

Transaction Liability Insurance is More Popular than Ever in Hungary

Due to investors' reluctance to take on the risk of liability allocation during property acquisitions in Hungary, transaction liability insurance has become a valuable tool for deal facilitation for both sellers and buyers on the real estate market.

Right after its introduction to the market a couple of decades ago, American and Israeli investors were the first to demand the use of transaction insurance when acquiring real properties in Hungary. In the past few years even domestic inventors and financial institutions have started requiring it for the coverage of inherent transaction risks that neither of the parties is willing to assume. Just about half of all real estate transactions with a value over EUR 10 million now involve transaction insurance.

As the market evolves, **warranty and indemnity insurance** seems to be the most popular type of transaction liability insurance.

What does it cover?

The aim of warranty and indemnity insurance is to cover financial loss or liability arising from a breach of a seller's warranty and from claims under the seller's indemnification covenants.

Warranty is a commonly known institution under Hungarian law. If a warranty declaration is breached by the seller, the onus is on the buyer to prove the seller has committed a breach and then the seller is required to compensate the Buyer for the damage or loss the buyer suffered (i.e. the decrease in the value of the property) as a result of the breach.

Under Hungarian law, however, indemnity means an objective obligation to indemnify the injured party. In real estate transactions indemnities are usually provided by the seller as coverage for losses potentially caused by a specific event or predetermined risk. The due diligence phase of a transaction is where potential risks can in particular be revealed. Under the Seller's indemnification obligation, if a specific event or risk occurs, the Seller is obliged to make the Buyer whole for all the financial consequences of such a risk event.

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Why is it beneficial?

The warranties and indemnities section of a sale and purchase agreement is usually the most heavily negotiated and contentious part of the whole transaction, often because of the different indemnification and warranty expectations and the widely differing requirements of limitations by the buyer and the seller. With warranty and indemnity insurance, the parties may bridge such differences and get security for otherwise uninsured risks.

Besides de-risking transactions by transferring deal risk to the insurance market, a warranty and indemnity insurance may also enable a clean exit for the seller and allows distressed or dissolving sellers to sell a business.

Which party should take it out?

Most commonly the buyer takes out the warranty and indemnity insurance policy and becomes the insured party. In this case if a breach occurs, the buyer can directly make a claim to the insurer under the policy for the amount to which it is contractually entitled under the sale and purchase agreement (subject to any policy exclusions). The advantage of this solution is that the insurer directly pays the amount to the buyer, without needing any contribution to the process from the seller.

On the other hand, it is also possible that the seller is the policyholder under a warranty and indemnity insurance policy. In this scenario, the seller seeks coverage for the buyer's claims arising from the seller's breach of its own warranties or indemnities. In this case the warranty and indemnity insurance is rather similar to liability insurance. If the claim is reported by the seller to the insurer, the insurer pays the relevant amount to it and it is then liable towards the buyer for the buyer's warranty or indemnity claims. In such a situation it is also possible that the buyer does not even know about the existence of the insurance.

Who is liable for the costs of the insurance?

Regardless of whether the buyer or the seller takes out the insurance, typically the seller covers all (or most) of the insurance costs (i.e. the premium). The insurance premium is usually calculated as a percentage of the total limit of insurance coverage and generally varies from 0.8 to 1.5% of the total sum insured. If the buyer is the insured party, the costs of the policy are usually covered by a reduction in the purchase price. The characteristics of the warranties, indemnities and limitations, the industry sector, the geographic risks, and the identity and creditworthiness of the



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parties can each have a serious impact on the amount of the premium.

What are the likely risks that will be excluded from policies?

In many cases, insurers include certain exclusions in their policies that limit the scope of the insurance. These exclusions may be included for example because the insurer finds that the due diligence review of the target has not been comprehensive, or the issues raised in it have not been completely resolved. In addition, insurers tend to exclude coverage for certain issues, such as bribery and corruption, certain environmental matters, certain regulatory issues and financial warranties and certain tax risks, such as those resulting from transfer pricing arrangements.

Under what jurisdiction can insurance be taken out?

Warranty and indemnity insurance products are mostly offered in Hungary by foreign insurers (mainly entities incorporated in the United Kingdom). Logically, these insurers tend to insist on using the laws of England and Wales when issuing their policies. However, in the past few years – due to increased competition – some insurers have started to offer policies under Hungarian law for the Hungarian market, which has

also contributed to the rapid spread of warranty and indemnity insurance arrangements. In Hungary all real estate sale and purchase agreements must be concluded under Hungarian law, an insurance policy governed by the laws of Hungary can be easily “paired” with the sale and purchase agreement and can significantly decrease the risks and costs of possible claim enforcement under the insurance contract.

The increasing number of real estate transactions in Hungary has also significantly driven up demand for this multi-use transaction instrument, which has mainly gained popularity thanks to its power to close the gap between the transactional interests of the buyer and the seller. Recent trends in Hungary show that requests for title policies covering “unknown” title risks have decreased while demand for specific or “known” risks arising from not fully comprehensive due diligence reviews have vastly increased. As things presently stand, this trend is likely to continue and the popularity of warranty and indemnity insurance will only grow on the real estate market.

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