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## REREGULATED NON-ACCESSORY LIEN IN THE HUNGARIAN CIVIL CODE

### 1. The problem

Lien is an accessory collateral in rem in most jurisdictions of Europe. However, some jurisdictions also recognise the non-accessory form of lien. The different forms of non-accessory lien have developed in German law (*Grundschuld*) and in Swiss law (*Schuldbrief*). Closely linked to these, Hungarian private law before World War II already recognised and regulated non-accessory mortgage (land charge/*telekadósság*).<sup>2</sup>

The arguments for recognising the non-accessory form of mortgage are basically economic in nature: the legislative measures taken to mitigate the impacts of the lending crisis were an important means to recover from the post-World War I economic collapse. Many regulations created in the 1920s were designed to enable simpler and cheaper access to credit. Among these laws, Act XXXV of 1927 on Mortgages (hereinafter “Mortgage Act”) stands out. The Mortgage Act regulated the non-accessory form of mortgage, including land charge. The introduction of the land charge (*telekadósság*) was also motivated by legislators’ intention to improve the conditions of access to credit.<sup>3</sup>

Following the political changeover, Hungarian legislators were inspired by similar economic policy considerations. 1996 brought sweeping amendments to Civil Code provisions on lien so as to align them to the conditions of the market economy. The institution of non-accessory lien – known as independent lien – re-appeared in Hungarian law. In the next 15 years, independent lien would become deeply nested in Hungarian private law and fulfilled an important role in the functioning of the domestic market of bank refinancing.<sup>4</sup>

However, various considerations raised during the drafting of the new Hungarian Civil Code, particularly based on dogmatic law, led to a decision that the institution of independent lien should cease to exist. Accordingly, Act V of 2013 on the Civil Code (hereinafter “Civil Code”), which entered into force on 15 of March 2014, only regulated the accessory form of mortgage. In other words, the Civil Code determined the concept of lien as a right to accessory

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2 For more details see Balázs BODZÁSI: *Entwicklung der Regelungen zum ungarischen Pfandrecht unter besonderer Berücksichtigung des nicht akzessorischen Pfandrechts*. Zeitschrift für Europäisches Privatrecht, 1/2016. 225–230. pp.

3 BODZÁSI, *op. cit.* 218–219. pp.

4 For more details see BODZÁSI, *op. cit.* 230–237. pp.

value in rem. Another important change affecting collaterals in rem was the declaration of prohibition against the use of fiduciary collaterals (Section 6:99 of the Civil Code).<sup>5</sup>

Importantly, the revised regulatory concept of the Civil Code referring to collaterals in rem, including lien, seems to make sense from the perspective of dogmatic law. While the basic design of mortgage provisions attracted much criticism, regulation enshrined in the Civil Code admittedly followed coherent logic.

However, the main problem was that the Civil Code was adopted in period after 2008 when the Hungarian economy was still struggling with the negative impacts of the ever-deepening financial and lending crisis. In particular, small and medium-sized enterprises found it increasingly difficult to obtain bank loans but, in general, the entire Hungarian economy was hit by the credit crunch and a sharp decline in domestic financial sector lending. It was against this economic and financial background that the Civil Code took effect and did away with formerly well-established legal institutions in domestic corporate lending (such as fiduciary collaterals, independent lien and lien on property). It is now clear that such a drastic transformation of regulation under private law has not made the situation of domestic businesses and their access to credit any easier.

Abolishing non-accessory or independent lien was not one of the most important problems. The drafters of the Civil Code were aware that a sudden shift to using classic accessory mortgage as a result of abolishing independent lien would cause dysfunctions in the issuance of domestic mortgage backed securities and the closely related bank refinancing market. That had to do with the fact that these branches of the financial sector had been relying on non-accessory – or independent – lien for nearly fifteen years. Therefore, the Civil Code created a special form of lien known as “separated lien”.

The main feature of separated lien lied in its allowing the lienor to transfer accessory mortgage on one occasion. Thereby, accessory lien could be separated from the original secured claim once. The economic purpose of the separation was to enable the same accessory lien to secure another claim concurrently. This other claim burdened the original lienor as opposed to the new lienor acquiring the mortgage as separated lien. However, the new lienor did not enter into a direct relationship with the lienee. In addition, this arrangement had several shortcomings. Separated lien of an accessory nature could not, therefore, fulfil the same role that was formerly fulfilled by independent lien. The use of separated lien caused uncertainty in the Hungarian financial sector and therefore in 2015 the need to reregulate independent lien arose. That need ultimately led to the amendment of the Civil Code in 2016.<sup>6</sup>

With regard to the 2016 amendment of the Civil Code and the reregulation of independent lien, it is important to look at recent years’ trends prevailing in the Hungarian economy in general and in the financial mediation sector in particular. Basically, only in the light of these economic developments can we make sense of the amendment of the Civil Code.

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5 The original normative text of Section 6:99 of the Civil Code (in effect until 01 July 2016) read as follows: “Any clause on the transfer of ownership, other right or claim for the purpose of security of a pecuniary claim, or on the right to purchase, with the exception of the collateral arrangements provided for in the directive on financial collateral arrangements, shall be null and void.” About the so-called fiduciary securities and about their prohibition see more in detail at Balázs BODZÁSI: *A fiduciárius hitelbiztosítékok tilalma*. In: Balázs BODZÁSI (ed.) *Hitelbiztosítékok*. HVG-ORAC, Budapest, 2016. 37–44. pp.

6 For arguments against the re-regulation of the independent lien, see Péter GÁRDOS: *Észrevételek a Ptk. tervezett módosításának egyes zálogjogi és kötelmi jogi rendelkezéseihez*. *Polgári Jog* 5/2016. (online journal)

## 2. The Hungarian economy and banking sector after 2008

We should start our analysis by stating that the Hungarian economy and financial system have remained bank-centred (or, rather, financial institution-centred) to date. Capital markets play second fiddle in financing Hungarian businesses. Therefore, the lending activity of the financial institution system is pivotal to the development and growth of the Hungarian economy.<sup>7</sup> In particular, lending to small and medium sized enterprises (known as the SME sector) is critical. Dysfunctions in the financial mediation system are to a great extent manifested in shrinking domestic corporate lending, which hurts the SME sector first of all.

Bank lending practically collapsed in Hungary after 2008. This meant that corporate and retail lending equally faced several years of depression. Private sector borrowing continued to decrease even in 2013.<sup>8</sup> The credit crunch resulted in declining investments, with many companies forced to delay capital expenditure project due to lack of credit. National Bank of Hungary (hereinafter “NBH”) figures suggest that all this stymied Hungary’s economic growth by 1% on average.<sup>9</sup>

Tightening lending restrictions did not, however, affect the Hungarian corporate sector to the same degree. Large – overwhelmingly foreign-owned – companies had easier access to loans provided by foreign banks or their own foreign owners. By contrast, Hungarian-owned enterprises having to rely on domestic bank financing were far more adversely affected by the credit crunch often making their operations impossible.<sup>10</sup>

Large domestic enterprises increasingly sought foreign loans and domestic borrowing by this sector significantly decreased. At present, large undertakings borrow either from foreign banks or from their own foreign parent companies, and hardly if at all from domestic banks. As a result, the total volume of Hungarian corporate borrowing from domestic banks had fallen to EUR 19 billion by the end of July 2016 (the low point last recorded in 2005).<sup>11</sup>

At the same time, the overall debt of domestic companies did not decrease. Hungarian companies merely shifted from domestic bank loans to increasingly – and to a significant degree – borrowing from foreign banks or their own foreign parents. According to NBH figures, the total volume of Hungarian corporate debt amounted to EUR 93 billion in March 2016. In other words, the share of domestic bank loans in corporate borrowing shrunk to 20%. Having said that, corporate borrowing from other (overwhelmingly foreign-owned) companies now total EUR 27 billion, while the volume of Hungarian companies’ foreign bank debt reached EUR 39 billion.<sup>12</sup> Accordingly, over 40% of domestic corporate debt is now made up by foreign bank loans. In total, the share of foreign debt in overall Hungarian corporate borrowing has grown to 65%. As a consequence, the balance sheet structure of the Hungarian banking sector has changed drastically since 2008.

7 Ádám BALOG – György MATOLCSY – Márton NAGY – Balázs VONNÁK: *Credit crunch Magyarországon 2009-2013 között: egy hiteltelen korszak vége?* [*Credit crunch in Hungary between 2009 and 2013 – End of an Era without Credit?*] *Hitelintézeti Szemle*, 4/2014. 4. p., 15. p.

8 BALOG – MATOLCSY – NAGY – VONNÁK: *op. cit.* 15–16. p.

9 BALOG – MATOLCSY – NAGY – VONNÁK: *op. cit.* 16. p.

10 BALOG – MATOLCSY – NAGY – VONNÁK: *op. cit.* 19., 22. p.

11 <http://www.vg.hu/penzugy/hitel/tobb-kolcsont-vesznek-fel-a-cegek-kulfoldrol-mint-magyarorszagrol-475012> (7 September 2016)

12 <http://www.vg.hu/penzugy/hitel/tobb-kolcsont-vesznek-fel-a-cegek-kulfoldrol-mint-magyarorszagrol-475012> (7 September 2016)

Concurrently, the amount of EUR-denominated loans taken out by Hungarian enterprises grew to some extent. NBH figures suggest Hungarian companies borrowed EUR 1.4 billion in EUR-denominated loans between January and August of 2016, representing a year on year increase of 14%.<sup>13</sup> Foreign currency-denominated loans are primarily extended to large enterprises and mostly by foreign banks. The amount of foreign currency-denominated loans provided by foreign banks far outweighs those provided by domestic banks.<sup>14</sup>

This picture becomes somewhat more refined when we look at small or medium-sized enterprises without considering large undertakings. That is because the share of loans offered by foreign banks to SMEs is significantly smaller, even if the volume of foreign currency-denominated borrowing by the SME sector has increased in the recent period. However, in the first half of 2016 the aggregate value of SME debt decreased by about 4%. In July 2016, total SME borrowing stood at EUR 11.6 billion, reflecting a decrease of EUR 300 million since March 2016.<sup>15</sup> As a consequence, the lending gap has widened between large undertakings and SMEs.<sup>16</sup>

As opposed to corporate lending, the decrease in retail (consumer) lending halted in the meantime and growth in foreign currency-denominated retail borrowing, especially the volume of mortgage loans<sup>17</sup>, picked up again following the conversion of foreign currency-denominated consumer loans into HUF<sup>18</sup>. This indicates a growing housing loan portfolio primarily driven, for the time being, by significantly increased demand for used housing. The main reason for this is low interest rates bound to stimulate further significant volume growth in housing loans.

The low interest rate environment is an unprecedented challenge for the Hungarian banking system. The Hungarian banking sector incurs a loss of EUR 65-100 million annually due to low interest rates alone. The low interest rate environment rendered the former business model untenable, as it depended heavily on net interest income (which poses a very serious problem to the savings cooperative sector in particular).

Low interest rates are also a serious headache for clients seeking lucrative investment opportunities. Even so, retail savings rose by 25% in 2015.

As regards bank lending, the concurrent steady decline of amounts deposited by commercial banks with the National Bank of Hungary is another overarching factor. However, the government security portfolio increases simultaneously.

Also linked to low interest rates are banks' diminishing short-term external resources well-illustrated by changes in the loan-to-deposit ratio showing a falling trend from 160% in recent years to 85% 2016. The situation is even worse in the savings' cooperative sector, which plays

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13 <http://www.vg.hu/penzugy/hitel/viszik-az-eurohitelt-476200> (4 October 2016)

14 <http://www.vg.hu/penzugy/hitel/viszik-az-eurohitelt-476200> (4 October 2016)

15 <http://www.vg.hu/penzugy/hitel/tobb-kolcsont-vesznek-fel-a-cegek-kulfoldrol-mint-magyarorszagrol-475012> (7 September 2016)

16 For more details see: MNB Hitelezési folyamatok [National Bank of Hungary Lending Processes], May 2016 – <http://www.NBH.hu/letoltes/hitelezesi-folyamatok-2016-majus-hu.pdf> (11 August 2016)

17 Act LXXVII of Act LXXVII of 2014 on the settlement of matters relating to the currency conversion of certain consumer loan agreements and to interest rate rules set forth the provisions about the conversion of foreign currency-denominated consumer loans to HUF.

