

Gusztáv Báger

Introduction of a Debt Management Procedure for Natural Persons in Hungary

SUMMARY: Excessive indebtedness makes support for rehabilitation necessary for millions of households. Hungary – mainly using the experiences of European countries – introduced the institution of personal bankruptcy this year. This paper attempts to compare the European model and the US practice, the former being characterised by a creditor-oriented approach, while the latter focusing on the debtor. On the basis of this, the paper discusses the objectives of the Hungarian personal bankruptcy law in an international context, including the importance of a “new beginning” for the debtor and the main features of the procedure in and out of court. It emphasises that in Hungary as well, the debtor must initiate a debt management procedure – an agreement to be reached through negotiations – first out of court and then in court. The debt remaining at the end of the procedure can be cleared after five years – similarly to European practice. Since the procedure under the new law can be initiated first by debtors who can no longer pay their housing mortgage loans, it is expected to have favourable social and macro-economic effects.

KEYWORDS: consumer insolvency, debt management, debt management in Europe and the US

JEL CODES: D18, D19, G33

On 3 April 2012, the National Assembly requested the government to examine the possibility of introducing the rules of the procedure for the debt management of natural persons, that is, the institution of personal bankruptcy. The settlement of debts – by virtue of law – could help the resolution of the problems of both debtors with a foreign currency loan and those who have accumulated a debt in some other way and have become insolvent.¹ As a result of this, the National Assembly adopted Act CV of 2015 on the debt management of natural persons (hereinafter: Debt Management Act), thus Hungary has become

one of the countries that have introduced the institution of personal bankruptcy.

The aim of this paper is to present the main features of the Hungarian procedure in an international context: on the basis of the experiences gained in European countries and the United States of America. After outlining the development of the legal institution, two models used as an example for the procedure, the US and the European models will be compared. Then, the new Hungarian legal institution will be presented, showing the diversity of the European model in individual countries. Finally, the paper will illustrate how the debt management procedure for natural persons is applied in Hungary.

E-mail address: bagerg@gmail.com

THE DEVELOPMENT AND SPREADING OF THE INSTITUTION OF PERSONAL BANKRUPTCY

Before this legal institution appeared in our country, there was no opportunity to use a special procedure for natural persons in judicial enforcements that is different from the general procedure, which resulted in considerable social tension, since a judicial procedure against the registered seat of a business requires consideration of different criteria than a procedure initiated against the home of a family. At the same time, it should be noted that before the introduction of the institution of personal bankruptcy, the provisions of Act LIII of 1994 on judicial enforcement had to be applied. The aim of adopting this law was to ensure, according to the ministerial justification, that the economic organisations and private persons active in the economy could be obliged by the force of law to perform their obligations.

Due to the widespread availability of consumer loans in developed countries – the deregulation of the credit market – the failure to perform obligations represented a major problem to be resolved for consumers as well as the entire society (Joslin, 1964–1965). This view urged France to be the first to introduce the institution of personal bankruptcy for consumers (Anderson et al, ed., 2011). On the spreading of the institution in Europe, *see Figure 1*.

The fact that the European Court of Human Rights established, in a decision made in 2004, that personal bankruptcy does not injure the right of creditors to property created favourable conditions, *inter alia*, for the development of the institution of personal bankruptcy. This institution fulfils an important supplementary role in addition to the social care system, making it possible to consider social criteria in addition to those used in judicial enforcement.

On the basis of the experiences of debt management procedures used in developed countries, we can establish that for the most part, these procedures become necessary as a result of a change occurring in financial conditions (crisis situations) rather than due to irresponsible personal or family overspending. Extensive debt management involving a large number of people becomes necessary at the time of economic crises or huge downturns, when the new conditions, such as unemployment or a decrease in the household's income in crisis situations, hit the families hard.

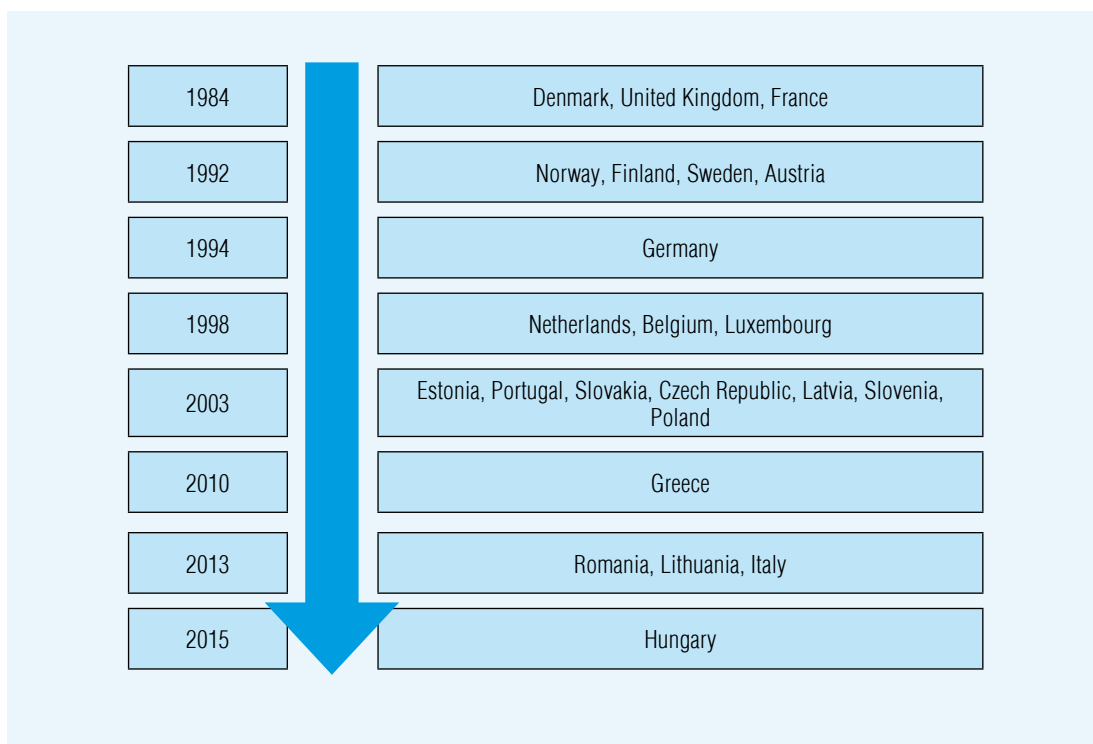
On the basis of international experience, we also need to mention additional reasons, such as the substantial indebtedness and insolvency of people living under a particular income level, the poverty level; a change in family status (for example divorce); and the excessive loans taken out by pensioners and people with higher qualifications. In this context, increased attention should be paid to the experience gained in the United States, which shows that – due to the social regulation system in force – healthcare expenses often exceed the solvency of households. According to an earlier survey conducted in 2005, 46 per cent of those filing for bankruptcy mention high costs of healthcare services as a reason for becoming highly indebted.

