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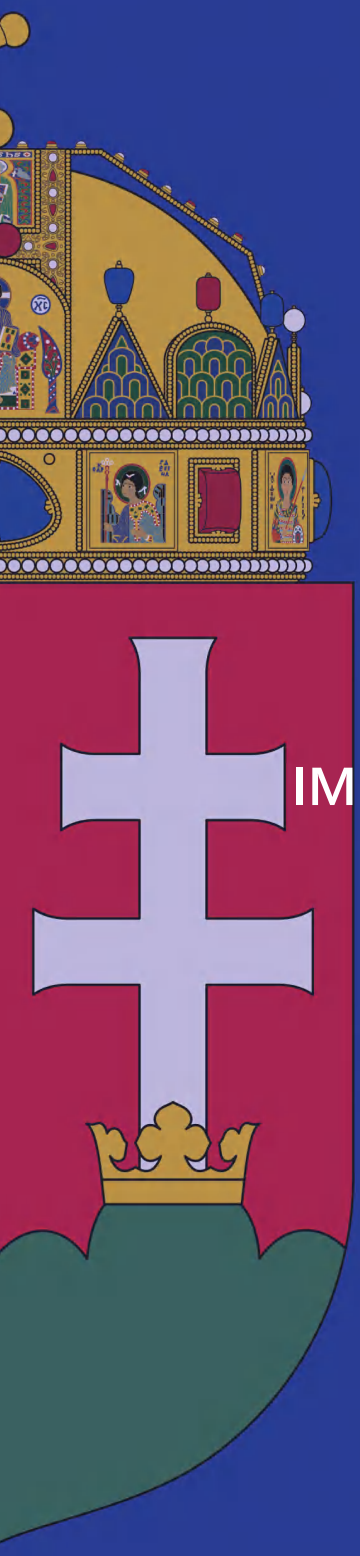

Tibor Szekfü

IMPROVING ACCESS TO MICROFINANCE IN HUNGARY

- Challenges and opportunities -
2021-2027

Székesfehérvár
2022

The study was conducted as part of the project Access to Microfinance for Small and Medium-sized Enterprises - ATM for SME's launched by the European Union

ATM for SMEs
Interreg Europe

RVA

MINISZTERELNÖKSÉG

INNOVÁCIÓS ÉS TECHNOLÓGIAI MINISZTÉRIUM

ZALA ZMVA 1992

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within the framework of the European Regional Development Fund
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1. INTRODUCTION

The aim of the Interreg Europe (2014-2020) project ATM for SME's - Access to Microfinance for Small and Medium-sized Enterprises launched by the European Union is, inter alia, to collect European good practices in microfinance, through the sharing of which the positive social impact of microfinance can be boosted in Europe. The extension of the programme in 2021 aimed at identifying additional good practices in microfinance that will help mitigate the negative economic impact of the COVID-19 epidemic, and improve the resilience of micro-enterprises to crisis with a set of instruments offered by microfinance.

The objectives of the programme include the analysis of the good practices, and **the drafting of recommendations to policy-makers on how to enhance the social utility and use of microcredit schemes to increase the resilience of the target sector to crisis based on the outcome of the analysis.**

The lead partner of the international consortium implementing the programme is **Fejér Enterprise Agency (Hungary)**, and the other Hungarian project partners are the **Prime Minister's Office,** the **Ministry of Innovation and Technology** through a delegated expert, and **Zala County Foundation for Enterprise Promotion.**

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27 September 2022, Budapest, National University of Public Service, the closing conference of the ATM for SME's project. From the left: Dr. Tamás Bódizs Chairman of the Board of Trustees, FEA, Prof. Dr. Györgyi Nyikos, Head of Institute, National University of Public Service, Balázs Greinstetter Deputy State Secretary, Prime Minister's Office, Tibor Szekfü Managing Director, FEA, Viktor Bárdi Head of Department, Prime Minister's Office, Péter Vonnák Deputy Managing Director, FEA

The purpose of this document is to examine the microcredit sector in Hungary in order to identify areas where there is potential to improve the social utility of microcredit and to provide specific recommendations for action to help policy-makers achieve positive social goals.

This includes a review of the **legal environment and regulation** of microcredit, **the adequacy of financing and the ability of the operational background to meet professional objectives.**

In addition, the aim is to formulate recommendations that may improve the social utility of microcredit schemes - and the public funds allocated forthese programmes-to the relevant decision-makers.

In reviewing each programme – taking into consideration the objectives of the programme – we did not seek to carry out an in-depth, comprehensive impact assessment, but rather focused on those factors that might be relevant for identifying recommendations for improvement. Nor did we seek to be exhaustive in our description of the operation of each programme, thus, we only described individual events and documents to the level of detail that we consider absolutely necessary for the understanding.

2. PROFESSIONAL PRINCIPLES OF SOCIAL MICROCREDIT

Microcredit is the extension of small loans or credits to borrowers who do not have or only have limited access to loans/credits granted by the profit-oriented commercial banks but wish to pursue an independent income-generating activity or business.
This reduced creditworthiness can be attributed to

- the small borrowing requirement of the clients,
- the lack of collateral, or
- the fact that they are start-ups, and have no verifiable entrepreneurial history.

A significant feature of social microcredit (microcredit having a social purpose) is the non-profit approach, because **the positive social impact of loans is more important than making profit.**
Microcreditshould be coupled with intensive and effective mentoring activities and technical assistance, as well as high-quality business development services.
Currently, in the European Union, loans of less than € 25,000 (approximately HUF 10 M) facilitating selfemployment are considered microcredit.

13 May 2016, Székesfehérvár, Hungary, founders of the MicroFinet collaboration. From the left: Giampietro PIZZO (RITMI) Italy; Joerg SCHOOLMANN (DMI) Germany, Tibor SZEKFÜ (HMN) Hungary, Unni Beate SEKKESÆTER (Microfinance Norway) Norway, Jaime DURÁN NAVARRO (AEM) Spain.

The principles concerning the use of public funds for the provision of microcredit were laid down by MicroFiNet® (Committee of National Microfinance Networks in Europe). The members of MicroFiNet® signed a document called **'PROFESSIONAL RECOMMENDATIONS FOR EUROPEAN DECISIONMAKERS REGARDING THE LEGISLATION OF MICROFINANCE'** (hereinafter referred to as 'Rome Directives'

http://microfinancegoodpractices.com/wp-content/uploads/2022/05/European_recommendations.pdf
Annex 1) on 29 September 2016 in Rome, which sets out the professional recommendations and directives that should be followed in order to achieve the positive social impact of microcredit schemes implemented from public funds.

These directives are now part of university curriculum in Hungary at the National University of Public Service, and in Spain at the University of Cádiz. This knowledge has also been published in printed format as a textbook in Hungary, and in digital format in English and Spanish (Szekfü-Vonnák-Pizzo: "MICROCREDIT – From Theory To Practice", Fejér Enterprise Agency, 2020. ISBN 978-615-81559-0-8).

As these directives are of paramount importance in terms of the optimal social relevance of public funds used for microcredit, they are presented in detail on the basis of the above-mentioned literature.

The European professional organisations drafted their professional recommendations in two main fields. These are:

- Legal and regulatory field
- Financing

The recommendations belonging to each field are detailed below.

2.1. LEGAL AND REGULATORY FIELD

The Committee drafted its recommendations concerning the legal and regulatory fields in two main logical groups:
- Institutional background regulation (Directives 1; 1.1; 1.2)
- Client protection (Directives 2; 3)

2.1.1. RECOMMENDATIONS CONCERNING THE OPTIMUM LEGISLATION OF THE INSTITUTIONAL BACKGROUND (LEGISLATION OF MFIS)

> ***Directive 1: 'Non-bank' credit institutions should also be allowed to perform lending activities with the authorisation defined in the Act.***
>
> ***Directive 1.1: The establishment of financial enterprises that do not take deposits, are specifically specialized in microlending, fulfil positive social purposes and are entitled to pursue lending activities and to provide micro loans not exceeding the individual microcredit limit specified by the member state and/or the European Union per transaction should have lower founding capital requirement and their records should be kept separately.***
>
> ***Directive 1.2: Non-profit foundations or foundations that do not take deposits and fulfil positive social purposes specifically from donations and public money, which are prepared to pursue such an activity, should be allowed to pursue microlending activity and to provide microloans not exceeding the individual microcredit limit specified by the member state and / or the European Union per transaction.***

It must be noted that microfinance has two main sectors. On the one hand, there are **profit-oriented microfinance providers** operating under market conditions (this is basically profit-oriented microlending funded by profit-oriented investors) and **non-profit microfinance providers**. Non-profit microcredits may be granted from private money (donations) and public money.

It is important to know that the 'banking acts' of the specific member states mainly ensure the **protection of depositors**, and are regulated by the rules of the profit-oriented **money and capital market.**

The essence of the above-mentioned **Directive 1** is that separate legislation is needed for credit institutions not taking deposits (since the protection of depositors is not an issue in their case).

Specifically, the essence of **Directive 1.1** is that the establishment and registration of '**financial enterprises'** that do not engage in deposit-taking, but who are active in money market (in a profitoriented manner) and wish to provide specifically microloans should be facilitated with lower seed capital requirement and their records should be kept separately.

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Directive 1.2 aims to promote non-profit microcredit delivering positive social goals **outside the money market** by proposing microcredit activities for non-profit organisations – foundations – not taking deposits under separate legislation.

Therefore, if the microcredit scheme is implemented by a specialized microfinance institution – a non-profit foundation - which

- **does not deal with deposit-taking**,
- distributes the funds to the target group intended to be supported under the conditions set by the donor,
- performs its lending activity in the interest of the public and its **goals are not profit-oriented**,

it is not legally justified for its microlending activity to be subject to the 'banking act' in force in the specific country.

2.1.2. CLIENT PROTECTION

Directives 2 and 3 call for the protection of clients constituting the target group of microcredit schemes with legal instruments. **Directive 2** proposes the application of direct, whereas **Directive 3** recommends indirect legal protection.

> ***Directive 2: The opportunity to abuse the situation of the vulnerable social strata should be limited with regulatory and financing instruments.***

Despite the fact that the financing of the clientele interested in microcredit is usually uneconomical for the actors of the profit-oriented financial market, and therefore an unserved market is generated in spite of the existing demand (See: the economic theory of market failures), unethical funders, who work with high usurers' capital and use and abuse the situation of highly vulnerable people, may also appear. In order to prevent this phenomenon and its harmful social impact it is highly recommended that:

- the interests and fees that can be charged by the market actors should be limited by law at the level of the specific member state;
- an 'artificial supply' should be generated for the target group with microcredit schemes – implemented through non-profit intermediaries – which are financed from public money and have a fixed ethical interest level.

> ***Directive 3: An 'entrepreneur friendly' regulatory system should be created.***

It is important for the state to 'let the target group intended to be supported with microcredit live'. Excessive taxes and contributions, administrative burdens, and intolerant control and fining practices may hamper economic growth, and make it extremely difficult for businesses, in particular for start-up micro enterprises, to survive. Therefore, assistance should also be reflected in the correct and tolerant state legislation, with special regard to undertakings younger than three years of age.

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2.2. FINANCING FIELD

The committee placed great emphasis on drafting the most important regulatory guidelines concerning the financing field. As we have already mentioned, it is absolutely essential that microfinance programmes should have a positive impact on society.

IN CASE OF PUBLICLY FUNDED PROGRAMMES THIS IS A BASIC REQUIREMENT! That is why the funding conditions as well as the rules and procedures of such programmes must be defined carefully, otherwise we miss the target and the expected positive social impact is not realized.

Furthermore, it is highly recommended that publicly funded microcredit schemes be introduced and maintained in those states where:

- government intervention is needed for the creation of an 'artificial supply' adjusted to the existing demand in underserved markets, in order to fulfil positive social purposes (social and/or enterprise promotion-economic development objectives);
- government intervention is needed in order to force back the appearance of unethical funders working with high usurers' capital, using and abusing the situation of highly vulnerable people.

The recommendations concerning the financing field can be put into four main logical groups:

- the principle of social utility and its precedence over financial gain
- ensuring the achievement of positive social goals with various funding terms,
- funding terms of client protection,
- principles of financial efficiency.

2.2.1. PRINCIPLE OF SOCIAL UTILITY – THE POSITIVE SOCIAL IMPACT ENJOYS PRECEDENCE OVER FINANCIAL GAIN

In order to comply with the principle of social utility, it is essential to take into account and adhere to the following recommendations.

> ***Directive 4: Publicly funded microcredit schemes need to be interpreted as assistance provided out of social solidarity, which, in return, has positive social impact on society.***

In case of publicly funded microcredit schemes, the concept of investing public money as invested capital, which has to be returned with interest, serves the individual interests of the specific private people involved in the management, supervision and control of the funds and fails to support the interests of the desired target group or society as a whole. This approach may significantly hinder access to the available sources by those who need this support the most. As a result, it is highly recommended that the following should be considered when the rules of the schemes are developed:

> ***Directive 4.1: In case of publicly funded microcredit schemes positive social impact should have priority over the 'preservation' or increase of the funds at nominal value in the course of the implementation.***

> ***Directive 4.2: The requirement of sustainability should be interpreted and expected primarily on the basis of the humane approach to a sustainable society and not on the basis of absolute financial sustainabilit***

According to the Declaration issued by the World Academy of Sciences: "Sustainability is the satisfaction of current human needs through preserving the environment and natural resources for future generations". The most important criteria and the essential requirements of a sustainable society are:

- **social justice, the basis of which is ensuring equality regarding access to opportunities**, and sharing social burdens;
- **continuous efforts to improve quality of life; the sustainable use of natural resources,** the implementation of which requires the environmentally conscious and environmentally ethical attitude of the society;
- **preservation of the environmental quality.**

The quality of life includes health – the complete physical, mental and social well-being – and in connection therewith material well-being, healthy environmental conditions, democratic rights, safety and education accessible to all.

The objective for ensuring decent living conditions, suitable quality of life and well-being applies to everybody, to the future generations as well.

A systemic approach and governance are inevitable for the implementation.

> ***Directive 4.3: Time interval (short-term, medium-term or long-term sustainability) should be assigned to the expected financial sustainability, during which period the scheme must achieve or maintain the planned positive social impacts.***

The requirement of absolute financial sustainability would mean that the revenues of the specific microcredit scheme should cover at all times and under any circumstances

- all the costs required to operate the scheme (including the costs of collection as well)
- all the costs related to central fund management and financial audit,
- the written-off losses, and
- inflation if there is a need to preserve the fund in real terms.

The joint achievement of these objectives would also mean that the members of the disadvantaged target group intended to be supported who are able to pay back the loans and the interests

- must finance all the costs required to operate the scheme,
- must pay back the uncollectible loans instead of the non-paying members (the losses must be covered). (This is socially unacceptable and unfair, and it reduces the development opportunity of the 'successful' undertakings).
- have to pay all the operating costs related to the maintenance of central auditors and the fund managers (who, in this case, make sure that the microfinance organisations do not lend high risk money to a target group that can only be financed with extremely high risk, thereby jeopardising the preservation of the public funds used for this purpose).

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Obviously, community funds are not intended to support a small group of people whose task is to 'safeguard' that such money is not lost. Its purpose should be to cover the necessary expenditures of the community, including **assistance provided as the manifestation of social solidarity (which investment results in a positive social impact) as well as programmes, such as microcredit schemes, securing the objectives of sustainable society**.

Therefore, in case of microcredit schemes it is expedient that the expectations related to financial sustainability are not defined in absolute terms, but are tied to a time interval (schemes that can be maintained in the short term, medium term or long term.)
This means that the programme must be operated in a way that the income received from the funds should be able to cover the costs for a certain period of time, e.g. for 5, 10 or 15 years – even if their nominal value falls - while achieving or maintaining the expected social impact.

2.2.2. ENSURING THE ACHIEVEMENT OF POSITIVE SOCIAL GOALS WITH VARIOUS FUNDING CONDITIONS

> ***Directive 5: The involvement of non-profit funders in the arrangement of publicly funded microcredit schemes should enjoy priority over profit-oriented creditors.***

The primary objective and function of profit-oriented businesses created from private capital is to make profit for the owners. In case of undertakings performing lending activities this also means that the enterprise continuously attempts to maximise profits and minimise risks. In case of microcredit schemes this otherwise absolutely natural attempt may significantly hinder the sources to reach the targeted clientele. This may seriously jeopardise the achievement of the actual social goals. The risk is considerably lower for non-profit creditors, for example foundations.

> ***Directive 6: In order to reach the clients targeted by the publicly funded microcredit scheme efficiently and to achieve the set social objectives, the credit risk should not be transferred to the intermediaries or, in exceptional circumstances, should only be transferred thereto to a lesser extent.***

By transferring the credit risk to the intermediaries, social solidarity is not manifested in any form in the specific microcredit scheme. The obligation to assume risks leads to a risk-averse attitude in lending. In case of high-risk microcredit this also means that the sources do not reach the targeted clients that can be financed with very high risk (typically start-ups and young undertakings not older than three years of age), which significantly hinders the achievement of the social objectives.

> ***Directive 6.1: The losses on loans should be able to be written off from the funds.***

By taking into consideration the length of the time interval determined to ensure financial sustainability, various risk-sharing proportions may be established between the 'Credit Fund' and the intermediary. This risk-sharing proportion could also be given as ranges. (E.g. in case of financing start-ups, more losses should be able to be written off to the debit of the fund than in case of undertakings operating for several years, since the financing of start-ups presents a significantly higher risk.)

However, it must be clear that the higher the risk an intermediary should assume, the greater extent it will avoid it. Thus, the microcredit scheme, the purpose of which is to finance high-risk clients, cannot fulfil its original function, so the expected social impact may not be felt.

2.2.3. FUNDING PRINCIPLE OF CLIENT PROTECTION – MICROCREDIT HOULD NOT DESTROY, IT SHOULD PROVIDE ASSISTANCE

> ***Directive 7: The scheme should not put the people intended to be supported, having payment problems through no fault of their own, in a more difficult situation than what they were in prior to receiving the support.***

If, for example, we expect the intermediaries to apply 'hard' collection procedures due to an erroneous approach to 'protecting public funds', some of the people intended to be supported may find themselves in a worse situation after the assistance than in the past. (Some or all of their assets may be lost whereas their debt continues to exist.) In this case social solidarity is not manifested in any form in the programme, and the expected positive social impact cannot be realised properly.

> ***Directive 8: The social success of the scheme should be facilitated with advice and assistance provided to the target group intended to be supported.***

The approach to providing complex assistance promotes the social success of the scheme. This should be manifested in the necessary advisory services and assistance closely linked to the microcredit scheme when the loans are followed up, especially when it comes to helping start-ups and young – not older than three years of age – undertakings.

2.2.4. PRINCIPLE OF FINANCIAL EFFICIENCY

> ***Directive 9: The costs of central fund management and financial control should not exceed 5% of the actual programme implementation costs, and if the micro enterprise is a start-up business or younger than 3 years of age, the operating costs should be able to be accounted for partly or fully to the debit of the 'Credit Fund'.***

The pressure to earn the operating costs motivates the intermediaries to avoid risks. However, one of the most important aspects of publicly funded microcredit schemes is that, in compliance with the principle of social solidarity, it is the society providing the public funds that assumes the financial risk of the programme in the interest of the expected positive social impact. At the same time proportionality should be taken into account when the costs are accounted for. The overwhelming majority of eligible costs should be spent on the actual operation of the programme and not on the financing of a central 'watch organisation'.

3. MICROCREDIT SCHEMES IN HUNGARY

In this chapter, we will focus only on those programmes that have achieved a considerable, measurable social impact, or in case of which the amount spent is so significant that it is necessary to mention.

3.1. NATIONAL MICROCREDIT SCHEME

Since the National Microcredit Scheme was launched in 2000, after the end of the first Hungarian microcredit programme, which was the "Phare Microcredit Programme", based on its institutional background,

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we will deal with it in more detail. This is also justified by the fact that in Hungary, according to the international professional criteria mentioned above, non-profit microcredit with a positive social purpose is only provided by the **county and metropolitan enterprise promotion agencies** ensuring the institutional background for the programme.

We also believe that, if renewed and modernised, this is the area where we can achieve the greatest growth in positive social impact with the provision of microcredit in Hungary.

Making our recommendations as legally and professionally sound as possible, we carried out the full legal and technical screening of the programme. We would like to mention that we asked Dr. Imre Csuhaj Varju, Chairman of the Board of Trustees of the Hungarian Foundation for Enterprise Promotion (HFEP) coordinating the programme to delegate an expert to carry out this work, however, he did not respond to our request.

In reviewing the legal context of the programme, we found that the current legal situation can only be understood and interpreted if the events are analysed in their sequence. Therefore, we also present the **historical background** of this programme in detail. However, for reasons of space, we only refer to those events, documents, expert opinions, ministerial memos and reminders, contracts and legislation that are absolutely necessary for comprehension.

3.1.1. 1992 - MICROCREDIT PROGRAMME LAUNCHED UNDER HARE'S ENTERPRISE DEVELOPMENT PROGRAMME IN HUNGARY

FUNDS FROM THE EUROPEAN UNION (EU) ARE CHANNELLED TO LOCAL ENTERPRISE AGENCIES (LEAS) BY THE HUNGARIAN FOUNDATION FOR ENTERPRISE PROMOTION (HFEP) IN THE FORM OF TARGETED SUBSIDIES SUBJECT TO CONDITIONS.

With its Regulation (EEC) No 3906 of 18 December 1989, the Council of the European Communities decided on the provision of economic aid to the Republic of Hungary and the Polish People's Republic. The aid was to be used primarily to support the process of reform in Poland and Hungary, in particular by financing projects aimed at economic restructuring, and the Community aid, in general, operated in the form of **grants**.
On the basis of the above-mentioned Regulation, the PHARE Centre of the European Union (Phare stands for Poland-Hungary Assistance for Restructuring the Economy) and the Hungarian Government signed a Framework Agreement on the use of the PHARE Aid Programme on 3 September 1990, which was promulgated by Government Decree No 85/2002 of 19 April, and pursuant to Section 3 (2) of the same Government Decree, the minister without portfolio responsible for the coordination of the PHARE programme was to ensure its implementation.

The PHARE Programme included the Small and Medium-sized Enterprises (SME) Development Programme, for the operation and coordination of which the Government concluded an agreement with the Hungarian Foundation for Enterprise Promotion (HFEP). Local (county) Enterprise Agencies (LEAs) – Business Centres – were set up to implement the Programme.
The Microcredit Programme for start-ups within the SME sub-programme was coordinated and funds were channelled through the HFEP as explained above, with the LEAs participating in the implementation on the basis of contracts concluded with the HFEP.

It is important to note that the LEAs were set up by different founders as independent legal entities. The HFEP exercises full founder's rights in two of the LEAs, and was involved in the establishment of others together with other founders, but the majority of **the local enterprise agencies were set up by founders completely independent of the HFEP.**

With the transfer of targeted subsidies provided for microcredit, **the LEAs gained ownership of the funds**. In this first period, the funds were not yet earmarked for microcredit. They were channelled to the LEAs to finance their general business plan, from which they themselves decided how much to use for microcredit. At that time the LEAs could grant loans to and provide non-repayable grants for their clients from the sources received. The dedicated transfer of funds specifically for microcredit purposes started in 1993.

Pursuant to Section 523 (1) of Act IV of 1959 (the old Civil Code), "Under a loan contract the financial institution or other creditor shall be obliged to place a certain amount of money at the disposal of the debtor, and the debtor shall be obliged to repay the loan in accordance with the contract."

The clear position of legal theory is that the loan gives the debtor ownership of the amount of money lent. If the debtor becomes the owner of the amount of money, the creditor had to be the owner of the amount of money, because you cannot acquire ownership from a 'non-owner'. This is also an ancient principle of Roman law (the principle of '**nemo plus iuris**': "No one can transfer more rights (to another) than he himself has").

There is no dispute that the LEAs concluded the loan agreements in their own name, thus **the specific LEA was already the owner of the amounts lent.** The detailed conditions and procedures of the programme were set out in the 'Handbook of Microfinance' adopted by the EU. The programme was managed according to this Handbook, as agreed by the actors therein (EU-the Government of HungaryH-FEP-LEAs). The HFEP was the 'custodian' of the Handbook, however, **since it was a binding instrument, it could only be amended with the agreement of the EU and the LEAs**. (Clause 8 of the REGULATIONS OF THE SME MICROCREDIT PROGRAMME.) The framework agreements providing the funds always referred to this document as binding rules of procedure.

It is important to note that this document was prepared in English by BIOTECHNOLOGY CONSULTANTS LIMITED, a UK consultancy, based on the practice applied in the United Kingdom. The Hungarian version (translation) of this document was introduced in Hungary. This Handbook (Chapter 6 of the Handbook as per version 2 of 1993 contained the Rules of Procedure) included the requirement to establish the socalled 'Revolving Funds' by each foundation, in compliance with the British practice. In the Hungarian Handbook this was called as 'MICROCREDIT Fund'. In the United Kingdom, 'real' funds in the legal sense (e.g. THE PHOENIX FUND) had been set up to finance microcredit.

In Hungary, no microcredit fund has ever been established as a fund in the legal sense under Hungarian law, and neither the LEAs nor the HFEP had or have a statutory fund manager authorisation. The legislation in force does not even allow the LEAs to carry out this activity, which is subject to licensing.

According to Clause 17 of the Microcredit Regulations referred to above "**If the Microcredit Programme is managed in accordance with the relevant rules, the fund does not have to be repaid by the Foundation [note: to the HFEP].**"

From the available documents it can be inferred that the HFEP transferred the ownership of the subsidy disbursed quarterly to the LEAs, and it was only entitled to withdraw such ownership (i.e. to deprive the LEAs of their ownership) under certain conditions. With regard to the fact that the HFEP did not exercise the right of withdrawal in any case until the termination of the contracts, it can be concluded that the LEAs acquired ownership of these subsidies definitively. The termination of the contracts can be established because each contract contains a clause stating that "**this Framework Agreement shall remain valid as long as the Foundation (HFEP) transfers funds for the provision of microcredit to the Business Centre as defined in this Agreement.**" (It can be noted that this sentence is a condition subsequent, and the legally correct wording would have been 'shall remain in effect'.)