18 [http://www.portfolio.hu/finanszirozasi/hitel/uj\\_orulet\\_magyarorszagon\\_mindenki\\_szemelyi\\_kolcsont\\_akar.235426.html](http://www.portfolio.hu/finanszirozasi/hitel/uj_orulet_magyarorszagon_mindenki_szemelyi_kolcsont_akar.235426.html) (July 29 2016)

a key role in agricultural lending, where the same ratio is barely 40%.<sup>19</sup> This is a very low level clearly pointing to the need to increase lending, which, however, cannot be financed from ever-decreasing bank deposits. Therefore, financial institutions must seek long-term resources (including, for example, mortgage bonds).

Bear in mind that the continued tightening of domestic and EU banking supervision rules forces banks to exercise increasing prudence in their operations. An indication of that is banks' obligation to reach a capital adequacy ratio of 16% in the future. In addition, the rules of consumer lending have also become stricter.<sup>20</sup>

As a result, the Hungarian banking system has been facing several challenges in recent years. In addition to having to adjust to low interest rates mentioned above, the growing volume of non-performing loans presents an increasingly serious issue. These bad loans should be purged from banks' balance sheets as soon as possible, along with concurrently improving domestic banks' profitability.

The amendment of the Civil Code in respect of lien has been most influenced by economic policies designed to stimulate the mortgage bond market. It was to this end that the National Bank of Hungary issued Decree No. 20/2015 (VI. 29) on the forint maturity match of credit institutions. Consistent with this is the fact that in 2016 three new actors appeared in the domestic mortgage banking market.<sup>21</sup>

### 3. Circumstances determining the reregulation of independent lien

Two important items of legislation need to be highlighted separately in connection with the reregulation of independent lien:

- Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (hereinafter “CRR Regulation”); and
- Decree No. 20/2015 (VI. 29) by the National Bank of Hungary on the forint maturity match of credit institutions.

In relation to minimising exposure resulting from mortgage lending, Article 402 (3) of the CRR Regulation directly applicable in EU member states specifies non-accessory independent mortgage liens. This fact alone encouraged Hungarian legislators to reregulate independent lien.

However, an even more compelling argument was the uncertainty arising under the CRR Regulation as regards the assessment of separated lien, created by the Civil Code, since it was unclear whether or not domestic mortgage lenders could invoke the CRR Regulation's clause on exemptions from “limits to large exposures”<sup>22</sup> in applying separated lien. Invoking the exemption clause of the CRR Regulation for the purposes of providing mortgage loans to financial institutions they refinance secures an important competitive advantage for mortgage banks. The CRR Regulation does not recognise the concept and institution of separated lien,

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19 Source: National Bank of Hungary

20 Act LXXVIII of 2014 amending Act CLXII of 2009 on consumer loans and certain related Acts

21 <http://www.vg.hu/penzugy/harom-jelzalogbank-johet-455693> (August 16 2015)

22 Based on this, the exposure of an institution falling under the CRR Regulation to another institution must not exceed 25% of its eligible capital.

which used to be an accessory mortgage arrangement. Accordingly, mortgage banks applying separated lien in their refinancing activities were running the risk of violating the “limits to large exposures”.

The need to introduce the other item of legislation, namely Decree No. 20/2015. (VI. 29.) by the National Bank of Hungary, arose after the compulsory conversion of long-term foreign currency-denominated consumer mortgage loans into HUF<sup>23</sup>, which resulted in the Hungarian banking sector’s need to secure stable long-term HUF resources. Since the term to maturity of the overwhelming majority of consumer mortgage loans converted to HUF was over 10 years, a maturity mismatch between mortgage loans and deposits gave rise to a systemic risk, due to deposit-financed lending. That was because banks had no other choice after HUF conversion than to finance their existing mortgage exposures from deposits placed with them. The National Bank of Hungary intended to manage the resulting liquidity risk by requiring banks to secure stable funding in HUF.

Decree 20/2015. (VI. 29.) provides that banks are required to secure stable HUF resources up to 15% relative to their total mortgage exposures. They are also obliged by the Decree to comply with this requirement in respect of existing mortgage loans. Thereby, the Decree prescribes the duty to engage adequately stable resources to cover the financing of long-term retail mortgage loans.

The NBH Decree seeks to strengthen the Hungarian banking system by ordering banks to cover long-term assets with long-term liabilities. Reducing the mismatch between maturities in this manner encourages banks to finance their exposures by issuing mortgage bonds or from refinancing loans secured by mortgage bonds rather than from deposits as the former two are recognised as long-term liabilities. That is because criteria laid down in the Decree are at present only met by mortgage bonds and refinancing resources obtained from mortgage banks. All this can also reduce the costs of domestic credit institutions since the interest on mortgage bonds and refinancing loans tend to be lower than the costs of funds used at present. Thereby, price competition in the mortgage loan market can intensify, which can in turn improve the availability of funds and increase lending volumes.

Since separated lien was not an adequate form of security in relation to the transactions the NBH Decree identified as desirable, the need to reregulate independent lien appeared.

## 4. Reregulated independent lien

### 4.1. *The concept of independent lien*

The reregulation of independent lien aimed to facilitate the implementation of economic policy objectives outlined above. This step is enshrined in Section 11 of Act LXXVII of 2016 on amending Act V of 2013 of the Civil Code (hereinafter “CCAA”), which took effect on 01 October 2016. The new legal definition reads as follows: “*Mortgage may also be established on real property for the benefit of a financial institution in such a manner that it encumbers the mortgaged item independently of the claim secured, up to a certain amount (independent lien).*”

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23 Mandatory conversion to HUF was laid down by Act LXXVII of Act LXXVII of 2014 on the settlement of matters relating to the currency conversion of certain consumer loan agreements and to interest rate rules.

Clearly, the reregulated concept of independent lien differs substantially from that referred to with the same term in the former Civil Code. An important difference lies in the limitation of the range of lien holders to financial institutions as lienors. Independent lien can only be established in favour of and transferred to a financial institution.

There is no such restriction on the lienee's side, i.e. any entity can be a lienee under an independent lien. Accordingly, consumers can also be lienees in respect of independent lien.

Another important change compared to the provisions of the former Civil Code is that independent lien can only be established or created in the form of mortgage on real property. That is so because the legislator claims that the land registry is the only existing vehicle that provides the level of security critical to protecting the lienee as owner. Apart from that, economic actors do not need options to establish other types of lien in non-accessory form in addition to mortgage on real property. Hence, except for mortgage on real property, all other types of encumbrance (pledges, bailments or chattel mortgage) can be established exclusively as accessory lien.

After reregulation, independent lien contains an important conceptual element, notably the fact that it encumbers the hypothecated asset (real property) independently of the secured claim. This is to make it clear that even if a secured claim exists in the case of an independent lien its legal fate is independent of the legal fate of the independent lien.<sup>24</sup> Independence in this respect is tantamount to the absence of statutory accessoriness and its attendant legal consequences. In other words, by virtue of this independence allows, independent lien can, in principle, be created and transferred without a secured claim and may even survive the termination of the claim. From a legal aspect, the reregulated form of independent lien, also known as "security-oriented" independent lien (independent lien tied to a security purpose) also remains independent of the secured claim. From a financial aspect, the situation is naturally different as in practice independent lien is also linked to a secured claim. In a financial sense, independent lien without a secured claim, known as isolated independent lien, is therefore irrelevant.

With independent lien, independence also means that the legal grounds or legal relationship underlying the secured claim need not be specified either in the mortgage contract or in the real estate register. Consequently, legal independence also means being independent of legal title. This, among other things, is an important feature of independent lien from the perspective of securitisation. That is because in the event of securitisation, not having to specify the legal grounds or legal relationship underlying the securitised claim when entering independent lien in the real estate register is a great advantage, which can further increase the financial significance of independent lien in the future.

#### 4.2. *The requirement to define an amount*

Subject to Section 5:100 (1) of the Civil Code, independent lien encumbers the liened item up to a certain amount (independent lien). The lienor is only entitled to satisfaction from the liened item up to this specific amount.

<sup>24</sup> The main characteristic of the independent lien is its independence from the secured claim. See Péter GÁRDOS – Lajos VÉKÁS (eds.): *Kommentár a Polgári Törvénykönyvről szóló 2013. évi V. törvényhez, Ptk. 5:100. §, 2. Önálló zálogjog. A szabályozás célja, módszere* (online version – manuscript closed on 17 November 2016).

Therefore, the question arises as to the exact meaning of the term “certain amount”. The point of the question is first of all whether this certain is interpreted to include charges, or whether it only means a certain amount of principal in addition to which the lienor may also claim interest and other charges?

In our view, “certain amount” refers to a framework amount that includes both principal and related charges (interest and enforcement expenses). It is, therefore, similar in nature to the framework amount referred to in Section 5:98 (3) of the Civil Code up to which (accessory) lien secures the principal and related charges. With accessory mortgage, this framework amount applies to the secured claim and its charges.

Thus, interpreting “certain amount” as a framework amount means that the lienor can exercise its right to satisfaction up to that amount. This interpretation also governs cases where the amount of the secured claim (in the wording of the Civil Code: *the claim as per the security agreement or the claim which may be satisfied from the lienied item as per the security agreement*) (and its charges) might exceed this amount. Consequently, the lienor may not claim more from the lienee even if the amount as per the security agreement (and its charges) exceeds a certain (framework) amount, which is also entered in the real estate register.

When determining the amount in the mortgage contract, or on the basis thereof, in the real estate register, it is of course possible for this amount to cover not only the principal but also its charges. That would, however, oblige the lienor as lender to calculate the amount up to which satisfaction can be sought from the lienied item in advance for the entire duration of the loan. This amount can be determined in several ways. It is, however, a requirement that calculation of the secured debt and its charges, if any, taken together should produce an amount that may be entered in the real estate register. Independent lien only ensures coverage up to the registered amount.

As a consequence of all of the above the entry in the real estate register will be different for independent lien than for accessory lien. When entering independent lien in the real estate register, the wording “HUF X in principal + Y% interest” may not be used and only the term “definite amount of HUF X” may be used, given that the definite amount also includes interest.

In respect of exercise by the lienor of its right to satisfaction, the lienor setting and entering in the real estate register a higher amount than the actual claim does not harm the lienee’s interests. That is often the case with accessory mortgage as well. That is so because the lienee’s liability is limited to the amount of the actual debt. It follows from the above, that the lienee may only be demanded to pay under independent lien the higher of the actual amount of debt and the amount specified in the real estate register (and in the mortgage contract).

If, by creating independent lien, the legislator wished to allow the lienor to obtain satisfaction from the lienied item beyond the amount entered in the real estate register and also use it to cover related charges, the Civil Code should contain a separate provision to that effect. Although Section 5:100 (1) of the Civil Code refers to an “amount” (*certain amount*), rather than a “framework amount”, the text of the Decree should still mention specifically the option to use the lienied item as lienee’s liability out of which interest and other charges may also be covered.

The Mortgage Act also adopted the latter solution by expressly stipulating that interest and other ancillary services may also be entered in the land registry in addition to the principal amount of the land charge. Any interest payable on the land charge was subject to the rules applicable to interest on the mortgage debt [Section 82 (2)-(3) of the Mortgage Act].



Forward to Section 269 (1) of the former Civil Code the liened item could also be used to cover charges. That followed from a provision that allowed mortgaging the liened item without a personal claim. When that occurred, the lienor was entitled to seek satisfaction from nothing else but the liened item *up to the amount specified in the mortgage contract and the related charges*.

The German BGB, too, includes interest and other charges within the scope of coverage ensured by *Grundschuld*.<sup>25</sup> Thus, the BGB allows the parties to obtain satisfaction from the liened item (real estate) against interest and other ancillary services on an alternative basis.

