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# *Strengthening the Small and Medium Enterprise Sector by Switching to Bills and Notes*

**SUMMARY:** The proposal to switch to bills and notes might be shocking. The fact that Act CLXXXV of 2017 on the Regulations for Bills of Exchange and Promissory Notes entered into effect in Hungary on 1 January 2018 in order to enforce the uniform regulations pertaining to the legislation on bills of exchange and promissory notes, yet we still cannot talk about the issuance and use of bills and notes, is just as odd. In our study, we argue that in the absence of other short-term corporate securities, bills and notes could help the liquidity management of SMEs owing to their elaborated legal background. We briefly present the importance of corporate securities in the financing of companies both on domestic and international level, as well as the evolution of financial services related to bills and notes in the mirror of the statistics of the Hungarian supervisory authority, and we also provide possible ways for developing the financial services related to bills and notes. We review the previous and current Hungarian legal-regulatory environment of bills and notes and then summarise the arguments for their use in Hungary.<sup>1</sup>

**KEYWORDS:** bills of exchange, promissory note, securities market, SME, fintech, payment services

**JEL CODE:** G20

**DOI:** [https://doi.org/10.35551/PFQ\\_2020\\_3\\_6](https://doi.org/10.35551/PFQ_2020_3_6)

Only traces of the previously successful legal instrument forming part of law and economy courses (and, thus, considered to be known) can be found in Hungary today, at the same time, the financial information-technology changes that took place in recent years may substantiate the issuance and use of bills of exchange and promissory notes again. Therefore, we are looking for the method of using bills and notes that can be brought back in order to strengthen and improve the crisis-resistance of the Hungarian economy, and,

especially the Hungarian small and medium enterprises sector. This paper presents the possibility and advantages of the distribution of bills of exchange and promissory notes in addition along with to the banking sector. There are several simultaneous phenomena in today's financial-regulatory environment that make us say that the renaissance of bills and notes has arrived (Dagonya, 2012).

First, we present these constellations, by also indicating their possible role in financing the corporate, and, especially, the small and medium enterprise sector. The paper reviews the opportunities of the new act on bills of exchange, promissory notes and financial

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digitalization, analyses the decline of the use of bills and notes amongst the domestic financial market intermediaries, and presents some international examples of their use. By evaluating the antecedents and main characteristics of Hungarian legislation, our study argues that by revivifying the distribution of bills of exchange and promissory notes, the dependence of our national economy on foreign markets may be reduced.

### CHANGES PROMOTING THE REINVIGORATION OF THE USE OF BILLS AND NOTES

The new act on bills and notes, the so-called Act CLXXXV of 2017 on the Regulations for Bills of Exchange and Promissory Notes, which had earned the agreement of the Hungarian Banking Association, (Banking Association, 2018-17), was made for the purpose of enforcing the uniform Hungarian legislation pertaining to bills and notes. According to this act, banks are not dominant participants in the distribution of bills and notes, as the word 'bank' only occurs once in its text, in the compound word 'bank interest rate'. According to *Dagonya*, lawyer specialised in EU law: '*bills and notes are simple, they have hardly any costs, no attorneys, banks or notaries are necessary for their issuance*' (Dagonya, 2012-2). This is particularly true because looking at the genealogy of banknotes, the use of bills and notes precedes the development of the banknotes chronologically (Spufford, 2007). Banknotes were created based on the use of bills and notes on the basis of the customary law applied at the time, as promissory notes. Based on all of this, our allegation is substantiated: the revival of the use of bills of exchange and promissory notes and the issuance of bills and notes can be implemented without the intermediation of banks.

The information technology changes that have taken place in the field of payment settlement and payment services in the past few years allow economic operators to reinforce the settlement-type relationships existing between them. The financial services will become quicker and cheaper in a digitalized form. The transparency of economic relations and the continuous monitoring of participants has become natural. *Lemák* explains how the banks lost their digital competitive advantage against the so-called FINTECH companies (startups providing financial services) (Lemák, 2016). This results in a two-fold conclusion: on the one hand, the motors of reviving the distribution of bills and notes are the non-banking financial service providers, and it must be primarily digital-based, on the other hand. These two characteristics, however, allow the strengthening of the liquidity of the small and medium enterprise sector (always having a disadvantage in bank financing), and they make it possible for the entire sector to become self-financing to a certain extent.

Directive (EU) 2015/2366 of the European Parliament and of the Council on payment services in the internal market adopted in 2015, the so-called PSD2 (Payment Service Directive 2) also promotes digital payment services, and it also supports the entrance of new service providers into the financial markets. This directive, despite its primary objective, reinforces the usability of bills and notes by promoting digitalization and the entrance of new participants. At the same time, Section 22 of the directive (Page 39 of the cited work) sets out that the new rules are not applicable where '*...the transfer is based on a paper cheque, paper-based bill of exchange, promissory note or other instrument, paper-based vouchers or cards ...*'. This means that the directive implicitly leads us towards electronic bills and notes.