Thus, the HFEP had the right to withdraw funds in the event the LEA was found to have discontinued the operation of the programme before the end of the programme, or was not acting in compliance with the regulations, or was not managing the programme properly in any respect. This did not happen until the formal termination of the programme in 2000, when there was a financial settlement between the parties.

It is important to mention again that the term 'Fund' or 'Microcredit Fund' as used ever since does not refer to a real financial fund, but to the money held in a separate bank account as a contractual 'voluntary' commitment having a specific use, owned by each LEA.

3.1.2. 1998 – THE PHARE DECENTRALISED MICROCREDIT PROGRAMME IS DECLARED A EUROPEAN GOOD PRACTICE

1997. Strasbourg, France
LEA delegation to the Council of Europe

IN MAY 1998, IN THE FRAMEWORK OF THE SOUTH EAST EUROPEAN COOPERATION INITIATIVE (SECI), UN ECE, TOGETHER WITH USAID, ORGANISED AN EXPERT MEETING ON BEST PRACTICES IN MICROCREDIT, ATTENDED BY 12 COUNTRIES FROM CENTRAL EASTERN EUROPE, INCLUDING GREECE AND TURKEY.

According to a survey carried out by the British firm Bannock Consulting, the decentralised Hungarian microcredit practice at the time was the best microcredit programme in the region. This is a significant recognition of the work of LEAs performed in the field of microfinance.

3.1.3. 1998 – THE REPRESENTATIVES OF HFEP AND THE LEA NETWORK COME TO AN AGREEMENT ON THE OWNERSHIP OF MICROCREDIT FUNDS AND THE DEVELOPMENT OF A NEW MICROCREDIT MANAGEMENT STRUCTURE

ON 22 JUNE 1998, THE 'WORKING COMMITTEE ON THE CLARIFICATION OF THE OWNERSHIP OF THE MICROCREDIT FUND', WHICH WAS SET UP AT THE REQUEST OF THE EU DELEGATION IN BUDAPEST AND COMPOSED OF REPRESENTATIVES OF THE HFEP AND THE LEAs, HELD A MEETING IN SZEKSZÁRD, IN THE CONFERENCE ROOM OF TOLNA COUNTY BUSINESS CENTRE.

Taking into account several legal opinions, the Committee made the following important findings:

"The HFEP was entitled to transfer the funds to the LEAs as subsidies subject to conditions for the operation of the Microcredit Programme in accordance with the provisions of the Microcredit Regulations. Thus, the LEAs **acquiredownership of the funds** received once they were disbursed as microcredit. The HFEP acted legally and in compliance with the rules adopted by the EU Delegation when transferring the funds."

There was complete consensus on this position among the members of the Committee, including HFEP's Managing Director, Financing Director, Financing Manager and Legal Counsel acting at the time.

The Committee examined several options for continuing micro-lending after the Microcredit Programme ended. The setting up of a 'separate, financially and legally distinct Microcredit Fund' or 'the operation of the funds within the framework of a business association' were rejected. The Committee's proposal was as follows:

"A central Microcredit account is set up by the HFEP. The right to dispose over the subaccounts per Business Centre is delegated to the LEAs by the HFEP. In this solution the funds available for the specific county **are handed over provisionally** by the Business Centres to the HFEP to be kept on the Microcredit subaccount opened at the HFEP for the LEAs."

"Main steps concerning the introduction of this solution:

- After the forthcoming quarterly audit – taking of inventory - of the Local Enterprise Agencies, a separate Microcredit current account consisting of 20 subaccounts (one per LEA) is opened by the HFEP at theirpartner bank.
- The right of disposal over the subaccounts is delegated by the HFEP to the LEAs.
- The funds kept at the own current accounts of the LEAs are transferred to the Microcredit subaccount opened for HFEP **as funds provisionally handed over.**
- The LEA commits to transferring the loan repayments to the central Microcredit subaccount within 2 banking business days. In the event of failure to do so, the HFEP shall have the right of immediate collection.
- The HFEP undertakes to provide collateral to the extent of its own assets as security for the microcredit funds transferred by the LEAs and to ensure that the funds so transferred are continuously available for the operation of the Microcredit Programme of the respective LEA and are not used for any other purpose."

The content of the memo, which contains the agreement in principle between the HFEP and the representatives of the LEAs on the concept based on which the parties continued the provision of microcredit after the end of the Phare Microcredit Programme, using the funds owned by the LEAs, is presented in such detail because it helps to understand the contracts and events that took place afterwards.

3.1.4. 1999 – FINANCIAL SETTLEMENT CLOSING THE PHARE MICROCREDIT PROGRAMME

IN ORDER TO CREATE THE NEW OPERATIONAL STRUCTURE DESCRIBED ABOVE FOR THE PROVISION OF MICROCREDIT, A FINANCIAL SETTLEMENT TOOK PLACE BETWEEN THE LEAS AND THE HFEP WITH REGARD TO THE MICROCREDIT FUNDS PROVIDED FOR THE LEAS.

The financial settlement took place based on the audit prepared by Arthur Andersen Rt, which was recorded in a protocol. (Ágnes Csanádi Co-chairman of the Board of Trustees of the HFEP and Szilvia Merkel Microcredit Manager of the HFEP participated in the site inspections.) The protocol included that "the LEA wishes to account for the microcredit fund provided to it under the previous microcredit programme and join the new central microcredit scheme" and "undertakes to make the payment commitment to the central microcredit fund under the title 'Payment Commitment'."

The protocol included **numerical data concerning the closure of the Phare Microcredit Programme,** with which the parties settled accounts with one another in order to close the programme.

As we have already mentioned, the foundations that started the provision of microcredit as early as 1992, first received funding for microcredit as part of their business plan. The parties agreed that this amount and its increment would form **the local microcredit fund of the LEAs** concerned, over which amounts the LEA would not grant the HFEP manager's rights

3.1.5. 1999 – THE MONEY-LENDING ACTIVITY OF THE HUNGARIAN FOUNDATION FOR ENTERPRISE PROMOTION FROM THE NATIONAL MICROCREDIT FUND WAS REMOVED FROM THE SCOPE OF THE ACT ON CREDIT INSTITUTIONS AND FINANCIAL ENTERPRISES.

THE MONEY-LENDING ACTIVITY OF THE HUNGARIAN FOUNDATION FOR ENTERPRISE PROMOTION FROM THE NATIONAL MICROCREDIT FUND WAS REMOVED FROM THE SCOPE OF ACT CXII OF 1996 ON CREDIT INSTITUTIONS AND FINANCIAL ENTERPRISES PURSUANT TO SECTION 67 (1) OF ACT CXXV OF 1999.

According to the preliminary draft law, the microcredit activities of the LEAs would have been removed from the scope of the Act, however, the Ministry was already preparing the legal background for the centralised microcredit activity presented later

In 1992, when the programme was launched, there was no general legal framework for the provision of microcredit in Hungary, nor any specific legal regulation for the microfinance activities of individual microfinance institutions.

The general rules on the accounting and reporting obligations of the organisations involved in the operation of the microcredit programme were laid down in **Act XVIII of 1991 on Accounting** (repealed and replaced by **Act C of 2000 on Accounting**).

The internal rules of procedure of the programme were contained in the **Handbook of the (Phare) Microcredit Programme**. The Handbook and the conditions of the programme were developed by a British expert company with the assistance of Hungarian experts, taking into account the specificities and legal background of Hungary.

Under the Regulations, the programme was run in a **decentralised** manner, with each local enterprise agency managing its own funds, kept separately from other funds.

The entire assessment and portfolio management process relating to the provision of microcredit was carried out by the microcredit department of the Foundations (LEAs). The **Microcredit Committee**, established at each Foundation, was responsible for the assessment of the loans. The Microcredit Committee decided whether to grant the loans on the basis of the proposal made by the Microcredit Department. The operation of the programme was audited quarterly by an international audit firm contracted by the HFEP.

A bank under contract with the LEA disbursed the loans - for an extra fee - from the money deposited with the bank in a current account by the LEA (and entered into loan agreements), collected repayments and interests, and kept loan records. However, the microcredit department of the foundations was responsible for monitoring the loan portfolio, carrying out follow-up checks and managing any legal proceedings aiming at the possible collection of debts.

Customer payments, including interests, were made to this separate bank account of the LEAs.

This role of the commercial banks in the operation of the scheme was not professionally justified and only made the scheme more expensive and slower to operate.

The problem was exacerbated by the fact that commercial banks became less interested in participating in the scheme, as they found it difficult to recruit potential customers for themselves from this programme. This led to repeated cancellations of the relevant contracts in several counties, and made it increasingly difficult to find a bank willing to take on the task, leaving the scheme vulnerable.

Throughout the operation of the programme there was an ongoing dispute as to whether it was legally justified to involve commercial banks in the operation of the programme based on the relevant act on financial institutions, then on credit institutions.

The solution seemed obvious. If it is not clear that the Act on Credit Institutions does not apply to the operation of the Microcredit Programme, it should be made clear. The proposal was that the section of the Act that specifies which organisations are removed from the scope of the Act should be amended to include foundations involved in the operation of the Microcredit Scheme with respect to the Microcredit Scheme.

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This was also justified by the fact that the non-profit foundations involved in the operation

- did not engage in deposit-taking,
- received and used the sources – public funds – in the form of targeted subsidies subject to conditions, to finance a specific programme with a social purpose in a dysfunctional financial market requiring government intervention,
- were not profit-oriented organisations (they did not make any profit).

This amendment was yet to fully clarify the necessary legal background, but it already made it possible to exclude the commercial banks from the conclusion of the loan agreements in the context of the centralised management that had been established.

3.1.6. 9 DECEMBER 1999 – MEETING OF THE BOARD OF TRUSTEES OF THE HFEP: DRAFT CONTRACT FOR THE COLLABORATION BETWEEN THE HFEP AND THE LEAS FOR THE LAUNCH OF THE 'NEW MICROCREDIT SCHEME'

The background to the contract for the LAUNCH OF THE 'NEW MICROCREDIT SCHEME', which was to be concluded later, can be better understood by looking at the wording of the draft contract prepared for the meeting of the Board of Trustees of the HFEP held on 9 December 1999. Whereas:

"The outstanding balance of microcredits granted as at 31 December 1999 shall be transferred by the LEA, **through the transfer of assets without compensation**, to the central microcredit current account managed by the HFEP, in accordance with the following schedule, subject to the provisions of point…"

It is worth examining this together with the draft Memorandum mentioned earlier. That document did not yet state that the "Fund is established under this Agreement". Instead, it included the following wording:

"In this Agreement and the Annexes thereof the Microcredit Fund (hereinafter referred to as 'Fund') shall have the following meaning: the Fund is a revolving financial instrument that will serve the purposes of the fund. The Fund shall consist of **financial sources provided by the European Commission, the Hungarian Government, the HFEP and other donors** and their revolving funds."

"The Parties hereby agree that the Republic of Hungary represented by the Ministry of Economy **SHALL BE** the owner of the funds below and the **HFEP SHALL BE the Exlusive Fund Manager thereof…**"

"The Exclusive Fund Manager shall be entitled to dispose over the Fund specified herein, to **hold it**, use it, **transfer the use thereof to third parties, and to reinvest it.**"

This proves that the HFEP was aware that the microcredit funds were the property and **assets** of the LEAs, and believed that they could only be transferred as **donation**. They were also aware that the **Hungarian Government was not the owner**, which would only be possible after the donation of the funds to the state, and that the **HFEP was not a 'Fund Manager**'.

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Furthermore, the draft also shows that the centralisation of the funds was imposed in order to allow the HFEP to **'hold'**, **'invest'** and **'transfer'** them to third parties.

However, pushing this through was impractical. On the one hand, the LEAs could only transfer assets (in the form of gifts or donations) if their articles of association expressly allowed it. However, this was not the case for any of the LEAs, thus there was a clear legal obstacle to the transfer. Furthermore, as we have shown, the LEAs HAD NO INTENT TO TRANSFER THEIR ASSETS! During the preliminary discussions, the LEAs only agreed to transfer limited management rights to the HFEP, while retaining ownership, for a specific purpose. The contract that was signed later, which we will present below, contains this.

3.1.7. 17 MAY 2000 – MEMORANDUM OF UNDERSTANDING, IN OTHER WORDS, AGREEMENT ON THE CREATION OF THE NATIONAL MICROCREDIT FUND (NMF)

ON 17 MAY 2000, APPROVED BY DR. IMRE BOROS, THE MINISTER WITHOUT PORTFOLIO RESPONSIBLE FOR THE COORDINATION OF THE PHARE PROGRAMME, DR. GYÖRGY MATOLCSY, THE MINISTER FOR ECONOMIC AFFAIRS ON BEHALF OF THE GOVERNMENT OF THE REPUBLIC OF HUNGARY, DR. IMRE CSUHAJ VARJU, THE CHAIRMAN OF THE BOARD OF TRUSTEES OF THE HFEP, AND LÁSZLÓ BÚS, THE PROGRAMME MANAGER OF HFEP, CONCLUDED A CIVIL LAW CONTRACT WITHIN THE MEANING OF THE HUNGARIAN LEGAL SYSTEM, FOR THE ESTABLISHMENT OF A MICROCREDIT FUND OWNED BY THE STATE. THE AGREEMENT WAS APPROVED BY MICHAEL LAKE, HEAD OF THE EUROPEAN COMMISSION DELEGATION TO HUNGARY.

Clause XI (2) of the Agreement states that "This Agreement shall be governed by the laws of the Republic of Hungary." It may be noted as a matter of fact that the legal position of the NMF was and continues to be surrounded by legal concerns and doubts.

In the subject, a number of independent legal and auditor's opinions were issued, which were commissioned by both the LEAs and the supervising ministry. The individual evaluations all point in the same direction, and a summary of their main findings is presented below.

- On 17 May 2000, the Government of the Republic of Hungary represented by the Minister for Economic Affairs and the HFEP signed a 'Memorandum of Understanding', which states that the owner of the funds of the microcredit programme is the Hungarian State, their manager is the HFEP, and the agreement 'created' the Microcredit Fund. This agreement was approved by both the Commission of the European Communities (the delegation of the Commission to Hungary) and the minister without portfolio responsible for the coordination of the PHARE Programme.
- This agreement, however, is invalid under Hungarian law, as the Agreement stipulates (clause III (1))that "the Fund is created based on this Agreement." The Fund is owned "by the Republic of Hungary represented by the Minister for Economic Affairs and the Fund is managed by HFEP." Section 54(1) of Act XXXVIII of 1992, in force at the time of signature, stated that "**a Fund may only be established by an ACT specifying the purpose of the Fund, its sources of revenue, the expenditure to be met and the Minister responsible for its use.**"

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- The fact that the NMF as a public fund could only have been created with an act is of particular importance in this context. Since it was not 'created' in such a manner, it is not a public fund. If it is not a fund, then the contract is null and void, and therefore cannot be owned by the state, or the other way around, if it is not owned by the state, it cannot be a public fund.

- Based on this premise, the 'creation' of the Microcredit Fund is null and void, as the agreement 'creating' it is illegal. According to Section 200(2) of Act IV of 1959, in force at the time of the conclusion of the contract, "Contracts in violation of legal regulations and contracts concluded by evading a legal regulation shall be null and void...". Partial invalidity is out of the question and the whole agreement is to be considered null and void because the rest of the agreement is closely linked to the 'creation' of the Fund, without the 'creation' of the Fund the parties would not have concluded the rest of the agreement.

- It should also be noted that the agreement was not signed by anyone on behalf of the LEAs **as owners**, and the signatories were not entitled to transfer ownership of the sources to anyone in the absence of a right of disposal (as the most important element of ownership). It is not disputed that the LEAs also had two other sub-entitlements of ownership, the right of use and the right of possession. This is evidenced by the existence of the loan agreements concluded.

- The 'memo' mentioned earlier confirms that the parties considered the 'funds' to be owned by the LEAs, and agreed to grant HFEP management rights for a new operating model.

- Another important fact is that the HFEP was not authorised by the foundations to sign the Memorandum, and the Memorandum was not countersigned by any of the foundations. All the documents and all the annexes thereto drafted in the case were countersigned by all parties except this most important one. This may be because the signatories did not agree with it and/or they did not have the Memorandum at the time of signing the contract. All of these are important facts, as the memorandum is null and void if it does not reflect the concordant will of the contracting parties (or the parties concerned by the contract). It is these facts that make the whole contractual framework and the microcredit procedures that underpin it null and void.

- Another consequency of the change that occurred in 2000 is that the provision of microcredit continued in a manner other than what was described in the earlier framework agreement, which falls outside the concept of 'maintenance'. The **condition subsequent** therefore occurred for all LEAs, because the model set out in the agreement signed in 2000 replaced the previous one, which, in the generally accepted sense of the word, also meant the end of the formerly 'defined method'. This was also established by a final court judgment in a lawsuit between HFEP (plaintiff) and the Borsod-Abaúj-Zemplén County Development Agency (defendant) [Budapest-Capital Regional Court, 22.G.43.732/2013/29; Budapest-Capital Regional Court of Appeal, 3.Pf.21.745/2014/6/I; Curia, Pfv.V.20.341/2016/5].

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3.1.8. JUNE 2000 – A PART OF THE LEAS ENTERED INTO A COOPERATION AGREEMENT WITH HFEP FOR THE OPERATION OF THE NEW MICRO-CREDIT SCHEME

UNDER THE "MEMORANDUM OF UNDERSTANDING" REFERRED TO ABOVE, THE NEW MICROCREDIT SCHEME WAS LAUNCHED WITH A NEW OPERATING STRUCTURE.

As from July 2000, practically simultaneously with the 'creation' of the Microcredit Fund, the new Microcredit Scheme was introduced with an increased ceiling. This new scheme was open to those foundations which accepted the conditions necessary for the operation of the Programme and the related contracts as binding on themselves, and signed the relevant 'Cooperation Agreements', in which they undertook to transfer the **fund manager's rights** over the funds made available to them under the above-mentioned programmes.

Thus, instead of financing under the framework agreements, from that time onwards the HFEP exercised control and limited fund manager's rights over the 'fund' 'created' by the Memorandum, through a centralised bank account. The LEAs transferred the right to manage their respective funds to HFEP for specific purposes and subject to specific conditions, **limited to those purposes and conditions**, while it is clear that they retained the right of disposal of their property.
As regards the amounts specified in the cooperation agreements, the wording of the agreements and the fact that the LEAs granted the **fund manager's right** to the HFEP under the agreements clearly show that the parties considered the amounts specified in the agreements to be the exclusive property of the LEAs. If those amounts had been the property of the HFEP, the provision in the agreement granting the fund manager's right to HFEP would be incomprehensible.

The 'memo' referred to earlier verifies that the parties considered the 'funds' as the property of the LEAs and agreed to grant fund manager's rights to HFEP for a new operating model. These contracts reflect this.

Act IV of 1959 on the old Civil Code, in force at the time the agreements were concluded, listed the partial rights of ownership. If the LEAs had not been the owners of the sums concerned, they could not have granted fund manager's rights to the HFEP. If the HFEP had been the owner, obviously it would not have been necessary to agree on granting fund manager's right to the HFEP. If, in addition to the above, a third party had been the owner of the above sums, obviously that third party would have been able to arrange for the transfer of the fund manager's rights.

In conclusion, it can therefore be concluded that **HFEP is certainly not the owner** of these amounts.

The conditions prevailing at the time the contracts were signed are well illustrated by a memo from that period, which shows that a meeting was held at the HFEP for the directors of the LEAs, where they were put under great pressure to transfer their funds to the HFEP account. According to the memo, Dr. Márton Braun, the HFEP's Managing Director (Member of Parliament) said that "if the network does not cooperate with the HFEP, the state and the EU Delegation, there will be consequences. In the future, the network could lose the opportunity to participate in programmes. Consideration should be given to whether the foundations wish to participate in Phare or other central programmes."

Dr. Imre Csuhaj Varju, Chairman of the Board of Trustees of the HFEP said that "it is also expected that if the assets are not returned to the state permanently, public debt may arise on the part of the parties

concerned. The question is whether any of the foundations can be involved in the programmes supported by the Széchenyi Plan. These options need to be considered."
The above-mentioned Curia judgment in the litigation between HFEP (plaintiff) and the Borsod-Abaúj-Zemplén County Development Agency (defendant), which established that the HFEP did not have the right of control over these funds [Budapest-Capital Regional Court, 22.G.43.732/2013/29.; BudapestCapital Regional Court of Appeal, 3.Pf.21.745/2014/6/I.; Curia: Pfv.V.20.341/2016/5.], clearly demonstrates that the recovery of funds as public debt was an empty threat.

It is a fact that the LEA that did not sign the contract could not participate in tenders later on.

On the basis of the above, it can be stated beyond any doubt that the 'funds', which are designated as public in the contract, referred to as 'Fund' in the Memorandum, cannot be a legal entity called 'Fund' under Hungarian law. Consequently, they cannot be a 'Fund' from a legal point of view, and therefore HFEP cannot be a 'Fund Manager' from a legal point of view either. However, since, by reference to this contract, HFEP received funds from various owners, such as the Hungarian State or the LEAs, it is necessary to examine what legal status these transferred funds have at the HFEP. As mentioned earlier, it can be established with absolute certainty that these funds cannot be the property of HFEP (and their inclusion in the HFEP's own capital could even constitute an infringement of the accounting rules). Funds transferred to HFEP are considered to be funds provisionally transferred for a specific purpose, while retaining the right of ownership. Therefore, the 'Fund' cannot be more than the sum of the funds held by different owners and managed by the HFEP.

However, if the 'Fund' is understood to mean the sources managed by the state-owned HFEP, then the funds provisionally transferred by the LEAs do not constitute part of the 'Fund'. In this respect, only funds provided by the Hungarian State are considered public, funds provided by the LEAs through the transfer of Fund Manager's rights are certainly not. Based on the above-mentioned Curia judgment, it can also be stated that the LEAs may not be forced to cooperate in this way, that isto transfer the funds they hold to the HFEP by any means, neither by the HFEP nor by the State. If they may not be compelled to do so, this also applies to the LEAs that signed a contract with the HFEP, in other words, the contract already concluded may be terminated at any time. It therefore seems clear that the contracts concluded constitute an agency relationship in which the funders are the principals and HFEP is the agent, which is obliged to manage the funds and act in compliance with the agreement.

In this respect it must be noted that both the Memorandum and the cooperation agreements concluded between the LEAs and the HFEP refer to the microcredit 'Handbook' as the document that sets out the rules relating to the operation of the programme. It is important to highlight that all the parties to the contract accepted the existence of the handbook as an annex to the contract, however, no handbookhas been fully accepted by consensus and signed by all parties until today. It should be pointed out that there is a significant legal difference – in addition to the difference in content – between the 'Microcredit Handbook' of the Phare Microcredit Programme operated before 2000 and the "New Microcredit Scheme", which is currently being detailed, operated after 2000. While the handbook of the Phare Microcredit Programme was defined by the funder itself, that is European Union (approved and amended in Brussels) and compliance with it was a condition for the operation of the programme, the post-2000 handbook was to define, by mutual agreement between the parties, the way in which cooperation and the lending procedure were to be carried out. In order to define the contents of the handbook and for mutual consultation, the parties set up a 'National Microcredit Committee', which included the representatives of the LEAs, a representative of the HFEP and a representative of the competent ministry. It was agreed that the amendments to the Handbook would enter into force after approval by the relevant ministry and no-

tification to the EU delegation. To the best of our knowledge, the National Microcredit Committee has not been convened by the HFEP for more than a decade. The consolidated standardised handbook, as we know it today, issued by the HFEP as a diktat in 2017 without a version number, defines its purpose as follows: "The purpose of this Microcredit Handbook is to describe the methods and procedures to be used in the screening, processing and collection of microcredits. The handbook has been prepared **to facilitate the day-to-day operations** of the Microcredit Departments of the Local Enterprise Agencies (LEAs) with the aim of:

- providing guidance to the staff of the Microcredit Department in the performance of their daily work;
- providing a systematic approach with regard to the entire lending cycle of Microcredits;
- ensuring the consistency of methods and procedures; and
- reducing the time and effort required to disburse the loans.

The handbook contains the **Regulations of the Microcredit Programme for SMEs**, published by the Hungarian Foundation for Enterprise Promotion, the organisation that manages the **Microcredit Scheme**."

In other words, the 'Handbook' is not a legal instrument - especially as regards the ownership of the funds managed by the HFEP - but an aid for the staff working in the microcredit programme. The **'Regulations of the Microcredit Programme for SMEs' was incorporated into the document, which, according to the document, is also a unilateral 'declaration' issued by the HFEP.**

In this Handbook the HFEP defines the 'Microcredit Fund' as follows:

"The Microcredit Fund (hereinafter 'the Fund') is a revolving **financial instrument** which serves the purposes of the HFEP. **The Fund contains the sources made available by the Commission, the Hungarian Government, as well as the funds and repaid amounts made available by the Foundation.**

The Fund is the property of the Republic of Hungary. The Fund was established under the Memorandum of Understanding.

Under the Memorandum of Understanding, the Foundation is the Fund Manager."

It is important to note that the document does not derive the definition and creation of the 'Fund' from itself, but from the Memorandum (not signed by the LEAs), which we consider to be a serious violation of the law. Also, **it fails to mention the funds owned by the LEAs, with regard to which the LEAs provisionally transferred the fund manager's right to the HFEP for the operation of the National Microcredit Scheme, as part of the 'Fund'.**

It is important to highlight again that according to the draft contract presented at the meeting of the Board of Trustees of the HFEP held on 9 December 1999, which was not approved, "...financial sources provided by other donors and the revolving funds thereof..." would have constituted part of the Fund. However, this never happened, and the HFEP should be aware of this.

It should also be pointed out that even the Memorandum, cited as a source, fails to mention the funds owned by the LEAs as part of the 'Fund'. III (2): "The Fund is a financial instrument of revolving nature, which serves the objectives of the Programme. The Fund shall comprise the financial sources provided by the Commission, the Government of the Republic of Hungary and the HFEP, as well as the funds repaid."
This also omits the reference to "...financial sources provided by other donors ...".

Therefore, references claiming that "by joining the programme, the LEAs also accepted the Handbook, according to which the Fund is the property of the Hungarian State and managed by HFEP, they also accepted that by transferring the fund manager's right over their own funds to HFEP, the transferred funds became the property of the Hungarian State and are now part of the 'Fund', are not legally valid in any way.