Based on the foregoing, if the Hungarian legislator held that coverage provided by independent lien should extend to interest and other charges in addition to the amount entered in the real estate register, then a provision to that effect would have to be explicitly stated in the text of the codification. In our opinion the most practical solution would be for the Civil Code to grant this option to the parties as an alternative. By doing so, the parties could freely decide whether they consider the amount specified in the mortgage contract designed to establish independent lien (and accordingly in the real estate register) as a framework amount or as an amount that designates the principal only, given that the liened item may also be used to cover any related charges. Pursuant to the Civil Code, this option is already available to the parties in the case of accessory lien.

However, the wording of Section 5:100 of the Civil Code, which entered into effect on 01 October 2016, suggests that the “*certain amount*” should be interpreted as a quasi-framework amount, in excess of which independent lien does not cover any further claims.

### 4.3. Mortgage contract in the case of independent lien

#### 4.3.1. A mortgage contract is a necessary condition of establishing lien

Forward to the reference included the provision of in Section 5:100 (10) of the Civil Code, independent lien is subject to the provisions applicable to lien securing a claim as appropriate, unless otherwise concluded from the independence from the secured claim. Accordingly, to establish independent lien, one also needs a mortgage contract.

Pursuant to the Civil Code, there are, therefore, two conditions for establishing lien:

- the parties must enter into a mortgage contract, and
- they must ensure the publicity of the lien, i.e. a legal act ensuring publicity must take place (for lien it involves entering the lien in the appropriate register and for pledges it means transferring the pledged item into possession).

Based on the foregoing, there are also two conditions to be fulfilled for establishing independent lien: the parties must enter into a mortgage contract and the lien must be recorded in the real estate register.

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25 BGB 1191. § (1) Section: „Ein Grundstück kann in der Weise belastet werden, dass an denjenigen, zu dessen Gunsten die Belastung erfolgt, eine bestimmte Geldsumme aus dem Grundstück zu zahlen ist (Grundschuld). (2) Die Belastung kann auch in der Weise erfolgen, dass Zinsen von der Geldsumme sowie andere Nebenleistungen aus dem Grundstück zu entrichten sind.”

#### 4.3.2. Substantive elements of mortgage contracts

The Civil Code prescribes the following substantive elements for concluding a mortgage contract:

- indication of the liened item;
- definition of the secured claim; and
- the intention to establish lien.

Naturally, the mortgage contract must indicate the parties accurately and in an identifiable manner. This is also indispensable for the subsequent entry of the lien in the real estate register.<sup>26</sup>

The parties to the mortgage contract are the lienor and the lienee. With mortgage, the mortgagee is the owner of the real estate. The mortgagee is the beneficiary of the secured claim, except where the beneficiary appoints a mortgagee's trustee.

If the personal debtor of the secured claim is not identical with the lienee providing the security, the personal debtor will not be a party to the mortgage contract. This fact remains unchanged despite the widespread practice whereby a mortgage contract, which is most often notarised, is also signed by the personal debtor. For, only in this capacity can the personal debtor sign a mortgage contract. This is reflected by the definition included in Section 5:89 (1) of the Civil Code stating that lienee and lienor agree in a mortgage contract on creating lien on a specific liened item to secure a specific claim.

In the absence of the aforesaid substantive elements, no mortgage contract will be concluded. This is clearly stated by Section 5:89 (3) of the Civil Code saying that the mortgage contract shall not be considered effective unless the liened item and the secured claim are specified".

The statutory definition of the compulsory substantive elements of a mortgage contract does not mean that the parties could not agree on other matters in a mortgage contract, which is an agreement under contract law. Thereby, they can, first, depart from those provisions of the Civil Code on lien which are not cogent. For, the fact that the Civil Code regulates lien in its Book on Rights in Rem does not mean that all lien-related provisions are cogent. Dispositive rules can be departed from, for which the most appropriate place is the mortgage contract. In addition, the parties can also cover issues in the mortgage contract that are not regulated by the Civil Code at all.

#### 4.3.3. Formal requirements

Section 5:89 (6) of the Civil Code is also applicable to independent lien and says that "pledge agreements shall be executed in writing". However, since independent lien is a mortgage encumbering real estate, additional requirements laid down in Section 32 (3) of Act CXLI of 1997 on Real Estate Registration (hereinafter "RRA") must also be considered.

Accordingly, registration of the lien must be based on a public document or a private document countersigned by a lawyer. A legal counsel's countersignature must also be accepted if either of the contracting parties is an organisation represented by a legal counsel.

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26 On the lien contract and the emergence of the law on lien see more in detail at András POMEISL: *A zálogjog fogalma és létrejötte*. In: Balázs BODZÁSI (ed): *Hitelbiztosítékok*. HVG-ORAC Kiadó, Budapest, 2016. 291–340. pp.

Section 32 (5) of the Act on Registering Real Property allows only one exception to this stating that “registration of a mortgage (independent lien) having been filed, amended or terminated may also be performed on the basis of a private document duly signed by an authorised signatory of a credit institution, with the name of the credit institution indicated, if the signature can be positively identified”.

Therefore, in view of registration in the real estate register, special formal requirements are applicable to a mortgage contract establishing independent lien. No such requirements apply, however, to a security agreement, which is another contract related to independent lien.

#### 4.3.4. Differing provisions pertaining to the contents of a mortgage contract establishing independent lien

Provisions of the Civil Code determining the compulsory formal elements of a mortgage contract are also applicable in the case of independent lien.

An important difference is, however, that in the case of independent lien a mortgage contract only determines the amount of the secured claim but it does not have to include the legal grounds of the claim. In other words, with independent lien, the mortgage contract does not have to include the legal relationship or legal grounds from which the secured claim arises or may arise. All this follows from the independence of independent lien of the secured claim.<sup>27</sup>

In the case of independent lien, the amount determined by the parties in the mortgage contract must be entered in the real estate register as well. This is expressly stated in Section 5:100 (2) of the Civil Code, which provides that “the contract forming the independent lien contains, apart from the description of the liened item, that amount determined, up to which satisfaction may be sought out of the liened”. Section 5:100 (2) of the Civil Code also makes it clear that the “amount determined” indicates a framework or upper limit up to which the lienor may exercise its right to satisfaction.

This also answers the question as to whether the following provision can be applied to independent lien: in addition to stating its amount, a secured claim may be specified in any other way suitable for its identification. Given that a mortgage contract whereby independent lien is created does not include the secured claim, the parties cannot avail themselves of this option, which is ensured in Section 5:89 (5) of the Civil Code for independent lien. The amount indicated in a mortgage contract establishing independent lien must always be specified. The requirement for it to be specific is also met if the parties determine a certain percentage of the principal owed by the personal debtor, up to which the lienor is entitled to seek satisfaction from the liened item (e.g. X% of the loan principal).

Provisions governing the specification of the liened item are also applicable to independent lien. Since, however, independent lien can only be established in the form of mortgage on real property, the liened item (real property) must, in all cases, be uniquely specified in the mortgage contract and in the consent to registration. This follows from Section 5:93 (3) of the Civil Code pursuant to which registration in the real estate register shall be effected based on

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<sup>27</sup> The independent lien contract and the accessory lien contract are different because the independent lien contract does not contain a reference to the secured claim, instead, it provides for a threshold up to which satisfaction may be sought. See more in detail at GÁRDOS – VÉKÁS: *op. cit.* 4. A zálogszerződés

the mortgage agreement or upon the lienee's consent to registration if the mortgage agreement or the consent to registration uniquely identifies the liened real property. Provisions in relation to consent to registration are also applicable to independent lien.

A further condition of establishing independent lien is for the lienee to be the owner of the real estate as indicated in the real estate register. It follows therefore that independent lien may not be established in respect of the future asset (real property). This, however, does not preclude cases where independent lien encumbers a piece of land used for constructing additional real property – as part of a capital expenditure project pursued for the purpose.

The Mortgage contract establishing Independent lien between the parties can also provide the lienor's right to transfer independent lien with or without the claim specified in the security agreement. Naturally, the transferability of independent lien does not depend on whether or not the parties actually include a provision to that effect in the mortgage contract. Transferability is ensured by the Civil Code. Including a special clause to that effect in the mortgage contract is important for the provision of appropriate information to the lienee, whose importance is even greater in the case of consumer mortgage contracts.

The parties can also specify in the mortgage contract the person entitled to exercise the lienor's right to satisfaction in the event of transfer. Frequently, the right to satisfaction against the lienee is exercised not by the new lienor but by a former lienor who had transferred the independent lien. This, however, is conditional on the new lienor transferring the independent lien back to the original lienor. This usually happens when the new lienor acquiring independent lien during a refinancing arrangement refrains from recording the lien, and hence transferring the lien back does not require an additional entry in the register either. Under this refinancing arrangement, the new lienor may not exercise the right to satisfaction, other than exceptionally: typically in situations where the secured claim also transfers to it. In this case, the new lienor notifies the lienee or the personal debtor about the transfer of the new secured claim.

Concerning the transferability of independent lien, the mortgage contract should also contain authorisation by the lienee of the lienor as creditor to transfer the lienee's data covered by bank secrecy to the new lienor.

Once the parties expressly stipulate the transfer of independent lien, the question arises as to whether they must do so in the mortgage contract or in the security agreement. The security agreement includes provisions applicable to the accrual and manner of exercise of the right to satisfaction with regard to independent lien. Transferability, however, is not linked to the right to satisfaction, except from the aspect of which obligee is entitled to exercise it in case of transfer. As a mortgage contract is subject to stricter requirements of form and, in relation to that, as the lienee should be advised properly, it makes more sense to include transferability provisions in the mortgage contract.

Also, nothing prevents the parties from including provisions on the termination of independent lien in the mortgage contract concluded to establish independent lien. When that occurs, the contract should contain a provision to the effect that independent lien will terminate by deletion from the real estate register. In relation to that, the provisions of Section 5:100 (8) of the Civil Code could be repeated. Doing so would be tantamount to providing in the mortgage contract that the lienee may – provided that the appropriate conditions exist – request re-registration of the independent lien or deletion from the real estate register.

#### 4.3.5. Legal consequences of a missing mortgage contract

The absence of the mortgage contract or the failure to conclude it incurs the same legal consequences in the case of independent lien as in the case of accessory lien securing a debt: independent lien cannot be established in the absence of a mortgage contract. The statutory requirements relevant to the establishment of independent lien are not fulfilled in the absence of a mortgage contract and without the act of establishment no independent lien can be created.

#### 4.4. *Consumer mortgage contract for establishing independent lien*

The case of consumer mortgage contracts in relation to independent lien must also be examined separately. Section 5:90 of the Civil Code on consumer mortgage contracts was also modified as of 01 October 2016. Based on that, a consumer mortgage contract is created if:

- the lienee is a natural person; and
- the lien item is not used primarily for purposes within the scope of the lienee's profession, occupation or business activities; and
- the claim secured by lien does not derive from a legal relationship falling within the scope of the lienee's profession, occupation or business activities.

In the case of consumer mortgage contracts, the provisions on mortgage contracts must be applied with the following differences:

- a) the lien item can be a uniquely identified asset or real estate owned by the lienee, title to which is acquired by the lienee by way of a loan provided by the lienor or with the help of a period of forbearance;
- b) the identification of the secured claim must contain the amount of claim – without charges – or the amount up to which the lienor is entitled to seek satisfaction from the lien item.

The reregulation of independent lien also affected the statutory definition of a consumer mortgage contract. Accordingly, consumer mortgage contracts designed to establish independent lien must contain the amount up to which the lienor is entitled to seek satisfaction from the lien item. This is fully consistent with Section 5:100 (2) of the Civil Code.

However, in this respect it must be emphasised that non-consumer mortgage contracts establishing independent lien must also contain the amount up to which the lienor is entitled to seek satisfaction from the lien item. From this aspect, therefore, there is no difference between consumer and non-consumer mortgage contracts establishing independent lien.

In fact, however, nor is there a difference between the two types of mortgage contracts establishing independent lien from the aspect of the other provision of Section 5:90 of the Civil Code. For, the condition contained in Section 5:90 a) of the Civil Code is equally fulfilled by non-consumer mortgage contracts establishing independent lien in that the lien item can only be real property in their case as well. It follows from all of the above that a unique situation is created with regard to independent lien since there is no difference between the subject matter covered by consumer and non-consumer mortgage contracts. This is, however,

merely a coincidence since, naturally, not all mortgage contracts establishing independent lien can be considered consumer mortgage contracts.