Hungary adopted PSD2 into Hungarian

legislation with Act CXLV of 2017, which paved the way for account information (*AISP*) and payment initiation (*PISP*) service providers as third party service providers, and so the exclusive role of banks shrunk further. The question is to what extent will the new participants want to and to what extent can they include the electronic bills and notes<sup>2</sup> in their portfolios after the launch in mid-September 2019.

Out of the Central Bank of Hungary's competitiveness programme (MNB, 2019a), we consider the sections focusing on the development of a reversed suretyship programme, the promotion of the establishment of a modern corporate bond market, and on launching a specialised trading platform tailored for SMEs are worth our attention in terms of the future possibilities of the application of bills and notes in Hungary. The supporting circumstances also include the due introduction of instant payments, as this can also be regarded as a preparation for the issuance and use of bills and notes. In the followings, we will review the financial services that can be observed in relation to bills and notes in the Hungarian financial sector today.

### CURRENT MAZES ASSOCIATED WITH THE USE OF BILLS OF EXCHANGE AND PROMISSORY NOTES

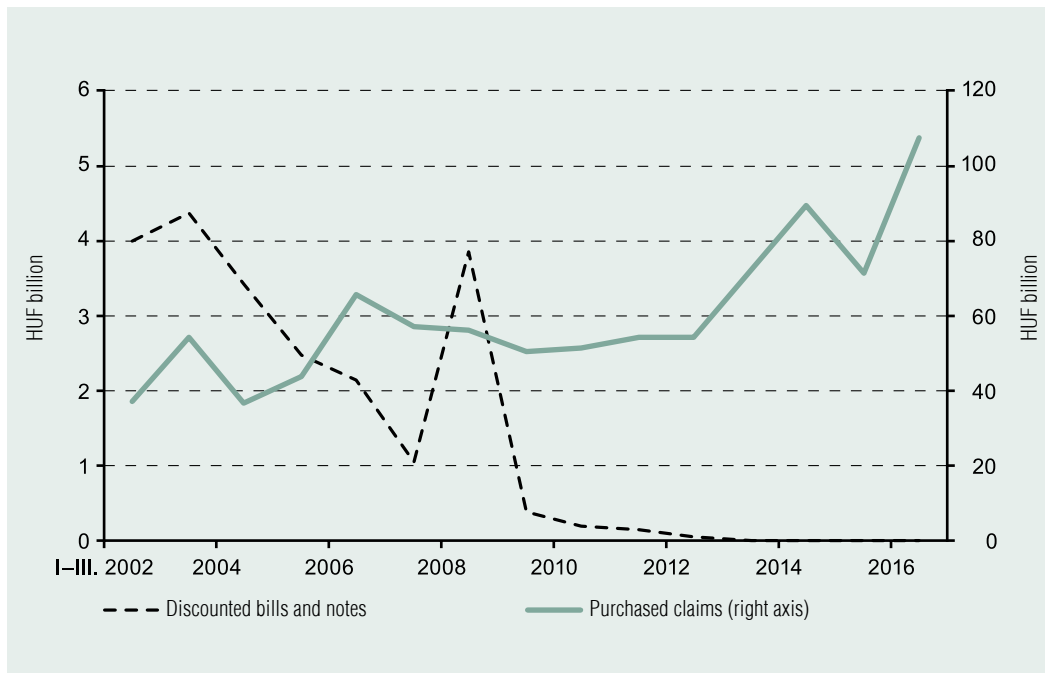
No data can be found in the securities statistics published by the Central Bank of Hungary in terms of the use of bills and notes in Hungary, since full coverage cannot be ensured in the framework of data supply (MNB, 2019b). In contrast, prior to the introduction of IFRS, the operations of credit institutions related to bills and notes appeared in the balance sheet statistics of the supervisory authority, and so it can be tracked how the discounting of bills and notes was replaced by factoring in the

lending activities of financial corporations. Both financial services qualify as a credit-like allocation, as in this case, the credit institution does not provide the loan to its client directly, but to a third party indirectly by purchasing the claim. Based on the credit institution data available from 2002 (*Figure 1*), it can be concluded definitively that the role of discounting bills and notes has been completely taken over by factoring today, which can be observed in the balance sheet of banks in an increasing volume. (The volumes can only be compared until 2016, as the balance sheet of credit institutions applying IFRS no longer contains the active-side operations in such a detailed manner so as to allow the transactions related to factoring and bills and notes to be quantified.)