Special attention should also be given to the findings of a survey carried out in Germany in the context of debt management, where more than half of excessive indebtedness (50.6 per cent) is due to the emergence of unexpected problems. The key factor in these problems is unemployment and the forced reduction of working hours (29.6 per cent), followed by the separation or divorce of spouses (12.9 per cent) and the situation of self-employed being made impossible (11.8 per cent) (Knobloch, 2012).

The reasons for excessive indebtedness and non-performance in Hungary differ from

Figure 1

ENTRY INTO FORCE OF THE REGULATIONS ON THE DEBT MANAGEMENT OF NATURAL PERSONS IN EUROPE



the international experience in several respects. Just before the outbreak of the crisis, households were typically indebted in foreign currency in Hungary², and therefore the significant depreciation of the Hungarian forint during the crisis dramatically increased the amount of instalment payments expressed in the Hungarian currency. Furthermore, due to the previous shortcomings of the Hungarian regulations, the banks had an excessively dominant position in respect of modifying the pricing and the conditions of credit agreements unilaterally and subsequently. As a result, they were able to counterbalance their decreasing profitability by raising the interest rate of foreign currency loans.³ Thus, for Hungarian debtors, the downturn in the real economy was coupled with the shock associated with interest rates and exchange rates, while

monetary easing in other countries typically led to an improvement in the financial position of debtors.

Due to the scale of the problem in Hungary, several studies and publications addressed the reasons for the default of non-performing loans, including the National Bank of Hungary, which looked into the issue on several occasions – mainly in its Financial Stability Reports (MNB, 2015).

“For the purpose of supplementing the findings of previous analyses, we examined the reasons for indebtedness and non-performance in the focus group research conducted with debtors. The results gathered in the focus groups largely confirmed our theoretical reasoning: on the basis of the loan stories outlined by debtors, the direct cause of non-performance was typically a dramatic increase in the payment-to-income ratio

(PTI), which was primarily due to the surging exchange rate. This was made even worse by the sudden change in the position of the people on the labour market who participated in the focus group survey – typically, they have lost their job, their income has decreased due to an illness or having a child as well as to the difficulties they have to face when trying to reintegrate into the labour market – and by the constantly dropping incomes in terms of real value (which occurred, according to respondents, mostly after taking out a loan).²⁴

COMPARISON OF THE US AND THE EUROPEAN MODELS

In contrast to earlier special regulations for the debt management of natural persons, in the past 2–3 decades more importance was attached to statutory regulations. However, the regulations adopted in each country vary significantly, which is demonstrated by the wide range of solutions regarding the settlement of the remaining debt at the end of the debt management procedure. There are examples for instances of both “no exemption” and “automatic exemption.” According to the US practice, the debtor may be exempted from repaying some or all of the remaining debt relatively easily and automatically. In Germany, debtors need to wait for exemption to take place (Walegn, 2014).

IN THE UNITED STATES, the aim of the federal bankruptcy law regulating consumer and corporate insolvency (United States, 1978) is to ensure,

- on the one hand, that an “honest” debtor can start a new life by waiving most or even all of the outstanding debt;
- on the other hand, that creditors get as much of the debt as possible that the debtor can pay from their property and income.

It is obvious that these goals clearly put the debtor’s interests first. Debtors can submit their application for the debt management procedure in accordance with Chapters 7 or 13 of the Bankruptcy Act. In a procedure pursuant to Chapter 7, the debtor relinquishes all of their assets – which are not subject to the regulation on exception –, which the trustee in bankruptcy liquidates and uses the revenue to pay the creditor, after which the debtor is relieved of all of his obligations. In accordance with the procedure under Chapter 13, the debtor certifies their regular income and submits a payment programme to the creditors which makes it possible for them to cover the costs of livelihood. If debtors can meet the payment obligations in accordance with this program, they will be exempted from the remaining debt after a specific period (3–5 years). In this case, the aim of the procedure is to rehabilitate the debtor. The procedure under the two different chapters obviously provides different advantages for the debtor. About two-thirds of debtors choose the procedure pursuant to Chapter 7 and one-third of them opt for the procedure under Chapter 13 – in view of longer periods.

The aims of the REGULATIONS IN THE PERSONAL BANKRUPTCY LAWS OF THE EUROPEAN COUNTRIES are different, focusing on the protection of the interests of debtors instead of safeguarding the interests of creditors – as compared to the situation in the US.

▶ Similarly to the United States, the aim of the regulation in the United Kingdom is to relieve debtors of most of their debt by dividing their assets and income in a fair manner among the creditors (United Kingdom, 1986).

▶ In Ireland, the aim of the regulation is to satisfy the claims of creditors by selling the debtor’s assets (Ireland, 2012).

▶ In Germany, the insolvency regulation that entered into force on 1 January 1993 was designed primarily to satisfy the claims of

creditors and concurrently provide a chance for debtors to get out of the insolvency situation by ensuring a reasonable and fair level of subsistence during the debt management procedure. To ensure this, some parts of the debtor's assets and income are not subject to the debt management procedure (Germany, 1999).

▶ In France, the aim of the regulation is similar to that in Germany, and the accomplishment of this aim is supported by the so-called Household Debt Committee (France, 1989).⁵

▶ In Spain, the regulation focuses on satisfying creditor claims while it is also designed to protect the debtor from the serious consequences of excessive indebtedness (Spain, 2003).

▶ In Greece, the aim of the consumer debt management law adopted in 2010 is to eliminate the state of insolvency in the case of natural persons who have not committed fraud (Greece, 2010).