## 4.5. Security agreement

### 4.5.1. The nature of security agreements and their relationship with the mortgage contract

In the case of independent lien, the parties must enter into another agreement, which is a security agreement, in addition to the mortgage contract. The security agreement is necessary due to the lack of statutory accessoriness. It plays a primary role in that it is designed, as a means of ensuring accessoriness under contract law, to settle issues not covered either by law or by the mortgage contract. These are provisions regulating primarily the accrual and manner of exercise of the right to satisfaction related to independent lien.

The question arises as to why the parties must enter into another agreement in addition to the mortgage contract. There are several practical arguments for this. Principally, mortgage contracts establishing independent lien must meet additional former requirements due to entry into the real estate register. However, it seemed unnecessary to extend these additional requirements to security agreements.

Another important argument for the separation of the two contracts was that if the parties only entered into a mortgage contract then, in the event of claim replacement the records in the real estate register should also be modified. In the case of independent lien, claim replacement is a wide-ranging option since independent lien does not terminate automatically upon the termination of the original claim. Therefore, the parties are free to use the same lien for securing another claim. If a change in the secured claim had to be recorded in the real estate register, the parties would unnecessarily spend money and time on such action. However, pursuant to the Civil Code, if the original secured claim terminates for whatever reason and the parties decide to use the surviving independent lien to secure another claim, all they will have to do is modify the security agreement or enter into a new one. That, however, does not affect recording in the real estate register or the mortgage contract and therefore does not call for modifying either records in the real estate register or the mortgage contract.

Based on the foregoing, specifying security agreements in the Civil Code as separate agreements under contract law offers primarily the advantage that a change in the amount of the secured claim, or the replacement of the claim itself, does not have to be recorded in the real estate register.<sup>28</sup> Besides, the security agreement does not have to be filed with the real estate register authority either. All this is conducive to developing independent lien into a truly flexible lien arrangement in practice.

Of course, nothing prevents the parties from incorporating a mortgage contract and a security agreement in the same document. This can also be justified by the parties to both contract law agreements being the same. That is so, because the security agreement is also made between the lienor and the lienee as is expressly provided by Section 5:100 (3) of the Civil Code. What

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<sup>28</sup> Some scholars opine that the security agreement does not meet the general expectations of contract law thus these should be viewed as property law instrument, emphasizing the mixed characteristics of the security agreement. See GÁRDOS – VÉKÁS: *op. cit.* 5. *A biztosítéki szerződés*

should be born in mind is that if the original purpose as security has been achieved – i.e. the original claim determined in the security agreement has terminated – and the parties wish to use the surviving independent lien to secure another claim, then they must amend the security agreement. In this case, there is no need to amend the mortgage contract since it does not have to show the legal grounds of the claim. When the purpose of the security is modified, there is no need to change the records in the real estate register; yet, the lienor must be mindful of the fact that it can only enforce its right to satisfaction up to the amount indicated by the record in the register, should the claim amount indicated in the security agreement exceed that amount. Consequently, from the aspect of the scope of the lienor's right to satisfaction, independent lien is governed by the (original) amount indicated in the real estate register even in the case of a change in claim and the corresponding amendment of the security agreement.

In the case of incorporation in the same document, it is also possible for the parties to add the underlying transaction, typically a loan agreement, from which the secured claim originates. Notarisation required for what is known as “immediate enforceability” typically covers all three contracts in the same notarial deed.

#### 4.5.2. Compulsory substantive elements of security agreements

In addition to specifying the security agreement by name, the Civil Code does also determine its compulsory substantive elements. The compulsory substantive elements of security agreements as determined in Section 5:100 (3) of the Civil Code are as follows:

- objective of the formation of the independent lien as being a security;
- conditions and scope of the accrual of the right to seek satisfaction;
- if the right to seek satisfaction accrues by termination, then also the manner of the exercise of termination and the notice period;
- other conditions of the accrual of the right to satisfaction such as objections that can be raised by the lienee.

Since independent lien can exclusively be established in order to secure a claim, the security agreement must specify security as the objective. The Civil Code states clearly and definitively that independent lien cannot be established for any other purpose (“*objective of the formation of the independent lien as being a security*”). The objective of the security is the claim of money secured by the independent lien. This is what Section 5:100 (6) of the Civil Code refers to as “*claim which may be settled as per the security agreement*”.

With independent lien, the secured claim must be a claim that can also be secured by way of an accessory lien. That means that Section 5:97 of the Civil Code also applies to independent lien. Therefore, as a general rule, the secured claim must be a claim of money and when a claim is non-pecuniary, the lien secures damages other claims of money arising from default. However, with independent lien, also in this latter (exceptional) case, one needs to consider the fact that the claim must be specified in the mortgage contract in a way to enable recording in the real estate register.

It has to be emphasised that the requirement to define the purpose as security in the security agreement must be interpreted in a flexible manner. That means it is not a requirement to

determine the exact amount of the secured claim. It is sufficient to refer to the underlying legal relationship from which the secured claim originates (for example, to claims and related charges precisely defined in a specific loan agreement).

If the same document (for example a notarial deed) incorporates a loan agreement (Part I), a mortgage contract (Part II) and a security agreement (Part III), then indicating the objective as being a security is deemed to be sufficient, provided that the following clause is included: *“Lienor and lienee declare that they have established the independent lien contained in the mortgage contract incorporated in Part II of this document with the objective to secure all claims – including the expenses of enforcement – due to the creditor and arising from the loan agreement specified in Part I of this document. Lienor is entitled to exercise its right to satisfaction from nothing else but the liened real property as a liened item to cover its claims arising from the loan agreement but not exceeding the amount determined in the mortgage contract and the lienee is required to tolerate such satisfaction”*.

Based on the foregoing, the security agreement must be separated not only from the mortgage contract but also from the underlying contract. Application of the same level of detail in regulating the secured claim in the security agreement as in the underlying agreement is not a requirement. What has to be made clear is the legal grounds from which the secured claim originates. Thus, in respect of the security agreement – as opposed to the mortgage contract – the principle of independence of legal grounds is not fulfilled, but nor does the requirement to specify the exact amount.

The parties can use the existing independent lien to secure another claim if the original secured claim has terminated for any reason or has decreased to an extent that the scope of the independent lien allows the parties to do so. There is no requirement that the independent lien must secure a new claim existing between the same parties.

The free transferability of independent lien – i.e. independent of the claim – enables the independent lien to be used by

- a new lienor and the original lienee (provided the lienee is also a personal debtor);
- the new lienor and a new personal debtor; and
- the original lienor and a new personal debtor  
to secure a claim between them.

To avoid subsequent legal disputes arising from this arrangement, Section 5:100 (4) of the Civil Code also provides that “with the transfer, the party acquiring the independent lien shall replace the transferor in the security agreement, to the extent of the transfer. The acquiring party may request the recording of his/her acquired right (...) in the real estate register.”

In the event of the final frustration of the purpose as security, the lienee may request the reregistration or deletion from the real estate register of the independent lien. Section 5:100 (8) of the Civil Code includes a special provision about this.

A further compulsory substantive element of a security agreement is the definition of conditions pertaining to the accrual of the lienor’s right to satisfaction and also the scope thereof. As a consequence of the absence of the accessoriness, with independent lien Section 5:126 (1) of the civil Code cannot be applied. That is because it provides, in respect of accessory lien, that the lienor’s right to satisfaction will accrue when the claim secured by lien falls due and performance has failed. Due to the absence of accessoriness, however, the right to satisfaction arising from independent lien does not accrue automatically when the secured



claim falls due and performance has failed. Accordingly, the parties must determine separately in the security agreement how and on what conditions the right to satisfaction accrues. This is particularly important for the lienor since in the absence of such a provision will prevent the lienor from exercising the right to satisfaction.

In principle, the parties can link the accrual of the right to satisfaction to any legal fact. Similarly, nothing prevents the right to satisfaction from accruing at a predetermined time, i.e. the security agreement from setting a specific date. It is also possible that the parties to the security agreement agree that the lienor's right to satisfaction accrues upon non-payment by the deadline set in the loan agreement for loan repayment or when the lienor declares the full amount of the loan due and payable by terminating the loan agreement.

Moreover, the right to satisfaction can also accrue by termination of the independent lien. In that respect, the Civil Code specifically stipulates that if the right to satisfaction accrues by termination then the manner of exercising the right to termination and the notice period must be laid down in the security agreement. This, however, will obviously not be necessary in cases where the right to satisfaction accrues not upon termination but depends on some other legal fact.

The security agreement must also specify the scope of the right to satisfaction. In practice it means specifying the claim amount and its charges, if any, to be satisfied under the security agreement. That is because the lienor has the right to satisfaction only up to that amount. There is no problem in cases where the claim to be satisfied under the security agreement does not exceed the amount indicated in the mortgage contract – and hence in the real estate register – up to which satisfaction can be sought based on the independent lien. To put in other words, the lienor's right to satisfaction in respect of the claim included in the security agreement is limited to the amount recorded in the real estate register. The scope of the right to satisfaction may not exceed the amount recorded in the register even if the claim set in the security agreement is higher.

The Civil Code stipulates in general that the conditions of exercising the right to seek satisfaction from the lienor must be laid down in the security agreement. This also means that if the parties wished to determine other conditions of exercising the right to satisfaction in addition to the foregoing, then they must do so in the security agreement. That can include the stipulation of objections the lienor may raise. However, this will only have practical significance if the parties wish to furnish the lienor with a wider range of objections than those accruing to the personal debtor. That follows from the provision enshrined in Section 5:100 (6) of the Civil Code, which states that objections available to the personal debtor are also automatically available to the lienor. Under this express provision of the law, lienors can raise against the lienors under an independent lien the objections available to the obligor of the claim specified in the security agreement, i.e. the personal debtor. These objections do not have to be specified separately in the security agreement as their enforceability is not subject to that. Similarly, any objections available to the lienor based on other legal relationships with the lienor need not be determined in the security agreement either.

In respect of exercising the right to satisfaction, the parties are also free to agree that the lienor may seek satisfaction by way of the enforced simplified sale of the lienor's item. This is stipulated by Chapter XI of Act LIII of 1994 on Judicial Enforcement (Sections 204/B-204/H).

In this case, however, the lowest selling price must also be stipulated in the security agreement.

Nothing prevents the parties from making subsequent additions to the security agreement between them even in respect of the conditions of exercising the right to satisfaction. This constitutes a contractual amendment just as when determining a new objective for the security. The general contract law provisions of the Civil Code must otherwise be applied to the amendment of the security agreements as appropriate.<sup>29</sup>

As a general principle, the Civil Code also says that the right to satisfaction can be exercised subject to the terms and conditions of the security agreement. Any application of the law to the contrary will constitute a breach of contract, which can ultimately give rise to a claim for damages in the lienee's favour.

#### 4.5.3. Other provisions related to security agreements

A security agreement is an agreement under contract law to which provisions of the Contract Law Book of the Civil Code must also be applied. These rules also govern the conclusion, validity, effectiveness, amendment, breach and termination of a security agreement.

A security agreement must be made in writing. This, naturally, is also applicable to amendments to the security agreement. Hence, no agreement – verbal or by way of acceptance by conduct – may result in the creation or modification of a security agreement.

However, no further formal requirements are prescribed either by the Civil Code or other legislation. The validity of a security agreement is, therefore, not conditional on either a lawyer's or a legal counsel's countersignature or on notarization. However, the latter can be relevant from the aspect of immediate enforceability.

The question is what legal consequences arise from the parties' failure to enter into a security agreement. Establishing an independent lien requires a mortgage contract. The absence of a security agreement does not affect the creation of independent lien, provided that the parties have concluded a valid mortgage contract. Therefore, the legal consequences of the absence of a security agreement will be different from the legal consequences arising from the absence of a mortgage contract. In particular, they include first of all the lienor's inability to seek satisfaction under the independent lien.<sup>30</sup> Consequently, the existence of a security agreement plays a key role for the lienor since lien without the right to satisfaction is unlikely to have any real collateral value.