Once again, it is emphasised that in the contracts, the LEAs accepted the 'existence' of the Handbook, but they did not accept that in this document the HFEP unilaterally defines the funds owned by the LEAs as the property of others, according to its own intentions, over which it is free to dispose.

Furthermore, it is important to note that this document does not define the 'Fund' as a separate legal entity, but as "a financial instrument to be revolved". It should also be mentioned that, according to the information available to us, the provisions of the 'Handbook' are interpreted and selectively applied by the HFEP in a rather liberal manner. The details of this are described later

3.1.9. 2003 – THE ACTIVITY OF THE LEAS, I.E. THE COUNTY AND METROPOLITAN ENTERPRISE PROMOTION AGENCIES, AIMING AT THE PROVISION OF MICROCREDIT IS REMOVED FROM THE SCOPE OF THE ACT ON CREDIT INSTITUTIONS.

THE HUNGARIAN PARLIAMENT AMENDED ACT NO. CXII OF 1996 ON CREDIT INSTITUTIONS AND FINANCIAL ENTERPRISES BY SECTION 2 OF ACT NO. XXXIX OF 2003. AS FROM THE ENTRY INTO FORCE OF THE AMENDMENT, THE MONEY LENDING ACTIVITIES OF THE HUNGARIAN FOUNDATION FOR ENTERPRISE PROMOTION AND THE ACTIVITIES OF COUNTY AND METROPOLITAN ENTERPRISE PROMOTION AGENCIES AIMING AT THE PROVISION OF MICROCREDIT ARE REMOVED FROM THE SCOPE OF THE ACT PURSUANT TO SECTION 2 (1) H) OF ACT NO. CXII OF 1996.

The clarification of the law now makes a clear distinction between the provision of microcredit and money lending from the National Microcredit Fund.

Money lending: the provision of a sum of money under a credit or loan agreement between a creditor and a debtor, which the debtor is obliged to repay on the date specified in the agreement, with or without interest.

The regulatory gap is that there is no legislation defining the concept of microcredit.

It is important that the legislation from that moment on makes a clear distinction between microcredit and the lending of money from a specific (otherwise not actually created, i.e. non-existent) legal entity, the 'National Microcredit Fund'. It is clear that the provision of (micro) credit certainly covers a broader scope than the lending of money as defined above.

In a general technical sense, lending includes the following activities:
- the provision of information, pre-negotiation with the client;
- applying for the loan;
- assessment of the loan (censorship procedure);
- approval of the loan (appraisal, decision);

- contracting (conclusion of a loan or credit agreement);
- **lending money (disbursement under the loan or credit agreement);**
- credit monitoring;
- monitoring the use of the loan;
- collection/repayment.

It is therefore clear that the HFEP would have legal authorisation for one element in the process aiming at the provision of microCREDIT, in other words to lend money from the **'National Microcredit Fund', which does NOT legally EXIST as a fund, so it does not have legal authorisation for anything.** The LEAs received legal authorisation for all the elements of the lending process as from this date.

We believe that the management of HFEP is well aware of this. In 2020, Dr Márton Braun, Managing Director of HFEP, told an Internet magazine the following:

"From the very beginning, HFEP has considered one of its most important tasks to support the start-up and development of small businesses that are 'non-bankable', i.e. not creditworthy in the eyes of commercial banks, by providing them with preferential funds. This is why we launched the European Microcredit Programme in the past," he continues, adding that "**in the classical sense, this is not a loan - HFEP is not a financial institution - but a repayable assistance provided at a preferential interest rate.**"
(Source: https://azuzlet.hu/braun-marton-az-mva-tudast-is-kinal-nem-csak-kedvezmenyes-forrast-biztosit/)

Based on the statement, it is our understanding that the Managing Director is aware that the HFEP is not allowed to lend money (and therefore, in general, cannot grant loans either).

This is also evidenced by the fact that in 2020 the HFEP instructed the LEAs involved in the National Microcredit Scheme to insert the following paragraph in the "**Microcredit contract**" concluded with the client:

"In view of the fact that the Hungarian Foundation for Enterprise Promotion applies the Government Decree on the credit moratorium in respect of the National Microcredit Scheme, **which, although not a commercial lending activity, but a repayable assistance programme run by non-profit organisations**, the contracting parties agree not to apply the institution of credit moratorium in respect of the **present microcredit loan agreement.**"

It can be seen that by this time, the HFEP had fully 'become aware' of the fact that the **National Microcredit Fund did not legally exist as a separate fund**. If it were a separate fund, the lending activity of HFEP would not have to be called 'repayable assistance', because if the National Microcredit Fund legally existed, the HFEP would be authorised to lend money from it. It can also be presumed from the wording that the **HFEP was aware that the repayable assistance provided by them was in fact a loan.**

3.1.10. PREVIOUSLY NOT EXPERIENCED LEGAL DISPUTES AND OPERATIONAL ANOMALIES IN THE OPERATION OF THE MICROCREDIT SCHEME AFTER 2000

FOLLOWING THE FORCED CENTRALISATION OF MICROCREDIT FUNDS, THE RELATIONSHIP BETWEEN THE HFEP AND THE LEAS BECAME HIGHLY CONFLICTUAL

The HFEP's behaviour as a superior, assertive '**authority**' – as some say – had a profound effect on cooperation. The HFEP, in breach of the provisions of its own handbook, intervened in the decisionmaking

processes of lending by 'manual control'. It took over the actual credit decision, despite the fact that it had no legal authority to do so (this practice still exists today and can be evidenced with documents). This is documented in numerous letters, expert opinions and notes. However, these will not be discussed in detail in this document. To illustrate the main problems, we will quote from a position paper issued by the heads of the microcredit departments of the LEAs and released to the press on 15 October 2003, which was signed by the directors of the LEAs and sent to the **Minister for Economic Affairs** on 1 March 2004 at the request of the Ministry's technical department.

"During the centralised management of the microcredit scheme in Hungary, it was proven that centalisation was a failure, t**he operation centralised by the HFEP failed**, since as a consequence thereof, the operation of the programme

- became significantly **more expensive**,
- **bureaucracy** increased severalfold,
- administrative **lead times increased enormously**,
- the system **became extremely slow and inflexible** due to unjustified bureaucratic elements from a professional point of view, **and**
- the implementation of the programme **significantly moved away from the original objectives and international practice**.

As a result of the above problems, there has been a noticeable **increase in dissatisfaction**, both among the business **clientele** targeted by the programme and among the **professional staff** running it.
...
In the light of the above, the professional organisations consider the following fundamental changes to the operation of the programme necessary without delay:

- Restructuring the operation of the microcredit programme **to make it fully decentralised in the future,** since the essence of the microcredit programme is to ensure fast, flexible local decision-making outside the banking sector, which is only possible with decentralised operation. (All decisions on loan transactions should be taken at local level by experienced professionals, who have a good knowledge of all the circumstances and local conditions. Bureaucrats sitting in remote offices applying a bureaucratic approcach cannot make good decisions with regard to these transactions.) This is in line with the international best practice used in Hungary between 1992 and 2000.
- In parallel with the structural reorganisation of the management of the programme, **we consider it necessary to manage the funds separately, in line with their real ownership.**
- **The central body** should only perform the central tasks that are actually necessary (periodic audits, central administration and data provision) and **should not intervene in individual credit transactions**.
- We consider it necessary to define **the framework conditions for microcredit activities** (including local microcredit programmes that are completely independent of the National Microcredit Scheme) at the legislative level (government decree).
- We consider it necessary to introduce a regulation that guarantees that in the future, decisions on microcredit programmes **will not be taken without the involvement of professionals with real practical experience in microcredit.**"

The use of sources spent on the operation is also irrationally distorted. To give an example, we quote from Péter Vonnák, "**MICROCREDITING IN HUNGARY, i.e. How can we optimise the social usefulness of microcredit schemes" (2015. ISBN 978-963-12-5845-5)**:

"The information provided by the Ministry of Economy and Transport illustrates the cost structure of the operation between 2000 and 2004:

"Cost structure
Microcredit commissions in 2002

Microcredit commissions in 2002	Ft	Σ		
HFEP	280 265 858	**549 848 184**	25%	48%
Postabank	269 582 326		23%	
Commission paid to LEA s	569 230 736	**591 790 459**	50%	52%
Bank charges/Coll. costs	22 559 723		2%	
Total:	**1 141 638 543**			

From the data it can be seen that in 2002 nearly half of the operating commission (48%) was used up by two organisations: HFEP and Postabank. The national network (20 foundations) actually implementing the credit scheme only received 50% of the costs. /Minister for the Economy and Transport, 2004/"

From the international directives presented above, we would like to highlight the following directives

> ***"Directive 9: The costs of central fund management and financial control should not exceed 5% of the actual programme implementation costs, and if the micro enterprise is a start-up business or younger than 3 years of age, the operating costs should be able to be accounted for partly or fully to the debit of the 'Credit Fund'."***

3.1.11. 2003-2006 - EXPERT DISCUSSIONS ARE ONGOING BETWEEN THE SUPERVISING MINISTRY AND THE REPRESENTATIVES OF THE LEAS ON RETURNING THE RIGHT TO MANAGE MICROCREDIT FUNDS

THERE WAS A GROWING SENSE OF FRUSTRATION AND DISSATISFACTION AMONG THE LEAS DUE TO THE LACK OF GOVERNMENT ACTION DESPITE THEIR CONSTANT WARNINGS.

With the intention of calling for government intervention to put the legal and professional background in order, which had clearly gone wrong, the LEA network set up a technical negotiating delegation, whose task was to act before the government to restore the legality and professionalism of microcredit.

According to the memo of the working committee meeting held on 15 January 2004 at the Department of SME Strategy and Promotion in the Ministry of Economy and Transport, the Deputy State Secretary for SME Development stated that "we are not aiming at rehabilitating the sources transferred to the LEAs before 2000, but considering the possibility of transferring the ownership of some HUF 4 – 5 billion from the entire National Microcredit Fund (Editor's note: since after 2000 the Government transferred additional state funds to the non-existent National Microcredit Fund)".

A lawyer from the Ministry's legal department informed the participants that rehabilitation was not planned because "in case of rehabilition, **the Government's liability for damages also comes into play,** since it acknowledges that the Government made a mistake in 2000 with its decision."

Here, too, it was argued that "pursuant to the agreements concluded with the HFEP, **the LEAs only transferred fund manager's rights to the HFEP, therefore they still hold ownership to the funds.**"

The project is the Interreg Europe programme
within the framework of the European Regional Development Fund
and is implemented with the support of Hungary.

At this meeting, the Ministry's lawyer also explained that "if a Government Decree level regulation provides for the removal of the fund manager's function of the HFEP concerning microcredit, it is binding for the HFEP."

At the meeting of the working committee held on 18 February 2004, the lawyer of the legal department of the Ministry said that "according to his legal opinion, **the fund manager's right of the HFEP - as an agency relationship – may be terminated unilaterally by the principal at any time, without giving any reason**". He also argued that "by signing the Memorandum, **the Hungarian party undertook to establish this fund, in other words, it creates the legal background for it, but this can only be done by law.** Thus, this has to be resolved."

The working committee agreed that "the aim is to create a viable microcredit programme, for which it is necessary **to take away the National Microcredit Fund from the HFEP, and to settle the situation from a legal point of view.**"

At the meeting of the working committee held on 24 February 2004 (according to the memo taken at the meeting), the representative of the legal department of the Ministry explained again that in his opinion "the obligations arising from the Memorandum currently in force must be satisfied, in other words a **fund must be created by law"**.

Note:

Meetings with the experts ended when János Kóka (former Minister of Economy and Transport between 2004 and 2008) took office as Minister of Finance. Mr Kóka decided to return the right to manage the funds, entrusting Csaba Kákosy, Chief of Staff, with the supervision of the negotiations. The ministry's professional staff was excluded from further negotiations, only Péter Pogácsás was involved in overseeing the process. The LEAs and the HFEP were forced to reach a mutual agreement on the matter, with Mr Kákosy supervising the talks.

Interestingly, as from 10 May 2006, Csaba Kákosy became a member of the Board of Directors of Start Garancia Zrt., owned by HFEP, in the company of Imre Csuhaj Varju, Chairman of the Board of Trustees of HFEP and Dr. Gergely Antal member of the Board of Truestees of HFEP (Deputy Director of HFEP, CEO of MiFin Zrt).

Remedying the unlawful situation created by the Memorandum, which the Ministry itself acknowledged as unlawful, and thus the creation of the Fund by law, is now completely off the agenda.

3.1.12. 2006 – THE HFEP RETURNS THE RIGHT TO MANAGE THE FUNDS TO THEIR OWNERS, THE LEAS, NEW 'LOCAL MICROCREDIT FUNDS ARE CREATED'

DISCUSSIONS WITH THE EXPERTS ON RETURNING THE RIGHT TO MANAGE MICROCREDIT FUNDS BY THE HFEP TO THE LEAS BEGAN BETWEEN THE REPRESENTATIVES OF THE LEAS AND THE HFEP IN 2006, UNDER THE MINISTERSHIP OF JÁNOS KÓKA, MINISTER OF ECONOMY AND TRANSPORT.

The discussions were conducted under the supervision of Csaba Kákosy, Chief of Staff of János Kóka Minister of Economy and Transport (from 2004, Kákosy was the Chief of Staff of the Ministry of Economy and Transport, he was Minister of Economy between 2007 and 2008, **member of the Board of Directors of Start Garancia Zrt owned by HFEP from 10 May 2006** to 10 May 2011) and Péter Pogácsás, Chair-

man of the National Microcredit Committee. (The establishment of the National Microcredit Committee is a mandatory requirement of the Memorandum of Understanding and the Handbook of the Microcredit Scheme. Accordingly, the Handbook cannot be amended without the decision of the National Microcredit Committee. A representative of the supervising ministry and a representative of the LEAs are also mandatory members of the National Microcredit Committee.)

The negotiations resulted in a draft agreement, the wording of which was accepted by both parties. There was consensus that the same contract should be concluded with all the LEAs on the basis of a single model contract.

The actual implementation deviated from this principle. Three versions of the text are known to us, of which only one version corresponds to the contractual template agreed by the parties. In the contracts concluded within a month, some 'insertions' were made in the text of the contracts, which made the legal and technical content of the agreement ambiguous and were clearly less favourable to the contracting LEAs.

Before briefly discussing the legal assessment of the versions, it should be noted that the change of circumstances does not explain why at least three versions were produced within a month. Nor can it be argued that the legal status of the funds is different for each of the fund manager's rights transferred by the LEAs and that is why a different wording had to be used. It is not plausible either that the heads of each LEA individually agreed on contractual terms that were less favourable to that specific LEA than the wording already agreed by their negotiating team.

All three versions agree on the following points:

"Under clause 3.1 of the contract referred to in clause 2 (NB: a clear reference to the agreement concluded in 2000, in which the LEA granted the right to the HFEP to manage the funds owned by the LEA for a specific, limited purpose), the LEA granted the right to the HFEP to manage the funds owned by the LEA."

"The Parties agree **to increase the Local Microcredit Fund already operated** by the LEA **by using the funds specified in clause I (3)** (NB: the funds described above, which are owned by the LEA and which the LEA provisionally transferred to the HFEP) in order to reinforce decentralised management."

As mentioned above, the funds called 'Local Microcredit Fund', are undisputedly the residual amount of funds owned by the LEAs, which were received in 1992 for business plan financing and used for the provision of microcredit. This, of course, applies to those foundations that had such 'residual funds'.

The contract also states that:
"The funds of the Local Microcredit Fund are listed in the table in Annex 1, which is based on the amounts set out in the table produced as a result of the KPMG audit (Annex 1)."

In the cases known to us, the said table contains the exact amount in HUF - without rounding - that the LEAs transferred to the HFEP to be managed (e.g.: HUF 220,293,404; HUF 330,604,832; etc.) under the heading '**Total to be returned by HFEP**'.

According to the original contract template, this table also includes the note that "(NB: the former residual funds/... shall constitute the former Local Microcredit Fund of the LEA in accordance with the common legal position of the parties.)"

ON THE BASIS OF THE ABOVE, IT CAN BE CLEARLY STATED THAT THE TRANSFER OF FUNDS MEANS RETURNING THE FUNDS OWNED BY THE LEAS, PREVIOUSLY TRANSFERRED TO THE HFEP WITH A LIMITED FUND MANAGER'S RIGHT TO THE OWNER OF THE FUNDS.

All other terms and conditions that the LEA undertook in this contract, as there is no binding external document or legislation outside this contract that could force it to do so, are voluntary commitments. In the absence of external compelling circumstances, termination of the contract for any reason shall relieve the LEA from the obligations undertaken therein.

The deviations of the wording from the contract template are briefly presented in order to examine whether these amendments substantially changed the above interpretation of the contract.

Version 1

"Under clause 3.1 of the contract referred to in clause 2 (NB: a clear reference to the agreement concluded in 2000, in which the LEA granted the right to the HFEP to manage the funds owned by the LEA for a specific, limited purpose), the LEA granted the right to the HFEP **to manage the funds** owned by the LEA."

Version 2:
"The Parties agree **to create a Local Microcredit Fund by using the funds specified in clause I (3)** (NB: the fundsdescribed above which are owned by the LEA and which the LEA provisionally transferred to the HFEP) in order to reinforce decentralised management. The funds of the Local Microcredit Fund are listed in the table in Annex 1, which is based on the amounts set out in the table produced as a result of the KPMG audit (Annex 1)."

This version of the wording was used for a foundation that did not have the 1992 'residual funds' mentioned above and did not provide microcredit from it own funds.

It is important to note that, due to the legal requirements already described, neither party was entitled to create a fund, either jointly or separately, and no such fund was created by this contract. Since this contractual provision is unlawful, it is null and void under the Civil Code. (In fact, under Hungarian legislation, neigher party is entitled to manage a Fund.) The term 'Microcredit Fund' used in the contracts actually means funds held in a bank account earmarked for a specific purpose.

So, legally, this would read as follows:

"The Parties agree that, in order to reinforce decentralised management, the HFEP shall repay to the LEA, **using the funds indicated in Section I (3)**, the funds belonging to the LEA, which were previously transferred to the HFEP to manage such funds provisionally, and which the LEA shall use for the provision of local microcredit."

Further deviation from the agreed contract template (the underlined part indicates the insertion):

"The purpose of the fundsis to provide loans from the local microcredit fund under the National Microcredit Scheme, which operates in parallel with the central microcredit programme."

Here, the term '**National Microcredit**' was arbitrarily inserted into the agreed contract template. Since the term 'National Microcredit Scheme' has no precise legal definition, everyone can mean whatever they want by it. The provision of local microcredit by the LEAs can be part of the National Microcredit Scheme, if that is how we want to interpret it. The insertion is not relavant in terms of the legal interpretation of the contract, and in our view, it merely serves to mislead by giving the impression that the HFEP may have some legal means of coercion to determine - or control - the microcredit activities of the LEAs conducted from their own funds.

Further deviation in version 2 of the wording:

Original wording:
/The LEA undertakes to/
"manage the Fund in its books separately,"
"supply data regularly to the HFEP on the operation of the local microcredit fund, using the computerised system adopted by the Hungarian Enterprise Promotion Network Consortium for the central uniform data supply, ..."

With a different wording compared to the original agreement:
/The LEA undertakes to/

"manage the Fund in its books separately,"

"supply data regularly to the HFEP – in the form required by the HFEP – on the operation of the local microcredit fund. The LEA acknowledges that in the event of non-compliance with its obligations under this clause, the HFEP has the right to suspend its microcredit lending rights in respect of both the central microcredit programme and the local microcredit programme..."

Compared to the template contract originally agreed, this sentence was presumably inserted into the contract to reinforce the impression that the HFEP has some external authority or power to make decisions on the micro-lending activity of the LEA. It is important to note that it was already clear at that time that the LEAs had a substantive right to provide microcredit outside the scope of the Act on Credit Institutions under Section 2(1)(h) of Act CXII of 1996 on Credit Institutions and Financial Enterprises and that HFEP could not in any way restrict them in this right.

This version of the wording is clearly less favourable to the LEA signing the contract, as it grants the HFEP additional power for no reason at all, without any consideration. As there is no external constraint to grant this additional power, it can only be considered as a 'voluntary' undertaking in this contract. In the event of termination of the contract for any reason (e.g. termination by the LEA), this power granted by the LEA shall cease to be exercisable by the HFEP and HFEP shall have no claim against the LEA in this respect.

A further modification to this version is the inclusion of the following as a separate clause in the contract:
/The LEA shall/

„be responsible for any credit loss resulting from the provision of microcredit inadequately."

This insertion does not change the substance of the contract or have any relevance for either party. As the funds are the property of the LEA, it is of course the LEA that is responsible for the credit losses, it is their loss. It can be seen clearly that this insertion was also made in order to give the impression that foreign funds were given to the LEA and not its own money, as it was demonstrated above. This assumption is reinforced by the wording inserted in the third version of the contract (the second version of the contract, which differs from the agreed template) as follows:

Version 3:
/The LEA undertakes to/

*„ manage the Fund in its books as **foreign funds** separately,"*

Notes:
This wording was included in the latest contract in time (not even a full month had elapsed between the different contract versions. The contracts were not signed by the LEAs at the same time. The contracts were printed by the HFEP, and the representatives of the LEAs went to the HFEP at different times to sign them. In the first period, the representatives of the LEAs signed contracts which were in line with the template (some of them, not trusting the HFEP, took a hard copy of the previously agreed wording of the contract with them, and compared it with the printout to check if there had been any changes.). It is possible that later on they 'tried' to make additions to the text, taking advantage of the trust and inattention of the contracting parties. Presumably, buoyed by the success, they went even further and inserted this most misleading passage.

This is the most disruptive intervention or change to the originally agreed contract template that we know of. Here, the intention was clearly not to show the funds repaid to the LEA as their own funds. The impact of this insertion on the interpretation and legal consequences of the contract needs to be examined.

On the one hand, we are of the opinion that this contractual term is contrary to law and therefore null and void under the Civil Code. The way in which an entity accounts for a particular economic event in its books is not determined by a contractual undertaking, but by the provisions of Act C of 2000 on Accounting.

The economic events should be booked according to their real content, so in this case, as we have shown, even according to this contract, the HFEP paid back their own funds to the LEA, so this should be booked accordingly. Any undertaking by the LEA contrary to the provisions of the Accounting Act is null and void.

It can be clearly stated that this paragraph, which cannot be considered as a legal declaration, does not create a right of ownership for anyone else, nor does it constitute a recognition of the right of ownership of anyone else in respect of the funds previously transferred to the HFEP under the transfer of the right to manage such funds.

Taking into account the previously described clauses of the contract, which are common to all versions of the wording, according to which the source of the amount 'repaid' by the HFEP is the amount - in the cases we know of, in HUF – with regard to which the right to manage had been transferred by the LEA to the HFEP, and whose ownership is not constrained by any external constraints, apart from the voluntary legal commitments undertaken in that contract, this specific insertion does not constitute a legal basis for HFEP to claim those funds back from the LEA at any time and under any title. If the law were interpreted otherwise, the HFEP would still owe the LEA the same amount quantified in the contract that has already

been paid back by the HFEP to the LEA under that contract.

The deliberately ambiguous wording and the insertion of arbitrary additions could be interpreted as a deliberate attempt to obscure the true legal economic content of the contract, with the express intention of making the contract itself unintelligible without an examination of the antecedents and circumstances. Furthermore, it may have been intended to give the impression that it was a one-off transfer of foreign capital which was not the property of the LEA and could therefore be subject to a legal basis for the HFEP to claim it back.

It is clear that the changes were not 'accidental', they could only have been done deliberately. It is also apparent and obvious that the changes are intended to conceal the real background and the legal and economic content of the agreement, that is the fact that the real owners of the funds are the LEAs and that the contract returns the right to manage the funds to the owner of the funds. We believe that the intention was clearly to create the impression that the transaction was a transfer of foreign capital. This only makes sense if the 'perpetrator' was aware that the real owners of the funds were the LEAs and that the funds concerned were in fact being returned to the owner by this contract.

However, in our view, the real fact is that in the event of termination of the contract for whatever reason, HFEP has no right to force the entity with proprietary rights – that is the LEA – to transfer the right to manage the funds back to HFEP. Upon termination of the contract for any reason, the selflimiting 'voluntary' obligations of the LEA under the contract shall cease to exist.

3.1.13. 2016 – CURIA DECISION CONFIRMS THAT THE HFEP DOES NOT EVEN HAVE THE RIGHT TO CONTROL THE MICROCREDIT FUNDS OF THE LEA.

ALL THE FACTS AND LEGAL OPINIONS SET OUT ABOVE ARE SUPPORTED BY THE DECISION OF THE CURIA ACCORDING TO WHICH THE BORSOD-ABAÚJ-ZEMPLÉN COUNTY DEVELOPMENT AGENCY WON THE LAWSUIT AGAINST THE HFEP

As already described above, litigation was initiated between some LEAs and the HFEP regarding the right to dispose of the residual funds of the PHARE Microcredit Programme. Several of the lawsuits were terminated because they were not renewed by the HFEP after cessation.

In 2016, however, the dispute between HFEP (as plaintiff) and the Borsod-Abaúj-Zemplén County Development Agency (as defendant) in the ongoing lawsuit [Budapest-Capital Regional Court, 22.G.43.732/2013/29.; Budapest-Capital Regional Court of Appeal, 3.Pf.21.745/2014/6/I.] ended with a **final court judgment confirmed by the Curia (Case No. Pfv.V.20.341/2016/5).**

Legal consequences:
It became clear that neither the conclusion (the contract concluded in 2000 presented above, according to which the signing LEAs granted the HFEP limited, specific rights to manage their own funds) nor the maintenance of the previous agreements with the Hungarian Foundation for Enterprise Promotion related to microcredit, concerning participation in the New Hungarian Microcredit Scheme, could be imposed on the LEAs by the HFEP or the Minister of Economy representing the Hungarian Government.

Therefore, any commitments made by the LEAs in the contract are considered voluntary and will cease to exist after the termination of the contract.

This is also important because, if a foundation cannot maintain this cooperation without jeopardising the achievement of its founders' objectives or the sustainability of its operations, it may decide to 'withdraw' from the cooperation by terminating the contract.