As far as the conditions for **WAIVING THE REMAINING DEBT** in the European arena is concerned, the American practice is closest to the regulation in the United Kingdom, where any insolvent debtor is automatically exempted from paying the remaining debt without a court ruling. In contrast, in Ireland debtors remain in an insolvent position for up to 12 years or for an indefinite period. In most European countries, debtors need to meet certain conditions for exemption for a certain period before exemption is finally granted to them. The length of time for exemption varies significantly by country:

- in France: 0–8 years;
- in England and Wales: 1–3 years;
- in the Netherlands and Slovakia: 3 years;
- in Belgium, Denmark and Germany: 3–5 years;
- in Greece: 4 years;
- in Austria, the Czech Republic, Estonia,

Poland, Norway, Portugal and Sweden: 5 years, and

- in Luxembourg: 7 years or less.

As this short overview shows, in addition to similarities, there are significant differences between the European and the US debt management regulation and practice. It should also be emphasised that there is no common debt management procedure at the European level. Only certain common procedural rules have been determined for the official decisions that establish insolvency, according to which the decisions made in a particular country is recognised by the other countries. The effective EU consumer directive can assist the efforts to harmonise the process of debt management only by standardising the reporting systems and determining the rights related to default on repayment and advance redemption. Additional directive regulations would be required to define the fundamental concepts under community law – such as excessive indebtedness and non-performing loans – by taking European best practices into account.

When comparing the two models, it can also be established that while the regulation on debt management in the US has been made more stringent in the last few years, the European regulation has gradually become less tight. For example, the length of time for exemption from paying the remaining debt is gradually getting shorter.

In view of this diverse picture, or because of it, there is good reason to establish that it is a complex task to select the right directions and the right extent of debt management, which requires due care. It is especially difficult to decide what the key priority should be:

- the increased protection of the interests of debtors (consumers) against the interests and rights of creditors, or
- to ensure that the repayment plans to be worked out are less stringent in order to

stimulate the debtors' consumer spending (Gerhardt, 2009).

Undoubtedly, in order to stimulate European economic growth on the demand side for recovery from the 2008–2009 international economic and financial crisis, the second priority should be given more importance.

MAIN FEATURES OF THE ACT ON THE DEBT MANAGEMENT OF NATURAL PERSONS

In accordance with the preamble of the Debt Management Act, the statutory provisions provide a tool that

- restores the debtor's⁶ solvency;
- ensures the livelihood and the housing of the debtor and their family; and
- contributes to the debt repayment plan which requires disciplined payment and takes into account the reasonable interests of the creditors.

As a result, the general rule of the Debt Management Act covers those natural persons who have payment difficulties or are excessively indebted.

Objectives of the debt management procedure

The aim of the regulated debt management procedure under the Debt Management Act is to ensure that the debt of natural persons is settled under regulated conditions and that their solvency is restored. The debt management procedure

- is based on the mutual cooperation of the debtor and the creditors;
- ensures conditions in accordance with the reasonable interests of the creditors in the interest of coordinated repayment of the debt;
- strengthens the debtor's repayment ability;

- defines the rules of asset sales, income and asset division and implements a repayment schedule that is adjusted to the housing and subsistence costs of the debtor and their close relatives of an active age living in the debtor's household; and
- grants final exemption from repayment of the remaining debt for the debtors who observe the rules of debt management and act in good faith – after they have met their payment obligations to the extent expected.

These goals – as can be seen – are closer to those of the model used in the European countries, especially in Germany, than to the US model. In the spirit of creditor orientation, one of the key goals of the Hungarian regulation is to ensure conditions that are in line with the reasonable interests of the creditors, just like in Ireland and Spain. As far as the conditions for waiving the remaining debt are concerned, the domestic regulation is also in line with the European practice, as final exemption from paying the remaining debt may be granted to debtors who observe the rules, act in good faith and cooperate. The conditions required for this kind of “rehabilitation” of debtors are significantly different in each country in terms of the length of time required for exemption or in how much of the debt (most of it or only a symbolic part of it) must be repaid in order to be granted exemption.

The parties taking part in the debt management procedure must cooperate with one another and must seek to ensure the best possible conditions for the debtor as far as the manner of debt management and its detailed rules are concerned. The debtor must refrain from any conduct during the debt management procedure which would jeopardise the objective of the debt management.

According to the Hungarian regulation, the debtor is obliged to cooperate with the creditors, the Family Bankruptcy Procedure Ser-

vice and the family insolvency administrator. Thus, the Hungarian regulation makes available for the debtor a professional consultative forum which can only be set up in European countries where outstanding debts are settled by using the debtor's assets and income, in addition to the other obligors meeting their own obligations undertaken in the procedure. The debt management procedure includes all the assets and income of the debtor which they possessed when the debt management procedure was initiated as well as all those assets and incomes that they acquire before the judicial debt management procedure is ordered or when the debt management procedure is in progress. At the same time, the assets and the income that are necessary for the basic subsistence of the debtor and the close relatives living in their household are justifiably exempt from the debt management procedure. This option (objective) is included in the regulation of most European countries.

Conditions for initiating debt management

The debt management procedure may be initiated exclusively under the following conditions, that is, if the affected person has a debt

- which is at least HUF 2 million but no more than HUF 60 million;
- which does not exceed twice the total wealth of the debtor;
- at least 80 per cent of which the debtor acknowledges;
- of which at least one debt is overdue for over 90 days in the amount of HUF 500,000;
- of which, the number of subordinated claims⁷ does not exceed five;
- which includes a debt arising from a consumer loan or a loan to finance a private enterprise⁸; and
- which does not include a debt created as a result of a court order which established that after closing a previous entrepreneurial activity, the debtor failed to perform their obligations in regard to the assets entrusted to them or unlawfully caused damage to their creditors.

The existence of the conditions listed here is verified by the Family Bankruptcy Protection Service when the procedure is started. If, however, it is established that the debtor has forged documents in order to satisfy these conditions, the creditor, the Family Bankruptcy Protection Service and the family insolvency administrator may initiate termination of the procedure.

However, the debtor may not initiate the debt management procedure if

- they do not qualify as a domestic natural person; that is, they do not reside in Hungary in accordance with the general rule;
- they have participated in a debt management procedure within the last 10 years;
- there is another debt management procedure in progress with their participation either in Hungary or abroad;
- there is any claim made against them abroad regarding an asset or a payment, or a final decision has been made against them which has to be recognised in Hungary;
- the enforcement of a claim against them in the amount of at least HUF 200,000 arising from a private legal relationship is in progress;
- they have a debt related to a fine or the costs of a criminal procedure imposed on them, or their assets are under a freezing injunction, or the confiscation of assets has been ordered against them;
- they have defaulted in paying a fine imposed on them in a misdemeanour or public administration proceeding in an amount exceeding HUF 500,000 including related contributions;

- they have overdue debt under public law⁹; and
- their residential property has been offered to the National Asset Management Inc. for purchase.