As another legal consequence, Section 5:100 (8) of the civil Code also enables the lienee to delete the independent lien from the real estate register or request reregistration (in favour of another financial institution or itself), if no security agreement exists.

A special situation may arise when a financial institution in its capacity as lienor sets forth the content of the security agreement in its general terms of contract or determines the same vis-à-vis a consumer in the form of contractual terms not negotiated in advance. If that occurs, the provisions of the Civil Code on general terms of contract and contractual terms not negotiated in advance vis-à-vis consumers must also be taken into account. This may be tantamount to the full or partial invalidity of a security agreement under certain conditions.

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29 On the amendment of the security agreement see GÁRDOS – VÉKÁS: *op. cit.* 5. *A biztosítéki szerződés*

30 For a supporting argument see GÁRDOS – VÉKÁS: *op. cit.* 5. *A biztosítéki szerződés*

From this aspect, the practice of the European Court of Justice in relation to Directive 93/13/EEC must also be considered in addition to the provisions of the Civil Code.

Full invalidity leads to a similar situation to that arising when a security agreement is not even concluded, i.e. the lienor is not entitled to seek satisfaction if full validity occurs. For example, a security agreement is invalid when the objective of the security (namely the claim to be satisfied under the security agreement) included therein does not exist due to the invalidity of the underlying transaction from which the claim constituting the purpose as security originates. With an accessory lien, however, it is the mortgage contract that is invalid in such a case. For independent lien, the situation is different as the mortgage contract establishing the independent lien will not be directly affected by the claim determined in the security agreement or by the invalidity of the underlying transaction. In the case of independent lien, it is the security agreement that will be rendered invalid as a result of the invalidity of the underlying transaction and of the claim originating therefrom. Hence, the lienor will not be entitled to seek satisfaction and the lienor may request the deletion of the independent lien or may have it reregistered to another financial institution. However, the reregistration of independent lien will only make sense if the parties enter into another – this time valid – security agreement.

#### 4.6. *Transfer of independent lien*

One of the key characteristics and great advantages of independent lien is that it can also be transferred without the secured claim.<sup>31</sup> This is what creates its negotiability. It also follows from the free transferability of independent lien that this arrangement can be applied to cases when the independent lien is acquired by a new lienor who wishes to transfer it to a third party financial institution. This is the great advantage of independent lien as a tool for boosting the refinancing market. Separated lien did not lend itself to multiple transfers of this kind.

The lienee's position does not become any more onerous as a result of the transfer of independent lien. Although the transfer serves to secure a claim between the original lienor and the new lienor (e.g. for the purpose of refinancing), it does not affect the extent of the lienee's liability. That is because the lienee is only required to tolerate satisfaction by the lienor from the liened item up to the claim amount determined in the security agreement but not in excess of the amount indicated in the mortgage contract and in the real estate register. The transfer of independent lien does not influence this at all since the claim between the two lienors does not become a part of the claim determined in the security agreement.

In addition, the lienee can raise the same objections vis-à-vis the new lienor of the independent lien that are available to the personal debtor in the underlying transaction. Based on this, the lienee can also cite vis-à-vis the new lienor acquiring the independent lien the fact that the claim specified in the security agreement has already been fulfilled. All this precludes situations where a lienee could be forced to perform twice.

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31 The Hungarian Civil Code does not contain a separate provision on the transferring of the independent lien. For these, the general transferring of rights provisions should be applied. See GÁRDOS – VÉKÁS: *op. cit.* 6. *Az önálló zálogjog átruházása*

#### 4.6.1. Transfer in part or in parts

Pursuant to Section 5:100 (4) of the Civil Code, an independent lien may be transferred to another financial institution in whole or in part, or in parts. The difference between transfer in part and transfer in parts is that the latter involves transferring the entire independent lien not only on one occasion but in several instalments. In contrast, in the event of partial transfer, only a part of the independent lien is transferred, the remaining part continuing to exist between the original parties to the legal relationship of the lien (mortgage contract).

The division of independent lien upon the transfer is a common feature of transferring independent lien in part or in parts. This kind of divisibility is an important advantage of independent lien, which also contributes to its flexibility. That is because in the case of accessory lien (mortgage), lien can only be divided in the exceptional case of the division and partial transfer of the secured claim.

As a result of partial transfer of the independent lien, several lienors, all equally ranked, will become party to the legal relationship concurrently. This does not hurt the lienee's interest as its liability does not become any more onerous. That is because the lienee's liability covered by the lien item is maximised at the amount entered in the real estate register even in the case of partial transfer. That is why it is especially important for lienors to determine in the transfer agreement the exact percentage or degree up to which the independent lien will be transferred in part. The same issue may arise in the case of transfer by instalments.

#### 4.6.2. Succession by law

The Civil Code also states that the transfer of independent lien results in succession in the lienor's position under the security agreement. The second sentence of Section 5:100 (4) of the Civil Code reads that "with the transfer, the party acquiring the independent lien shall replace the transferor in the security agreement, to the extent of the transfer".

As a consequence, it is pursuant to the provisions of the Civil Code that a legal relationship is established between the party acquiring the independent lien and the lienee. Thereby, the lienee cannot end up in a more adverse position as a result of a failure by the transferor and the party acquiring the independent to agree on the new lienor joining the security agreement.

Naturally, succession by law does not prevent concluding the former and the new lienors and the lienee from agreeing separately on entry into the security agreement. However, pursuant to the Civil Code, the new lienor will be deemed to have joined the security agreement even if there is no separate agreement thereon between the parties or if the lienee should not agree on the same.

It is by the force of law that the new lienor joins the security agreement as result of transfer of the independent lien. The question is whether this affects the mortgage contract as the person of the lienor will change. It is certain, however, that the new lienor's entry in the security agreement will as a rule affect recording in the real estate register. Reference to this is also made by Section 5:100 (4) of the Civil Code saying that "the acquiring party may request the recording of his/her acquired right and, in case of a partial transfer or transfer in parts, the

division of the independent lien in the real estate register.” The explanation for that is that rights in rem will only accrue upon the transfer of the independent lien once the new lienor’s lien is recorded in the real estate register. The new lienor may fail to request recording in the real estate register, in which case it may not be treated as a lienor from the perspective of rights in rem.

If the new lienor’s entry in the security agreement takes place by the force of law, it will be sufficient for the new lienor of the independent lien to verify its acquisition of rights as a fact for the purposes of recording in the real estate register. That, however, does not require the lienor to present to the real estate register authority a contract as legal grounds for the transfer of the independent lien.

It is not only in respect of the person of the new lienor acquiring the independent lien that the Civil Code provides that it replaces the transferor in the security agreement. For, lawful succession will take place also in a case where it is the lienee that is replaced rather than the lienor. That may occur if the owner of the liened item transfers title to the real estate encumbered by the independent lien. In order to avoid any dispute concerning the new owner’s entry in the security agreement, Section 5:100 (7) of the Civil Code provides that “the party acquiring ownership of the liened item encumbered with the independent lien replaces the lienee in the security agreement.” Pursuant to this, the new owner’s entry is not linked to obtaining the lienor’s consent or to modifying the existing security agreement.<sup>32</sup>

#### 4.6.3. Applicability of the new lienor’s general terms of contract

The question arises whether, in addition to a change in parties, the substance of the lien as a legal relationship will also change once the independent lien is transferred and the new lienor enters the security agreement by virtue of law. This could come about if the new lienor could integrate into the security agreement its own terms of business and general terms of contract and these deviated from the original lienor’s general terms of contract. In our view, however, this cannot happen.

Section 6:78 of the Civil Code specifies the conditions precedent to integrating any standard contract term into an individual contract. Under Subsection (1), standard “contract terms (...) shall become part of a contract only if they have previously been made available to the other party for perusal before the conclusion of the contract, and if the other party has accepted those terms.” In this case, acceptance does not have to be explicit, i.e. it can be implied and can take the form of acceptance by conduct. However, a different situation arises when general terms of contract are considered unusual or surprising. Pursuant to Section 6:78 (2) of the Civil Code, “the other party shall be explicitly informed of any standard contract terms that differs substantially from the relevant legislation and from usual contractual practice, except if they are in line with any practice the parties have established between themselves. The other party shall be explicitly informed of any standard contract term that differs substantially from any stipulations previously applied by the same parties. The terms defined in Subsection (2) shall form part of the contract only if the other party has expressly accepted them after being informed about them.”

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32 On this matter see more at GÁRDOS – VÉRÁS: *op. cit.* 5. *A biztosítéki szerződés*

Since there is no statutory provision stipulating that the standard contract terms of the new lienor entering the security agreement upon the transfer of the independent lien will also become part of that agreement, the application of Section 6:78 of the Civil Code cannot be dispensed with in this case either. Based on that, the new lienor's standard contract terms can only become part of the security agreement if the lienee has familiarised itself with and accepted them prior to concluding the contract (in this case, prior to the new lienor's entry in the security agreement). In the absence thereof, the new lienor's standard contract terms may not become part of the security agreement.

Further legal interpretation will be needed to answer the question whether the second sentence of Section 6:78 (2) of the Civil Code must be applied. It reads that "the other party shall be explicitly informed of any standard contract term that differs substantially from any stipulations previously applied by the same parties." Here the problem is that the new lienor entering the security agreement and the lienee had not been contractually related earlier and lienor does not qualify as a contracting party from the lienee's perspective. Still, we believe it is justified that if the standard contract terms of the new lienor entering the security agreement differ from those the original lienor applied and made part of the security agreement, then the lienee must be explicitly informed about those different standard contract terms. Subject to Section 6:78 (3) of the Civil Code, these different standard contract terms can only become part of the security agreement upon lienee's explicit consent after separate notification.

Therefore, the new lienor must inform the lienee under separate cover about its standard contract terms with regard to the lien and making them simply available for inspection is not sufficient for the purpose of integrating such terms into the security agreement. It is, furthermore, not sufficient for the lienee to accept those different standard contract terms tacitly, consent must be granted expressly.

However, the new lienor can initiate the amendment of the security agreement after entering therein by the force of law. The right to unilateral modification of contract is not available to the lienor by law but nothing prevents a contract from conferring this right upon the lienor. Pursuant to Section 6:191 (4) of the Civil Code, "the contents of a contract may be amended unilaterally by either of the parties if the parties so stipulated in the contract or if the party is so authorised by statutory provision". If the parties stipulated in the security agreement the lienor's right to modify the contract unilaterally and the lienor's person changes, then the new lienor can avail itself of the same right. However, in stipulating the right to unilaterally amend the contract, the provisions of the Civil Code pertaining to the nullity of unfair contractual terms included in a consumer agreement must be taken into special account. For, pursuant to Section 6:104 (2) d) of the Civil Code and contract term shall be considered unfair, *until proven otherwise*, if its object or effect is to enable a business party to alter contract terms unilaterally without a valid reason which is specified in the contract.

If under the security agreement the lienor is entitled to modify the contract unilaterally, the new lienor acquiring the independent lien must initiate bilateral amendment of the agreement to have lienor's its differing standard contract terms integrated into it. However, the requirements included in Section 6:78 of the Civil Code must also be applied when modifying the contract. Clearly, in this case the second sentence of Section 6:78 (2) the Civil Code must be considered applicable since the lienee and the new lienor are now deemed parties in amending the contract.

#### 4.7. Exercising the right to objection

The former Civil Code increased the negotiability of the independent lien through the institution of objection limitation. Based on that, the free transfer of independent lien without a connected claim deprived the lienee of the right to raise objections with reference to the underlying legal relationship against the new lienor acquiring the independent lien in good faith and for a consideration. In legal literature, this is known as the institution of objection limitation, which originates from bill of exchange law. Since Hungarian private law did not enable the securitisation of independent lien after the political changeover, this legal institution originating from security law exposed lienees (who are also personal debtors) to the risk of being forced to bear double liability.