Thus, it became clear that

- the county's funds remaining from the PHARE Microcredit Programme **became the property of the local enterprise agency concerned** after the closure of the programme,
- **the HFEP had no right of control** over the use of the funds or the microcredit activities of the foundation concerned, nor, as a result, can it oblige the foundation concerned to cooperate in a way that would infringe the foundation's unrestricted right to dispose of funds, its interests or the achievement of its founders' objectives.
- It follows from the above that any agreement between a local enterprise agency and the HFEP concerning the local enterprise agency's self-limiting use of funds is to be considered a '**voluntary undertaking' by the local enterprise agency**. Consequently, in the absence of any external legal obligation or constraint, **this voluntary restriction may be terminated at any time by the local enterprise agency concerned**. Accordingly, in the absence of eligibility, the HFEP cannot oblige the foundation concerned to maintain its previous voluntary commitments indefinitely.
- Furthermore, any previous contractual clause in which the HFEP attempts to restrict the right of the respective local enterprise agency to dispose of its own funds without an appropriate legal basis or to oblige it to transfer the right to manage again shall be considered unlawful and therefore null and void.

3.1.14. 2017 – THE PRIME MINISTER'S OFFICE SUPPORTS THE LAUNCH OF A NEW 'SOCIAL MICROCREDIT SCHEME' AND RAISES THE NEED FOR DETAILED REGULATION OF THE MICROCREDIT ACTIVITIES OF COUNTY AND METROPOLITAN ENTERPRISE PROMOTION AGENCIES

24 November 2017, Prime Minister's Office, Budapest. From the leftl: Péter Vonnák, Veszprém County Enterprise Development Foundation, VicePresident, Managing Director; Dr. Tamás Bartal Prime Minister's Office, Deputy Secretary of State; Tibor Szekfü, Veszprém County Enterprise Development Foundation, President of the Board of Trustees, FEA, Managing Director

IN A LETTER DATED 28 APRIL 2017 (KABHÁT 6/2/2017), THE MINISTER IN CHARGE OF THE PRIME MINISTER'S OFFICE, JÁNOS LÁZÁR, INFORMED THE NETWORK OF THE LEAS ABOUT HIS SUPPORT FOR THE LAUNCH OF A NEW SOCIAL MICROCREDIT SCHEME.

At the same time, he noted that "at present, no legislation sets out the conditions for the provision of microcredit by the local enterprise agencies. In the absence of a legal definition, the concept of microcreditis questionable...". "... I support the implementation of a Social Microcredit Scheme offering loans to the persons concerned at even 0% interest." "However, in my view, the current lack of regulation makes it difficult to allocate sources to the microcredit scheme. It is therefore essential to create an appropriate legal framework."

The majority of the LEAs agreed with the Prime Minister's Office that it would be in the national economic interest to settle the legal background of the provision of microcredit. It would be important to increase transparency and to enshrine in law the primacy of social objectives in case of non-profit microcredit. The necessary draft legislation had been sent (several times) to the relevant ministries in the form of an expert proposal. A reply was received that it would be examined in substance, however, it has not happened until today.

3.1.15. 2018 – FINDINGS OF A COMPREHENSIVE HUNGARIAN SURVEY CARRIED OUT IN THE FRAMEWORK OF AN EUROPEAN UNION PROGRAMME

IN THE FRAMEWORK OF THE ATM FOR SME'S INTERREG EUROPE PROJECT (FIRST PHASE), THE ZALA COUNTY FOUNDATION FOR ENTERPRISE PROMOTION (ZMVA) CONDUCTED A COMPREHENSIVE NATIONAL SURVEY ON THE EXPERIENCE OF MICROCREDIT IN HUNGARY IN 2018, WITH THE AIM OF IDENTIFYING AREAS WHERE ACCESS TO MICROCREDIT IN HUNGARY COULD BE IMPROVED.

22 November 2018, National University of Public Service, Budapest, ATM for SME's conference, András Nagy (†) ZMVA Managing Director

In November 2018, at a professional conference organised at the National University of Public Service with the participation of foreign speakers, András Nagy, the then Managing Director of ZMVA - who has since sadly passed away - gave a presentation on the main findings of the survey. The presentation can be found at the following link.
https://www.youtube.com/watch?v=jfEd7ysrjE&t=1s&ab_channel=RVAGROUPMAGYARORSZ%C3%81G

The survey has found **that there is a great social need** for nonprofit microfinance. This has been shown by several social impact surveys conducted among clients. The LEAs, members of the Hungarian Microfinance Network, have achieved significant results in the field of microcredit, even at international level.

The majority of the LEAs that participated in the survey agreed with the suggestion of the Prime Minister's Office that it would be advisable to supplement the regulation on microfinance with detailed regulations on the microcredit activities of county and metropolitan enterprise promotion agencies.

This would be important, among other things, so that the centrally funded programmes will take better account of the international professional recommendations, through the application of which the positive social impact of microcredit can be enhanced. In this respect, the LEAs own microcredit programmes are more successful, as the LEAs can adapt the rules of the programme more effectively and flexibly to socio-professional needs.

A brief summary of the findings of the survey on the 'National Microcredit Scheme':

For the National Microcredit Scheme, there are no data published by the HFEP as the 'central coordinator', and therefore only limited data could be obtained from the foundations involved.

It can be seen that the LEAs in the JEREMIE mcirocredit scheme, which will be presented in section 3.2, have an exceptionally high specific client reach. Comparing JEREMIE and the National Microcredit Scheme data, the **JEREMIE mcirocredit scheme outperforms the National Microcredit Scheme** in terms of both client numbers and the amounts disbursed.

This demonstrates that it is possible to improve the poor performance of the National Microcredit Scheme by modifying the various programme conditions, **and that the potential for higher performance is NOT limited by the attitude and lack of professionalism of the individual LEAs**.

Factors to be considered:

- lending is (in principle) based on the HFEP's outdated internal document, the 'Microcredit Handbook' (30 years old, 'updated' 22 years ago),
- procedures, rules and relevant contracts have not been adapted to changes in legislation and professional requirements;
- the **HFEP lost the lawsuit** against the Borsod-Abaúj-Zemplén County Development Agency. In the light of the legal consequences of this, the system of relations between the HFEP and the LEAs should be reinterpreted and re-examined.
- the role of the HFEP must be brought in line with the changed legislation,(also, for reasons of conflict of interest) the control of the programme should be entrusted to a public authority (with the reinforcement of the legal framework),
- the terms of the credit facility should be made more favourable for entrepreneurs. The requirement of at least twice the value of the unencumbered property as collateral does not allow the main mission of the scheme to be achieved, that isto finance entrepreneurs not having adequate collateral, who have reduced creditworthiness in profit-oriented organisations.
- in the future the professional recommendations of the LEAs should be considered.

Problems of the co-ordination:

- there is no professional feedback on the results of the programme,
- the allocation of funds that can be disbursed is not discussed with the LEA,
- it is not known who is in charge of the programme in the ministry that is supposed to supervise it,
- the ministry has no data or information about the programme,
- some versions of the amendments to the HFEP Handbook are not known and are not agreed with the LEAs,
- they do not operate the National Microcredit Committee,
- there is no central training and exchange programme for intermediaries,
- no social impact assessment is carried out,
- It is not known to whom the HFEP's Internet campaign has sent clients (and at which organisation the clients turn up, e.g. not at the LEAs participating in the survey), so its effectiveness is not known,
- the HFEP does not train its colleagues, they do not know the essence of social microcredit,
- the HFEP does not manage its 'network', does not take steps to improve the sustainability of its operation, and does not act to this end before the supervising ministry,
- the HFEP regularly interferes in the lending process contrary to the requirements of the Handbook,
- the HFEP makes the final credit decision in all cases, which is contrary to its own Handbook,
- the HFEP staff regularly behave in a patronising and intimidating manner, and do not consider the LEAs as partners.

The lending process of the National Microcredit Fund is slow, inflexible, cumbersome, and the centralised decision-making is against the law. Strong collateral is needed. The portfolio renewal, and the handling of insolvent clients is slow.

What is needed: faster lending, decentralised marketing and decision-making involving local intermediaries, own credit limit for the county, adaptation of the contracts to the legislation.

The lending process is too **bureaucratic**, requiring too much data and a detailed business plan.

3.1.16. AS FROM 2019, SEVERAL LEAS HAVE TERMINATED THEIR CO-OPERATION AGREEMENT WITH THE HFEP

THE SELF-LIMITING CONTRACTUAL CONDITIONS UNDERTAKEN VOLUNTARILY IN THE AGREEMENTS CONCLUDED WITH THE HFEP BECAME UNSUSTAINABLE FOR SEVERAL LEAS.

As a preliminary point, we would like to note that the ministry in charge of supervising the Microcredit Scheme on the part of the government was already on the opinion in 2003 that the fund manager's right of HFEP could be revoked at any time. In a memo sent to the Minister of Economy dated 29 July 2003, the Head of the SME Promotion Department of the Ministry of Economy and Transport stated that

"**With regard to the fund manager's right**, there is an agency relationship, in which the Government of the Republic of Hungary is the principal and HFEP is the agent, and the content of the fund manager's right is detailed in the Agreement (NB: the Memorandum)." "... **the Contract may be terminated**, with the simultaneous **termination of the HFEP's right to manage the funds.**"

As this is applicable to the right to manage granted by the Hungarian State, it is clear that this possibility also applies to the right to manage granted by the LEAs.

As circumstances changed, the financial sustainability of the operation of the LEAs in line with the founders' objectives deteriorated significantly. The HFEP either did not respond to the initiatives of the LEAs to amend their cooperation or categorically rejected them. However, in 2016, the Curia's decision made it clear to all that the LEAs cannot be forced to maintain these self-limiting commitments, which seriously jeopardise their operations. In light of this, first the Veszprém County Enterprise Development Foundation and then other foundations terminated their previous contracts with the HFEP. The case of the Veszprém County Enterprise Development Foundation is given as an example.

Established by the General Assembly of the Municipality of Veszprém County on 20 December 1991 and registered by the County Court of Veszprém under registration number Pk.60.048/1992/4,

the owner of the founder's right of Veszprém County Enterprise Development Foundation

"pursuant to Section 2 (8) of Act CLIV of 2011 on the consolidation of county local governments and on the take-over of county local government institutions and certain healthcare institutions of the Municipal Government of Budapest" is the

Hungarian State.

Pursuant to Government Decision No 1130/2013 of 14 March and Government Decision No 1170/2014 of 26 March, the founder's right of Veszprém County Enterprise Development Foundation, a**s a public benefit foundation, which right belongs to the Hungarian State, is exercised by the General Assembly of the Municipality of Veszprém County".**

In the period between 2016-2018, the Board of Trustees of the Veszprém County Enterprise Development Foundation (hereinafter: Veszprém Enterprise Agency) reviewed the Foundation's overall operational structure, its business development services and their methodology. In order to ensure sustainable operations as soon as possible, a full due diligence was carried out with the help of external experts, both in terms of operations, financing and contractual legal background.

During the legal due diligence, it was found that in previous agreements with the Hungarian Foundation for Enterprise Promotion (HFEP) (16-20 years ago) related to micro-lending, the Foundation made voluntary commitments that are now unsustainable and significantly impede the achievement of the Foundation's objectives and financial sustainability.

FINDINGS

Veszprém Enterprise Agency is a local enterprise agency within the meaning of Section 2 (1) f) of Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises. In accordance with this legislation, Veszprém Enterprise Agency, as a NON-PROFIT PLAYER, OPERATING OUTSIDE THE MONEY MARKET, is legally entitled to engage in microcredit activities outside the scope of the Credit Institutions Act.

The Veszprém Enterprise Agency's own funds used for microcredit consist mainly of funds transferred to the Foundation under the former **PHARE Microcredit Programme**, mainly in the form of targeted subsidies subject to conditions. The Phare Microcredit Programme ended in 2000 and the parties (Veszprém Enterprise Agency as the user of the funds and HFEP as the intermediary and programme coordinator) have settled their accounts with one another in full.

In accordance with the agreement concluded with HFEP in 2000, Veszprém Enterprise Agency - like most of the county and metropolitan enterprise promotion agencies - granted HFEP the right to manage the 'residual' funds of the PHARE Microcredit Programme in order to finance the '**New National Microcredit Scheme**' launched after the PHARE Microcredit Programme. The HFEP, with the right to manage the funds received from the enterprise promotion agencies and the State, set up a 'virtual financial fund' under the name of '**National Microcredit Fund**'. This fund **is not legally a financial fund and HFEP is not entitled to manage a 'real' financial fund**. The funds provisionally placed at HFEP's disposal by means of an agreement, which can be regarded as an agency relationship, were not definitively transferred when the rights to manage the funds were transferred and therefore did not come into HFEP'spossession.

Since the 'New Microcredit Scheme launched in 2000 did not prove to be sufficiently flexible and effective, the HFEP, under a new agreement, **returned** the right to manage the funds **to the owner of the funds**, that is Veszprém Enterprise Agency, similiarly to other local enterprise agencies, in 2006.

In the agreement, Veszprém Enterprise Agency agreed to allow the HFEP to control its provision of microcredit from these funds. It voluntarily limited its right to dispose of the funds owned therebythrough creating a 'virtual local microcredit fund', which is only used for the provision of microcredit, and limited the amount of the funds it can use for its own operations (legally this is not a financial fund either, but merely a separately managed fund).

LEGAL INTERPRETATION AFTER THE DECISION OF THE CURIA

The dispute over the remaining funds of the PHARE Microcredit Programme ended with **the final court decision of the Curia (Case No. Pfv.V.20.341/2016/5).**

Hence:

- following the closure of the programme, the remaining funds of the PHARE Microcredit Programme **came into the possession of the concerned local enterprise agencies**,
- **the HFEP had no right to control** as to the use of funds, as well as the micro-lending activity of the specific foundation, nor, as a consequence, to oblige the foundation to cooperate in a way that would jeopardise the foundation's unrestricted right to dispose of its funds, its interests or the achievement of its founder's objectives.
- It follows from the foregoing that any agreement between a local enterprise agency and the HFEP regarding the local enterprise agency's self-limiting use of funds is to be considered a '**voluntary undertaking**' by the local enterprise agency. Therefore, in the absence of any external legal obligation or constraint, **this voluntary restriction undertaken in the contract and the contract itself may be terminated at any time** by local enterprise agency concerned. Accordingly, in the absence of eligibility, the HFEP cannot oblige the specific foundation to maintain its previous voluntary commitments indefinitely.
- Furthermore, any previous contractual clause in which the HFEP attempts to restrict the right of the respective local enterprise agency to dispose of its own funds without an appropriate legal basis or to oblige it to transfer the right to manage such funds again shall be considered unlawful and therefore null and void.

DECISIONS CONCERNING THE OPERATION OF THE VESZPRÉM ENTERPRISE AGENCY

In the light of the legal opinions underlying the above, the Board of Trustees of Veszprém Enterprise Agency and the General Assembly of the Municipality of Veszprém County adopted resolutions and decisions.

In 2019, HFEP did not accept Veszprém Enterprise Agency's initiative to review and modify the cooperation based on previous contracts.

Subsequently, the Board of Trustees of Veszprém Enterprise Agency - with special regard to the provisions of Resolution No 48/2019 of 26 September (MÖK) of the General Assembly of the Veszprém County Municipality, **representing the Hungarian State** as the owner of the founder's rights - unanimously decided by Resolution No 4/2019 to terminate the previous agreement concluded with HFEP in 2006, which also included the self-limitation of the ownership of Veszprém Enterprise Agency.

Following that decision and the lawful termination of that contract, Veszprém Enterprise Agency ceased to earmark its own funds for microcredit.

In accordance with the previous recommendations of the municipality exercising the founder's rights of the Hungarian State, the Foundation will continue to use the funds to maintain the financial balance of the Foundation, to meet the expected payment obligations towards the **Hungarian Development Bank, also owned by the Hungarian State**, arising from the operation of the JEREMIE mcirocredit scheme, to further enhance the efficiency of business development programmes in order to achieve the founder's objectives, and to operate the Foundation.

Without presenting detailed calculations, we mention, as an illustration of the situation, that e.g. to create a coverage of approximately HUF 100 million required to maintain the operation of an average LEA (complete infrastructure, software, financing the salaries of the necessary employees, overheads, etc.), an average annual loan portfolio of around HUF 2.5 billion per year is needed, calculated at a real interest rate of 4% per year. Of course, this is nowhere near covering inflation, so the nominal value of the funds is not sustainable. No LEA has this amount of equity capital.

From a national economic and social point of view, it is more beneficial for the LEAs to use their own equity to co-finance or pre-finance direct EU tenders, for example, to bring additional direct EU funds into the country for economic development, rather than waste it in an unsustainable programme.

With regard to the legal background to the termination of contracts for 'local funds', we would also like to mention the following.

Section 207 (1) of the old Civil Code: "In the event of a dispute, the parties shall, in light of the presumed intent of the person issuing the statement and the circumstances of the case, construe statements in accordance with the generally accepted meaning of the words."
We are of the opinion that these contracts may be terminated with immediate effect by the foundations on the basis of Section 483 (1) of Act IV of 1959 of the old Civil Code, as the above agreements can be classified as 'atypical contracts', and cannot be classified as any of the contracts typified under the old -

Civil Code, but on the basis of their content they can be qualified as agency contracts (as it was already mentioned in case of the Hungarian State as well).

According to the EBH2000.331 court decision in principle of the Supreme Court, "contracts are to be judged by their content and not by their title".

3.1.17. OPERATIONAL CHARACTERISTICS OF THE HFEP

3.1.17.1. Coordination of microcredit based on its annual accounts

As can be seen from the above, the functioning of the HFEP as a programme coordinator is a key factor in the effectiveness of non-profit microcredit. Therefore, we briefly describe some of the operational aspects and background of this organisation.

First, we briefly review the role of HFEP in the National Microcredit Scheme based on their annual accounts.

Of the documents available for download from the public website of the National Office for the Judiciary, the public simplified annual accounts of year 2011 are the oldest available. The 'Independent Auditors' Report' annexed to the accounts was signed by the auditor company KPMG Hungária Kft.

The section 'NATIONAL MICROCREDIT SCHEME (NMS)' in the notes to the balance sheet includes a reference to the Memorandum (signed in 2000, as presented earlier, unlawful, therefore it is null and void) as a predecessor of the programme:

"According to the Memorandum of Understanding (Memorandum) signed on 17 May 2000 by the European Commission, the Ministry of Economy, the Prime Minister's Office and the Hungarian Foundation for Enterprise Promotion, the National Microcredit Fund (NMF) is owned by the Republic of Hungary and managed by HFEP."

It is important to mention that this sentence disappeared from the wording of the annual accounts as from 2016, when the HFEP lost the lawsuit initiated against it.

This year, on average, 6 loans were disbursed per week, which is an extremely low number. Interestingly, the reason for this weak result, according to the annual accounts, is "the insufficient lending activity of the local enterprise agencies (LEAs). This is because the LEAs, which currently have the exclusive right to lend, are implementing the JEREMIE credit programme. That is why the HFEP will restructure the microcredit system in 2012, and involve new partners."

This is important as it shows that the NMS managed by the HFEP could not offer a competitive alternative to the JEREMIE programme coordinated by the Hungarian Development Bank. The number of disbursed loans was extremely low, even though the LEAs were particularly interested in granting loans from the NMS because of the commission system.

The reasons for this were not investigated. It was easier to blame the poor performance of the LEAs for the extremely low result.

It should be noted that the annual accounts also mention the so-called '**REGIONAL MICROCREDIT SCHEME**, which „was established under the Memorandum of Understanding signed on 31 May 2000 by the Ministry of Agriculture and Rural Development, the Ministry of Economy, the European Union and the Hungarian Foundation for Enterprise Promotion. The Fund is managed by the Hungarian Foundation for Enterprise Promotion."

It should be noted that what we said about the creation of the NMS applies here as well, in other words,the creation of a '**State-owned Fund**' by means of a civil law contract is unlawful and null and void, as it can only be created by an act. However, it is worth noting that, to the best of our knowledge, **only the Hungarian State contributed to this fund**. It is also interesting that the accounts refer to and treat this fund as a fund independent of the NMS.

The authorisation granted by the Credit Institutions Act, cited several times before, authorises the HFEP to disburse loans from the NMS but not from the so-called '**Regional Microcrdit Fund**' (which had not been created in the legal sense either).

The accounts also mention "the local microcredit funds operating within the scope of the National Microcredit Scheme".

The accounts state that the "Local Microcredit Funds are funds managed by the local enterprise agencies (LEAs), but forming part of the National Microcredit Fund". The accounts also mention the value of these funds by county, the total value of which is HUF 5,583,529,000.

It is important to note that, as explained in detail above, these separately managed funds are not legally 'Funds', and they are not simply managed but **owned** by the LEAs. Furthermore, as mentioned above, the National Microcredit Fund had not been created legally, and therefore, these local funds could not form part thereof.

If we accept that the '**National Microcredit Fund**' can exist 'in the jargon' (that is, not legally), it cannot be considered as a single legal entity in terms of ownership. It should also be noted that, for example, the investors holding the securities (units) of private equity funds (which have a separate legal personality) may also be different. The establishment and operation of investment fund managers is governed by a separate act [Act No. CXCIII of 2011].

It is important to note that although the HFEP refers to the '**Funds managed thereby**' as '**state-owned**' in all the documents cited, it nevertheless shows them as '**Equity**' in its balance sheet under the row '**Changes in accumulated equity in previous years**'.

It appears from the accounts that the funds returned to the LEAs, which are actually owned by the LEAs, are presumably included in the accounts from year to year among **'Invested financial assets'** (as quasi disbursed long-term loans). We mention 'presumably' because the explanation part contains no information about it. These financial assets are shown as part of '**equity**' on the liabilities side. No liabilitiy of this magnitude is shown in any of the accounts, and they do not include any long-term liability either.

IN OUR OPINION, THE ANNUAL ACCOUNTS DO NOT GIVE A TRUE AND FAIR VIEW OF THE ASSETS AND LIABILITIES OF THE HFEP.

On the one hand, the funds owned by the State cannot be the own funds of the HFEP, they should be shown in the row '**Liabilities**' existing towards the State, and on the other hand, there should be a counter account held by the **Hungarian State Treasury**, on which **the Hungarian State Treasury should record its claim agains the HFEP**.

In our view, if the microcredit funds ('NMF', 'RMF') had indeed been legally established as public funds, the creation of this treasury account would have been natural. In this case, the funds could not be on the bank account of the HFEP, at most provisionally for the technical processing of a transaction (intermediation of funds). However, **in our opinion, the balance sheet of the HFEP contains untrue and misleading information**, with which it is in breach of the provisions of Act C of 2000 on Accounting, and therefore constitute a breach of the accounting rules.

The document also mentions that the "HFEP shall carry out its tasks in the implementation of the Hungarian Microcredit Scheme in accordance with the provisions of the Memorandum of Understanding concluded with the European Union and the **Microcredit Handbook** approved on the basis of the Memorandum." "The HFEP shall pay particular attention to the compliance of the LEAs with the provisions of the Microcredit Handbook in their activities related to the provision of microcredit. The specific lending activities, such as the reception of loan applications, **loan assessment**, contracting, collateral checks and follow-up are the responsibility of the LEAs. The monitoring of individual loans is also the responsibility of the LEAs. **The tasks related to the collection of debts once a loan is cancelled are carried out by the HFEP."**

On the one hand, we would like to note that we are not aware of any copy of the 'Microcredit Handbook' that has been countersigned by any LEAs indicating their full acceptance of it.

Furthermor, we consider it important to mention because the aforementioned 'handbook' **does not allow the HFEP to intervene in the credit decisions of the Individual LEAs**. By contrast, several written documents available to us show that the **actual loan assessment is in fact carried out and the decision is made by the HFEP**. The lending procedure of the LEAs is merely a preparatory activity. However, it is clearly recognised in the document that the success of the collection of the loans after cancellation is clearly dependent on the HFEP.

These procedures, which also violate the HFEP's own internal regulations – as it has been concluded earlier – could even constitute prohibited credit institution activity, since the HFEP has no legal authority to engage in these lending activities, only to lend money (from the otherwise non-existent National Microcredit Fund).

It also holds great significance in that it makes it clear that **the real responsibility for the recovery of loans lies with the HFEP, as both the loan decision and the collection in the final stage of the recovery process are concentrated in its hands. Therefore, in the absence of real responsibility, the transfer of risk to the LEAs by reference to any document is highly questionable from a legal point of view**.

Subsequent accounts – up to 2016, when (as mentioned earlier) the HFEP lost a lawsuit against a LEA – also contain the same information as presented herein, so we will only draw attention to some notable differences.

The annual accounts on 2012 state the following concerning the performance of the NMS:
"The HFEP reorganised its advertising policy in 2012, which led to a significant increase of around 25% in the amount of loans granted."

We mention this because, as we have shown, in a survey carried out in 2018, the LEAs that participated in the survey indicated that no clients were referred to them by HFEP, although it was known to be running costly advertising campaigns. Several of the LEAs believed that incoming clients were referred to Nógrád Enterprise Agency operated by HFEP, the sole founder exercising founder's rights.

This, **by no means, can be regarded as an impartial, professionally correct national coordinating activity**. If the Ministry, acting on behalf of the Hungarian State, through the chairman of the National Microcredit Committee, had properly supervised the programme in accordance with the relevant regulations, this could not have happened.

As regards the significant increase of about 25% mentioned in the accounts, the average number of contracts signed per week increased from 7 to 9 nationwide (NMS and RMS combined).

In the annual accounts on 2013 the following text, which appears under the heading 'START GARANTEE PROGRAMME', is new compared with the previous text:

"In 1991, with the benevolent support of the Federal Republic of Germany, the START Guarantee Fund was established under the management of the Hungarian Foundation for Enterprise Promotion. The START Guarantee Fund is an unincorporated, separately managed fund with a specific economic development objective (to support the development of small and medium-sized enterprises), which does not qualify as a separate public fund under the Public Finance Act, nor as a statutory investment fund or venture capital fund."