Similarly to Hungary, in most European countries the possibility for debtors to participate in the debt management procedure is determined by taking into account the amount of the debt and the financial income situation of the debtor, or some kind of a joint ratio of these two conditions. For example, in the United States the procedure can be initiated – in accordance with the procedure under Chapter 7 – independently of the amount of the debt; it only depends on the amount of the debtor’s income available in a year, which is determined on the basis of a so-called income and asset test. For example, in 2007 it was enough for a family of three members to have an income of USD 62,815 a year to initiate the debt management procedure (City Bar Justice Center et al., 2007). In Greece, not only a bankrupt debtor can participate in the procedure but any person who is constantly struggling with solvency problems – which are initially small – and who has not committed a fraud (Greece, 2010).

Legal consequences of initiating debt management

Once the debt management procedure has started, the financial institution¹⁰ may only enforce its claims against the debtor under this procedure. Furthermore, the financial institution may not put itself into a more favourable position against the other creditors, and in the event it does so, it must compensate for the damage caused to the debtor and the other creditors.

Furthermore, the debtor must manage their assets and revenues included in the debt man-

agement procedure from the time the debt management was initiated and rationalise their expenses in such a way that it does not jeopardise the interests of the creditors, and furthermore, the debtor should refrain from any conduct that would frustrate or endanger the aim of debt management.

Any enforcement must be stopped by the bailiff immediately after receiving notification of the commencement of the debt management procedure. With the commencement of the debt management procedure, the enforcement case is suspended.

A creditor claim which has not been reported in the debt management procedure despite a request to this end may not be enforced during the debt management procedure and such claims do not generate any interest. This provision is meant to ensure that creditors indicate, as possible, what claims they have against the debtor.

The legal consequences of debt management are specified in the Hungarian regulation in accordance with the best European practice. At the same time, the Hungarian regulation sets out even stricter limitations for financial institutions by providing that they may not take any measures which would put them or any other creditor into a more favourable position against other creditors.

The enforcement of favourable legal consequences may be facilitated by giving a special role to regular mediation between the debtor and the creditors in financial cooperation.

At the same time, in other countries debtors are encouraged to restructure their outstanding debts and refinance them by taking out new loans. For example, in Ireland the Irish Money Advice and Budgeting Service (MABS) assists debtors, working together with the Irish credit union, in opening a bank account and getting the necessary loans (Korczaq, 2004). In Finland, even more is done in order to facilitate harmonious cooperation

between the debtor and the creditor by the Finnish Guarantee Fund providing a surety for the loans of private individuals who have been excessively indebted, making it possible for the banks to grant “reconstruction loans” to the debtors (Anderson et al, ed., 2011).

Debt management procedures

The debt management procedure can be divided into two categories: debt management out of court and debt management in court.

The debt management procedure out of court

If a financial institution registered in Hungary has a mortgage on the debtor’s residential property, or the debtor has concluded a financial lease contract for a property used for housing, then the debtor must first initiate the conclusion of an agreement for debt management out of court with the beneficiary of the mortgage and the financial institution as the beneficiary of the financial lease. Thus, the debtor first must turn to the *principal creditor*¹¹ before initiating the debt management procedure to indicate their willingness to initiate debt management out of court. The financial institution notifies the debtor within eight days if it cannot be regarded as principal creditor and simultaneously with this, it forwards the documents submitted by the debtor to the Family Bankruptcy Protection Service. The Family Bankruptcy Protection Service

- forwards the application to the principal creditor within 8 days if the identity of the principal creditor can be established on the basis of the available documents,
- forwards the application to the court competent in the debtor’s domicile within 8 days if the identity of the principal creditor cannot be established on the basis

of the available documents or there is no principal creditor, and this opens the judicial debt management proceedings.

If the principal creditor is known, the principal creditor or the majority of the creditors may request the Family Bankruptcy Protection Service to ask the notary of the municipality competent in the debtor’s domicile to prepare a detailed study of living conditions. The aim of this study of living conditions is to examine the housing conditions of the debtor and the persons living with them, the number of persons authorised to use the debtor’s home, the legal title of such use as well as the financial situation of the close relatives living in the debtor’s household.

If on the basis of the application and the study of living conditions the principal creditor agrees to perform the tasks in connection with the coordination of the debt management out of court, then the principal creditor prepares the draft agreement for the settlement of the debt and the restoration of the debtor’s solvency jointly with the debtor within 30 days, which is then sent to every creditor by mail signed by the debtor. In the letter sent to the creditors, the principal creditor informs the other creditors that they may make comments and proposals on the debt management draft agreement within 15 days of its receipt, which they should send both electronically and by mail to the principal creditor and by mail to the debtor. By taking into account the comments and proposals received, the principal creditor, together with the debtor, revises and amends the debt management draft agreement as necessary. The debt management agreement will be created when this text is accepted by all the creditors as well as the debtor.

On the basis of the above, the principal creditor coordinates and participates in the examination of the conditions of the out-of-court debt management procedure, per-

forms the tasks related to the preparation of the agreement made on debt management between the debtor and the creditor under civil law and sends the agreement so concluded to the Family Bankruptcy Protection Service for registration in the debt management registry.

The out-of-court debt management procedure must be deemed unsuccessful if

- the out-of-court debt management agreement is not concluded within 90 days of the principal creditor receiving the certificate on the positive results of the examination following the submission of the application;
- the principal creditor establishes that the debtor has failed to report certain creditor claims when initiating the out-of-court debt management procedure or during this procedure; or
- the principal creditor or any of the other creditors reports to the Family Bankruptcy Protection Service that the debtor has failed to perform the obligations undertaken in the debt management agreement within 30 days of being called upon to do so.

The out-of-court debt management is a common practice in a number of European countries. One of its forms is implemented through public administration (in the United Kingdom, France and Sweden), and the other form, the judicial stage can begin after this procedure or in its place.

