

SUMMARY OF HUNGARIAN FDI REGIMES

FDI screening is a topic that has become of increased importance in recent years both across Europe and more widely, and Hungary is certainly not alone in having introduced new restrictions.

The restrictions have been introduced for a number of reasons and are used for several purposes – protectionist sentiment became more acceptable and politically necessary; specifically there were concerns in many countries about the extent of Chinese investment; during the pandemic there was a focus on healthcare assets being of strategic importance and also a wish to protect businesses in a range of sectors that might be heavily affected by the economic consequences of the pandemic.

The Hungarian regulations currently in force are a combination of those introduced in 2019 implementing the EU Regulation no. 2019/452 and those introduced in the context of the Covid pandemic during 2020. The two regimes have many similarities but need to be considered separately and have notable differences in substance and procedure.

What we set out in this memorandum is a summary of the applicable regulations. They need to be looked at in a number of contexts, most obviously in the course of cross-border M&A transaction but also quite frequently in the case of existing investment when capital changes are being made.

We hope this addresses many initial questions but will be pleased to provide further advice and assistance if questions arise, whether leading to conclusion that clearance is not needed or to assist in the process of filing for the necessary clearances.

WHICH ARE THE APPLICABLE FDI REGIMES IN HUNGARY?

In Hungary there are currently two separate FDI regimes in force. The so called „General FDI Regime”, which was introduced to implement EU Regulation no. 2019/452 has a relatively narrow scope regarding the sectors covered. The General FDI Regime entered into force on 1 January 2019 and is effective for an indefinite period of time although, currently, there are some interim extensions to its personal scope and the sectors covered, which are only effective while the Covid related state of emergency lasts.

The second effective FDI regime is the New FDI Regime that has been adopted due to and in connection with the Covid-19 pandemic. Compared to the General FDI Regime's scope it concerns a much wider number of sectors and activities, however also contains significant exceptions, which are commonly used in practice to avoid FDI screening (such as the indirect nature of the transaction, see below for more detail). The new FDI regime was introduced in response to the Covid pandemic and it was stated that it will remain in force so long as the Covid state of emergency continues. However, it is now clear that it is the intention of the Government to make this regime permanent.

The New and the General FDI Regime are regulated in separate pieces of legislation, which do not refer to each other. However, as their subject matter (FDI screening) is similar, their main logic is the same, focusing on the origin of the investor and the activities of the Hungarian target companies. However, there are major differences between the two regimes. (e.g. not even their “foreign investor” definitions match, different exemption rules apply etc.). The similarities and differences make the Hungarian FDI screening system quite complex and sometimes confusing, so we set out the separate regulations in each sections below.



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WHAT IS THE ESSENCE OF FDI SCREENING IN HUNGARY?

Transactions which fall under either the General or the New Regime require both notification to and acknowledgement by the competent Minister, as a precondition to implementation of any foreign investment which falls within the ambit of the legislation. The competent ministers are (i) the Minister of Interior under the General FDI Regime and (ii) the Minister of Innovation and Technology under the New FDI Regime.

BASICS OF HUNGARIAN FDI SCREENING

Both regimes concentrate mainly on (i) the origins/residence of the investor (whether it qualifies as a foreign investor under the respective measures or not), and (ii) on the activities of the Hungarian company concerned. If the investor does not qualify as a foreign investor, then the personal scope of the FDI regimes does not apply to the investor, thus no FDI screening is needed even if the Hungarian target pursues listed activities. Equally if the Hungarian target does not carry out such activities that are listed in the relevant laws, then no FDI clearance will be needed even if the investor is e.g. outside the EU or the EEA.

In practice, the following shall be evaluated when assessing the need for a potential FDI approval in Hungary:

- whether the investor may qualify as a foreign investor;
- whether the Hungarian company pursues any activity (as its main or ancillary activity) that is listed in the relevant FDI laws; and
- other more detailed criteria concerning the particular transaction if the first two criteria are met (like the exact transaction structure, transaction value, to assess whether any exceptions rule may apply etc.).

No other information has particular relevance when deciding on the need for a Hungarian FDI approval, e.g. the number of employees or turnover of the target, the activities of the investor, or the activities of the parent company of the Hungarian target/the group are not relevant.

WHO QUALIFIES AS A FOREIGN INVESTOR?