We consider it important to mention this because it obviously shows that the management of the HFEP was also aware that the NMF had not been created as a 'public fund', **as it was not 'created' as a separate public fund under the Act on Public Finance, and obviously it cannot be an investment fund or a venture capital fund, as defined by law either. As they put it, it was at most 'a separate fund without legal personality'. This, however, means that under Hungarian law, it – as we have concluded it earlier – does not in fact qualify as a 'Fund' either.**

This is also true of the 'Local Funds' managed by the LEAs, with the proviso that these funds are owned by them, whereas the funds managed by the HFEP are owned by the Hungarian State and, in cases where the funds transferred to the HFEP for management have not yet been returned to certain LEAs, by the respective LEAs. These amounts should be treated as foreign funds and reported in the accounts accordingly.

Another new feature is that from this year onwards a new chapter 'BALANCE SHEET, PROFIT AND LOSS ACCOUNT BROKEN DOWN BY FUNDS' is added to the annual accounts.

Here a separate column is allocated for 'Founders', 'NMF', 'Regional Microcredit' as well as 'START – Guarantee Fund'.

The Equity row includes the NMF with HUF 11,635,661,331 (which also includes the funds owned and managed by the LEAs) and the Regional Microcredit with HUF 1,069,802,801. As mentioned above, this cannot be true according to the accounts themselves, as the accounts identified these '**separately managed funds without legal perssonality**' as belonging to the Republic of Hungary, so this cannot appear as equity of the HFEP. The accounts thus show 'foreign funds' as 'equity'.

UNFORTUNATELY, AS PREVIOUSLY MENTIONED, WE BELIEVE THAT THE ACCOUNTS DO NOT THEREFORE GIVE A TRUE AND FAIR VIEW OF THE ASSETS AND LIABILITIES OF THE HFEP.

What is new **in the 2015 annual accounts** compared to the previous ones is that "the Foundation did not apply for the registration of its public benefit status until 31 May 2014, therefore the Court cancelled the public benefit status of the Foundation as of 1 June 2014, pursuant to Section 75 (5) of Act CLXXV of 2011".

In this year, the 'Local Microcredit Funds' (the own funds returned to and owned by each LEA) are still shown in the accounts broken down by county, with a total amount of HUF 5,831,362,000.

In the annual accounts, under the heading 'Financing Funds', the accounts show HUF 20,306,643,000 as 'Equity' (which, as mentioned above, in our opinion, is false), and START Garancia Zrt is mentioned as a 'subsidiary' of the Foundation.

The annual accounts for the year 2016 (the year when HFEP (as plaintiff) lost its lawsuit against Borsod Abaúj-Zemplén County Development Agency (as defendant) [Budapest-Capital Regional Court, 22.G.43.732/2013/29.; Budapest-Capital Regional Court of Appeal, 3.Pf.21.745/2014/6/I. Curia (Case No. Pfv.V.20.341/2016/5.]) **are substantially different from the previous ones.**

The notes to the annual accounts have not been uploaded for the National Office for the Judiciary, so there is nothing on the Court's website about the programmes and 'Funds' of the HFEP for this year.

As from 2017, significant changes can be seen in the annual accounts of the foundation.

With regard to the National Microcredit Scheme, the reference to the (infringing) Memorandum as an antecedent was completely removed from the accounts. The reference to and the statement of the 'Regional Microcredit Scheme, the 'Local Funds' and the statement of the change in assets 'by Fund' were completely removed from the accounts.

The annual accounts were audited by KPMG Hungária Kft as before, but the person of the auditor was different.

However, the amount of 'Equity' shown remained similar (HUF 23,125,483,000), so it can be seen **that the HFEP did not adjust the balance sheet despite losing the lawsuit, and shows the funds owned by the LEAs (and also the funds owned by the Hungarian State) as equity.**

In the annual accounts of HFEP for 2018 it is a novelty that the following sentences appear very prominently (in bold, underlined):
"**The Foundation is an independent private foundation. The Foundation does not perform any public tasks**."

As mentioned earlier, with regard to the National Microcredit Scheme and the Regional Microcredit Scheme, these accounts do not contain reference to the (infringing) Memoranda, as an antecedent, nor reference to and the statement of the 'Regional Microcredit Scheme and the 'Local Funds', or the statement of the change in assets 'by Fund'.

Compared to this, there are some changes **in the annual accounts of the HFEP for 2021**:
„... an impairment loss of HUF 226 million was recognised in 2021 with regard to the Local Microcredit Funds managed by the local enterprise agencies."

Without going into further detail again, we would like to note that the funds used for microcredit (either the own 'Funds' managed by the LEAs, or other funds managed by the HFEP and owned by the Hungarian State or other LEAs) **are most certainly not the property, 'equity' of the HFEP, and therefore they cannot be subject to impairment loss either.**

The question may arise whether the HFEP could have acquired the funds it received directly from the Hungarian State in addition to those transferred for management by the LEAs through 'expropriation'. We understand that the HFEP has not been sending accounts to the ministry 'supposedly' performing supervison about the operations of the NMS for a long time. (When requested, the ministry was not able to provide data in 2018 for the preparation of the national microcredit survey mentioned earlier.)

As an example, we would like to quote paragraph 8 of Government Decision 1167/2002 of 10 October, whereas:
"(8) The Microcredit Fund has to be increased by One billion HUF in order to support small and medium-sized enterprises;"

On the one hand, it can be seen that at that time the author of the government decree was still under the (mis)belief that the state-owned Microcredit Fund had been created and that is why the decision was taken to increase it, and it is also clear that this fund was not intended for the HFEP nor could the HFEP have received it as its own property.

Furthermore, despite the fact that in its accounts the HFEP has not mentioned the received funds as 'State-owned' (it has shown them as equity) since 2016, in its communications to the LEAs, with reference to the the (infringing) Memorandum, amnd in its own internal 'Handbook' it calls the NMF a 'Public Fund', thus the HFEP itself states that the funds are state owned. We believe that, for example,
due to this inconsistency, the HFEP cannot refer to 'expropriation' either with regard to the funds owned by the Hungarian State.

In addition, we would like to quote from an Internet magazine. In 2019, Imre Varju Csuhaj, Chairman of the Board of Trustees of the HFEP, said the following:
„... the National Microcredit Scheme running between the 1990s and the 2000s based on the Phare Programme, which is financed by funds coming from abroad, and the operational rules of which were signed by the Hungarian government, the European Commission and the Hungarian Foundation for Enterprise Promotion. Essentially, this **FUND** must support micro-enterprises, and as **the foundation linked to the project received no new funds**, the existing fund of **approximately HUF Thirteen billion is still used today** with due prudence in such a manner that the revolving funds are disbursed again through the foundations."

„The **Hungarian Foundation for Enterprise Promotion does not lend any money**. This activity is done by its partners having sufficient local knowledge, operating in the various counties and regions of the country. However, today, we no longer cooperate with all of them, because **we have terminated collaboration with those** who made significant losses in their lending activities, or **did not perform their activities to the required professional standards. Their role has been taken over by those who are very active and who are disbursing hundreds of millions of forints.** However, there has also been an example where a foundation that was provisionally excluded from the system was allowed to join again the lending system once it had provided the appropriate infrastructure and professional background."

(Source: https://azuzlet.hu/mva-tamogatas-kezdoknek-lehetoseg-a-masodik-eselyre/)

It is important to note that obviously
- it is not true to say that after the PHARE funds, the HFEP did not receive new funds for the provision of microcredit,
- it is not true that this is a 'FUND';
- it is not true that it is the legal 'owner' of the fund (which it considers to be a singe fund worth nearly 13 billion HUF),
- it is not true that the HFEP does not perform a lending activity.

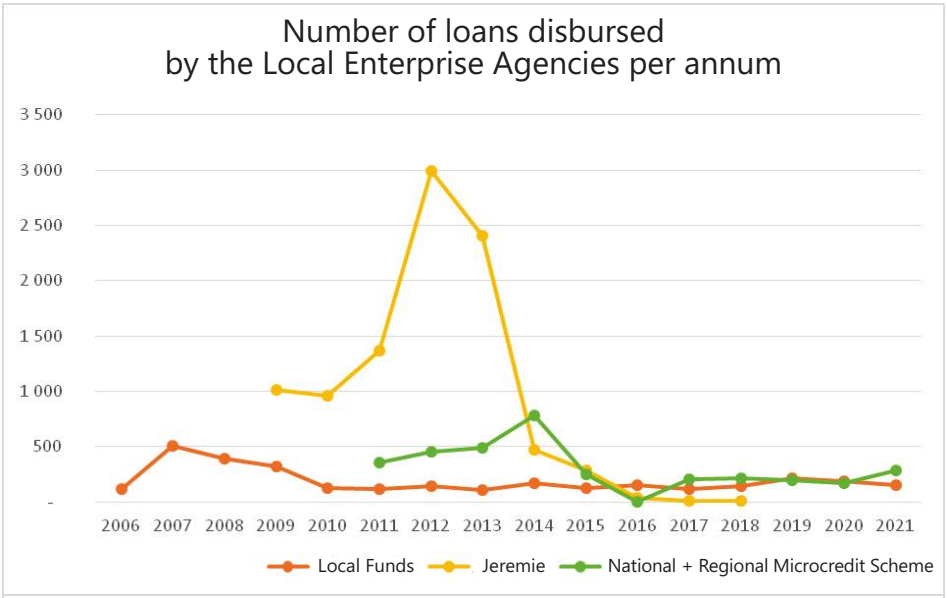
However, Csuhaj acknowledges that some foundations have been excluded from lending for various reasons. We would like to recall that it would not have had the right to do so arbitrarily, without the investigation of the National Microcredit Committee and the approval of the supervising ministry.

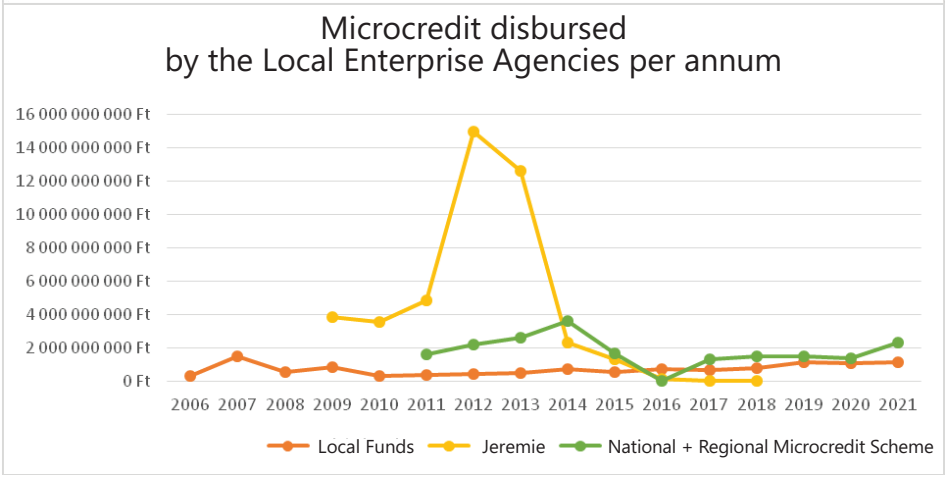
Note:

Interestingly, according to the accounts, "the START guarantee programme was closed after 15 years of successful operation." The HFEP sold START Garancia Zrt and used the capital received to set up the "**START FUTURE Private Equity Fund**". The fund manager of the START FUTURE Private Equity Fund (as well as the "START INOVATION" fund) is **Accessio Equity Partners Kockázati Tőkealap-kezelő Zrt**, in which Dr. Márton Braun the Managing Director of HFEP is a Supervisory Board member. The main shareholder of **Accessio Equity Partners Kockázati Tőkealapkezelő Zrt** is the **Foundation for the Cooperation of Central European Entrepreneurs**, 7100 Szekszárd, Csonka utca 8, whicch is the address of Dr. Márton Braun Managing Director of HFEP in Szekszárd. The founders of the Foundation are the **Hungarian Foundation for Enterprise Promotion**, the Chance for a Better Life Foundation, the Pont-E Foundation, the National Federation of Traders and Caterers, the Association of Cooperatives and Enterprises, the Hungarian Association of Craftmen's Corporation, the legal representative is Dr. Ferenc Papcsák,who is also the legal representative of HFEP.

3.1.17.2. Money disbursed from the NMS shown on diagrams

The line graphs below show the number of own loans disbursed by the Local Enterprse Agencies per annum (from their own funds and from the JEREMIE fund) compared to the number of loans disbursedfrom the NMF reported in the annual accounts of the HFEP. (With regard to year 2016, no data are available. In 2021, the number of loans disbursed is an estimate based on the average number of loans disbursed in the previous year.) It can be seen that the highest number of loans was disbursed from the JEREMIE Programme due to the size of the available funds and the flexibility of the disbursement conditions. A more detailed description of the programme will be given in the next chapter.





We would like to point out that concerns were raised in the past with regard to the 'fund management' activity of the HFEP and its unwillingness to cooperate. In a memo sent to the Minister of Economic Affairs dated 29 July 2003 by the Head of the SME Support Division of the Ministry of Economy and Transport, which oversaw the Microcredit Scheme for the government in 2003, it is mentioned that

"The private foundation nature of the HFEP does not allow for a level of control commensurate with the volume of public funds it manages, as the founders' means are indirect and not capable of exerting operational influence."

"The Legal Department continues to consider changes to the composition of the Board of Trustees.

It recalls that the HFEP has certain ***reporting obligations*** *to both our ministry and the European Commission under the Memorandum. If the Foundation* ***failed to fulfil, or only partially fulfilled these obligations, the Board of Trustees, as the managing body, might be held liable****, which could justify the appointment of a new Board of Trustees by the founders. In this case, it is suggested that consideration be given to the need to transfer the management of the NMF to another organisation.*
If the Board of Trustees is jeopardising the Foundation's objectives, the appointment of a new body is legally unobjectionable, but it is up to the founders to prove the existence of jeopardy, ***which must be preceded by a detailed, comprehensive and professionally sound investigation. The election of a new Board of Trustees would solve the problems arising from the unwillingness to cooperate...****"*

When the HFEP was established, the 'original' founders of the foundation were as follows:

The Government of the Republic of Hungary;
National Bank of Hungary;
Országos Takarékpénztár és Kereskedelmi Bank Rt (since then it has become a public limited company);
ABN AMRO (Hungarian) Bank Rt (it merged with K&H Bank);
Ministry of Economy;
Kereskedelmi és Hitelbank Rt (since then K&H Zrt);
Ministry of Agriculture and Rural Development;
Ingatlan Portfólió Rt (it has since been liquidated, which was completed on 20 February 2002);
Hungária Biztosító Rt (its legal successor as from 22 June 2001 is Allianz Hungária Biztosító Zártkörűen Működő Részvénytársaság);
Postabank és Takarékpénztár Rt (its legal successor as from 31 August 2004 is ERSTE BANK HUNGARY RT);
Hungarian Association of Craftmen's Corporation;
Ministry of Health, Social and Family Affairs, Ministry of Human Capacities;
Westdeutsche Landesbank Hungária Rt (its legal successor as from 20 May 2010 is GRÁNIT Bank Zártkörűen Működő Részvénytársaság);
Konzumbank Rt (its legal successor as from 1 July 2004 is Magyar Külkereskedelmi Bank Rt);
National Committee for Technological Development;
Confederation of Hungarian Industrialists and Employers;
Dunabank Rt (liquidated and deleted from the company register. Date of deletion: 1 February 2008);
Hungarian Industrial Association;
National Association of Entrepreneurs and Employers.

The 'new' group of founders after the changes:

The Government of the Republic of Hungary;
National Bank of Hungary;
Ministry for Innovation and Technology;
Ministry for Human Capacities;
Ministry of Agriculture;
National Association of Entrepreneurs and Employers;
Confederation of Hungarian Industrialists and Employers;
Hungarian Association of Craftmen's Corporation;
Hungarian Industrial Association;

Országos Takarékpénztár és Kereskedelmi Bank Nyrt;
K&H Zrt;
Magyar Külkereskedelmi Bank Rt;
ERSTE BANK HUNGARY RT;
GRÁNIT Bank Zártkörűen Működő Részvénytársaság;
Allianz Hungária Biztosító Zártkörűen Működő Részvénytársaság.

Pursuant to Government Decision No 1513/2019 of 27 August, the founder's rights of the HFEP vested in the State are exercised by the ***Minister for Innovation and Technology****. Pursuant to Instruction No 4/2019 of 28 February of the Ministry of Innovation and Technology, this right was delegated to the* ***Deputy State Secretary for Economic Development.***

Since then, the Ministry for Innovation and Technology has ceased to exist, and we are not aware of any other founder appointed by the Government to exercise founder's rights.

In 2018, the Board of Trustees of the HFEP opened the opportunity for five more organisations to join the Foundation with full founder's rights.

They are:

Association for Entrepreneurial Networking and Tourism Development *with a contribution of HUF 200,000. It is represented by László Horváth, one of the deputy directors of HFEP, and its former representative was* ***Dr. Márton Braun*** *Managing Director of HFEP;*

Mifin Mikrofinanszírozó Pénzügyi Szolgáltató Zrt*. with a contribution of HUF 500,000. The CEO of Mifin Zrt is* ***Dr. Gergely Antal, who is the other deputy director of HFEP****.*

Owners of MiFin Zrt:

- ***HUNGARIAN FOUNDATION FOR ENTERPRISE PROMOTION*** *49.02%;*
- ***FOUNDATION FOR THE CO-OPERATION OF CENTRAL EUROPEAN ENTREPRENEURS*** *27.07%, legal representative: Papcsák Law Firm, one of its board members is Attila Lerch, one of the representatives of the Forum of Hungarian IT Organisations for Information Society,*

  Founders of the foundation:
  - *o Hungarian Foundation for Enterprise Promotion;*
  - *o Dr. Márton Braun, Managing Director of HFEP;*

- ***GYŐR-MOSON-SOPRON COUNTY FOUNDATION FOR ENTERPRISE PROMOTION*** *23.91%, Chairman of the Board of Trustees: Dr. Gergely Antal, member of the Board of Trustees: Dr.Ferenc Papcsák and György Vertán, Managing Director and 'final owner' of Tigra Computer és Irodatechnikai Kft;*

Pannon Finance Pénzügyi Szolgáltató Zrt*. with a contribution of HUF 500,000. It is represented by Dr.* ***Papcsák Ferenc, President of the Board of Directors, legal representative of the HFEP,***

Owner:

- *KISALFÖLD FOUNDATION FOR ENTERPRISE PROMOTION, Chairman of the Board of Trustees: Dr. Ferenc Papcsák, founder of the foundation:*
  - *o HUNGARIAN FOUNDATION FOR ENTERPRISE PROMOTION*

Tigra Computer és Irodatechnikai Kft. *with a contribution of HUF 1,000,000. It is the information technology service provider of HFEP, Managing Director and 'final' owner:* ***György Vertán****, member of the Board of Trustees of GYŐR-MOSON-SOPRON COUNTY FOUNDATION FOR ENTERPRISE PROMOTION;*

Forum of Hungarian IT Organisations for Information Society*, with a contribution of HUF 100,000. One of its representatives is Attila Lerch, who is a member of the Board of Trustees of the FOUNDATION FOR THE CO-OPERATION OF CENTRAL EUROPEAN ENTREPRENEURS.*

We have no information as to why the Board of Trustees of the HFEP considered it absolutely necessary in 2018 to allow for an organisation to join the foundation with a contribution of HUF 100,000 and receive as many rights, for example, ***to amend the deed of foundation (and thus appoint the Board of Trustees)*** *as the Hungarian State has, which has provided billions of forints. With this move, the number of founders loyal to the management of HFEP has increased by five, while the number of founders exercising the founder's right of the State has decreased from four to one with the previous merging of the founder's rights.*

It must be noted that due to the legal concerns detailed earlier, a law was enacted in 2004 to transfer the tasks related to the provision of microcredit to the Hungarian Development Bank.

Section 4 (2) of Decree No 128/2004 of 8 December of the Ministry of Economy and Transport: Section 5 (4) of Decree No 80/2004 of 18 May is replaced by the following provision:

"(4) The ***Hungarian Development Bank shall perform the tasks in connection with the arrangement of*** *Midihitel and the* ***Microcredit facility,*** *..."*
The legislation has not been implemented.

Decree No 80/2004 of 18 May of the Ministry of Economy and Transport repealed ***Section 8 (c) of Decree No 84/2006 of 14 December of the Ministry of Economy and Transport.*** *Ineffective: as from 17 December 2006.*

Note: As mentioned earlier, when the law was repealed, ***Csaba Kákosy*** *(Chief of Staff of the Ministry of Economy and Transport from 2004, and Minister of Economy and Transport between 2007 and 2008)* ***was a member of the Board of Directors of Start Garancia Zrt, owned by HFEP, from 10 May 2006****.*

The possibility of dissolving the HFEP was already considered in 2003 by the Ministry, which was still in charge of the supervision at that time. According to the above-mentioned memo sent by the Ministry:

"The Legal Department pointed out that, pursuant to Section 38(4) of Act XXIV of 2003 on amending certain acts related to the ***use of public funds, making the use of public property more public and trasparent and subject to greater control, organisations established before 1 January 1994 and still operating as foundations at the time of the entry into force of this Act shall be converted into public foundations or dissolved by 31 December 2003.***

To this end, the Deed of Foundation shall be amended, a measure which shall be taken by the founders irrespective of the change in the manager's right of the NMF".

It should be highlighted that the above provision was repealed by Section 13(2) of Act LXV of 2006. It has been ineffective as from 24 August 2006, but by that date, that is until 31 December 2003, the provisions of the said Act should have already been implemented, in other words, the HFEP should have been transformed into a public foundation or dissolved.

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3.1.18. SUMMARY

In the previous sections, we analysed the legal background and the professional characteristics of the National Microcredit Scheme in order to identify the areas that could be changed to improve access to microfinance in Hungary and to enhance the positive social benefits of microcredit. We will now briefly summarise the features presented in more detail in the sections of the previous chapter, with a view to making recommendations on the measures we consider necessary, in comparison with the programmes presented in the following sections.

Legal problems in the operation of the NMS:

- The lending structure and the procedure are based on an unlawful civil contract, and are therefore infringing fundamentally:
  - the 'National Microcredit Fund' as a 'Public Fund' constituting the declared financing source of the National Microcredit Scheme has not been created,
  - thus, the account has not been set up with the Hungarian Treasury for the fund, so the Hungarian State does not keep a record of it,
  - the use of the funds has not been checked by the State Audit Office;
  - the 'National Microcredit Fund', from a legal point of view, means the entirety of the funds that do not exist as a Fund, do not have a legal personality, are only 'uniform' from a reporting point of view, and are owned by various organisations (LEAs) and the Hungarian State;
- the HFEP would have statutory authorisation for only one element of the microcredit process, namely lending money from the legally NON-EXISTING 'National Microcredit Fund' (in other words, they have authorisation for nothing). The LEAs have statutory authorisation for all the elements of the microcredit process. For this reason, even the entire operation of the HFEP could be considered as an illicit credit institution activity, but it certainly does not have the legal authority to assess loan applications and to carry out the recovery procedure;
- the HFEP calls the National Microcredit Scheme a 'repayable assistance programme', but concludes a 'microcredit contract' with the clients. Obviously, it is aware that this may constitute an illicit credit institution activity, however, it is not aware that legally the repayable assistance is also a loan;
- lending is (in principle) based on the HFEP's outdated internal document, the 'Microcredit Handbook', which is annexed to the contract concluded between the HFEP and the LEAs for the provision of microcredit, but at the same time there is no version of this document clearly agreed and countersigned by the parties;
- the HFEP unilaterally amends the handbook 'at its own discretion' without attempting to build consensus, without consulting either the LEAs or the competent ministry, thus violating the provisions of its own handbook;
- not all LEAs are aware of the specific versions of the amendments to the HFEP Handbook,
- the HFEP arbitrarily selects which requirements of the 'handbook' it complies with (or wants to enforce) and which ones it does not comply with (the operation of the programme is therefore based on 'common law'), for example
  - the HFEP intervenes in loan assessment, basically making the final decision on loan disbursements, despite having no authority to do so, thus **violating its own rules**;
  - it does not consult either the LEA or the competent ministry on the allocation of disbursements, thus violating its own rules;
  - it does not operate a Microcredit Committee, which is a consultative forum, thus violating its own rules;
  - to the best of our knowledge, it also fails to satisfy its data supply obligation towards the competent ministry,

- procedures, rules and relevant contracts have not been adapted to changes in legislation and professional requirements and are therefore technically outdated;
- the **HFEP lost its lawsuit against** Borsod-Abaúj-Zemplén County Development Agency. In view of the legal consequences of this, the entire system of relations and accounting between the HFEP and the LEAs should have been interpreted and reviewed again, but the HFEP rejected the intitiatives to that end;
- It is a conflict of interest that the HFEP checks its own foundations in the programme (e.g. in case of Nógrád Development Agency, the sole holder of the founder's right is the HFEP),
- the HFEP's accounting statements are not likely to reflect its true financial position, as they also show funds belonging to other entities (LEAs) and the Hungarian State as 'equity', in violation of the provisions of Act C of 2000 on Accounting, and thus it may constitute a breach of the accounting rules.
- **There is a complete lack of state control, as well as the legal and professional control of the HFEP's activities and use of funds, the assessment of social impact, and the adaptation of the programme to social needs.**

Problems related to professional co-ordination:

- There is no professional feedback on the results of the programme for the operators.
- There is no central training and exchange programme for intermediaries,
- No social impact assessment is carried out,
- It is not known to whom the HFEP's Internet campaign has sent clients (or at which organisations the clients turned up), thus its effectiveness is unknown,
- The HFEP does not provide training for its employees, they do not know the essence of social microcredit,
- The HFEP does not manage its 'network', does not take steps to improve the sustainability of its operation, does not act to this end before the supervising ministry, thus violating the contract concluded with the LEAs for the arrangement of microcredit;
- The HFEP provides practically no substantive service to the LEAs, it engages in costly, bureaucratic and unnecessary activities, and its involvement in the microcredit process is not justified;
- The HFEP staff regularly behave in a patronising and intimidating manner, and do not consider the LEAs as partners;
- Sometimes, as a retaliatory measure, loans are not disbursed, even after a contract has been signed, to 'discipline' recalcitrant LEAs,
- It excludes LEAs from the programme arbitrarily and deprive them of the opportunity to participate in the programme, (even as a retaliation) without prior consultation with the Ministry.
- They use intimidation and threats – showing off their political influence and influential networks – to prevent the LEAs from daring to stand up for their rights.