▶ It is especially the French procedure that deserves attention among the methods used in public administration, in which the Household Debt Committees financed by the state play a crucial role. The central member of this committee is the French central bank, which is also trusted by the creditors, performing administrative tasks in the process – on the basis of a service contract concluded with the state – and provides an office for the committee. The “one-stop shop” administration

offered by the committees ensures that the plan to recover solvency can be worked out within a year and the debtor – on the basis of a five-year repayment plan – may be granted exemption from repaying the remaining debt. One of the key features of this procedure is its strong social sensitivity, which was mainly due to the high rate of unemployment in the 1990s. Therefore, this procedure is often seen as the manifestation of social rights. It is to be noted here that in spite of the above, in 2010 the French State Audit Office criticised the committee’s procedure because they did not examine the execution of the exemption decision subsequently and failed to create a proper relationship between the committees and the social authorities (Cour de Comptes, 2010).

In many countries, the European regulation systems require the debtor and creditors to come to an agreement through negotiations before a judicial procedure is initiated, which has proved to be difficult in practice (Niemi – Henrikson, 2006). The ratio of successful agreements in Germany is only 10 per cent and it is even lower in the Netherlands.

▶ The insolvency law in Germany encourages the debtor and the creditor to come to an agreement out of court. To this end, it requires the debtor to make proposals in two phases to the creditors in order to work out a reasonable payment agreement. In the first phase, the debtor should seek consensus with all the creditors in such a way that the debtor is assisted in this effort by an “appropriate person or office”, the selection of which is crucial and therefore it is determined by the provincial public administration authority who this person should be (a lawyer or a debt management adviser supported by the state). The suitability of these persons – on the basis of experience – may have a significant influence on the success or failure of reaching an agreement. If the majority of the creditors re-

ject the plan worked out in the out-of-court procedure, in the second phase the debtor may initiate a simplified insolvency procedure which may not be longer than one year, but this deadline is hard to meet because of the overburdened debt consultancy centres. The simplified insolvency procedure is conducted by an asset manager appointed by the court, who sells the assets that are not necessary for the subsistence of the debtor in order to settle the debts with the creditors. The objection that may be raised against this procedure is that the debtor actually loses ownership rights over their assets, which are such fundamental rights in the Hungarian legal system that this element of the procedure could not be made compatible with the current Hungarian regulation.

The debt management procedure in court

If the debtor does not have a principal creditor, or the principal creditor refuses to undertake the coordination of the debt management out of court, the judicial debt management procedure commences at the debtor's request.

After the application is received, the court orders to carry out the debt management procedure and the Family Bankruptcy Protection Service designates a family insolvency administrator¹², who will monitor and oversee the management of the debtor's household during the judicial debt management procedure.

The creditors may not terminate the loan relationship during the term of the judicial debt management procedure by relying on the non-performance or late performance of the debtor, nor may they cancel the lease contracts for residential properties or the contracts on the provision of services that are necessary for the everyday life of the debtor and the close relatives living with them.

The family insolvency administrator calls upon the creditors who duly registered themselves for participation in the debt manage-

ment procedure to reach an agreement. This invitation should contain the programme designed to restore the debtor's solvency and the debt management plan which is prepared by the family insolvency administrator jointly with the debtor and sent to the creditors as a proposal for agreement. On the basis of this proposal for agreement, the majority of the creditors may request that a negotiation on agreement be held where, in the presence of the family insolvency administrator, the debtor and the creditors may amend the proposal for agreement by mutual consent. However, the majority of the creditors may decide that they do not want to enter into a negotiation on agreement but accept the proposal.

Under the agreement – accepted either as a result of a negotiation or without it – the debtor and the co-debtor agree with the creditors on the conditions of debt management, in particular:

- on the easy terms of payment (for the principal sum and/or its interests and other contributions);
- on the rescheduling of payment;
- on conversion of the debt from a foreign currency into Hungarian forints, if applicable, and on the exchange rate;
- on sharing the exchange rate risk in the future;
- on the way in which the amounts collected in the ongoing judicial enforcements and the sale of pledged property should be used for debt settlement; and
- on any other conditions which the debtor and the co-debtor undertake in connection with the judicial debt management procedure in order to restore their solvency.

The court approves the agreement in its ruling. In the course of executing the agreement:

- the debtor's management of the household is overseen by the family insolvency

administrator, who may at any time carry out supervision at the creditors' request or *ex officio*;

- every six months, the family insolvency administrator asks the debtor to report, in writing, on the execution of the agreement, the sale of assets under the debtor's discretion, the division of the revenues coming from the sale of these assets among the creditors, the current status of the total debt, the performance of the instalment payment obligations as well as on any other aspect that is relevant for the execution of the given agreement; and
- the creditors included in the agreement may exercise their rights in accordance with the provisions of the agreement and must support the debtor in the execution of the agreement.

The amendment of the agreement may be initiated by the creditors if the debtor is able to pay an amount as advanced redemption, proportionally to every creditor, which is higher than the amount undertaken in the agreement. At the same time, the debtor may also initiate amendment of the agreement at most twice if any extraordinary and unexpected event occurred in their personal, financial or income situation, due to which they are unable to perform under the original conditions of the agreement and can verify the existence of such circumstances which can be reasonably taken into account.

The debt repayment process begins after the agreement is successfully concluded under which the family insolvency administrator, together with the debtor, prepares a list of the assets and income sources of the debtor that are available for the debt repayment procedure. The family insolvency administrator prepares an asset division, asset sale and debt repayment plan for the assets included in the debt management procedure which are still available as well as for the revenues that can be

used for the purpose of debt settlement. The debt repayment plan:

- specifies the assets and revenues that can be retained by the debtor;
- determines the rules of the sale of assets to be used for debt repayment;
- specifies the revenue from the sale of assets and the rules governing the division of the debtor's funds and the revenues generated during debt management; and
- specifies the duties of the family insolvency administrator, the debtor and the creditor in the debt repayment procedure.

The court approves the debt management plan in its ruling within 15 days.

After the expiry of the five-year debt repayment period, the family insolvency administrator prepares a closing account on the implementation of the debt repayment order together with the debtor, accounting for the repayment of the instalments for each creditor, the sale of assets, the revenues involved in the procedure and their distribution among the creditors.