General FDI Regime

Under the General FDI Regime any natural person or legal entity qualifies as a foreign investor, if it is (i) citizen of/registered in a country outside of the EU, EEA or Switzerland or (ii) a legal entity registered in the EU, EEA or Switzerland if controlled by a non-EU/EEA/Swiss person/entity. ("EU entity controlled by non-EU investor"). **According to Covid-19 related interim measures to the General FDI Regime, any natural person or legal entity citizen of/registered in a Member State of the EU/EEA or Switzerland is also considered as a foreign investor currently.**

New FDI Regime

According to the New FDI Regime foreign investors are those (natural or legal) persons or organisations which are (i) citizens of/registered in a country which is outside of the EU, EEA or Switzerland; or (ii) legal entities registered in the EU, EEA or Switzerland, if they are under the majority control of (natural or legal) persons or organisations citizens of/registered in a country which is outside of the EU, EEA or Switzerland. The New FDI Regime also applies to EU/EEA/Swiss investors (natural and legal persons) if they acquire majority control and the investment exceeds approx. EUR 1 million.

Currently (and temporarily, see above) the personal scope of the General FDI Regime is broader, as it covers all EU/EEA or Swiss persons/entities as well, while the New FDI Regime only applies to EU/EEA or Swiss persons/entities if (i) they are under the majority control of a person outside of the EU, EEA or Switzerland, or if (ii) the EU/EEA/Swiss investors would acquire majority control and their investment would reach/exceed approx. EUR 1 million.

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SECTORS CAUGHT

General FDI Regime

The General FDI Regime concentrates on those sectors (and companies which pursue such activities) that are closely related to national security, or financial and utility services. These sectors and activities are:

- manufacture of weapons and ammunition as well as of military equipment and devices subject to licence;
- manufacture of dual use products;
- manufacture of intelligence devices and equipment specified in the government decree on the detailed rules of obtaining a licence for military activity and certifying businesses;
- provision of financial services specified in the act on credit institutions and financial enterprises and from among auxiliary financial services and insurance and reinsurance activities including activities directly related to insurance, the operation of a payment system;
- services governed by the act on electricity;
- services governed by the act on natural gas supply;
- services governed by the act on water public utility services;
- services governed by the act on electronic communications;
- the set-up, development and operation of electronic information systems governed by the act on the electronic information security of central and local government agencies.

New FDI Regime

The New FDI Regime introduces a vague definition of 'strategic companies' which covers (i) public and private companies (Nyrt. Zrt. or Kft.) and institutions of higher education, having their registered seat in Hungary and (ii) whose registered principal or ancillary activities fall into the detailed list of activities listed in the respective Government Decree, which activities pursued in the energy, transport or communication sectors or which fall within a sector that qualifies as a sector of strategic importance, which is determined by using the EU law criteria.

The above definition of 'strategic companies' has been widely criticised by local practitioners as it is not clear whether the listed and registered activity of the company is relevant or whether such activity is pursued in relation to the energy, transport or communication sectors. Unfortunately, the practice of the Ministry suggests the first interpretation i.e. if the registered activity of the local company is indicated in the respective Government Decree, then such company qualifies as strategic. This implies that the New FDI Regime has a much wider scope and includes a large number of activities commonly pursued by companies. For the detailed list of caught activities please see the [Annex](#) at the end of this Newsletter.

As the sectors and activities caught by the two regimes are basically different, the applicability of only one regime arises in most cases. However in certain sectors (e.g. in the telecommunication and electronic communications sector) it is possible that FDI clearing is needed under both regimes.

TRIGGERING EVENTS FOR FDI SCREENING

General FDI Regime

Under the General FDI Regime the following events trigger FDI screening:

(1) a foreign investor establishes a new Hungarian company or acquires in an existing Hungarian company solely or together with other foreign investor(s) a stake exceeding 25% (for privately held companies) or 10% (in publicly listed companies); or acquires a 'dominant influence' meaning that a member of or shareholder in that company:

- a) has the right to appoint and recall the majority of the executive officers or supervisory board members of the legal person; or
- b) other members of or shareholder in that legal person are committed under an agreement to vote in concert, or exercise their voting rights through the holder of such dominant influence, provided that together they control more than half of the votes; or

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- (2) foreign investor(s) acquire(s) a stake of less than 25% in a privately held company registered in Hungary, but the total stakes held by foreign investor(s) exceed 25% as a result; or
- (3) a foreign investor registers a branch office in Hungary for the purpose of carrying out strategic activities; or
- (4) a foreign investor acquires a right to operate or use infrastructure or assets that are indispensable for carrying out strategic activities; or
- (5) a company registered in Hungary in which foreign investor(s) hold a stake equivalent to that in point (1) or (2) above takes up a strategic activity.