Problems related to organising programmes

- The lending process of the NMS is slow, inflexible, cumbersome (centralised decision-making is even against the law). Strong legal collaterals are needed.
- The lending process is too **bureaucratic**, requiring too much data and a detailed business plan.

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3.2. JEREMIE MCIROCREDIT SCHEME

3.2.1. BRIEF DESCRIPTION OF THE PROGRAMME

The Hungarian Foundation for Enterprise Promotion (HFEP) and the Mikrofinanszírozó Pénzügyi Szolgáltató (MiFiN) Zrt, a joint venture of national small business associations, disbursed the first microloan nder the New Hungary Microcredit Scheme. At the press conference, ordon Bajnai, Minister of Local Government and Regional Development, said that the fund, which is a repayable assistance, will be available again, so that it will be possible to finance the project in 70 years' time as well. (Note: It did not happen.) (Photo: Internet)

The Council of the European Union wished to reinforce measures to promote convergence, competitiveness and employment throughout the Community, with a view to reducing the increased economic, social and territorial disparities both at regional level and between Member States in the enlarged European Union. The instrument providing support under cohesion policy is the European Regional Development Fund (ERDF). Under the multi-annual programme, the European Union and the Hungarian State, with the help of market players, aimed to improve access to finance for micro, small and medium-sized enterprises. Pursuant to Section 44 of Council Regulation (EC) No 1083/2006, the Hungarian Managing Authority and the designated holding fund manager - Magyar Vállalkozásfejlesztési Zrt - allocated the assistance to the beneficiaries through the intermediaries selected by means of a public tender. A call for tenders for the selection of intermediaries was published in October 2007, which was amended several times. The conclusion of contracts with the selected intermediaries started in 2008.

The regulatory and operational framework for local microcredit has enabled the LEAs to apply independently of the HFEP to act as intermediaries for the microcredit programme called **JEREMIE Microcredit**.

A brief description of the programme and, in particular, the role of the non-profit microcredit providers - LEAs - involved in the programme is given, in agreement with what has been written, by quoting from Péter Vonnák, **"MICROCREDIT IN HUNGARY, i.e. How can we optimise the social usefulness of microcredit programmes?" (2015. ISBN 978-963-12-5845-5).**

"The JEREMIE Microcredit Scheme contributed to the apparent expansion of the Hungarian microfinance sector. This was caused by the fact that the sources were provided with a low cost of fund, and the intermediaries could realize significant profit from the interest paid by the clients. The sources were received under the same conditions by all the financial institutions, which enabled the profit-oriented organisations to perform active 'microfinance' activity in the market. According to the rules of the programme, non-profit foundations could grant loans up to HUF 10 million (EUR 33 900), whereas in case of the profit-oriented financial institutions this limit was HUF 50 million (EUR 169 500), and in case of loans combined with a grant it was HUF 20 million (EUR 67 800). (Editor's note: calculated with the then valid HUF-EUR exchange rate.) Due to the rules relating to the loan amount that coculd be disbursed and the necessity of legal collateral as well as the characteristics of the financed customer base, ***this type of financing is not considered as a microfinance according to the internationally accepted directives.***

The programme was financed from public funds. However, due to the characteristics of the rules, profito-riented organisations could also participate in the implementation of the programme alongside with the non-profit organisations. The operation was financed from the profit. As a result, the intermediaries became interested in making more profit, which had a negative impact on the achievement of social goals. This is confirmed by the fact that although the scope of clients requesting micro-loans was limited (micro entrepreneurs), no specific social goals were set. The financing of the intermediaries did not depend on the fulfilment of such goals either. Thus, the positive social impact of the scheme could only be seen in enterprise promotion when looking at the model from the microfinance aspect. However, it is important to know that if we examine the operation of the scheme in a wider context, the achievement of the positive social impact cannot be disputed, since it provided sources in a period when banks had an aversion to lending money due to the credit crunch.

The model only complied with the international directives to a slight extent due to the characteristics of the above-mentioned rules.

The scheme only complied with directives 5 and 8 partly. The reason for this was that non-profit microfinance institutions did not enjoy preference, but, at the same time, they had the opportunity to join the operation of the programme together with other financial intermediaries. The active provision of advisory services and assistance belonged to the declared objectives of non-profit foundations, which ensured that the entrepreneurs could receive help from the non-profit foundations during the implementation of the programme.

Its deficiency was, however, that microfinance did not give preference to the achievement of positive social goals regarding its target client group. The social impact could only be felt in case of enterprise promotion. Since intermediaries had to assume the risks connected to the lending activity, they often applied a risk-avoiding attitude, which does not ensure the provision of sources to the concerned social strata. Furthermore, the model did not comply with directive 9 due to the costliness of the staff in charge of central fund management. Also, central control checked whether the intermediary requested adequate collateral ensuring the collection of the loan later on. As opposed to the PHARE Microcredit Scheme where the clients could not be asked for legal collateral, this control did not take into consideration the interests of clients.

All in all, it can be said that the social goals and the objectives of the intermediaries do not coincide, thus, when examined from the aspect of microfinance, the positive social impact cannot be achieved efficiently, specific focus is given to profit-making, and sustainability is not linked to a time interval. By accessing public funds, profit-oriented financial institutions create competition, which hinders the appropriate servie provision to non-bankable clients.

Taking into consideration the above, the operation of the specific model needs to be changed significantly. Intermediaries should be made interested in the achievement of social goals and not in the making of profit. This could mainly be achieved by reducing the costs of the intermediaries, by giving preference to non-profit microfinance institutions and by disbursing loans again from revolving funds."

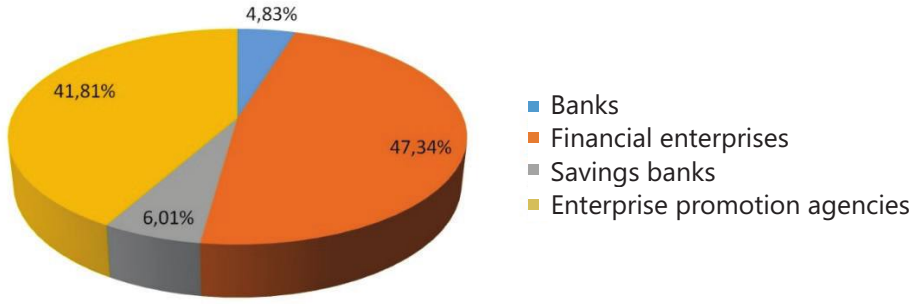
3.2.2. DATA RELATED TO THE NUMBER OF TRANSACTIONS HANDLED IN THE JEREMIE PROGRAMME

The number of transactions handled in the programme is also presented on the basis of the study **"MICROCREDIT IN HUNGARY, i.e. How can we optimise the social usefulness of microcredit programmes?" (2015. ISBN 978-963-12-5845-5)** written by ***Péter Vonnák***

"From the data provided by the Hungarian Development bank (Hungarian Development Bank, data relating to the JEREMIE Microcredit Scheme) it can be seen that earlier the enterprise promotion agencies and financial enterprises could participate in the implementation of the financial programmes more efficiently than the banks and savings banks selected for mediating the current financial sources. The table below illustrates the role taken up by the financial intermediaries expressed as a percentage in the operation of the Economic Development Operational Programme and Central Hungary Region Operational Programme.

Financial intermediaries	Number of transactions (pieces)	Distribution (%)
Banks	819	4,83 %
Financial enterprises	8 022	47,34 %
Savings banks	1 018	6,01 %
Enterprise promotion agencies	7 085	41,81 %
Total:	16 944	100 %

Distribution of the transaction numbers of financial intermediaries on the basis of the data of the Hungarian Development Bank relating to the JEREMIE Microcredit Scheme (31 December 2015)



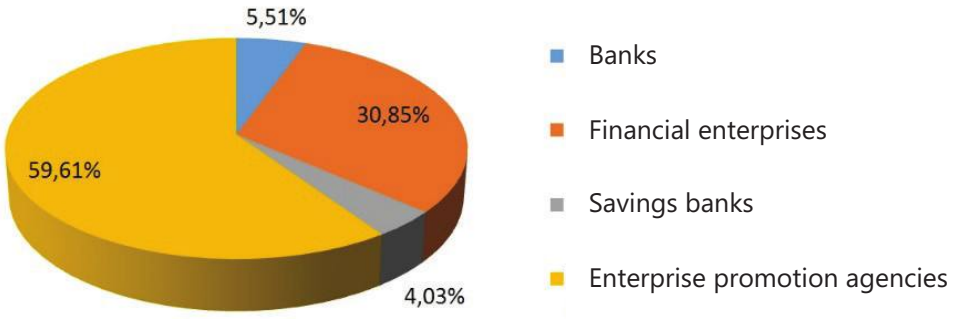
Distribution of the transaction numbers of financial intermediaries on the basis of the data of the Hungarian Development Bank relating to the JEREMIE Microcredit Scheme

When conducting the analysis, we rely on the data provided by the Hungarian Development Bank regarding the JEREMIE Microcredit Scheme, in which we compared the number of transactions of the specific financial intermediaries with the total number of transactions in order to illustrate the distribution of the number of transactions. It can be seen clearly that

the banks and savings banks performed a significantly lower number of transactions than the enterprise promotion agencies and financial enterprises when implementing the scheme. When the financial programme was implemented, the transactions were carried out by 20 banks (4.83%) and 34 savings banks (6.01%) as opposed to the 16 enterprise promotion agencies (41.81%) and 35 financial enterprises (47.34%). However, it is important to see that the analysis must be further clarified in order to obtain the performance-related data of financial intermediaries in the operation of the microcredit scheme. For this, we will project the number of active transactions onto one financial intermediary, and then prepare another analysis about the operation of the programmes with the additional examination of the financial intermediaries relevant to us.

Financial intermediaries	Number of transactions (pieces)	Number of intermediaries participating in the operation of the programme (pieces)	Number of transactions per financial intermediary (pieces)	Distribution (%)
Banks	819	20	40,95	5,51 %
Financial enterprises	8 022	35	229,2	30,85 %
Savings banks	1 018	34	29,94	4,03 %
Enterprise promotion agencies	7 085	16	442,81	59,61 %
Total:	16 994	138	742,90	100 %

Performance-based distribution of the transaction numbers of financial intermediaries on the basis of the data of the Hungarian Development Bank relating to the JEREMIE Microcredit Scheme (31 December 2015)



Performance-based distribution of the transaction numbers of financial intermediaries on the basis of the data of the Hungarian Development Bank relating to the JEREMIE Microcredit Scheme

From the table it can be seen well that the enterprise promotion agencies performed a lot better (59.61%) than savings banks (4.03%) and banks (5.51%) during the operation of the programmes. These statements point out that the replacement of the tried and tested financial intermediary network was an unjustified step.

Financial intermediaries	Average refinancing amount (HUF)	Average repaid source (HUF)
Banks	14 504 676	11 286 838
Financial enterprises	13 959 688	4 728 752
Savings banks	9 847 132	6 142 073
Enterprise promotion agencies	6 115 428	3 100 847

Average loan size on the basis of the data of the Hungarian Development Bank relating to the JEREMIE Microcredit Scheme (31 December 2015)

As it can be seen from the table, the average loan amount granted by the enterprise promotion agencies (HUF 6 115 428) was well below the average loan amount granted by the savings banks (HUF 9 847 132), banks (HUF 14 504 676) or financial enterprises (HUF 13 959 688), thus only the loan amount granted by the enterprise promotion agencies fits into the EUR 25 000 limit set by the European Union for microcredit. Furthermore, when comparing the average repaid sources with the refinancing amounts it can be ssen that banks and saavings banks grant the loans for a significantly shorter period of time, so they are paid back a lot sooner. The disadvantage of this is that the granted loan amounts serve the efficient development of micro and small enterprises for a much shorter time. Ont he basis of this it can be said that there is great need for the lending activity of the enterprise promotion agencies in case of micro and small enterprises.

On the basis of the above-mentioned, it is recommended that the non-profit foundations having great experience should be involved in the intermediary network to solve the current situation so that micro and small enterprises can access sources to an adequate extent. Their active and successful role played in the former microcredit schemes justifies their involvement in the current and future financing activities, because that would guarantee the achievement of positive social impact for the micro and small enterprisse sector by exempting the banks from having to lend small loan amounts, which are complicated and carry high costs for them."

3.2.3. OPERATIONAL SPECIFICITIES

When the tender for the selection of intermediaries was launched, the programme was designed to allow the funds drawn down by the intermediaries **to be re-invested as revolving funds**. This would have resulted in predictable disbursements, long-term operation and better managed expected losses. Unfortunately, the intermediary contract was unilaterally amended several times in the course of the programme by the holding fund manager, **to the detriment of the intermediaries, and the funds repaid by the clients were continuously withdrawn from the intermediaries**. (In the course of the programme, the programme coordinator – the holding fund manager – also changed, as the tasks were directly takenover by Magyar Fejlesztési Bank Zrt.) In the meantime, the central IT system was changed, and the connection to it required additional development costs and effort on the part of the intermediaries.

The rules were defined in such a way that above a certain PAR (Portfolio at Risk) value, the intermediary's possibility to draw down new funds could be suspended. This made it almost impossible for some intermediaries to correct their practices and thus improve their portfolio (because it became mathematically

almost impossible to improve this indicator). This cannot be considered a fair procedure, especially in the light of the fact that initially **the programme coordinator explicitly encouraged rapid disbursements**, saying that the quality of the loan portfolio was less important than the country's ability to draw down EU funds as much as possible and to stimulate the economy to alleviate the economic crisit.

The **university textbook** (Szekfü-Vonnák-Pizzo: "**MICROCREDIT – From Theory To Practice**", Fejér Enterprise Agency, 2020. ISBN 978-615-81559-0-8) referred to earlier includes the following about this procedure considered as a professional error:

"INDICATOR OF PORTFOLIO AT RISK (PAR):

$$\textit{Portfolio At Risk} = \frac{\textit{Doubtful outstanding portfolio}}{\textit{Total outstanding portfolio}} \%$$

The indicator refers to the value of all loans outstanding that have one or more instalments of principal more than a certain number of days past due. (Providers may calculate with PAR 30, 45, 60, 90 etc.)

The indicator is also suitable for characterising the status of the loan portfolio, but it shows greater financial risk than there actually is. This is due to the fact that, for example, even in case of credit accounts having rating 'B' – in other words the outstanding principal is less than 30 days past due – it considers the total outstanding principal as a possible loss.

It includes an entire unpaid principal balance, both past-due and future instalments, but not accrued interest."

An important aspect of the analysis is that **we always search for and examine the reasons**. That is, why a given value or indicator is so high or low. The reasons behind an indicator are often more important than the specific value of the ratio itself.

It must also be noted that the same figure may be considered as very good in certain cases, and very bad in others. For example, a 4% PAR30 ratio is considered excellent in case of a profit-oriented microcredit provider. However, in case of a microcredit programme where the goal is to assume extremely high risk even at the expense of significant credit losses, and which has been operating for quite a while with high numbers of loans, it may also mean that the microcredit provider fails to channel the sources to the target clients, and tries to retain them for some reason.

This situation can also be true the other way around. For example, a microcredit provider might have a very high PAR30 value because it tries to implement a high-risk credit scheme for a socially important target group. In this case the high PAR30 value **results** from the fact that the provider is implementing a social programme and not from the fact that the provider grants the loans in bad quality.

"One of the most frequent errors is when certain indicators – especially PAR30 – **ARE USED CARELESSLY TO COMPARE THE QUALITY OF THE ACTIVITIES OF THE VARIOUS MICROFINANCE INSTITUTIONS.**"

"It is clear from the method of calculation that if a specific microcredit programme is not funded from a revolving fund but from **one-time capital**, which is **continuously withdrawn** from the microfinance institution by the funder after the clients have made their payments, the value of the indicator will deteriorate, and sooner or later will reach 100%. When the well-paying clients have completely repaid their debts, the remaining debts can only be collected slowly, or not at all. **It is a serious professional**

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mistake to use this ratio to compare the activity of such an organisation with that of an organisation that manages a revolving fund (in other words to draw the conclusion that the organisation that has a lower indicator performs its lending activity "in better quality")."

As it can be seen, it is a professional error to interpret and apply an indicator this way, and now some universities in Europe also try to call the attention to this fact in their curriculum. Unfortunately, this practice was not corrected when the contracts were amended unilaterally.

In addition to the above, it is worth noting that it would have been technically justified to treat nonprofit microfinance institutions under separate rules from for-profit financial enterprises.

As described above, one of the reasons why local enterprise agencies are eligible for the provision of microcredit outside the scope of the Credit Institutions Act is that **they need to reach a clientele that is not eligible for funding from organisations operating under the Act, for example because they either cannot offer adequate collateral or do not have a verifiable entrepreneurial track record.**

Among the international professional directives mentioned in the first part of our study, we would like to recall the following:

> *"Directive 4: Publicly funded microcredit schemes need to be interpreted as assistance provided out of social solidarity, which, in return, has positive social impact on society.*
>
> *Directive 4.1: In case of publicly funded microcredit schemes positive social impact should have priority over the 'preservation' or increase of the funds at nominal value in the course of the implementation."*

The failure to apply this principle is, in our view, a professional shortcoming of the programme.

However, the change that introduced the possibility of **loss sharing** between the fund and the intermediary is definitely **positive**. We do not see it professionally justified why this was not extended retroactively to the whole scheme. On the one hand, as we have already mentioned it, in the early stages of the programme, **the coordinator specifically encouraged risk-taking and increased lending. The fact that the coordinator changed in the course of the project, or that the coordinator's organisation itself changed, is completely irrelevant from the point of view of the intermediaries. For them, it means the funder and the authority on an ongoing basis**. In any case, the rush for disbursements may be justified from a technical point of view, as this period coincided with a period of economic crisis that affected all European economies, and **therefore business recovery was a major priority. However, this also justifies extending risk sharing to this period, as it is clear that in a period of crisis, significantly higher risk is associated with higher losses. Penalising intermediaries for having taken on lending during this period is not a fair approach, especially in the light of the foregoing.**

Another problem was that during a certain period of the programme the central coordinator pushed for increasing the role of savings cooperatives. (The presented data show that it happened with little success.) This has led to operational anomalies. According to our information, there was, for example, a savings cooperative which had HUF 800 million in their bank account that were not disbursed to clients, while

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some foundations had to wait more than a month for a block of drawdown of HUF ten or twenty million - already contracted with the client. With such disbursement uncertainties, it was not advisable to publicise the programme (so as not to put the client in the uncomfortable position of not receiving the loan in the short term despite the contract), and as a result the disbursement rate for foundations was lower than it could have been with proper coordination.

3.2.4. PUBLIC PROCUREMENT WITHOUT NON-PROFIT MICROFINANCE PROVIDERS

As from 2013, EU-funded business finance programmes have been carried out with a completely different intermediary and operational background. Instead of the open call method, intermediaries were selected through public procurement, in which non-profit organisations were not even given the chance to participate.

During the more than thirty-year history of microcredit in Hungary, it has happened several times that the creation of certain microcredit programmes was not preceeded by professional consultations with financial intermediaries having great knowledge and experience, which is also the case here.

Once again, we would like to recall one of the international directives already presented:

> ***"Directive 5: The involvement of non-profit funders in the arrangement of publicly funded microcredit schemes should enjoy priority over profit-oriented creditors."***

3.2.5. SUMMARY OF THE MAIN FEATURES OF THE JEREMIE MICROCREDIT SCHEME

Overall, apart from the problems mentioned above, the JEREMIE Microcredit Scheme in Hungary can be **considered successful in terms of social microcredit**. On the plus side, non-profit foundations were also able to apply to act as intermediaries in the context of an **open call for proposals**. On the minus side, it is not technically justified that these organisations were no longer allowed to participate in the continuation of the programme.

In any case, the **operating model** passed the test with flying colours. With the refinancing and coordination of the Hungarian Development Bank, fewer LEAs performed better than all the other organisations participating in the National Microcredit Scheme together. Individual foundations with more unbiased programme coordination also **performed significantly differently compared to each other than in the HFEP-coordinated NMS**. This also confirms that the poor performance of the NMS is not due to the LEAs but to the professionally inadequate central coordination.

In line with the above-mentioned international directive, we would consider it appropriate to implement a microcredit programme through non-profit organisations combined with business development services, specifically for the highest risk (essentially start-up) entrepreneurs.

WE WOULD CONSIDER IT IMPORTANT TO EXTEND THE POSSIBILITY OF LOSS SHARING. The individual parts of the JEREMIE Microcredit Scheme were the 'New Hungary Microcredit', the 'New Széchenyi Credit' and the 'Combined Microcredit'.

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The deadline for the final settlement of the **New Hungary Microcredit Scheme** was 1 December 2021 (it was supposed to be 1 December 2021, but due to the credit moratorium caused by the COVID-19 epidemic, it was postponed).

In this programme – which was launched during the 2008 economic crisis – the intermediary contract did not yet include the rules relating to loss-sharing. With special regard to the fact that the said intermediary contract was unilaterally amended several times by the coordinator, to the detriment of the intermediaries, **WE RECOMMEND THAT THE LOSS SHARING RULES APPLIED UNDER THE OTHER TWO CREDIT PROGRAMMES BE EXTENDED TO THIS PROGRAMME BY A FURTHER AMENDMENT OF THE CONTRACT.**

This would be all the more justified and fair, as **when calculating the bad portfolio ratio during the monitoring, the coordinator combined the portfolio data of the New Hungary Microcredit and the subsequent New Széchenyi Credit** (which is clearly a continuation of the previous programme) and decided on the basis of this data to disburse refinancing units.
THUS, **WE BELIEVE THAT THE CORRECT APPROACH WOULD BE TO TREAT THE TWO LOAN PORTFOLIOS TOGETHER FOR LOSS RECOGNITION PURPOSES.**

We would like to quote again one of the international directives presented above:

> ***"Directive 6: In order to reach the clients targeted by the publicly funded microcredit scheme efficiently and to achieve the set social objectives, the credit risk should not be transferred to the intermediaries or, in exceptional circumstances, should only be transferred thereto to a lesser extent."***

To sum up:

Positive operating features

- much more professional, unbiased central programme coordination by the Hungarian Development Bank than in the case of HFEP at NMS,
- flexible rules on loan structures, giving intermediaries sufficient freedom;
- the possibility of loss-sharing is positive in terms of access to finance for businesses that are risky to lend to.

Negative features

- unilateral contract amendments in the course of the programme fundamentally changed theconditions of its operation
- the possibility of loss-sharing does not cover all phases of the programme,
- non-profit microcredit institutions are no longer eligible to participate in the subsequent programme (although the results of the programme would justify this),
- the mentoring, which is crucial for microcredit, was not funded by a complementary programme.

Compared to the NMS

- overall, LEAs performed exceptionally well in terms of customer outreach;
- the results have shown that the poor performance of the NMS is not due to the LEAs, but to the operating rules and the central management organisation.

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3.3. INDEPENDENT MICRO-LENDING BY THE COUNTY AND METROPOLITAN ENTERPRISE PROMOTION AGENCIES

3.3.1. COUNTY AND METROPOLITAN ENTERPRISE PROMOTION AGENCIES - AS NON-PROFIT MICROCREDIT PROVIDERS

The first local microcredit programmes were launched in Hungary by Fejér Enterprise Agency. In 2001, the 'Fehérvár Microcredit Programme' was launched in cooperation with the Municipality of Székesfehérvár to finance start-up entrepreneurs in Székesfehérvár. It was followed by the 'IBM Microcredit Programme' in 2002, which addressed the labour market crisis following the closure of the IBM factory in Fehérvár and helped former employees become entrepreneurs. At that time, the programmes were implemented through a commercial bank in accordance with the Phare Microcredit operating structure. The policy structure, lending methodology and loan management software (the basis of the later international award-winning CREDINFO system) developed at that time became the standard, and was later adopted by the LEAs for their own credit programmes.

Currently, as already described, the county and metropolitan enterprise promotion agencies are entitled to provide microcredit outside the scope of Section 2 (1)(f) of Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises. Only these non-profit organisations are entitled to engage in this activity based on their subjective right.

THESE ORGANISATIONS ARE ALSO AUTHORISED TO PROVIDE MICROCREDIT TO ENTERPRISES THAT ARE NOT ELIGIBLE FOR CREDIT FROM FINANCIAL MARKET OPERATORS OPERATING UNDER THE CREDIT INSTITUTIONS ACT (AS REQUIRED BY THE FINANCIAL MARKETS ACT), FOR EXAMPLE BECAUSE THEY DO NOT HAVE ADEQUATE LEGAL COLLATERAL.