The transactions related to bills, notes and the assignment of claims are also available in the balance sheet statistics of financial enterprises prepared by the supervisory institution, in this case, the transition to IFRS did not take place, and so the data are available up to 2018 (although in this case, comparable statistics are only available from 2004). Tendencies observed in the case of credit institutions can be shown in the case of financial enterprises, too. The volume of discounted bills and notes shrunk to zero by 2012, while the volume of factoring transactions increased until 2015, with a slight decrease from 2016 (*Figure 2*). We do not find statistics in terms of pre-2012 factoring that would allow comparison with the current data, and so in that case, the transition from transactions of bills of exchange to those of factoring can only be presumed, but not established. In addition, the balance sheet of financial enterprises also tells us that bills and notes have not been erased from domestic financial markets completely, as, even if in a continuously decreasing manner, the guarantee of payment of a debt by bills and notes is still used today. These transactions,

Figure 1

**THE VOLUME OF BILLS AND NOTES AND CLAIMS PURCHASED BY CREDIT INSTITUTIONS FROM NON-FINANCIAL CORPORATIONS**



*Comment:* The data are only available until 2016, as the balance sheet statistics of the supervisory institution only contain the data of the entire credit institution sector until such date pursuant to Hungarian accounting laws. The volume of purchased claims also includes maturities over five years, and so it does not only cover factoring transactions.

*Source:* Central Bank of Hungary, supervisory time series, end-of-the-year data, authors' own compilation

contrary to the statistics of credit institutions, are not necessarily limited to the corporate sector, as the balance sheets of non-financial enterprises are not broken down by sector.

For the international review of transactions of bills and notes, we do not find data detailed at least to the level of detailedness of Hungarian data. Bills and notes are usually accounted in bank balance sheet statistics and securities statistics amongst the debt instruments merged with other items. After the examination of the financial sector, in the next chapter, we will take a look at the financing structure of the other side, the side of producer and service provider enterprises.

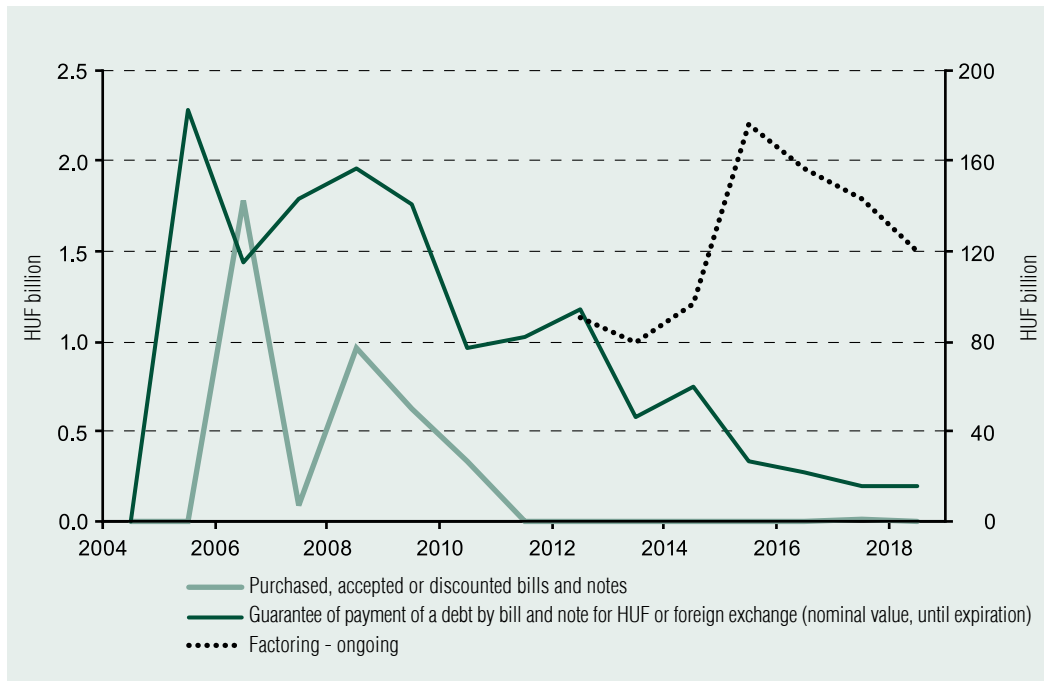
**THE ROLE OF SECURITIES AND THE FINANCING STRUCTURE OF HUNGARIAN ENTERPRISES**

The dominance of two resource types can be observed in the financing of Hungarian non-financial enterprises.

