction on the real estate has the same price-reducing effect, too.This is especially unfavourable for the creditor if the bearer of the right of usufruction is the same person as the debtor. Two factors are of major importance with regard to the more efficient managing of real estate prosecutions and public sales. Factor 1: the widest possibly publicity. It may be achieved through diversifying the methods of publishing public sales. A decisive step in accomplishing this objective was taken by the Executive Chamber of Hungarian Courts when it established the paper called Public Sales News which has a weekly circulation of several thousands. Factor 2: proper legal background that gives guarantees to the creditor and the purchaser of the real estate as well as to the debtor.

The present regulation is far too lose. It does not provide the participants of the process with a clear-cut concept of occupation and with precise methods of appropration of the real estate occupied by the debtor. Thus, it excludes a major portion of potential purchasers from the public sales of real estates. Very few well-meaning people are determined to take part in a public sale under such circumstances.
The present regulation, thus, gives too much space for speculations which have an unfavourable influence upon both the prosecutor and the interested parties.
The Chamber proposes to resolve the situation by the following legal regulations.
The paragraph no. 137 of the Law No. LIII of 1994 becomes with the same content Article (1) and we propose to add the following attachment as Article (2):
"Article (2): the right of usufruction is lost in case its bearer is responsible as debtor or with the same rank for the claim that is being prosecuted."

The content of Paragraph No. 143 remains unchanged as Article (1). We propose the following attachement to be added as Article (2):
"Article (2): the real estate may be regarded as being occupied if
a) it is occupied by a person or organisation with a valid lease contract;
b) it is occupied by the usufructor;

c) it is occupied by a non-debtor co-owner, in cases of undivided jointly owned real estates.
(3) A real estate occupied by the debtor or his/her family cannot be regarded as being occupied."
Paragraph No. 154 is amended with the following Article (4):
a) The debtor and his/her family is obliged to leave the real estate within 30 days following the public sale of the real estate, by evacuating it from all his/her belongings and thus to secure that the prosecutor can handle over the real estate to the purchaser.

I.

b) In case the debtor does not comply with this rule, the prosecutor takes the measures indicated in article (3) of Paragraph No. 183.

II.

b) At the request of the purchaser the prosecutor submits the case to the court. The court takes the measures indicated in Paragraph No. 183.

In case the regulations outlined above were put to effect, legal security would be universal with respect to the debtor, the creditor and the purchaser as well, since guarantial regulations would eliminate all the uncertainties encountered at public sales so far. The advantages would consist in the followings:

1. Considering the fact that the purchaser would be guaranteed that he/she can actually have the real estate, the regulations outlined above would yield the highest possible price at the public sales, exceeding even market prices, because in these cases the purchaser can buy the real estate with nearly 100% security.
2. The creditor would enjoy great safety with regard to the meeting of his claims due to these regulations and his/her cautious crediting policy.
3. Due to the higher prices, the debtor would receive the highest possible price for his property and could thus establish the bases of his/her living.
4. Furthermore, these provisions would put an end to all talks about the possible links between the "housing maffia" and the justice system.
5. Legal security would become universal.

Zoltán Levente, Presidential Secretary of the Chamber of Executioners

SECTION II.

MORTGAGE LENDING AND PUBLIC DOCUMENTS

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

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

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

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

Then the Civil Code rules on liens were amended.

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

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

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

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

1. Advantages

1.1. Evidence

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

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

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

1.1.1 The document is an evidence of the circumstance that the parties were not in legal mistake in the course of concluding the contract.

The notary public who is independent and impartial by the law should inform the parties on their rights and liabilities relating to the contract. The notary reads out and explains the document in the presence of the party and then he should get assured on its approval by the party. Therefore, in the course of a legal dispute nobody can assert that he was in legal mistake in concluding the contract.

1.1.2 The document is an evidence that the parties involved in the contract were in possession of competence and authorisation for contracting.