New FDI Regime

In connection with the scope of the New FDI Regime we see that in practice the most important rules are those which set out exceptions, and provide that indirect acquisitions and higher level intragroup restructurings fall outside its scope (based on the latest interpretation of the Ministry of Innovation and Technology FDI clearance may be needed for such intragroup restructurings as well where Hungarian strategic companies are affected directly!). This means that only direct acquisitions of Hungarian entities by foreign investors (and by EU/EEA/Swiss investors in certain cases) are caught by the New FDI Regime.

Among direct transactions the following transaction types require both notification to and acknowledgement by the competent Minister:

- acquisition of ownership interest;
- capital increase;
- mergers, demergers, transformations to another company form;
- issuance of bonds which are convertible or convert to equity or provide preferential subscription rights;
- establishing usufruct right over equity,

provided that as a result of such transaction the foreign investor would acquire

- majority control (by way of ownership, voting rights, appointing management or otherwise) if the investment reaches or exceeds HUF 350 million (approx. EUR 1 million); or
- at least 10% ownership interest, if the investment reaches or exceeds HUF 350 million (approx. EUR 1 million); or
- an ownership interest reaching 15%, 20% or 50 % in a strategic company or any level of interest which, if computed together with any other foreign investors' interest, exceeds 25 %.

In addition, irrespective of ownership thresholds or transaction sizes, the transfer of using / operational rights of infrastructures and assets that are 'indispensable for the operation of strategic companies' (including the pledging of these assets and infrastructures) require both notification to and acknowledgement by the Minister.

WHAT ARE THE MAIN PROCEDURAL RULES?

General FDI Regime

A notification to the Minister of Interior must be made before implementation, within 10 days from

- (a) signing the contract, in the event of stake acquisitions and operation right acquisitions;
- (b) the registration of the newly subscribed strategic activity in the company registry, in the event of the new pursuit of strategic activities.

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The deadline for review by the minister is 60 days (extendable by 60 days) from the date of filing. The minister either issues a clearance decision or a prohibiting decision, the latter if the triggering event "harms Hungary's security interests". In the case of an EU entity controlled by non-EU investor, a blocking decision can only be made in the case of circumvention, i.e. if it can be established that the EU entity's involvement in the transaction aims to circumvent the screening rules. This could be the case, in particular, if the EU entity controlled by a non-EU investor does not carry out any actual economic activities or has no long-term presence in the EU member states of its establishment.

A prohibiting decision can be challenged by the foreign investor or by the affected company only on a procedural basis (i.e. if the procedural rules of FDI screening has been breached materially). The only exception is that a prohibiting decision can be challenged on a substantive legal basis concerning the Ministry's opinion on whether or not the EU entity controlled by a non-EU investor carries out actual economic activities or has long-term presence in the EU member states of its establishment.

New FDI Regime

A notification shall be made by the foreign investor to the Minister of Innovation and Technology within 10 days from signing the transaction documents. The notification shall include, in addition to the identifying data of the foreign investor (including ownership structure and AML data), a detailed description of the proposed transaction and a full set of the transaction documents. The language of the procedure is Hungarian and legal representation is obligatory. The Minister has 30 business days to decide on the transaction, which deadline may be extended by 15 days.

In its procedure, the Minister is bound to make his decision on the basis of evaluating the following criteria:

- a) whether the proposed transaction endangers or threatens to endanger the national interest, public order, public security of Hungary with particular attention to the safety of catering for the basic needs of the society, in accordance with the relevant articles of the Treaty on the Functioning of the European Union (TFEU Art. 36, 52 (1) and 65 (1), which invoke, among others, public policy, public security or public health issues);
- b) whether the applicant is directly or indirectly under the control of any administrative agency of any non-EU state (including its ownership structure or financing);
- c) whether the applicant was involved in any activity relating to public security or public order issue in any other member state;
- d) whether there is substantial risk that the applicant will commit any crime or illegal activity.

If the Minister finds that any of the foregoing conditions apply, it shall issue a decision which forbids the completion of the contemplated transaction, otherwise the Minister shall acknowledge the notification.

The Minister is obliged to set out the reasons for any negative decision. However the vagueness of the terms of relevant laws practically allows the Minister to deliver decisions in a discretionary or arbitrary manner.

The decision of the Minister cannot be appealed, but is subject to a challenge before the Metropolitan Court of Budapest, which has 30 days to deliver its decision.

If the court establishes that the rejecting decision was unlawful, it shall set aside such decision and order the Minister to conduct a new procedure.

As a general remark we note that based on our experience, the relevant Ministries do not always comply with the deadlines set out in relevant laws, therefore substantial delays may occur in certain cases and there are no effective remedies against such delays.