If the debtor has fulfilled their obligations specified in the debt management agreement or the debt repayment decision as well as all the other obligations set out in this act, and the creditors have received at least a minimum return, the court makes an exemption decision on the basis of the closing account. As a result of the exemption decision, all the claims of the creditors participating in the procedure will be cancelled against the debtor which have not had to be satisfied in full on the basis of the debt repayment decision by the end of the debt settlement period.

In the European countries and the US, the debtors can eventually be granted exemption at the end of this or a similar judicial procedure. As has been seen above, the duration of the exemption period is between 0–8 years but five years in most countries, which is the same as in Hungary. It can also be established that in the past two decades, some countries made

the conditions easier for the debtors by reducing the length of the exemption period and the amount of the income that could be taken away by the creditors from the debtors. For example, in Germany the duration of the exemption period was reduced to 3–5 years from 6 years, while the ratio of the income that remains with the debtor was raised close to 50 per cent in 2002 in the case of single persons and married couples without children and to 30–40 per cent in the case of debtors with children. In this context it should be noted that since then, the amount allocated for the subsistence of the debtor has been adjusted in every other year by the inflation rate (Kilborn, 2004).

The question is how the life of the debtors changes after the debt management procedure is closed and the exemption is granted. The experiences gained in Germany in this respect are clearly illustrated in *Figure 2*.

As a result of the completed debt management procedures, the former debtor’s well-

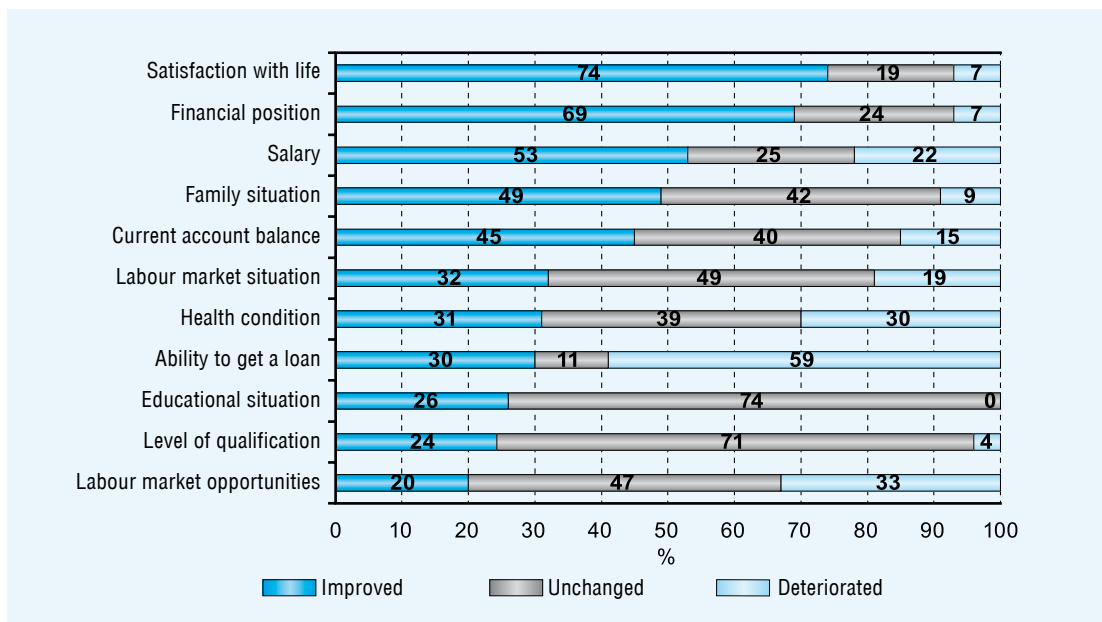
being and satisfaction with life, their financial situation and salary improved by more than 50 per cent, which suggests that the primary goal of the procedure has been accomplished. The family situation and the current account balance of the individual (family) also exhibits considerable improvement. The strongest neutral effect can be seen in education and the level of vocational training. However, this effect was the smallest in respect of getting a loan, as the situation of 59 per cent of the debtors deteriorated in this respect. The deterioration in salary, health conditions and opportunities on the labour market is also informative.

ESTIMATING THE NEEDS FOR A DEBT MANAGEMENT PROCEDURE

The assessment of the need for debt management has been made difficult until now by the fact that there was no comprehensive

Figure 2

THE OPINION AND SITUATION OF DEBTORS IN GERMANY IN 2012 AFTER EXEMPTION



Source: Knobloch (2012)

Table 1

DEBTORS (BORROWERS) THAT CAN BE INVOLVED IN THE PERSONAL BANKRUPTCY PROCEDURE – ESTIMATE

| Legal provision | Statutory condition | Filtering condition | In the ratio of non-performing debtors (%) |
|---------------------------------|--|--|--|
| Act CV of 2015, Article 7 (1/a) | Total outstanding debt between HUF 2 and 60 million | The current principal sum of the loan meets the conditions | 74.7 |
| Act CV of 2015, Article 7 (1/b) | Ratio of total outstanding debt and total assets between 100% and 200% Property also including the income calculated for the next 5 years that can be used for debt settlement | “Loan-to-wealth” value meets the conditions. The income calculated for the next 5 years could not be taken into account | 18.2 |
| Act CV of 2015, Article 7 (1/e) | Number of subordinated debts does not exceed five | The household may have a debt to no more than 4 service providers | 14.7 |
| Act CV of 2015, Article 7 (1/d) | Has at least one debt overdue for 90 days, in the amount of at least HUF 500,000 | Using the ratio included in the credit institution’s data supply: 70.9 per cent of the 90+ volume with an overdue debt of at least HUF 500,000, based on number of contracts | 11.0 |

Note: the percentage value shows the ratio of the given filtering condition and the segments corresponding to the previous conditions to the entire population.

Source: MNB estimate

database available that covered micro-level data as well. Therefore, in the summer of 2015 the MNB requested contract-level data from market players that had the largest non-performing mortgage loan portfolio. Under this extraordinary data supply process, 14 financial institutions – 12 banks, one branch office and one financial enterprise – supplied data for the mortgage loan database. The database contained about 229,000 problematic mortgage loan agreements with an aggregate principal sum of over HUF 1,600 billion as at 30 April 2015, while the total amount of debt including the overdue interests and fees amounted to HUF 1,780 billion. On 30 April 2015, nearly half of the agreements included

in the database, about 109,000 agreements, had arrears overdue for more than 90 days.