The notary is liable to get assurance on the personal identity of the parties, on the competence and authorisation for contracting, on the veritable intent of the parties and should certify all these in an authentic document.

1.2 Direct execution power

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

1.3 Responsibility of the notary public

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

2. Disadvantages

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

2.1 Feeling of distrust

In the course of providing a loan the bank places out other persons' money (depositors, shareholders) and is obliged to ensure the reimbursement of the loan in all possible and necessary means. One of these sureties can be that the bank relies on the power of the executable notarial document. As the executives of the bank risk not their own but other people's money, in such a business transaction the emotional questions like the feeling of distrust can not play any role. Scrutinising the procedure from other side, the involvement of a guarantor does not reflect higher or lower degree of distrust than the relying on the tool of a notarial document.

2.2 Complicated procedure

2.2.1 If the loan contract is written in the notarial document

Unitas actus

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

Place of compiling the document

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

Checking the personal identity, the ability and authorisation for transaction

In the course of the procedure, the notary public should check whether the parties appearing are in possession of the preconditions indicated in the title. This means that he can not be satisfied on the declaration in this sense by the parties themselves, but he should get assured on the existence of preconditions.

In case of natural entities this only involves the presentation of the personal identification card or another official document having a signature and photograph in it.

If the client is a legal personality, the contract will be signed by its representative. In such a case the task of the notary public extends – in addition to the investigation of the personal identity of the representative – to the checking of the existence of the legal personality client, its identifier data and the manner of representation.

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

From the aspect of executable power, it is very important that it should become unequivocally clear from the text of the contract that the subject of the legal transaction is not the representative but the economic association or other organisation represented by him. Frequently, it is necessary to determine on the base of the deed of association whether the economic association has not

delimited the authorisation of the representative, is not a special approval by the members' assembly (or a resolution by the general assembly) is required.

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

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

2.1.2 If the debtor acknowledges his debt in the presence if the notary:

The above outlined circumstances that are adverse for the bank staff (loss of time, difficulties of authentication of authorisation) do not prevail if the bank makes the disbursement of the loan dependent on signing a debt acknowledgement committed to notarial deed.

In this case only the debtor's side should be present at the notary public. The notary should commit to notarial deed all those conditions of the contract that are relevant from the aspect of implementation and in such a solution the charge of the notary will be 50% less as compared to the bilateral contract.

2.2 Charges

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

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

In addition to the charge according to the transaction value and the lump sum covering the cost related with the former, the notary charges also his cash

expenses, which are regulated – instead of the transaction value – according to the actually implied expenditures (typing fee by pages, attestation by the number of pages attested, telephone, fax and travel expenses whenever and in which extent these are necessary).

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

2.3 Examples of calculating the charges

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

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

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

List of charges:

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

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

List of charges:

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

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

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

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

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

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

2.3.6 Is the notarial fee too high or too low?

The examples given above appropriately represent the extent of the notarial work fee, its ratio to the transaction value and its degressive grading.

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

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

3. Proposals for the solution

3.1 Price-to-value ratio

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

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

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

3.2 Security contracts

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

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

3.3 Other problems

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

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

Two characteristic examples concerning this issue:

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

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

"Based on a lien contract, the obligee ensures the right for him-/herself that in the case where the obligor fails to perform, the obligee can seek satisfaction from the collateral that secures the claim. It is possible that a third person pledges an item of property as a collateral to the debt of another person. In that case, this latter person - the obligor of the debt - is the personal obligor, and the third person is the obligor in rem.
When the personal obligor and the obligor in rem are different persons, then the obligee may chose which one to turn against. The obligee may seek satisfaction from the item of property that secures his/her claim, when the obligor fails to perform (Art. 251 of the Civil Code). Therefore the right of satisfaction will open upon maturity date and not upon non-performance on the debt.
The court of first instance had misinterpreted Art. 136 (1) of the Execution Act when they had drawn the conclusion from it that no execution can occur over the real property of the mortgagor.