In order to protect lienees as owners, the CCAA abolished objection limitation and thus the risk of double liability was removed. In relation to that, Section 5:100 (6) of the Civil Code states that “the lienee may refer against the obligee of the independent lien at any time also to those objections which the obligor of the obligation determined under the security agreement is entitled to raise”. This means that the lienee can, by operation of law, also raise the same objections that are available to the personal debtor. Therefore, this right is not subject to whether the parties agreed on these objections in the security agreement. The lienee is entitled to raise objections available to the personal debtor even if such provisions are not included in the contract. In this respect, independent lien is not different from accessory lien. In other words, reregulated independent lien is of an accessory nature as regards raising objections. Therefore, accessoriness linked to the enforcement of rights also exists with independent lien.

Among the statutory objections available to the lienee, the objection to the fulfilment of the secured claim is the most relevant. However, the lienee can also invoke other reasons for termination and base its objection citing the invalidity of the secured claim on grounds of the invalidity of the underlying legal relationship from which it originates.

In addition to citing objections available to the personal debtor, the lienee may also invoke objections available to its own person vis-à-vis the lienor. These can originate from the independent lien itself, such as for instance the fact that a lien has not been created. Objections directly related to the independent lien are rights in rem by nature. However, the lienee may also raise objections under contract law available to it forward to its other legal relationships with the lienor. They include objections related to the right to offset which the lienee can enforce based on any pecuniary claim against the lienor. On this basis, the lienee under the independent lien, just as the lienee of the accessory lien, is entitled to offset its pecuniary claim vis-à-vis the lienor against an amount up to which the lienor is entitled to seek satisfaction from the lienated item.<sup>33</sup>

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33 Connected with this is the question of whether the lienee is entitled to offset the amount of a counterclaim that is due to the personal debtor. As regards suretyship, there are special provisions on this matter in Section 6:417 (2) of the Civil Code. Formerly, Section 44 (1) of the Mortgage Act included similar provisions in respect of mortgages to allow the mortgage holder to offset all those amounts – in addition to its own counterclaims – vis-à-vis the mortgage creditor which the personal debtor was entitled to offset. However, neither the Civil Code, nor other legislation under our current law contains provisions to this effect and therefore, in our opinion, it is not possible for the lienee in rem to offset vis-à-vis the lienor such amounts of counterclaims as are due to the personal debtor. For a differing opinion see GÁRDOS – VÉKÁS: *op. cit.* 8. A zálogkötelezett kifogásolási joga. e) pont

Naturally, nothing prevents the parties from specifying these objections in the security agreement. However, this is not a prerequisite for raising such objections.

Regulating the enforcement of objections is an area where reregulated independent lien differs to the greatest extent from the former Civil Code and from the Mortgage Act of 1927. Objection limitation was abolished to protect the lienee. That, however, was also conducive to lending an accessory character to reregulated independent lien as far as raising objections are concerned. This is an important instrument for protecting owners, which, however, does not significantly prejudice the advantages attached to independent lien or the compliance of reregulated independent lien with the CRR regulation.

#### *4.8. Protection of the personal debtor*

Revoking the objection limitation, or in other word allowing objections protects the lienee. At the same time, it was also necessary to take increased care of protection of the personal debtor.

The issue of protecting the personal debtor can primarily arise if the lienee and the personal debtor are not the same person and the original lienor has transferred its independent lien. In this case, the possibility exists that the original lienor, who is also the obligee (creditor) of the legal relationship underlying the secured claim, demands performance from the personal debtor while the independent lien's new lienor turns against the lienee. Although the lienee can invoke objections available to the personal debtor now that the objection limitation is abolished, it also had to be stated that the personal debtor may not be forced to perform either, if the lienee had already performed or tolerated the exercise by the lienor of its right to satisfaction from the liened item. To this end, Section 5:100 (6) of the Civil Code also stipulates that "the amount of the claim which may be settled as per the security agreement is reduced by the purchase price proceeds accrued in the course of the exercise of the right to seek satisfaction".

On that basis, therefore, if the lienor of the independent lien has – by reason of its right to satisfaction – already received reimbursement from the lienee, the purchase price received in this process will reduce the debt owed by the personal debtor. If the purchase price thus received is equal to the amount of the original claim, i.e. the claim that can be demanded under the security agreement, the debt owed by the personal debtor will cease to exist. If, however, the purchase price received is less than the debt owed by the personal debtor, only the difference can be demanded from the personal debtor. Naturally, the lienee will also be entitled to reimbursement vis-à-vis the personal debtor, in accordance with Section 5:142 (2) of the Civil Code.

That prevents a situation where the acquirer of the independent lien and the original lienor collect the same debt from the lienee and from the personal debtor, respectively. The lienors can only claim reimbursement once and they must settle the consequences thereof in the legal relationship between them. At the same time, neither lienor's interests are violated, provided that the independent lien has been transferred for a consideration. However, in the event of free transfer, the original lienor must reckon with the prospect of losing entitlement to the secured claim or a part thereof since it has already been collected by the new lienor from the lienee.



Naturally, it can also happen that the personal debtor – unaware that the amount of the secured claim has already been collected from the lienee – will pay voluntarily. This payment, however, can be recovered subsequently – by invoking the Civil Code provision referred to above – from the original lienor who transferred the independent lien and was the creditor of the performing personal debtor on the basis of the underlying legal relationship. However, the lienee's claim for reimbursement against the personal debtor also exists if the personal debtor has made a full payment to the original lienor and has not been able to enforce its related claim for reimbursement. Therefore, it is recommended to ascertain prior to performance whether the lienor has already exercised its right to satisfaction vis-à-vis the lienee and, if so, to what extent the debt has been paid to the lienor. In this respect, it is also appropriate to admit that the lienor of the independent lien cannot invoke bank secrecy when imparting such information.

Based on the foregoing, the Civil Code excludes the risk of double performance by both of the lienee and the personal debtor. That is because neither of them can be obliged to perform twice in respect of the debt specified in the security agreement or to tolerate satisfaction from the liened item once payment has been made.<sup>34</sup>

#### 4.9. *Accrual of the right to satisfaction upon termination*

In the absence of accessoriness in the case of independent lien, the falling due of the secured claim and failure to perform payment do not automatically result in the accrual of the lienor's right to satisfaction. This requires some additional legal act. Based on experience relating to the domestic and international regulation of non-accessory lien, this legal act is usually termination.

Under the former private law, Section 83 of the Mortgage Act provided for termination. Section 1193 of the BGB also contains special provisions on termination. Finally, Section 269 (2) of the former Civil Code regulated termination under separate provisions.

The amended Civil Code has complicated matters in that it governs security agreements under special provisions within the scope of independent lien. Based on that, the following cases of termination must be distinguished:

- termination of the security agreement;
- termination of the independent lien;
- termination of the underlying legal relationship.

Termination of the security agreement results in the termination of the agreement, in which case, however, the lienor will not be able to exercise its right to satisfaction. That is one of the legal consequences of the absence of a security agreement. The Civil Code does not lay down separate provisions on termination of the security agreement; however, nothing prevents the parties from including separate provisions about this matter in the security agreement.

By contrast, the Civil Code regulates the termination of the independent lien separately. Pursuant to Section 5:100 (5) of the Civil Code, independent lien may be terminated by both

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<sup>34</sup> The critical viewpoints of the legal literature acknowledge the fact that this provision does restrict the risk of double performance, however, the wording of the provision is regarded incorrect. See GÁRDOS – VÉKÁS: *op. cit.* 8. A zálogkötelezett kifogásolási joga. f) pont

the lienor and the lienee. Section 5:100 (3) of the Civil Code also clearly determines the legal consequence thereof: the right to satisfaction accrues upon termination. Pursuant to Section 5:100 (3) of the Civil Code, if the right to satisfaction accrues by way of termination then the method of exercising the right to terminate and the notice period must be determined in the security agreement. This is also confirmed by amended Section 5:126 (2) of the Civil Code, pursuant to which the lienor's right to satisfaction, unless otherwise agreed by the parties in the security agreement, will accrue upon termination of the independent lien or upon expiry of notice period.

Thus, termination of the independent lien results in the accrual of the lienor's right to satisfaction. This happens upon expiry of the notice period. In accordance with the dispositive rule of the Civil Code, the notice period – unless otherwise agreed by the parties – is 6 months. In this regard, one has to emphasise that specifying a notice period which is either too short or too long is inconsistent with the requirement to exercise a right for its intended purpose. If the notice period is stipulated in the lienor's previously existing general terms of contract, then the fairness of such stipulation can also be made subject to scrutiny (provided, naturally, that the given stipulation has also become part of the agreement).

As an important safeguard, Section 5:100 (5) of the Civil Code provides that if the right to satisfaction accrues by reason of termination then its exclusion will be null and void. This means that if the parties select another manner for the right to satisfaction to accrue, for example if they link it to a particular condition or date, then, as a matter of course, termination can be excluded. In that case, the security agreement is not likely to contain provisions in respect of termination of the independent lien anyway. If, however, the parties have not linked the accrual of the right to satisfaction to another legal act, then the right to terminate is available to both the lienor and the lienee by operation of law. To regulate the latter case, the Civil Code provides that the exclusion of the right to terminate will be null and void under such circumstances, since the exclusion of the right to terminate would lead to an undesirable outcome whereby the lienor's right to satisfaction would never accrue in the absence of a legal act to produce that legal consequence.

Ensuring the right to terminate is critically important for both parties. If the right to terminate only accrued to the lienor who refrained from exercising it, a situation could arise whereby the lienee would never be relieved of this burden in rem. On the other hand, the lienee may also find it important to ensure that the lienor is satisfied as soon as possible if, for example, they wish to replace the existing loan with one on more favourable terms.

Regulating the notice period is equally important for both parties. For the lienee, it provides a safeguard that its liability covered by the liened item will not fall due immediately. Conversely, an appropriate notice period is also essential for the lienor since it will provide sufficient time for performing the necessary replacement of independent liens that serve to back mortgage bonds.<sup>35</sup>

While, due to the absence of accessoriness, the Civil Code lays down special provisions in respect of the accrual of the right to satisfaction stemming from the independent lien, there is no difference between an accessory lien securing a claim and an independent lien in terms the content of the right to satisfaction. Accordingly, in exercising its right to satisfaction the

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35 On the termination of the independent lien contract see GÁRDOS – VÉKÁS: *op. cit.* 7. Az önálló zálogjog felmondása

lienor under the independent lien enjoys the same rights and is bound by the same obligations as the lienor of an accessory lien.

The termination of the underlying legal relationship must be distinguished from terminating the independent lien and the security agreement. As a rule, terminating the underlying legal relationship does not affect the independent lien. However, the parties may also link the accrual of the right to satisfaction under an independent lien to the termination of the underlying relationship. In this case, the termination of the underlying relationship alone is sufficient for the right to satisfaction to accrue and there will be no need in this case to terminate the independent lien.

Based on the foregoing, the following provision on the accrual of the right to satisfaction in a security agreement is appropriate: *“The Contracting Parties agree that the Lienor’s right to satisfaction from the independent lien shall – without any special notice – accrue*

- (1) when the Debtor’s payment obligation arising from the Loan Agreement as a secured legal transaction falls due and the Debtor fails to fulfil such obligation or to do so in a contractual manner, or
- (2) |when the Loan Agreement is terminated in a manner whereby the Debtor’s payment obligation arising therefrom survives.

*The parties shall exclude termination of the independent lien as the right to satisfaction from the lien shall accrue not by reason of termination but in accordance with the foregoing”.*

#### 4.10. Reregistration and deregistration of the independent lien

In order to make the independent lien more flexible, Section 5:100 (8) of the Civil Code offers the lienee several new options. What these options have in common is that the lienee can rely on them if the original purpose of the independent lien to serve as a security ceases to exist for some reason. Pursuant to the cited provision of the Civil Code, that can happen in the following cases:

- if the security agreement has not been concluded;
- if the purpose of establishing the independent lien as indicated in the security agreement has been finally frustrated;
- if the security agreement has terminated;
- if the claim to be satisfied from the liened item – including a claim for reimbursement – as indicated in the security agreement has terminated; and
- if any reason or condition stipulated in the security agreement and resulting in termination of the independent lien has occurred.

In such cases, the lienor has an obligation to consent, at the lienee’s written request, to

- a) entering the lienee as the lienor of the independent lien in the real estate register; or
- b) entering the financial institution designated by it as lienee in the real estate register; or
- c) deregistering the independent lien from the real estate register.