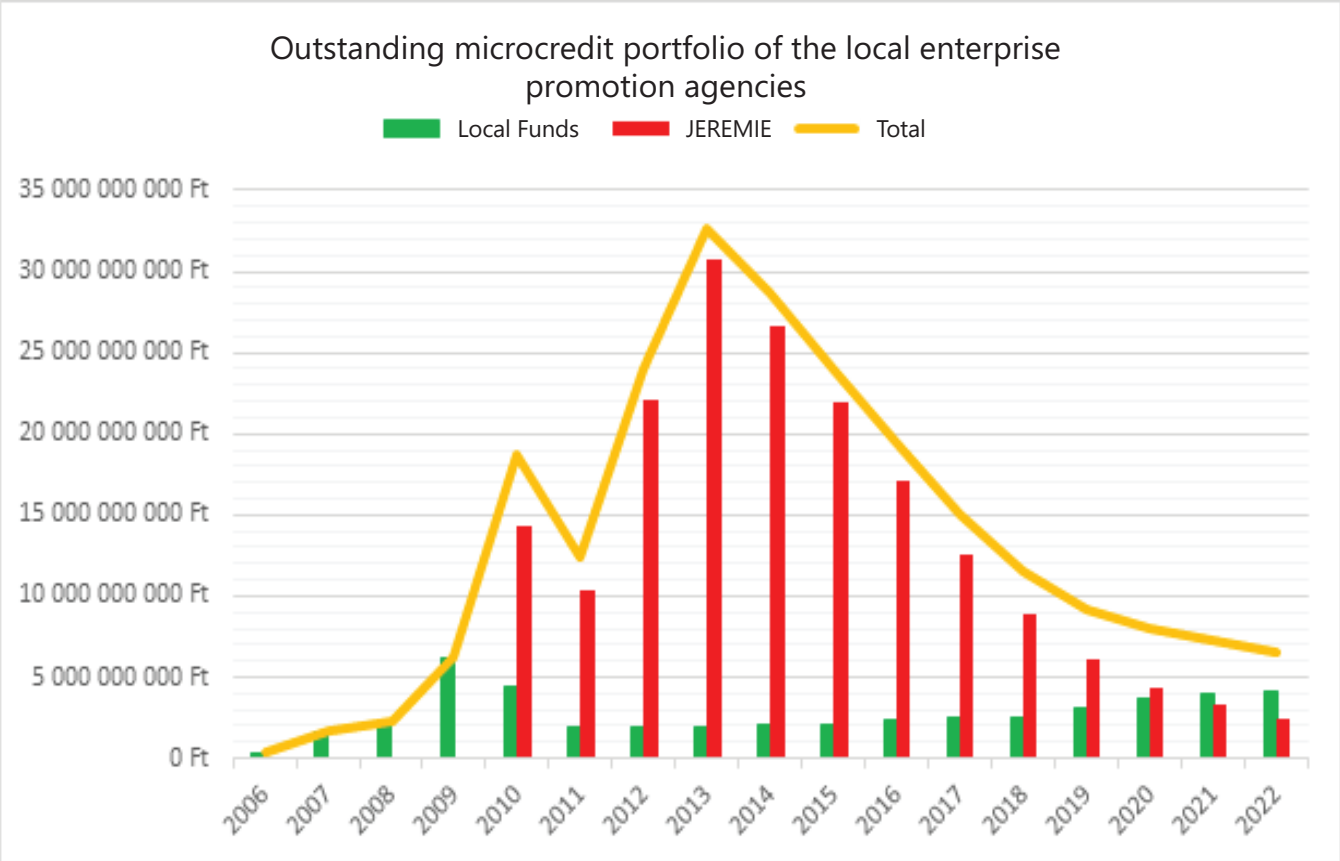
*Several enterprise promotion agencies were involved successfully in the implementation of JEREMIE mcirocredit schemes, **providing over HUF 44 billion in microloans to the most vulnerable entrepreneurs**.*

*The foundations had **the highest specific client outreach** among intermediaries. County enterprise promotion agencies: **59.61%**; financial enterprises: 30.85%; banks: 5.51%; savings cooperatives: 4.03%. As an example, we present some of the data of Fejér Enterprise Agency related to JEREMIE Microcredit.*

Name of the credit scheme	Expected loss in proportion to the disbursed amounts
New Hungary Microcredit	3,67%
New Széchenyi Credit	0,00%
New Széchenyi Combined Credit	1,07%
Total JEREMIE Microcredit portfolio:	1,42%

It can be seen that the 'New Hungary Microcredit Programme', which was launched directly during the economic crisis, had the highest expected loss rate, but even this is below 5%. By international standards, a loss rate of less than 5% is considered to be an exceptionally good result for social microcredit.

Overall, the ratio of expected loss in proportion to the disbursed amounts is less than 2%, which is considered to be an exceptionally good result.



Each of the enterprise promotion agencies that are currently eligible and able to operate a local microcredit programme in their own right is suitable to participate in the programme because of its internal regulatory background and technical capacity. In addition to microcredit, the foundations also provide mentoring and business development services to enterprises.

The IT infrastructure for the programme is provided by the internationally recognised, award-winning CREDINFO Credit Information and Credit Assessment Management System. This system is used by all the county and metropolitan enterprise promotion agencies (e.g. also in the JEREMIE scheme) and by a number of financial enterprises participating in the ongoing financing programme of the Hungarian Development Bank. It provides all the data required to satisfy the daily data supply obligation. It also enables the receipt of loan applications online, loan assessment management and also includes a credit register.

The system was Europe's first complex, integrated back-office and loan assessment management system that enables **fully digitised online (paperless) administration from the receipt of a loan application to the closure of the loan assessment.**

3.3.5. COMPARATIVE TABLE OF THE ACTIVITIES OF THE COUNTY AND METROPOLITAN ENTERPRISE PROMOTION AGENCIES® AND THE HUNGARIAN FOUNDATION FOR ENTERPRISE PROMOTION WITH REGARD TO MICROCREDIT

COUNTY AND METROPOLITAN ENTERPRISE PROMOTION AGENCIES®	HUNGARIAN FOUNDATION FOR ENTERPRISE PROMOTION (HFEP)
Legal framework for operation: *Pursuant to Section 2 (1) f) of Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises, the scope of the Act does not extend to*	
the microcredit activities of the county and metropolitan enterprise promotion agencies *The 'county and metropolitan enterprise promotion agencies', as 'non-money market' non-profit organisations, are entitled to provide microcredit outside the scope of the Act.*	**the activity of the Hungarian Foundation for Enterprise Promotion to grant loans from the National Microcredit Fund** *The HFEP is not allowed to engage in microcredit activities, it is only allowed to lend money from the National Microcredit Fund (NMF) (which does not even exist). The county and metropolitan enterprise promotion agencies are entitled to conduct the loan assessment procedure and make the loan decision on the basis of this legislation. The NMF is not a fund from a legal point of view (because it does not meet these legal criteria), nor does the HFEP have lthe right to manage the fund in a legal sense.*
OPERATING PROCEDURES	
Internal lending policies accredited by the Hungarian Development Bank (by the EU in case of some foundations), international awardwinning, **fully digitised loan assessment procedure** (The Norwegian Microfinance Network has adopted the full technology, it is already university curriculum at the National University of Public Service and in Spain!)	Lending procedure according to an **outdated** handbook, originally drawn up in 1992, 'updated' in 2000.

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The HFEP has no demonstrable achievements or activities in the following areas, so the following short list only describes some of the activities of the LEAs:

INTERNATIONAL AWARDS AND RECOGNITION RESULTING FROM THE ACTIVITIES OF THE LEAS

Milan, 2009: the digitised procedure is anked among the top five most innovative microcredit practices in Europe (FEA) MICROFINANCE BEST PRACTICES AWARD FONDAZIONE GIORDANO DELL'AMORE	 Milan, Italy, 2009: 'Microcredit Good Practices Europe Award' received by FEA
MicroFinance Recognition Awards	London, 2011: Innovation in Microfinance Europe Award, (FEA)
Best microfinance practice in Europe (DIFASS Interreg IV C project), (FEA)	 2012 Vonyarcvashegy, Hungary. DIFASS Interreg conference
	Best 'rural financing' practice ATM for SMEs Interreg Europe project, (FEA) http://microfinancegoodpractices.com/2018/09/16/9609/
Best microcredit implementation in Norway, ATM for SMEs Interreg Europe project (CREDINFO – FEA)	 Oslo, Norway, 2012: implementation of the Hungarian developed 'CREDINFO credit information and credit assessment management system' in Norway. From the left: Tibor Szekfü FEA Managing Director, owner of CREDINFO Kft; Unni Beate SEKKESÆTER, President of Microfinance Norway,

Cádiz, Spain, 2015 In the photo: FEA signs a cooperation agreement with the University of Cadiz

The IBM Microcredit programme run by FEA **is a good practice in the European Union and is already part of a university curriculum.**

SCIENTIFIC ACTIVITY

Regular consultation with the Scientific Advisory Board of the Hungarian Microfinance Network®

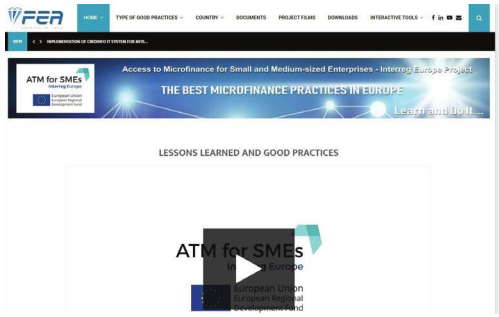
In the photo: Dr. László Erdey, Dean of the University of Debrecen, Tibor Szekfü, FEA Managing Director, lecturer:University of Cádíz, Spain, National University of Public Service (NIPS), President of the Hungarian Microfinance Network, Prof. Dr. Csaba Lentner, professor (NUPS), Prof. Dr. Magdolna Csath professor, Doctor of the Hungarian Academy of Sciences, Dr. Antal Szabó Scientific Director of ERENET, András Nagy (invited guests, deceased), Managing Director of Zala County Enterprise Promotion Agency, Prof. Dr. Györgyi Nyikos Head of Department, professor (NUPS), Péter Vonnák university lecturer, University of Cádíz, Spain, Managing Director of Veszprém County Enterprise Promotion Agency, Gergely Mazsu Hajdú- Bihar County Enterprise Promotion Agency, Managing Director (invited guest)
The photo was taken on 16 February 2017 at the National University of Public Service

Developing a university MASTER's degree e-learning curriculum in the field of microfinance (in the collaboration between Fejér Enterprise Agency and the University of Cádíz in Spain)

University of Cádíz, Spain 2019 From the left: Tibor Szekfü, Dr. Esther Puertas Cristobal, Péter Vonnák, Dr. Mercedes Diaz Rodriguez, Dr. Maria del Rosario Carmona Luque, Elena Torres Maestro

Collaboration with the National University of Public Service (organisation of scientific conferences, participation in joint research, introduction of the subject 'Microcredit from public funds', writing of textbooks)

Budapest, November 2018 International conference at the National University of Public Service



International researches and the collection of good practices (within the scope of the ATM for SMEs Interreg Europe project)

Involvement in drafting the 'National Directives for Decision-makers in Microfinance' (it is already part of the university curriculum in Europe)

Budapest, Hungary, 2013 Meeting of the European National Microfinance Networks, signing of the 'Budapest Directives'

Cádiz, Spain, 2015 From the left:
Dr. Krisztián Kádár, Péter Vonnák, Tibor Szekfü,
Dr. Miguel Ángel Pendón Meléndez,
Dr. Tamás Bódizs, Dr. Mercedes Diaz Rodriguez,
Dr. Maria del Rosario Carmona Luque

Teaching micro-lending **at foreign universities** (Tibor Szekfü President of HMFN and Péter Vonnák Vice-President, lecturer at the **University of Cádíz** and the National University of Public Service)

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Obtaining an international degree: 'Commercial aspect of social businesses: How can we avoid the distortion of mission?' (Péter Vonnák Vice-President of the Hungarian Microfinance Network, Université libre de Bruxelles, 2017)

Brussels, Belgium, 2022. Péter Vonnák Vice-President of the Hungarian Microfinance Network

INTERNATIONAL COLLABORATION AND ACTIVITY IN THE FIELD OF MICROFINANCE

European Microfinance Network membership,

- member of the legal and regulatory working group (Tibor Szekfü);
- member of the IT/Innovation working group (Tibor Szekfü)

Milan, Italy, 2009 Meeting of the IT/Innovation working group of the European Microfinance Network

Microfinance Centre membership

MICROFINANCE CENTRE

The project is the Interreg Europe programme
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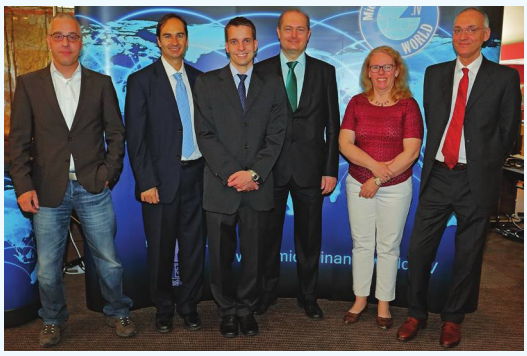
and is implemented with the support of Hungary.

Creation of MicroFiNet (Committee of the European National Microfinance Networks)



13 May 2016, Székesfehérvár, Hungary, setting up the MicroFinet collaboration. From the left: Joerg SCHOOLMANN (DMI) Germany; Jaime DURÁN NAVARRO (AEM) Spain; Péter VONNÁK (HMN) Hungary; Tibor SZEKFÜ (HMN) Hungary; Unni

Madrid, Comillas University, Spain, 2013 Cooperation agreement between the Spanish Microfinance Network and the Hungarian Microfinance Network. From the left: Jaime DURÁN NAVARRO (AEM) President, Spain, Tibor Szekfü Hungarian Microfinance Network, President

Special professional collaboration with the **Spanish Microfinance Network**, organising professional study trips to Spanish microfinance institutions: Granada, Madrid, Barcelona, Mallorca, Cádiz

Leading the international professional exchange programme, FEA is the consortium leader in the ATM for SMEs Interreg Europe Project, Hungarian partners are the Prime Minister's Officeand Zala County Foundation for Enterprise Promotion

13 May 2016, Székesfehérvár, Hungary. Launch event of the ATM for SME's Interreg Europe project.

ORGANISATION OF NATIONAL AND INTERNATIONAL PROFESSIONAL CONFERENCES AND WORKSHOPS

Workshop on innovative micro-lending practices, EMN conference, London, United Kingdom, 2010.

London, United Kingdom, 2010 Tibor Szekfü FEA, Managing Director at the international workshop

2013, Budapest, Hungary. IPFI International workshop

IPFI International workshop, Budapest 2013.

EEuropean Microfinance Day conference (organised by the Budapest Enterprise Agency, Budapest, 2015)

20 October 2015, Budapest, Hungary. Tibor Szekfü President of the Hungarian Microfinance Network opens the conference organised within the framework of the European Microfinance Day at the townhall

The project is the Interreg Europe programme
within the framework of the European Regional Development Fund
and is implemented with the support of Hungary.

EaSI funding international workshop, Budapest, 2016

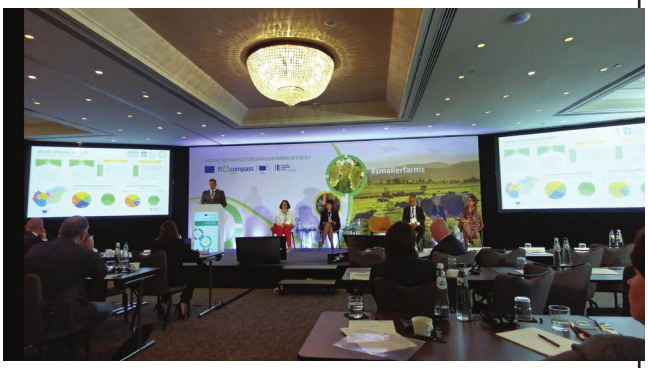
9 March 2016, Budapest, Hungary, EaSI funding international workshop organised by FEA

3 October 2018, Bilbao, Spain. International experience gained in the field of microfinance, independent workshop held by FEA at the EMN-MFC Conference

International experience gained in the field of microfinance, independent workshop at the EMN-MFC Conference held in Bilbao, Spain in 2018.

National University of Public Service-MMH, Microfinance and Economic Development, international conference, Budapest, 2018

22 November 2018, Budapest, Hungary National University of Public Service-MMH, Microfinance and Economic Development international conference

Regular conferences and workshops in Hungary (Velence, Zalaegerszeg, Nyíregyháza, Lenti, Békéscsaba, Székesfehérvár etc.)	 **5 March 2015, Velence, Hungary** Conference of the Hungarian Microfinance Network
 ***Brussels, Belgium, 2022*** *Presentation by Péter Vonnák, Vice-President of the FEA Group, at the EU Commission's Fi-Compas conference on agricultural finance*	Péter Vonnák, Vice-President of the FEA Group was invited to speak about FEA's experience in agricultural finance at a conference on agricultural finance (FiCompas) organised by the European Commission in Brussels in 2022.

It is important to note that the county and metropolitan enterprise promotion agencies are independently entitled to provide microcredit outside the scope of the Credit Institutions Act, thus they can finance a particularly risky group of entrepreneurs, which is not legally possible for organisations lending under the Act. For example, micro-entrepreneurs who do not have a verifiable entrepreneurial track record or adequate legal collateral.

3.4. SZÉCHENYI 'MICROCREDIT'

The Széchenyi Microcredit Schemes are operated by **KAVOSZ Zrt**. Since the **Széchenyi Microcredit Schemes are not considered microcredits** (apart from the name of the scheme) - according to the definition of 'microcredit' accepted in the European Union or in any other part of the world - in their amount or in their operational characteristics, **therefore they cannot be considered microcredits from a professional point of view**. Thus, a detailed analysis of them is not relevant for the purpose of our study. However, we briefly describe the essence of this scheme because its name and declared purpose may give the impression that it is a microcredit in terms of its technical content.

Launched in 2003, Széchenyi Microcredit MAX is **an investment loan with a guarantee fee subsidy**, subject to the involvement of a **state guarantee for interest, handling charges and guarantee institution**, which is specifically designed to support the development of domestic micro and small

enterprises. It can be used to finance agricultural and non-agricultural investment purposes (e.g. purchase, construction, development of real estate, purchase or acquisition of new or used machinery, equipment, other tangible assets (not belonging to the vehicle category), and can also be used to replace loans having a previous market rate. (Source: www.kavosz.hu)

Loan parameters:

- a loan amount of HUF 1-50 million (EUR 2 700 – 135 000)
- with a maturity of 13-120 months
- transaction interest payable by the client (as from 2023): subsidised annual interest rate fixed at 5%
- repayment frequency: monthly
- availability period: minimum 2 months, maximum 35 months
- grace period – same as the availability period, maximum 36 months
- legal collateral requirement:
  - real estate,
  - 3-8% security deposit
- minimum 10% own contribution
- working capital: maximum 20% of the loan amount

The credits are distributed by domestic **for-profit financial enterprises** applying for the call for proposals launched by KAVOSZ Zrt and not by the banks.

According to our information, from 2023 onwards, the gross interest rate has been changing continuously (it is around 22.5%), of which the client pays the fixed 5%. This goes straight to the Hungarian Development Bank, plus an additional 13.5% on the subsidies received from the Ministry of Economy.

The intermediary is left with 4%, but there is also a handling fee of 1.5% (calculated as the interest, i.e. on the outstanding amount) and an availability fee.

Financial intermediaries have multiple security over their loans with mortgages, right of purchase, preemption right, etc. They also require security deposit accounts, which provides extra security for the intermediary. Basically, if the client is only 1 day late with the payment, the debt is already deducted from the security deposit account.

We would like to note that we asked Mr László István Krisán, CEO of KAVOSZ Pénzügyi Szolgáltatásokat Közvetítő Zrt and KAVOSZ Vállalkozásfejlesztési Zrt to delegate an expert to our working group, but he did not respond to our request. Unfortunately, we do not have any information as to why KAVOSZ Zrtneeds to be inserted between the intermediaries and the Hungarian Development Bank in case of these schemes. In the JEREMIE programme, the Hungarian Development Bank maintained direct contact with the intermediaries, as it does in its other programmes.

The financial enterprise of **KAVOSZ Pénzügyi Szolgáltatásokat Közvetítő Zrt - KAVOSZ Vállalkozásfejlesztési Zrt** – also participated in the JEREMIE programme. Compared to the loans disbursed by the LEAs, it would rank 12th **in terms of the funds disbursed**. (16 LEAs participated in the programme.)

KAVOSZ Pénzügyi Szolgáltatásokat Közvetítő Zártkörűen Működő Részvénytársaság (KAVOSZ Zrt.)

Owner:

- HUNGARIAN CHAMBER OF COMMERCE AND INDUSTRY 50%
- NATIONAL ASSOCIATION OF ENTREPRENEURS AND EMPLOYERS 50%

- Sales revenue in 2021: HUF 9 441 790 000;
- After tax profit in 2021: HUF 2 812 604 000.

KAVOSZ Vállalkozásfejlesztési Zártkörűen Működő Részvénytársaság

Owner:

- KAVOSZ Pénzügyi Szolgáltatásokat Közvetítő Zártkörűen Működő Részvénytársaság 100%

- Sales revenue in 2021: : HUF 106 874 000;
- After tax profit in 2021: HUF 25 177 000.

Finally, we would like to quote briefly from the **university textbook** already referred to (Szekfü-Vonnák-Pizzo: '**MICROCREDITING – From Theory To Practice**', Fejér Enterprise Agency, 2020. ISBN 978-615-81559-0-8):

"...it is very important to differentiate between microfinance programmes funded (e.g. from public money) to achieve social goals and programmes serving the interests of the investors as well as the financial interest of the entities involved. Every microfinance programme aims to achieve social goals, at the same time it is completely obvious that the actual operation in certain cases only serves the financial gain of the entities involved."

4. THE JUSTIFICATION FOR REGULATING SOCIAL MICROCREDIT IN HUNGARY

For historical reasons, there are two very different approaches to legislation in the countries of the European Union, between Western Europe and the countries of Central and Eastern Europe, which still carry the approach of totalitarian regimes in some areas. In short and simple terms, these two approaches could be described as 'everything is allowed that is not forbidden' in the liberal civil democracies of Western Europe, while in Central and Eastern Europe 'nothing is allowed that is not explicitly permitted'.

We would like to mention Microlux, Luxembourg's first microfinance institution as an example, which was established on 31 March 2016 by ADA, BGL BNP Paribas, ADIE and FEI under the name Société Anonyme.

The Commission de Surveillance du Secteur Financier (CSSF - Financial Sector Supervisory Commission) concluded that Microlux's non-profit activity and the loans granted as an accompaniment do not constitute professional activities in the financial sector and therefore do not fall within the scope of the Financial Sector Act of 5 April 1993, as amended. (https://www.microlux.lu/fr/a-propos/missions/)

As presented above, microcredit in Hungary started in 1992 with the launch of the Phare Microcredit Programme. As there was **no specific legislation on this activity** at that time, the designers of the programme adapted the operation and the set of rules of the loan scheme to the legislation in force atthe time. It was already apparent that **optimising the positive social impact of the programme** would justify separate legislation in this area of financing.

As mentioned before, the funds for the programme were initially provided by the EU Phare Programme (and later by the Hungarian Government as co-funder) for the foundations **in the form of targeted subsidies subject to conditions.**

Since these foundations

- did not take deposits,
- received the funds – public money – in the form of targeted subsidies subject to conditions to fund a specific programme with social objectives in a dysfunctional financial market requiring government intervention,
- were not profit-oriented (they did not even make profit),

it was clear that their activities could not fall within the scope of the 'banking law' in force at the time.

When the programme was launched, the operation of profit-oriented financial institutions was regulated by Act LXIX of 1991 on Financial Institutions and the Activities of Financial Institutions, which was repealed and replaced by Act CXII of 1996 on Credit Institutions and Financial Enterprises.

A resolution issued by the State Financial and Capital Market Supervisory Authority on 12 March 1997 (Case No. 2520/1997) confirmed that the microcredit activity of the foundations did not constitute a financial service and therefore did not fall within the scope of the Act on Credit Institutions.

The most basic function of the respective 'banking laws' is **to protect depositors and investors and to regulate the functioning of the profit-oriented money and capital markets**.

Since in Hungary social microcredit is provided **for non-profit purposes** by non-profit foundations which **do not take deposit**, there is no legal justification for their microcredit activities to be subject to the 'banking law' currently in force. Furthermore, this is also justified by the fact that the socially important clientele involved in microcredit may be financed at a risk that the law does not allow service providers operating under its scope to take.

For the above legal and professional reasons, the microcredit activities of county and metropolitan enterprise promotion agencies are excluded from the scope of the Credit Institutions Act. Due to the circumstances described above, the legal regulation of this area was carried out in two stages.

In Section 67 (1) of Act CXXV of 1999, the Hungarian Parliament first amended Act CXII of 1996 on CreditInstitutions and Financial Enterprises by excluding from the scope of the Act the activity of the Hungarian Foundation for Enterprise Promotion to provide loans from the National Microcredit Fund, and then amended the Act again with Section 2 of Act XXXIX of 2003. As from the entry into force of the amendment, the money-lending activity of the Hungarian Foundation for Enterprise Promotion and **the microcredit activities of the county and metropolitan enterprise promotion agencies have beenexcluded from the scope of the Act** pursuant to Section 2(1)(h) of Act CXII of 1996.

Act CXII of 1996 was repealed and replaced by **Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises**, which is currently in force. **This did not change the wording of the previous act, only the numbering was changed. Thus, according to Section 2 (1) f) of the Act, the scope of the Act does not extend to the money-lending activity of the Hungarian Foundation for Enterprise Promotion from the National Microcredit Fund and to the microcredit activities of county and metropolitan enterprise promotion agencies.**

The aforementioned amendment to the Act carried out in 2003 clarified that the micro-lending activities of county and metropolitan enterprise promotion agencies are not covered by the Credit Institutions Act, but it also created a legal loophole, as the Act does not regulate

- the concepts of microcredit and micro-lending and the additional definitions necessary to interpret the legislation;
- the scope of the county and metropolitan enterprise promotion agencies;
- the general rules for microcredit activities;
- the designation of the authority competent to control microcredit activities.

This position is reinforced by the aforementioned letter of the Prime Minister's Office sent to Fejér Enterprise Agency, consortium leader of the Hungarian Microfinance Network in 2017, in which it raises the need for detailed regulation of the microcredit activities of the County and Metropolitan Enterprise Promotion Agencies.

FEA has worked out several versions of the draft law. A possible version of the legislation is set out in the Annex to this document (Annex 2: Draft law on the microcredit activities of the county and metropolitan enterprise promotion agencies.)

5. SUMMARY, RECOMMENDATIONS

In terms of improving access to microfinance, we have identified factors that are very effective in improving the social utility of microcredit in Hungary

We firmly believe that in Hungary, when it comes to providing microcredit to start-ups and microenterprises, which do not have or only have limited access to loans/credits granted by commercial banks, the best social impact can be achieved by building on the base of non-profit micro-finance institutions, in other words, county and metropolitan enterprise promotion agencies.

We examined the operating models and results of both the National Microcredit Scheme and the JEREMIE mcirocredit scheme in order to draw lessons from them to propose an optimal operating model and measures that increase efficiency.