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

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

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

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

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

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

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

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

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

"According to the certified copy of the public document containing the obligation undertaken, the obligor has recognized his/her outstanding debt, therefore his/her obligation was not subject to the existence of any other conditions or point in time. The fact that the obligor should have met his/her payment obligation before December 31, 1995 is a circumstance that does not need any special evidence by a separate public document.
The deadline for performance defined in the public document, or the fact that the deadline has passed is enough that enforceability can be established, since the person requesting execution stated that the obligor had failed to perform."

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

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

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

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

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

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

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

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

4. Examples from abroad

4.1 Austria

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

Attributable to the differences in subtantive law, the Austrian bank remits an offer to the client and the client approves the offer. The loan transaction is implemented by the disbursement of the amount of loan. Of the sureties (thanks to the bomb-proof cadastral registry) most frequently the mortgage on real estate is applied. In such cases the Austrian bank makes the disbursement of the loan on the registration of the mortgage. Its method of implementation is that the bank transfers the amount of the loan, parallel with remitting the offer to the "other people's account" of the notary public (custody in trust), then the bank provides a commission to the notary to compile the approving declaration of

the debtor, to have the mortgage right registered and after its completion, to disburse the amount of loan to the debtor. In case of paying the amount contrary to the commission received, the responsibility is imposed upon the notary, even to the full amount of the loan. The fee due to the notary public is determined according to the transaction value, in a degressive manner, similar to the Hungarian regulation.

4.2 France

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

4.3 Poland

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

4.4 Italy

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

5. Summary

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

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

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

Dr. Gabriella Molnár, Senior Legal Expert of OTP Bank

Dr. Judit Bókay, Member of the Chamber of Public Notaries

SECTION III.

Administration of Qualified Residential Housing Loans at Kereskedelmi és Hitelbank

Measures taken by the Bank before terminating the loan contract

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

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

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

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

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

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

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

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

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

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

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

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

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

- suspension of payment amortisation;
- prolongation;
- realization of the automobile;
- realization of the automobile combined with a loan granted for purchasing a less expensive automobile (or change of the automobile with the continuation of the original loan).

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

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

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

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

Balázs Horváth, Kereskedelmi és Hitelbank Rt.

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

The Vértes Savings Cooperative currently holds 518 loans for housing construction or purchase. Of them 60 are regarded as default or bad loans. In 7 of the 60 a legal procedure has been initiated.
A borrower is in default if the monthly amortization payment is not paid until the deadline day in the month.
In this case the computer loans registration system prints out an invoice letter that is mailed by the branch office that has issued the loan.
In case the payment is still not made a repeated letter is mailed in the next month (i.e. on the 30th day following the first letter) in which the client is warned that if payments are not made the loan will be managed centrally.
If the second warning has no effect, the branch office defers the loan file to the center and central collection procedures starts.
As a first step, the center requests the client to pay the arrears in one sum. It this request is not met, both the borrower and guarantors are called to a personal meeting in the center.

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

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

József Strén, President of Vértes Saving Cooperative

Measures Taken by the OTP Bank before Terminating the Loan Contract

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

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

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

General procedure for housing loans

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

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

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

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

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

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

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

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

delinquency, and therefore another solicitation letter demanding payment should be sent.

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

The modification agreement made with the obligors should be committed to writing, and monitored continuously for performance. Any collateral specified in the contract should be checked for existence, and the income to support payment should also be verified along with whether the requirements regarding any other security is met.

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

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

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

Special procedures for individual loan types

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

Term extension can also be agreed to under contract modification.

For deferred payment loans, the bank will agree to forbearance and term extension in exceptional cases only, and the main reason for that lies in the resulting substantial increases in payment obligations.

b) Credits with new conditions - with payment subsidy.

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

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

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

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

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

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

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

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

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

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

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

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