Consequently, the lienee will be entitled to one of the following three options in the cases described above:

- it may request recording in the real estate register another financial institution it designates as the new lienor of the independent lien;
- it can request recording its own person in the real estate register as the new lienor of the independent lien; and finally
- it can request deregistration of the independent lien from the real estate register.

Based on the foregoing, there are two possible cases of reregistering the independent lien:

- reregistering the independent lien in favour of another financial institution; or
- reregistering the independent lien in favour of the lienee as owner.

The latter creates an owner's independent lien, which is a new legal institution under Hungarian Private Law.<sup>36</sup> An owner's lien is also recognised by the provisions of Sections 5:142 (2) and (3) (however this designation is not used by the Civil Code). Compared to this, an owner's independent lien, as regulated in Section 5:100 (8) of the Civil Code, is a special category in that it exists without any actual claim, and therefore there is no demand for reimbursement either as would be secured by an owner's lien. Accordingly, owner's independent lien is similar to a claimless ranking right. Naturally, the three types of owner's lien may not exist simultaneously but their relationship relative to each other requires further clarification.

Owner's independent lien can facilitate the lienee's raising a new loan. In fact, as far as its financial function is concerned, it is a legal institution similar to securing a ranking position in advance or to disposing over a terminated ranking position. The question is, however, whether it can be used to ensure that the claim of the lienee as owner is satisfied ahead of other creditors in enforcement proceedings against the liened item or during liquidation proceedings conducted against the lienee. This question also concerns the cases of the owner's lien covered by Sections 5:142 (2) and (3) of the Civil Code.

Essentially, owner's independent lien should serve to ensure reimbursement for the lienee as owner during enforcement or liquidation proceedings brought against it. It would follow from this that during an enforcement proceeding, based on the ranking order of satisfaction, only that amount could be considered in favour of the lienee's other creditors from which the claim of the lienee in possession of an owner's lien has been subtracted. The lienor of the owner's lien (i.e. the lienee itself) could in this case be ranked among the creditors and would receive from the purchase price realised from the sale of the liened item, after its distribution, the amount that is due to it as a lienor based on its claim (e.g. its claim for reimbursement against the personal debtor). That would be the essence of the owner's lien related to a claim (claim for reimbursement).

However, the situation is different with the owner's independent lien. In this case, the lienee is not entitled to any claim, including a claim for reimbursement. Therefore, the owner's independent lien is a claimless ranking right. This, however, cannot be taken into account in an enforcement or liquidation proceeding initiated against the lienee when distributing the purchase price received.

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36 For a supporting argument see GÁRDOS – VÉKÁS: *op. cit.* 9. Az önálló zálogjog megszüntése

#### 4.11. Conversion

Both earlier Hungarian and current German legislation allow the parties to convert a non-accessory lien into an accessory lien and vice versa. Under German law, BGB Section 1198 provides the option to convert provided that it does not require the consent of equally ranked or subordinated obligees.

The wording of Section 5:100 (9) of the Civil Code is almost identical with this provision. Pursuant to that provision, “independent lien may be converted into a lien securing a claim, and the lien securing a claim may be converted into an independent lien, by a *written* agreement of the parties to that effect, and by recording the conversion in the real estate register, while preserving the ranking of the lien.” Under the Civil Code, that does not require the consent of lienors of the same or lower rank.

Conversion is, therefore, a bilateral agreement between the parties under contract law that must be reduced to writing. This is important to emphasise as, accordingly, conversion is not merely the amendment of the original mortgage contract, which can also be performed unilaterally by the lienor if appropriate. The lienor’s right to amend the agreement unilaterally as may be stipulated in the mortgage contract must not result in conversion of the lien. Neither party can decide unilaterally on conversion as doing so requires mutual agreement between the parties.

For conversion to be effective in rem, the fact of conversion must be recorded in the real estate register. When this is done, the mortgage resulting from conversion will retain the ranking position of the original lien.

During the conversion, the parties must also make arrangements to ensure that a valid security agreement is available once the accessory lien has been converted into independent lien. The parties can do so by incorporating their agreement on converting accessory mortgage into independent lien and the security agreement in the same instrument. Doing so will not prevent the parties from modifying their security agreement subsequently or from entering into a new one. Once the security agreement is in place, they will have no duty to consider the extra formal requirements applicable to a conversion agreement, i.e. the amendment or the conclusion of a new agreement will simply have to be made in writing.

A further question is whether the parties can agree on conversion in advance. Can stipulate in the mortgage contract establishing the independent lien or in the related security agreement, for instance, that upon fulfilment of certain conditions the independent lien will convert to an accessory mortgage (i.e. can they link effect of the conversion agreement to the fulfilment of certain condition precedent). Another option would be for the lienee to make a prior contractual representation about to conversion, in respect of which the lienor would only make an identical declaration of intent subsequently, for instance upon fulfilment of a particular condition. For example, such conditions can include a situation where the personal debtor falls into arrears with fulfilment of the claim specified in the security agreement. While the entry into effect of the conversion agreement would be linked to the occurrence of a particular condition agreed in advance in the former case, the conclusion of the agreement would be subject to the lienor’s unilateral decision in the latter case.

The two options outlined above can become relevant in the near future since, as opposed to independent lien, converted accessory mortgage – once duly entered in the real estate register

– also extends to charges in addition to the principal [Section 5:98 (2) of the Civil Code].

In our opinion nothing prevents the parties from making entry into effect of the conversion agreement contingent upon fulfilment of a particular condition. This option is provided in Section 6:116 (1) of the Civil Code.

Several questions arise about the second option, where the conclusion of a conversion agreement would be subject to the lienor's unilateral decision. It is possible that the lienor would decide to conclude the agreement upon fulfilment of a particular condition but in this case the emphasis is ultimately not on the occurrence of such condition but on the lienor's unilateral decision. This would give unilateral power to the lienor whereby it could decide whether or not to enter into a conversion agreement in view of the lienee's prior contractual representation.

In our opinion, nothing prevents the parties from vesting such unilateral freedom of decision in the lienor in the original mortgage contract. Such a contractual clause in and of itself is not contrary to law. Naturally, the court can still scrutinise whether the unilateral exercise of this right has been abusive on the lienor's part.

A separate issue is whether such a clause is permissible in a consumer mortgage contract. If the parties do not negotiate in advance but this prior declaration by the lienee is part of the lienor's general terms of contract, the issue of unfairness, if any, may arise, especially in view of Section 6:104 (2) d) of the Civil Code (provided that this is not a case of exercising a unilateral right to amend the contract).

Based on the foregoing, with an independent lien the lienee can give its prior consent to converting the independent lien into accessory mortgage that secures a claim. If, however, the lienee is a consumer, it makes perfect sense to include this prior declaration in the original mortgage contract and discuss the same with the lienee separately. Since in case the lienee's prior declaration is part of the lienor's general terms of contract and it is not negotiated separately with the lienee, then such a clause will likely constitute unfair practice vis-à-vis the lienee as consumer.

#### *4.12. Rule of Reference*

Since non-accessory lien is also classified as lien, the provision that it should otherwise be governed, as appropriate, by the rules applicable to accessory lien is of great importance.

This rule of reference is laid down in Section 5:100 (10) of the Civil Code stating that "in other respects, the provisions on the lien securing a claim are to be applied appropriately unless its independence from the secured claim has other consequences."

Thereby, nothing prevents the parties from creating an independent lien as universal lien. Pursuant to Section 5:105 (1) of the Civil Code, if a lien is established on more than one pledged property to secure the same claim, the relevant register shall indicate that the lien is universal. Pursuant to Subsection (2), if the lien is universal, all of the pledged properties shall serve as security for the entire claim. Hence, it is possible that an independent lien encumbers several pieces of real estate, i.e. to create a universal independent lien.

Formerly, the rule of reference included in Section 269 (5) of the former Civil Code was not examined in detail. The application of the reregulated independent lien would be greatly

facilitated in practice if the exact content of the rule of reference was developed precisely in Hungarian legal literature. This would require a thorough analysis of provisions applicable to accessory lien so as to judge which of those could be applied to independent lien as well.<sup>37</sup>

## 5. Independent lien created by transformation

### 5.1. *The concept and main characteristics of independent lien created by transformation*

In order to stimulate the domestic refinancing market, the legislator did not only reregulate independent lien but also made it possible for financial institutions to transform their accessory real estate mortgages, including separated mortgages, established prior to 01 October 2016 into independent liens. That gave rise to a special sub-type of independent lien known as “independent lien created by transformation”. Independent lien created by transformation can be instrumental in implementing the economic policy objective to make domestic credit institutions comply with the provisions of NBH Decree 20/2015. (VI. 29.) and thereby to improve the stability of the Hungarian banking system.

CCAA Section 29 (11) provides that the Civil Code provisions on independent lien must be applied to independent lien created by transformation. Accordingly, an independent lien created by transformation is also a freely transferable (claimless) and negotiable limited value right in rem. Accordingly, this arrangement also ensures compliance with the CRR Regulation.

In the process of enacting the institution of independent lien created by transformation, two important legal policy principles had to be harmonised. First, the legislator had to take into account the lienor’s interest in transforming its accessory mortgage into an independent lien as smoothly as possible and in using this lien to cover mortgage bonds. However, it was not possible to ignore the lienee’s reasonable need certainly meriting recognition that transformation should not make its position more onerous. The latter rule, which is also an essential constitutional safeguard, is laid down specifically in Section 29 (3) of CCAA stating that “*the mortgagor’s position may not become more onerous because of the transformation*”.

Similarly to reregulated independent liens, only a financial institutions can act as a lienor under an independent lien created by transformation. Besides, independent lien created by transformation can only be established as mortgage on real estate. Following transformation, the resulting independent lien is therefore mortgage on real estate just as the original mortgage was, the only difference being that the independent lien created by transformation is also of non-accessory nature and is negotiable.

In addition to the foregoing, an independent lien created by transformation is not identical with reregulated independent lien. The most important difference is that independent lien created by transformation may not be linked to anything else but the original claim (which is secured by the accessory mortgage). When the original claim ceases to exist, the independent lien created by transformation may not be used to secure further claims anymore. Naturally, in the case of the reregulated independent lien no such restriction exists.

The prohibition to use an independent lien created by transformation for securing further claims follows from Section 29 (5) of the CCAA. Pursuant to that provision, a(n) (accessory)

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37 On this see more in detail at GÁRDOS – VÉKÁS: *op. cit.* 2. *Önálló zálogjog. A szabályozás célja, módszere*

mortgage contract that established the mortgage affected by transformation should also be considered a security agreement applying to the independent lien created by transformation. Whether transformation takes place by a unilateral declaration of transformation or under a contract, the sanction of nullity stipulated in Section 29 (5) of the CCAA must be taken into account in both cases.

Accordingly, the secured claim specified in the original mortgage contract must be considered to constitute the claim to be satisfied subject to the security agreement. That will prevent the lienor from providing in the declaration of transformation that the independent lien created by transformation can also secure other claims. Since transformation terminates the original accessory mortgage, the scope of application of the independent lien created by transformation cannot be extended unilaterally either by the lienor or by agreement between the parties subsequently. Nor may the parties reach an accord after transformation by amending the security agreement so as to allow the independent lien created by transformation to secure further claims. That is because in this case the nullity sanction included in Section 29 (5) would become meaningless. Consequently, it is not possible to depart validly from the provisions of the original mortgage contract either by a unilateral declaration of transformation or by a transformation agreement between the parties subsequent to creating an independent lien by transformation.

Naturally, all that does not prevent the use of an independent lien created by transformation for refinancing purposes. That is because the claim between the former lienor and the new lienor does not affect the extent of the lienee's liability, just as in the case of a reregulated independent lien. The CCAA only prohibits that the lienee or the original personal debtor use an independent lien created by transformation to secure further claims. However, nothing prevents the lienor from transferring its independent lien created by transformation even on several occasions.

Independent lien created by transformation is not identical with the case regulated in Section 5:100 (9) of the Civil Code, which regulates independent lien as created by conversion from a lien securing a claim. An important difference is that while conversion is bilateral agreement between the lienor and the lienee under a contract law, transformation may occur through the lienor's unilateral representation (declaration of transformation). More importantly, however, an independent lien created by transformation can exclusively be used for the original security purpose, i.e. it may not secure another claim subsequently.