SANCTIONS FOR NON-COMPLIANCE

General FDI Regime

In the absence of a clearance decision (including lack of notification) or a prohibiting decision

- foreign investors cannot request their registration in the member's list or the share ledger of the Hungarian entity (or exercise any other rights towards the company);

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- foreign investors cannot exercise shareholder rights (if they had been registered in the members list or share ledger in the absence of a clearing decision, or contrary to a prohibiting decision);
- the contract for the pursuit of the operation right will not take effect.

The strategic activity must be deleted from the company registry in the event of a prohibition decision.

Foreign investors who fail to perform the notification obligation will be subject to a fine of

- HUF 100,000 (EUR 278/ USD 321) to HUF 1 million (EUR 2,777 / USD 3,207) for a natural persons or
- HUF 1 million (EUR 2,777 / USD 3,207) to HUF 10 million (EUR 27,768 EUR / USD 32,067) for a legal entity.

New FDI Regime

Any contract, declaration or corporate resolution which breaches the provisions of the rules of the New FDI Regime or the negative decision of the Minister shall be null and void. A subsequent acknowledging decision made by the Minister may cure such consequence.

In the absence of the acknowledgement of the Minister or in the case of the negative decision by the Minister, foreign investors cannot be registered in the members' list or the shareholder register of the respective company and thus cannot exercise ownership rights. The courts of registration are also required refusing register any corresponding change in the corporate data of the respective company regarding any ownership change without filing the acknowledgement of the Minister.

Finally, if the Minister (who is in charge of the implementation of the new Act) establishes that a foreign investor does not comply with the notification / acknowledgement requirement, then the Minister may impose a fine. The amount of the fine shall be at least (i) HUF 100,000 (EUR 278/USD 321) in case of natural persons and (ii) 1% of the respective target company's net annual turnover in the previous business year in case of legal entities. The maximum fine is capped at double the transaction value.

FAQ AND OTHER PRACTICAL INFORMATION

As failing to make an FDI notification can result in a void transaction, parties to transactions need to know whether their planned transaction is subject to FDI screening. Our experience to date is that FDI screening processes are always quite lengthy, as the competent authorities are likely to extend the administrative deadlines provided in the relevant laws (see above at the main procedural rules section). Moreover, in some cases the authority does not keep the statutory deadlines, against which there are no effective remedies available. As FDI screening is a condition precedent to closing, it is obvious that this kind of unpredictability is a highly undesirable factor in any transaction.

The evaluation criteria set out in both regimes are quite vague (e.g. "the transaction endangers or threatens to endanger the national interest, public order, public security of Hungary"), and give the possibility for discretionary decisions, when the decision on the acknowledgement of a certain transaction is made. The outcome of an FDI process cannot be predicted with a 100% certainty. A good example for such unforeseeable decision (and for the unpredictability of Hungarian FDI legislation) is the refusal to acknowledge the acquisition of insurer Aegon's Hungarian business by Austrian insurer VIG - in that particular case the applicable FDI rules were amended (insurance services have been added to the affected sectors) before the transaction could close. That decision has been challenged and the European Commission has opened an investigation into a possible violation of the European Union's merger regulation with regard to the veto of the acquisition. EC said it has "sole jurisdiction to examine concentrations with a Union dimension" under Article 21 of the EU merger regulation.

Ways of avoiding FDI screening

In the context of all of the above, the lengthy process and associated great uncertainty are to be avoided if at all possible. The relevant regulations are broadly drafted and consequently catch a wide range of market participants and sectors and the opportunities to avoid being obliged to make necessary filings are limited. However some opportunities arise, for example

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- potential structuring of the transaction to avoid the effects of the new FDI regime by making the transaction indirect; or
- in some cases some adjustment can be made to the registered activities of the target company. In some cases a wide list of activities is registered although the actually performed activities may be narrower. Such a formal change will not achieve the goal, however, if the substantive operations of the target are within the restricted sectors.

If the initial analysis gives rise to the need for filings to be made, our experience indicates that the process can be expedited if the filings are well prepared, address likely questions and appropriate communications and lobbying with relevant authorities are undertaken.

WHO TO CONTACT?

We see in our practice that Hungarian FDI rules concern many transactions and potentially have major impact on investors and on their planned transactions.

If your business may also be affected by the above FDI regimes, please do not hesitate to contact any member of our team:

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We at Lakatos, Köves & Partners will be producing Updates to our COVID19 Newsletters as the situation develops. If you would like to receive those Updates please write to us at subscribe@lakatoskoves.hu and we will send you Updates as they are issued.

Annex - List of sectors and activities

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