On the basis of the database, also using the results of a representative questionnaire survey, MNB’s researchers¹³ made a rough estimate of the number of debtors that could be included in the personal bankruptcy procedure (see Table 1). In their estimate, they had to apply several constraints in line with the possibilities of the survey: they relied on the distribution of the mortgage loan database – on the basis of the number of contracts – when calculating the precise number of late payment days, and the “noise” regarding the incomes specified by the respondents may be present in this estimate as well. They had to use the incomes

that can be included in debt management as a further constraint, and as a result, the forecast of the future incomes for the next five years exceeded both the framework of the questionnaire survey and the ability of the respondents to design a financial plan.

On the basis of the data – in our view – the debt management procedure may be a viable alternative for about 11 per cent of non-performing debtors (11.6 per cent of the credit transactions), for approximately 15,000 debtors.

It is also crucial to know the actual financial situation of the households for the purpose of the personal bankruptcy procedure. Therefore, the researchers of the MNB conducted a questionnaire survey on the relationship between the outstanding mortgage loan debts of households and debtor’s financial situation (See Figure 3).

The results of the survey show that with 40.5 per cent of households, outstanding debt

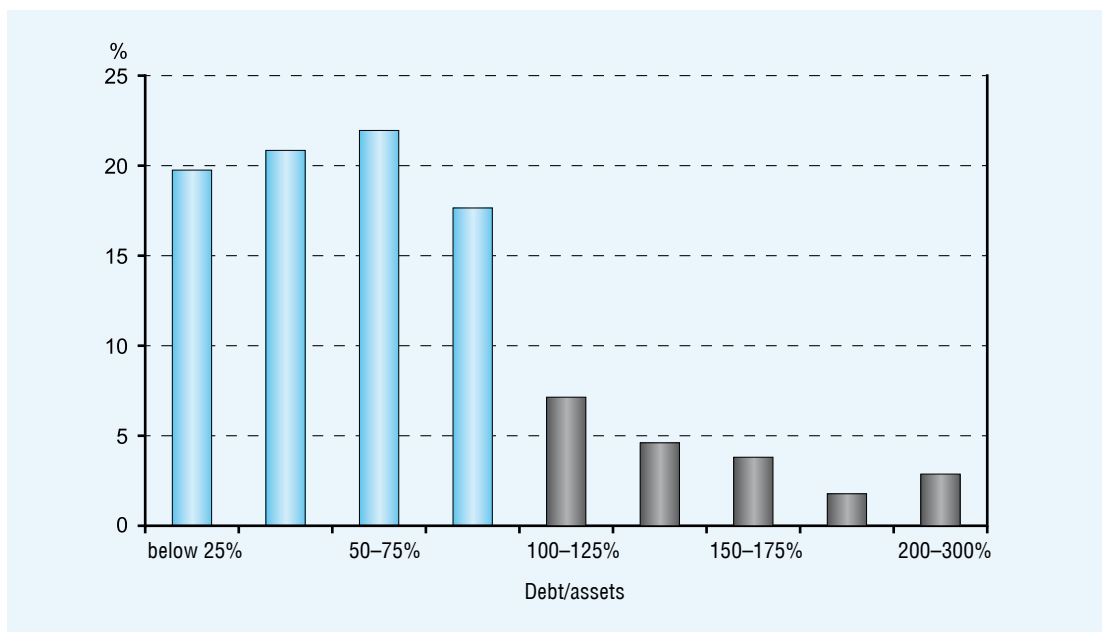
reaches half of the value of the household’s total assets. Excessive indebtedness, where the amount of the debt exceeds the value of the household’s assets, is typical of 20 per cent of households. Especially critical are 3 per cent of the debtors, whose indebtedness exceeds 200 per cent of the value of their total assets. The situation of these debtors will likely be not handled by the personal bankruptcy procedure either under the current conditions of initiating it.

The “demand” for personal bankruptcy in the future will probably be favourably influenced by the fact that as of 1 October 2016, the range of debtors eligible for initiating the procedure will be expanded.

At the same time, it should be considered how the application, which seems to be very difficult to complete on the basis of previous experience, can be simplified as soon as possible.

Figure 3

OUTSTANDING DEBT COMPARED TO THE TOTAL ASSETS OF THE HOUSEHOLD



Source: MNB representative questionnaire survey

Given that as of 1 September 2015, in the first phase, non-performing mortgage loan debtors may initiate the debt management procedure in Hungary, the impact will have to be assessed as it was in Germany. The result

of the Hungarian survey will likely be more positive than what can be seen on Figure 2, as the affected natural persons have been waiting for the settlement of the debtor situation for a long time.

NOTES

- ¹ Pursuant to Section 1, Subsection a) of National Assembly Resolution No. 31/2012 (IV.3.) on government measures to prevent the indebtedness of private individuals in a foreign currency.
- ² We do not want to discuss the evolution of foreign currency lending and its causes in detail in this paper. For more on these issues see Bauer et al. (2013) and Csajbók et al. (2010).
- ³ The rate hikes by the banks were partly justified by the increase in the cost of funds, the extra taxes imposed on the banks and higher impairment costs (Pitz – Schepp, 2013). However, the changes in interest rates were clearly asymmetrical: when the above factors would have justified a reduction in the interest rates, there was no change, as shown by the aggregate statistics.
- ⁴ See Bálint Dancsik, Gergely Fábrián, Zita Fellner, Gábor Horváth, Péter Lang, Gábor Nagy, Zsolt Oláh, Sándor Winkler, 2015.
- ⁵ Its members include representatives of local governments, the Association of Consumers, the credit institution, the treasury, the tax authority and the central bank as well as a lawyer and a social worker.
- ⁶ The term debtor always includes the co-debtor as well, as the debtor and the co-debtor may only jointly initiate the debt management procedure and pursuant to Article 7(3) of the Debt Management Act, each person can participate only in a single debt management procedure as debtor or co-debtor.
- ⁷ Subordinated claims are debts the beneficiary of which is the debtor themselves, or their close relative, spouse, an economic organisation in direct legal relationship with the debtor, or which is a private debt which can be enforced by an authority or in court.
- ⁸ A loan relationship in which the loan is taken out in connection with the commencement or pursuance of sole proprietor activities.
- ⁹ A claim under public law does not include the following:
 - ^{a)} the debtor's public debt originated in connection with a housing loan debt, the redemption of a state guarantee for a housing loan, or having a state housing subsidy or interest subsidy repaid;
 - ^{b)} the debtor's public debt originated from failure to repay a student loan;
 - ^{c)} the debtor's public debt originated from repayment of a budgetary subsidy taken out without justifiable legal ground and the amount of it does not exceed HUF 500,000;
 - ^{d)} the debtor was granted an instalment payment or deferred payment option and the rate of instalment payment does not exceed HUF 200,000 per month.
- ¹⁰ The financial institution shall mean a financial enterprise, other financial service provider or investment service provider responsible for the debtor's bank accounts and keeping a record of the debtor's financial instruments.
- ¹¹ The principal creditor

- is a credit institution with a registered address or a branch registered in Hungary or a financial enterprise extending loans, which has a mortgage on the debtor's property used for housing, or
- is the beneficiary of the financial lease contract concluded for the debtor's property used for housing.