In addition, transformation – as opposed to conversion – can only take place once. Accordingly, an independent lien created by transformation may not be transformed any more (or, rather, retransformed) and it may not once again turn into accessory mortgage to secure a claim. Transformation is a one-off and one-way process whereby accessory mortgage becomes independent lien. By contrast, conversion can take place several times if the parties so agree.

Transformation of an accessory real estate mortgage into an independent lien can take place in one of two ways pursuant to the CCAA:

- by agreement between the parties; or
- by the lienor's unilateral declaration of transformation.

Both the unilateral declaration of transformation and the transformation agreement must be reduced to writing.



In terms of substance, an independent lien created by transformation through a unilateral declaration is completely identical with an independent lien created by transformation under a mutual agreement. This follows from Section 29 (10) of the CCAA, which provides that the rules applicable to independent lien created by transformation through a declaration of transformation also govern, as applicable, transformation by agreement and the resulting independent lien created by transformation.

## 5.2. Requirement to determine an amount

As a prerequisite for transformation, the mortgage contract establishing accessory mortgage on real estate to be transformed must specify the amount of the secured claim.

Pursuant to Section 5:89 (5) of the Civil Code, a claim secured by a pledge shall be determined in a way by which it may be identified, either by *showing the amount, or otherwise in a way suitable for identifying the secured claim*. Of these two options, transformation into an independent lien may not occur unless the mortgage contract relating to real property specifies the amount of the claim secured by the mortgage.

Therefore, no transformation will take place in cases where the original mortgage contract fails to specify the amount of the secured claim and uses another way suitable for identifying the claim. Consequently, if – using the option included in Section 5:89 (5) of the Civil Code – the original mortgage contract determines the secured claim “*otherwise in a way suitable for identifying the secured claim*”, then transformation into an independent lien may not take place, not even by mutual agreement. Separation of the mortgage could, of course, be effected in this case as well before 01 October 2016; however, separated lien of this kind may not be transformed into independent lien, not even by agreement.

Determining the exact amount of the secured claim is an essential criterion since transformation can take place up to an amount not exceeding the amount determined in the original mortgage contract. Consequently, the lienor of an independent lien created by transformation may not exercise its right to satisfaction in excess of the originally specified amount. This is one of the safeguards that prevent the amount of the secured claim from increasing and the lienee’s position from becoming more onerous as a result of transformation.

The requirement to determine the exact amount takes into account the lienee’s interest as well as the interest of subordinated lienors and other subordinated obligees with rights in rem. If the law permitted increasing the original amount, it would also have to provide for obtaining the subordinated lienors’ consent, in addition to that given by the lienee. That, however, could lead to legal uncertainties in respect of transformation hence the law does not allow increasing the amount subsequently, even if the parties may agree to that effect.

It also follows from the requirement to specify the exact amount of the secured claim that transformation into an independent lien in respect of charges unspecified in terms of an exact amount is not possible even if the original mortgage contract contains a specific claim amount but without specifying the amount of related charges (e.g. by referring only to the percentage of charges and failing to specify the exact amount is). In such a case, if transformation into an independent lien takes place in respect of the principal, the lienor will only be entitled to enforce its claim (including principal and related charges combined) up to that framework amount

against the lienee. If the debt did not decrease sufficiently (i.e. principal amortisation is low) during the term to transformation or before the right to satisfaction accrues, that can create a situation where the charges not specified by giving an exact amount – and being in excess of the amount identified at the time of transformation – will no longer be secured by the lien.

Therefore, charges not specified exactly by amount can only be satisfied against and up to and never in excess of the amount indicated upon recording the independent lien created by transformation in the real estate register. Transformation into an independent lien creates an upper limit up to which a claim – be it principal or related charges – secured by the original mortgage contract can be satisfied based on the independent lien but any amount in excess thereof will cease to be secured by the lien. All of this is consistent with the obligation to treat the “certain amount” referred to in Section 5:100 (1) of the Civil Code as a framework amount in the case of reregulated independent lien.

Consequently, if the amount contained in the original mortgage contract is not a framework amount then the lienor of the independent lien can claim charges in excess of that amount (the “principal”) only up to the amount which the parties specified in the mortgage contract as the amount of the secured claim – without showing the exact amount of related charges. That means that an accessory mortgage created to secure EUR 10,000 plus charges can be transformed into an independent lien up to EUR 10,000. If – as a result of repayment in the meantime – the amount of the secured claim decreases to EUR 9,000 by the date when the right to satisfaction accrues, then satisfaction may also be sought for charges unspecified in terms of an exact amount up to the limit of EUR 9,000. The point is that the amount used for satisfaction under the independent lien may not exceed EUR 10,000.

To give another example, if the parties to the mortgage contract establishing an accessory real estate mortgage specified the amount of the secured claim at EUR 10,000 plus 4% interest per annum, then the amount thus specified in the mortgage contract must be deemed to refer to the principal only. Accordingly, the accessory mortgage may only be transformed into an independent lien of EUR 10,000. Naturally, the interest claim (EUR 400) due in a year’s time may be satisfied from this amount. However, the balance of the principal plus other charges, if any, and additional interest will only be secured by the amount of the independent lien created by transformation less the interest claim (of EUR 400), i.e. EUR 9,600.

However, the amount determined in the original mortgage contract may also be a framework amount pursuant to Section 5:98 (3) of the Civil Code. In that case, the parties have specified an amount as the upper limit of the lienor’s right to satisfaction (e.g. by stating that the specified amount serves as security for existing and future debt). However, to judge whether the parties have indeed applied the specified a framework amount in this sense requires an exact interpretation of the original mortgage contract since it is not always clear from the wording what the parties exactly understand by “amount”. A framework amount is unique in that it includes the principal as well as all charges (e.g. interest and enforcement costs). In this case, neither the original lienor, nor the lienor under the independent lien is allowed to exercise its right to satisfaction in excess of this amount even if its principal and charges may exceed this framework amount.

When a framework amount is specified, it is possible to transform accessory mortgage into independent lien also in respect of the portion not specified by an exact amount (e.g. charges) but only up to the framework amount.

The question is whether transformation also extends to interest and other charges shown as exact amounts in the original mortgage contract in cases when the parties specify both the claim and related interest and other charges as exact amounts. We think it reasonable to answer this question in the affirmative.

In fact, the lienee's position would not become any more onerous even if transformation in excess of the principal amount determined in the original mortgage contract extended to interest and other charges unspecified as exact amounts. That is because neither during transformation nor thereafter may the lienee or the parties modify the content of the original mortgage contract, which is deemed to constitute a security agreement. Therefore, contractual terms applicable to interest and other charges may not be modified either. Consequently, the amount of principal per se may not change by transformation. However, the law should include explicit provisions to the effect that transformation should also extend to interest and other charges unspecified as exact amounts, in addition to the specific amount of principal. Currently, no such provisions are laid down anywhere in the regulations. In view of that, the lienee's position may actually become even more favourable as a result of transformation since, potentially, the security provided by the lien may not extend to charges unspecified as exact amounts following transformation.

### *5.3. The security agreement and determining the target of the security*

A central element of the provisions of the Civil Code on independent lien is the security agreement. That given, regulations governing the security agreement were also necessary as regards the specific type of independent lien known as independent lien created by transformation. Accordingly, Section 29 (5) of the CCAA provides that the mortgage contract which established the mortgage affected by transformation and served as the basis for recording the original mortgage in the real estate register must be treated as a security agreement. Thus, in the case of an independent lien, the security agreement is created by operation of law.

Also, if the secured claim, whose amount is specified in the original mortgage contract, ceases to exist (e.g. by reason of performance), then an independent lien created by transformation may not be used for any other purpose. On that basis, no further security target may be attached – under a new security agreement – to an independent lien created by transformation once it has lost substance as the claim it covered ceased to exist. Moreover, the CCAA declares null and void any agreement departing from and any provision conflicting with the original mortgage contract included either in a unilateral declaration of transformation or in a transformation agreement.

This is also designed basically to protect the lienee but also provides protection to third parties – primarily subordinated obligees recorded in the real estate register – who could reasonably expect that the accessory mortgage transformed into an independent lien created by transformation would terminate upon fulfilment of the secured claim. That is because allowing to conclude a security agreement with content at variance with the original mortgage contract would give rise to the risk that an independent lien created by transformation would continue to exist even for an unlimited period. The absence of such statutory prohibition

would also allow the parties to enter into newer and newer security agreements or to modify the original mortgage contract as a security agreement repeatedly. Accordingly, it is not only not possible to depart from the original mortgage contract during transformation but it is also not allowed to amend the same subsequent to the registration of the independent lien created by transformation.

Therefore, it can be concluded that there is a significant difference between an independent lien and an independent lien created by transformation in that with the latter the parties do not have an option to use it to secure newer and newer claims. Naturally, there is no prohibition of this nature in respect of reregulated independent lien.

It also follows from the provisions of the CCAA that, with independent lien created by transformation, the mortgage contract constituting a security agreement by law is also applicable in respect of the question of when the lienee's right to satisfaction accrues. If the mortgage contract contains a provision to this effect then the rules governing the termination of the independent lien can be disregarded. This is supported by the wording of Section 5:100 (5) of the Civil Code saying that "*unless the security agreement provides otherwise*". As in the case of an independent lien created by transformation, the original mortgage contract must be considered the security agreement, therefore – if the original mortgage contract provides otherwise – the provisions governing termination of the independent lien will not apply. Thus, if the original mortgage contract makes the accrual of the lienee's right to satisfaction conditional on the secured claim falling due and overdue payment, then the same provision will also apply to the accrual of the right to satisfaction related to the independent lien created by transformation. In such a case, the application of provisions on termination of the independent lien can be dispensed with.

Importantly, it has to be emphasised that the original mortgage contract constituting a security agreement does not have to contain the compulsory substantive elements specified by Section 5:100 (3) of the Civil Code in respect of the security agreement related to the reregulated independent lien. Based on other provisions of the CCAA pertaining to independent lien created by transformation, the original mortgage contract becomes, in its entirety, the security agreement, which cannot be supplemented subsequently. If the original mortgage contract constituting the security agreement had to contain the compulsory substantive elements specified in Section 5:100 (3) of the Civil Code, it would be tantamount to assuming that the lienor would unilaterally or that the parties would collectively modify the content of the accessory mortgage contract subsequently. That, however, is not permitted and in fact is explicitly prohibited by the CCAA.

The option of unilateral transformation as such contradicts the requirement for the original mortgage contract to comply with the provisions of Section 5:100 (3) of the Civil Code. That is because a requirement of this nature would lead to the recognition of the lienor's right to supplement the original mortgage contract constituting a security agreement and to modify its content unilaterally. This would obviously hurt the lienee's interests, which is yet another reason why the original mortgage contract may not be amended subsequently.

It follows from all of the above therefore that, with an independent lien created by transformation, the existence of substantive elements stipulated by Section 5:100 of the Civil Code do not have to and cannot be examined in the original mortgage contract constituting a security agreement. Hence, an independent lien created by transformation does not support a

retrospective conclusion that the lienee is not in a position to exercise its right to satisfaction because a security agreement related to an independent lien created by transformation was not even concluded for lack of material substantive elements stipulated by law. When scrutinising the validity of concluding a security agreement, the point of departure must be the original content of the mortgage contract constituting the security agreement.

## 6. Summary

In our opinion, reregulated independent lien is an appropriate legal arrangement which responds to the economic needs calling for the facilitation of lending and the stimulation of the Hungarian mortgage bond market. That given, the application of the independent lien also offers much greater opportunities, such as for example the potential to combine it with the institution of fiduciary asset management and thereby offer new refinancing techniques to the Hungarian banking sector.<sup>38</sup>

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38 The potential to use fiduciary asset management for bank refinancing purposes is also discussed by *Norbert CSIZMAZIA*. See Norbert CSIZMAZIA: *Liens and Ockham's Razor*. *Polgári Jog* (Civil Law) 5/2016. 31.