Our findings and recommendations are briefly summarised as follows:

- It was found that the decentralised operating model of the JEREMIE mcirocredit scheme, coordinated by the Hungarian Development Bank, based on refinancing, was able to perform significantly better than the highly centralised and cumbersome National Microcredit Schememanaged by the Hungarian Foundation for Enterprise Promotion.
- We found that the exclusive source of financing of the National Microcredit Scheme, the 'National Microcredit Fund', owned by the Hungarian State, was unlawfully intended to be established not by a law but by a civil law contract, and therefore **it was not established as a State Fund** with legal personality.
- We found that, with regard to the NMS, a system of low efficiency was created based on the initial infringing operation, with further presumed infringements, accounting irregularities and contractual breaches. Its reform is not justified, however, **its placing on completely new footing is.**
- We have concluded that **the involvement of the HFEP in the coordination of microcredit at national level is highly questionable and unjustified from both a professional and legal point of view.**
- In view of the above, we recommend that,
    - the **Hungarian Government should order the transfer of the national coordination** of the National Microcredit Scheme from the Hungarian Foundation for Enterprise Promotion to the **Magyar Fejlesztési Bank Zrt**, which is **fully owned by the Hungarian State**, and has a good track record in the JEREMIE Programme (in fact this should have been done two decades ago);
    - the operating model and operating conditions of the National Microcredit Schemeshould be based on **the well-established decentralised operating model of the JEREMIE mcirocredit scheme, based on refinancing**, with the modification that, as planned at the beginning of the programme, the funds transferred to the LEAs **should be reallocated as revolving funds**.
    - Cooperation between the Hungarian Development Bank and the LEAs is not new. They currently provide **daily online data to HDB** through their common CREDINFO system. Through this software, **HDB can have full programme control virtually immediately without additional investment.**
    - The funds and microcredit portfolio **owned by the State and currently managed by the HFEP** can thus be transferred to the LEAs participating in the programme for microcredit purposes, coordinated by the Hungarian Development Bank.
    - **According to the decision of the Curia, funds owned by the LEAs and used for local microcredits do not require any further government action**, and the decision whether to use them for the provision of microcredit or for other purposes falls within the scope of the trustees of the foundations concerned. **This could reinforce the participation of the foundations in direct EU tenders, which could lead to the import of additional development funds into the country.**
    - We would consider it necessary to have an audit by the State Audit Office on the use of State-owned microcredit funds by the HFEP, for settlement purposes.
    - Recovered State funds shall be transferred to the LEAs participating in the programme in the form of revolving funds **through an account held with the Hungarian State Treasury,** with equitable allocation rates adjusted to the needs;

- As a later step, we propose the setting up of a 'real', legally created, **Separate Public Fund dedicated to the provision of non-profit microcredit**, to provide the appropriate level of funds.
- Given the possibility of a sufficiently large disbursement, the European Union's **InvestEU portfolio guarantee scheme** may offer the possibility to further reduce disbursement risks.
- In line with the Prime Minister's Office's suggestion and initiative, we propose the **adoption of detailed regulations on the microcredit activities of county and metropolitan enterprise promotion agencies**, which could reinforce the operation of the foundations with a focus on social impact and the **State's supervisory role** in this.
- Furthermore, we propose that the possibility for the Hungarian Foundation for Enterprise Promotion to grant loans from the National Microcredit Fund should be removed from the Credit Institutions Act, on the one hand, because the fund has not been established and therefore does not exist, and on the other hand, because **future operation does not justify the involvement of the HFEP in microcredit.**

In our view, the implementation of the above-listed measures is not a major professional challenge for those involved, can be implemented very quickly, and would best serve the interests of Hungarian society in the long term.

DISCLAIMER

This document is based on the legal and professional interpretation and presentation of the relevant documents available to us in the archives and in the public databases accessible on the Internet. Due to the scope of the contracts examined, the volume of documents available to us, the complexity of the contracts and the wide range of national and European Union legal provisions to be taken into account in connection with the contracts, we do not wish to assume any legal liability in respect of the positions presented in this document. The present study has been prepared on the basis of a review of the facts, documents and Hungarian legislation promulgated, excluding any liability on the part of the authors. It constitutes an expert opinion expressing the authors' views, liability for any legal consequences related to the use of this document is therefore excluded in its entirety, and to the fullest extent.

6. ANNEXES

Annex 1: '**PROFESSIONAL RECOMMENDATIONS FOR EUROPEAN DECISION-MAKERS REGARDING THE LEGISLATION OF MICROFINANCE**' (Rome, 29 September 2016)

Annex 2: Draft law on the microcredit activities of the county and metropolitan enterprise promotion agencies

European Union
European Regional
Development Fund

PROFESSIONAL RECOMMENDATIONS FOR EUROPEAN DECISION MAKERS REGARDING THE LEGISLATION OF MICROFINANCE

Foreword

The participants of the Committee of National Microfinance Networks **(MICROFINET)** hosted by the European Microfinance Network (EMN) have studied the situation of the European microfinance sector and unanimously defined the following international professional recommendations and directives based on the international professional experience.

PROFESSIONAL RECOMMENDATIONS

Legal and regulatory area

Directive 1: 'Non-bank' credit institutions should also be allowed to perform lending activities with authorization provided by the Act.
Directive 1.1: The establishment of financial enterprises not taking deposits, entitled to pursue lending activities (providing microcredit not exceeding the individual microcredit limit per transactions specified by the nation state and / or the European Union) and, in particular, specialized in micro lending, fulfilling positive social purposes should have lower funding capital requirement and their records should be kept separately.
Directive 1.2: The microlending activity (providing microcredit not exceeding the individual microcredit limit per transactions specified by the nation state and / or the European Union) should be made available for a particular group of non-profit foundations or foundations that do not take deposits and fulfil positive social purposes especially from donations and public funds.
Directive 2: The opportunity to take advantage of the situation of the vulnerable should be limited with regulatory and financing instruments.
Directive 3: An entrepreneur friendly regulatory system should be created.

Financing

Directive 4: Microcredit schemes financed from public funds should be interpreted as providing assistance out of social solidarity, which investment in return would have a positive impact on society.
Directive 4.1: In case of microcredit schemes financed from public funds the achievement of positive social impact should enjoy priority over the 'preservation' or multiplication of the funds at nominal value in the course of the implementation of the scheme.
Directive 4.2: The sustainability requirement should primarily be interpreted and expected on the basis of the humane approach to sustainable society and not on the basis of absolute financial sustainability.
Directive 4.3: The expected financial sustainability should be assigned to an interval (short-term, medium-term or long-term sustainability), during which period the scheme must achieve or maintain the planned positive social impact.
Directive 5: The involvement of non-profit funders should enjoy priority over the profit-oriented creditors in the arrangement of microcredit schemes financed from public funds.
Directive 6: In order to reach the clients targeted by the microcredit scheme financed from public funds efficiently and to achieve the set social objectives, the credit risk should not be passed to the intermediaries, or it should only be passed to a lesser extent.
Directive 6.1: The losses on loans should be able to be written off from the funds.
Directive7: The scheme should not put the supported people having payment problems through no fault of their own in a more difficult situation than what they were in prior to receiving the support.
Directive 8: The social success of the scheme should be facilitated with advice and assistance provided to the supported target group.
Directive 9: The costs of central fund management and financial control should not exceed 5% of the costs of the actual scheme implementation, and in case of financing start-up micro enterprises and micro enterprises younger than 3 years of age the operating costs should be able to be accounted for partly or wholly to the debit of the 'Credit Fund'.

Rome, 29 September 2016

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Annex 2:
Act ... of 2023 /PROPOSAL/
on the microcredit activities of the county and metropolitan enterprise promotion agencies

CHAPTER I
GENERAL PROVISIONS

Purpose of this Act

Section 1 (1) The purpose of this Act is

a) to determine the general requirements concerning the rules of operation of the microcredit activities;

b) to determine the general rules regarding the financing of microcredit activities; and

c) to make the microcredit activities transparent and verifiable

of the county and metropolitan enterprise promotion agencies entitled to perform microfinance activities, falling outside the scope of Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises (hereinafter referred to as Credit Institutions Act) pursuant to Section 2 (1) (f) of the same Act.

Definitions

Section 2 For the purposes of this Act

(1) 'credit-granting': shall mean a commitment fixed in writing in a credit agreement between the creditor and the debtor for the availability of a specific line of credit in return for a commission, as well as the creditor's commitment, subject to specific contractual conditions, to conclude a loan agreement or conduct other credit operations.

(2) 'lending money': shall mean the provision of money under a credit or loan agreement between the creditor and the debtor that is to be repaid by the debtor – with or without interest – at the time specified in the contract.

(3) 'microcredit activity': shall mean the lending activity of the organisations specified in Section 19 of this Act, which includes credit-granting and lending money, too.

(4) 'The microcredit activity aiming at credit-granting and lending money' shall include measures related to the assessment of creditworthiness, the preparation of loan and credit agreements, loan and credit assessment and decision, as well as the disbursement, registration, monitoring, control and recovery of loans and credits.

(5) 'Microcredit of positive social purpose' shall mean a loan that prioritises positive social impact over profit making, which may be combined with

(a) basic mentoring and advisory activities, and

(b) advanced business development services.

(6) 'Basic mentoring and advisory activities' shall mean, within the meaning of this Act, an activity directly related to microcredit under this Act, during which the microcredit organisation monitors the debtor's business activity and, where it considers necessary, advises the debtor in order to assist them in their operations.

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(7) 'Advanced business development services' shall mean any service complementary to microcredit that helps an enterprise to operate in any specific area of its activity, to increase its income and profitability.
(8) 'Active microcredit activity' shall mean the microcredit activity of an enterprise promotion agency that has active loan accounts recorded in its own books, carries out the entire lending procedure under its own internal rules relating to lending, and disburses loans from its own funds in its own name prior to the entry into force of this Act.
(9) 'Enterprise' shall mean a legal person, in particular, a sole proprietorship, a private entrepreneur, a business association, a law firm, a co-operative, a water association, a water utility association, a forestry association that is engaged in economic activity, and for the purposes of Sections 107 and 108 of the Treaty, enterprises and natural persons engaged in agricultural production, fish farming, agricultural processing and marketing, forestry and game management satisfying the SME criteria specified in Annex I to Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market.

CHAPTER II
DETAILED PROVISION

The general purposes of microcredit programmes

Section 3 The general objectives of microcredit programmes which may be operated under this Act are as follows:

(1) to serve micro-enterprises that receive no credit or receive insufficient amount of credit from profit-oriented funders with high quality credit products, and, where possible, to prepare them to become clients of profit-oriented organisations of the credit market;
(2) to promote self-support and self-employment from income earned from an independent activity,
(3) to promote job retention and job creation,
(4) to promote the transition from living on benefits to becoming a taxpayer,
(5) to improve the viability and competitiveness of the target enterprises;
(6) to generate disposable income by fostering independent income generating capacity, thereby achieving an economic stimulus effect,
(7) to reduce the dependency on social assistance and the associated risk of mental decline among the target group,
(8) other positive social objectives related to the need for government involvement to address the negative social impacts of financial market failures (in other words,market failures).

Eligibility for funding

Section 4 The target group of microcredit programmes under this Act is micro-enterprises as defined in Section 3 (3) of Act XXXIV of 2004 on small and medium-sized enterprises and the support provided to such entereprises.

Section 5 Pursuant to this Act, loans are to be provided primarily to clients listed under Section 4 seeking to earn a living from an independent income generating activity, who have reduced creditworthiness due to reasons typically related to the fact that

(1) they need low loan amounts, or
(2) they can offer inadequate legal collateral, or
(3) they have no verifiable entrepreneurial track record, or
(4) they have other disadvantages.

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Ceilings on lending/borrowing or risk-taking

Section 6 In the course of the provision of microcredit under this provision, the organisation defined in Section 21 of this Act shall be entitled to determine the maximum amount of credit or loan or guarantee that may be granted to a client in a single transaction by a microfinance institution.

Section 7 The ceiling of the total credit or loan or guarantee granted to a given client by a microfinance institution in all active transactions with that client at the same time may not exceed twice the amount specified in Section 6 of this Act.

Requirements for carrying out microcredit activities

Section 8 The operation of the organisation carrying out microcredit activities under this Act shall comply with the following requirements:
(1) the legal status of the foundation eligible for microcredit activities shall be that of a public benefit foundation;
(2) microfinance institutions subject to this Act may not engage in deposit taking;
(3) they may not engage in lending or credit intermediation activities for profit for profit-oriented investors;
(4) they may carry out non-profit lending for positive social purposes from the funds defined in Section 16 of this Act.

Section 9 Organisations carrying out microcredit activities under this Act shall have in place lending policies that ensure
(1) transparency in the use of the available funds;
(2) the professional use of available funds;
(3) the effective achievement of positive social objectives.

Section 10 The credit policies of organisations carrying out microcredit activities under this Act shall detail the following:
(1) the necessary technical, organisational and personnel conditions;
(2) rules relating to the lending procedure, including
(a) decision-making limits and powers;
(b) rules on conflicts of interest;
(c) the classification of each client and each transaction into risk categories and the maximum amount of lending or risk-taking for each risk category.

Section 11 Organisations carrying out microcredit activities under this Act shall have policies and procedures in place in the following additional areas:
(1) a definition of the social mission of the organisation;
(2) a social achievement plan indicating the expected social impact;
(3) the methodology and measurement procedures developed to measure social outreach.

Public benefit

Section 12 The microcredit activity under this Act shall be deemed to be a public service, and the microcredit activity of an enterprise promotion agency carrying out microcredit activity within the scope of this Act shall be deemed to be of public benefit.

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The Foundation's revenue from its activities

Section 13 The interest and other income from microcredit activities under this Act may be accounted for as public benefit income of the foundation's target activity.

Section 14 The amounts used by the microcredit organisation to finance operating costs, which may be charged to the foreign funds transferred to it for microcredit purposes, shall be considered as income as defined in Section 13.

Financing of microcredit activities, use of funds

Section 15 The microcredit organisation may use the repayments made by the borrowers, unless otherwise provided by the organisation providing the funding source, as follows:
(1) may grant additional loans,
(2) may fund basic mentoring and advisory activities;
(3) may fund advanced business development services;
(4) may fund direct and indirect operating costs.

Section 16 The origin of the funds that may be used for microcredit can be:
(1) funds from any source that are already the foundation's own assets;
(2) external funding
a) funds permanently transferred to the Foundation, i.e.
I. donations, contribution made by the foundation or
II. targeted subsidies subject to conditions;
b) grants, loans or other contributions of capital made by national or international organisations authorised to manage or channel public funds;
c) from the provision of subordinated capital transferred for the purpose of microcredit by a microfinance institution covered by this Act to another microfinance institution covered by this Act;
d) interest-free loans or other free benefits from any other source.

Section 17 The use of funds transferred for the operation of the microcredit programme pursuant to Section 16 (2) (a) of this Act shall be deemed to be a oneoff allocation of funds or a one-off commitment of an amount equal to the amount of the funds.

Section 18 Funds transferred under Section 16(2)(a) and already used may not be reclaimed by the funder under any legal title in the event of proper use, however, in the case of funds provided under Section 16(a)(ii), the funder may determine the time period within which the recovered funds must be reused for microcredit.

CHAPTER III
CLOSING PROVISIONS

Appointment

Section 19 Pursuant to Section 2(1)(f) of Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises, the organisation authorised under Section 20 of this Act shall be entitled to accredit county and metropolitan enterprise promotion agencies entitled to engage in microcredit activities

not falling within the scope of the Act, to determine the accreditation procedure and to verify the compliance conditions under this Act.

Section 20 The Ministry responsible for Economic Development (or the Ministry of Finance) shall be the competent authority for the control of microcredit activities under this Act.

Section 21 The body authorised under Section 20 of this Act shall be entitled to determine the maximum amount of microcredit that may be granted under this Act.

Section 22 Magyar Fejlesztési Bank Zrt is primarily responsible for the provision or intermediation of public or other funds for microcredit activities performed under this Act.

Transitional provisions

Section 23

(1) The organisation referred to in Section 19 of this Act shall have ten months to define the accreditation procedure and to draw up the criteria of conformity in accordance with this Act;
(2) the county and metropolitan enterprise promotion agencies, as defined under this Act, have twenty-four months from the date of entry into force of the Act to prepare for the provision of microcredit under the relevant provisions.

Section 24 From the date of entry into force of this legislation,
(1) any provision contrary to the provisions of this Act shall be repealed.

Changing legislation

Section 25 Section 2 (1) (f) of Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises shall be replaced by the following paragraph by deleting the words "the activities of the Hungarian Foundation for Enterprise Promotion to grant money loans from the National Microcredit Fund, and":

Section 2 (1) This Act shall not apply to:

f) the microcredit activities of the county and metropolitan enterprise promotion agencies.

Entry into force

Section 26 This Act shall enter into force on the day of its promulgation.

General justification

microcredit in Hungary started in 1992 with the launch of the Phare Microcredit Programme. As there was **no specific legislation on this activity** at that time, the designers of the programme adapted the operation and the set of rules of the loan scheme to the legislation in force at the time. It was already apparent that **optimising the positive social impact of the programme** would justify separate legislation in this area of financing.

As mentioned before, the funds for the programme were initially provided by the EU Phare Programme (and later by the Hungarian Government as co-funder) for the foundations **in the form of targeted subsidies subject to conditions.**

Since these foundations
- did not take deposits,
- received the funds – public money – in the form of targeted subsidies subject to conditions to fund a specific programme with social objectives in a dysfunctional financial market requiring government intervention,
- were not profit-oriented (they did not even make profit),

it was clear that their activities could not fall within the scope of the 'banking law' in force at the time.

When the programme was launched, the operation of profit-oriented financial institutions was regulated by Act LXIX of 1991 on Financial Institutions and the Activities of Financial Institutions, which was repealed and replaced by Act CXII of 1996 on Credit Institutions and Financial Enterprises.

A resolution issued by the State Financial and Capital Market Supervisory Authority on 12 March 1997 (Case No. 2520/1997) confirmed that the microcredit activity of the foundations did not constitute a financial service and therefore did not fall within the scope of the Act on Credit Institutions.

The most basic function of the respective 'banking laws' is t**o protect depositors and investors and to regulate the functioning of the profit-oriented money and capital markets.**

Since in Hungary social microcredit is provided for non-profit purposes by non-profit foundations which **do not take deposit**, there is no legal justification for their microcredit activities to be subject to the 'banking law' currently in force. Furthermore, this is also justified by the fact that the socially important clientele involved in microcredit may be financed at a risk that the law does not allow service providers operating under its scope to take.

For the above legal and professional reasons, the microcredit activities of county and metropolitan enterprise promotion agencies are excluded from the scope of the Credit Institutions Act. Due to the circumstances described above, the legal regulation of this area was carried out in two stages.

In Section 67 (1) of Act CXXV of 1999, the Hungarian Parliament first amended Act CXII of 1996 on Credit Institutions and Financial Enterprises by excluding from the scope of the Act the activity of the Hungarian Foundation for Enterprise Promotion to provide loans from the National Microcredit Fund, and then amended the Act again with Section 2 of Act XXXIX of 2003. As from the entry into force of the amendment, the money-lending activity of the Hungarian Foundation for Enterprise Promotion and **the microcredit activities of the county and metropolitan enterprise promotion agencies have been excluded from the scope of the Act** pursuant to Section 2(1)(h) of Act CXII of 1996.
Act CXII of 1996 was repealed and replaced by **Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises**, which is currently in force. **This did not change the wording of the previous act, only the numbering was changed. Thus, according to Section 2 (1) f) of the Act, the scope of the Act does not extend to the money-lending activity of the Hungarian Foundation for Enterprise Promotion from the National Microcredit Fund and to the microcredit activities of county and metropolitan enterprise promotion agencies.**

The aforementioned amendment to the Act carried out in 2003 clarified that **the micro-lending activities of county and metropolitan enterprise promotion agencies are not covered by the Credit Institutions Act**, but it also created a legal loophole, as the Act does not regulate

- the concepts of microcredit and micro-lending and the additional definitions necessary to interpret the legislation;
- the scope of the county and metropolitan enterprise promotion agencies;
- the general rules for microcredit activities;
- the designation of the authority competent to control microcredit activities.

The proposed legislation **will close the legal gap** and make the operation of the sector more uniform and regulated. It will make the overall operation and financing of the sector transparent and verifiable, and the social impact of microcredit activities measurable. The quality of services can be improved. Overall, in the long term, it can create a stable legal framework and institutional system to deal effectively and professionally with the social problem described above.

Detailed justification

CHAPTER I
GENRAL PROVISIONS

Section 1
Defining the purpose of the Act

Section 2
Defining the definitions

The draft legislation contains definitions of certain terms used in the legislation to ensure uniform interpretation.

CHAPTER II
DETAILED PROVISIONS

Section 3
General purposes of the microcredit schemes

AIn order to maximise the positive social impact of microcredit, we have set out the main objectives that microcredit programmes with a positive social purpose should achieve. It is very important that these programmes should reduce financial exclusion and channel resources to social groups for whom access to loans from profit-oriented financial market players is either not possible or limited.

Section 4
Eligibility for funding

Micro-enterprises have been identified as a target group to benefit from the project, as this is the group affected by the problems that microcredit can address.

Section 5

In order to better define the target group of microcredit activities covered by the law, we have listed the most typical reasons why the sector targeted by microcredit is excluded from commercial banking services.

Sections 6 - 7

Ceilings on lending/borrowing or risk-taking

It is necessary to define the maximum amount of microcredit per transaction that may be granted under this Act, in other words, the 'microcredit ceiling'. There is no such legislation in the European Union that would set such a ceiling. According to the generally accepted practice, which can be found in several official documents, the EU authorities consider loans of less than EUR 25,000 as microcredit. However, a number of different practices have developed at national level. In the Netherlands, for example, loans of up to EUR 50,000 are already granted under microcredit schemes.
However, it is not appropriate to set a ceiling for the microcredit activity covered by this Act, as its reasonable value can change rapidly and frequently depending on market conditions, the economic situation and exchange rates. It is therefore appropriate that the legislation should designate the body entitled to determine that amount.

Section 8

Requirements for carrying out microcredit activities

These provisions ensure that the microcredit activities covered by this Act are not carried out for profit and do not serve the interests of profit-seeking investors, while, pursuant to point (1), the public benefit status of the foundation improves controllability and transparency.

Sections 9 - 10

The rules ensure that microcredit activities covered by the Act are carried out according to a set of rules based on a single set of professional criteria. The rules set out reflect current practice.

Section 11

Because of the primacy of the positive social impact of microcredit programmes on society, we have also included in the legislation a requirement to measure social impact, in line with international practice.

Section 12

Public benefit

For the sake of controllability and transparency of the foundation running the programme, we consider it necessary that only a foundation with public benefit status should be allowed to run a microcredit programme under this Act. At the same time, it is important to underline that the need

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for government action in relation to market failures justifies the definition of the implementation of these tasks as a 'public task' in this Act. This could provide the sector with considerable stability and long-term efficiency, which would best allow it to achieve the expected positive social impact.

Section 13

The method of accounting for interest and income currently used in microcredit schemes will be set out in the Act in order to ensure uniform interpretation and to aim for a complete set of rules.

Section 14

The method of cost accounting currently used in microcredit schemes is set out in the Act in order to ensure uniform interpretation and to aim for a complete set of rules.

Financing of microcredit activities, use of funds

Section 15

These provisions of the Act will help to ensure that microcredit covered by the Act can also finance services and operations that support the viability of the businesses receiving the loans.

Section 16

We consider it important to ensure that sources of finance for positive social microcredit are widely available, while excluding the possibility of for-profit lending to profit-seeking investors in the context of microcredit activities under this Act.

Sections 17 - 18

The definition of the use of funds transferred for the purpose of microcredit covered by this Act should be clarified in order to avoid future disputes. Furthermore, in order to ensure the stable operation of the microcredit schemes operated under this Act, and taking into account in particular the public benefit foundation status of the organisations concerned, the possibility of reclaiming the funds transferred for lending purposes has been limited.

CHAPTER III
CLOSING PROVISIONS

Section 19
Appointment

The Act designates the organisation authorised to determine the enterprise promotion agencies entitled to carry out microcredit activities covered by the Act. All county and metropolitan enterprise promotion agencies engaged in active microcredit activities, as defined in Section 2(8) of the Act, may be entitled to carry out microcredit activities under this Act.

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Section 20

The microcredit activity that can be carried out within the scope of this Act does not fall under the Credit Institution Act and therefore does not qualify as a credit institution activity, therefore it is appropriate that the Ministry of Finance should be the supervisory authority in this case.

Section 21

It is not appropriate to set a ceiling for the microcredit activity covered by this Act, as its reasonable value can change rapidly and frequently depending on market conditions, economic conditions and exchange rates. It is therefore appropriate to leave the determination of this amount to the discretion of the supervising ministry.

Section 22

In order to ensure transparency and professionalism in the long term, it is appropriate that in the future all public microcredit programme funding should be provided by an accredited, fully state-owned, transparent entity entitled to manage the funds.

Section 23
Transitional provisions

The legislation gives the competent authority 10 months from the date of entry into force to prepare detailed accreditation requirements and rules.

The legislation gives the county and metropolitan enterprise promotion agencies affected by the legislation 24 months from the date of entry into force to prepare to comply fully with the requirements of the Act. This period is sufficient to meet the conditions.

Section 24

In order to avoid inconsistencies in the interpretation of this Act and to avoid circumvention by reference to other earlier provisions, it is appropriate to insert these provisions.

Section 25

It is necessary to delete the possibility for the Hungarian Foundation for Enterprise Promotion to grant loans from the National Microcredit Fund from the Act, on the one hand, because the fund was not actually established as a public fund, so it does not exist from a legal point of view, and on the other hand, because the future operation does not justify the involvement of the HFEP in microcredit.

Section 26
Entry into force

Enacting provision

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The study contains extracts taken verbatim from the following publications:

Szekfü-Vonnák-Pizzo. 'MICROCREDITING – From Theory To Practice', Fejér Enterprise Agency, 2020
ISBN 978-615-81559-0-8 / Pp 5-10

Péter Vonnák. 'MICROCREDITING IN HUNGARY, i.e. How can we optimise the social usefulness of microcredit schemes', Fejér Enterprise Agency, 2015
ISBN 978-963-12-5845-5 / Pp25, Pp52-57

The English version of the publication is based on the study by Tibor Szekfü 'IMPROVING ACCESS TO MICROFINANCE IN HUNGARY - Challenges and Opportunities - 2021-2027' (ISBN: 978-615-81559-1-5).

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