¹²The insolvency expert participating in the debt management procedure who is legally employed by the government office that includes the Family Bankruptcy Protection Service pursuant to Article 5 (15) of the Debt Management Act.

¹³Bálint Dancsik, Gergely Fábián, Zita Fellner, Gábor Horváth, Péter Lang, Gábor Nagy, Zsolt Oláh, Sándor Winkler, 2015.

LITERATURE

ANDERSON, R. – DUBOIS, H – KOARK, A. – GÖTZ, L. – RAMSAY, I. – ROETHE, TH. – MICKLITZ, HANS-W. (ED.) (2011): Consumer Bankruptcy in Europe: Different Paths for Debtors and Creditors. 09 EUI Working Papers. p. 19

BAUER, P. – ENDRÉSZ, M. – KISS, R. – KOVALSZKY, ZS. – MARTONOSI, Á. – RÁCZ, O. – SCHINDLER, I. (2013): Túlzott lakossági eladósodás: okok, trendek, következmények (Overindebted households: causes, trends, consequences). MNB Bulletin, special issue, October 2013, pp. 29–38

CSAJBÓK A. – HUDECZ A., – TAMÁSI B. (2010). Foreign currency borrowing of households in new EU member states. *MNB Occasional Papers*. No. 87, National Bank of Hungary

DANCSIK, B. – FÁBIÁN, G. – FELLNER, Z. – HORVÁTH, G. – LANG, P. – NAGY, G. – OLÁH, ZS. – WINKLER, S. (2015): A nemteljesítő lakossági jelzáloghitel-portfólió átfogó elemzése mikroszintű adatok segítségével (A comprehensive analysis of the non-performing household mortgage loan portfolio using micro-level data). *MNB papers, special edition*

GERHARDT, M. (2009): Consumer bankruptcy regimes and credit default in the US and Europe: a comparative study. *CEPS Working Document* No. 318, Brussels, Centre for European Policy Studies

JOSLIN, G. St. (1964–1965): The Philosophy in Bankruptcy: A Re-Examination. 17 U. Pa. L. Rev. 189. In: Walelgn, Dagnaw Gatahun (2014). Individual Bankruptcy Law for Ethiopia: Lessons from United States and Germany. Central European University. Budapest

KILBORN, J. J. (2004): The Innovative German Approach to Consumer Debt Relief: Revolutionary Changes in German Law and Surprising Lessons for the United States. *Northwestern Journal of International Law & Business*. Volume 24. Issue 2 Winter

KNOBLOCH, M. (2012): Consumer Insolvency in Germany. Tackling Household Overindebtedness. *European Conference*. Hotel Titania, Athens, Greece. 22nd of November 2012

KORCZAK, D. (2004): The Money Advice and Budgeting Service (Ireland). A service to help people with financial problems and to tackle over-indebtedness, Peer review in the field of social inclusion policies, Brussels, *European Commission*, DG Employment, Social Affairs and Equal Opportunities.

NIEMI, J. – Henrikson, A. (2005): Report on Legal Solutions to Debt Problems in Credit Societies. *Council of Europe*

PITZ, M. – & Schepp, Z. (2013). A banki hitelek árazásának vizsgálata strukturális VAR-modell segít-

ségével (Determinants of the pricing of bank loans: a structural VAR based analysis). *Public Finance Quarterly*, 2013/4, pp. 434–446

WALELGN – Dagnaw G. (2014): Individual Bankruptcy Law for Ethiopia: Lessons from United States and Germany. *Central European University*. Budapest

City Bar Justice Center – Committee on Bankruptcy and Corporate Reorganization – Committee on Consumer Affairs on the New York City Bar (2007): Personal Bankruptcy: Is it right for you? Association of the Bar of the City of New York Fund.

Cour de Comptes (2010): La Lutte contre le surendettement des particuliers: une politique publique incomplete et insuffidamment pilotée. Paris.

France (1989) Consumer Code. https://www.google.hu/url?sa=t&rcct=j&q=&esrc=s&source=web&cd=5&cad=rja&uact=8&ved=0CDgQFjAEahUKEwjgrpDCzZTIAhUiw3IKHdc4D5A&url=http%3A%2F%2Fwww.legifrance.gouv.fr%2Fcontent%2Fdownload%2F1960%2F13727%2Fversion%2F3%2Ffile%2FCode_29.pdf&usq=AFQjCNG3RqIj9GhGGfD_3A-XKszO70Ug6w&sig2=UiY1wiqDUBciAcOo8AIH1A [Downloaded: 26/9/2015]

Germany (1999) Insolvency Statute. http://www.gesetze-im-internet.de/englisch_inso/englisch_inso.html [Downloaded: 26/9/2015]

Greece (2010): Consumer Debt Adjustment Law (Law 3869/3.8.2010)

Ireland (2012) Personal Insolvency Act. <http://www.isi.gov.ie/en/ISI/Pages/Legislation> [Downloaded: 26/9/2015]

MNB (2015). Pénzügyi stabilitási jelentés (Financial stability report). May 2015. National Bank of Hungary.

Spain (2003): Insolvency Act. http://noticias.juridicas.com/base_datos/Privado/l22-2003.html [Downloaded: 26/9/2015]

United Kingdom (1986) Insolvency Act. <http://www.legislation.gov.uk/ukpga/1986/45/contents> [Downloaded: 26/9/2015]

United States (1978) Code-Bankruptcy. <https://www.law.cornell.edu/uscode/text/11> [Downloaded: 26/9/2015]