Above all, the preponderance of equity-type resources is typical. The largest companies – the subsidiaries of multinational corporations – are typically owned by foreign entities, and so the credits received from the parent company and foreign banks plays a large role in their financing (Stachó, 2005). Within the loans taken out by non-financial enterprises

Figure 2

**THE SERVICES OF FINANCIAL ENTERPRISES RELATED TO BILLS AND NOTES AND THEIR ONGOING FACTORING TRANSACTIONS**



Comment: The data are not limited to the transactions against non-financial enterprises

Source: Central Bank of Hungary, supervisory time series, end-of-the-year data, authors' own compilation

in 2018 – forming approximately 25% of the total debts – the volume of foreign loans is 50%, and the other half of the debt volume is divided between banks and partner companies at approximately the same ratio.

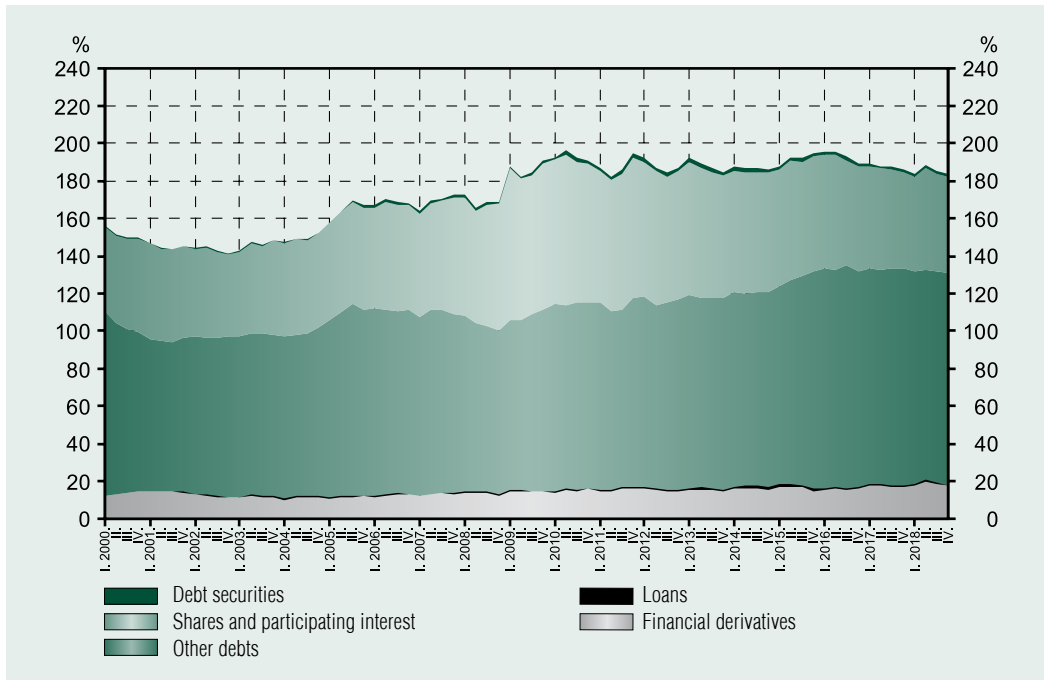
Debt securities give less than 1% of total debts. This can be explained by the fact that as a result of the dominant role of foreign ownership in the Hungarian corporate sphere and the traditional predominance of bank financing, a significant corporate bond market has not been established in Hungary. The bond volume of non-financial enterprises currently reaches 1.5% of GDP, but it has typically not exceeded 2% of GDP in the past ten years (Figure 3). Issuing forint-based bonds was not remunerative for years owing

to the higher levels of interest rates, therefore, domestic multinational companies obtained resources rather in euro or dollar on foreign securities markets, this way enjoying the advantages provided by the credit rating of the parent company. The resources acquired in said manner are passed on within the group (Stachó, 2005).

The domestic SME sector has less access to foreign resources, and so it needs bank loans in excess of the equity-type financing. Liquidity acquisition implemented through the claims assigned in the framework of factoring and the acquisition of assets under leasing schemes is becoming more and more significant amongst SMEs (Baranyi, 2017). In addition to the balance sheet data of credit institutions and

Figure 3

**THE CHANGING DEBT VOLUME OF NON-FINANCIAL ENTERPRISES AS A PERCENTAGE OF GDP (CONSOLIDATED VOLUMES)**



Source: Central Bank of Hungary

financial enterprises indicated before (See Figure 1-2), the expansion of factoring in the financing of the corporate sector is further supported by the analyses of the Hungarian Factoring Association. The former pinpoint the contradictions of the favourable tendencies at the same time.

The factoring turnover essentially stagnating between 2009 and 2013 (the period following the crisis) was followed by a dynamic period that started in 2014 and is still ongoing today, with an approximately (gross) 25% annual increase. The volume of financing also grew significantly (MFSZ, 2016; MFSZ, 2018; Péntech, 2019), while the banking sector was becoming more and more dominant amongst service providers. This resulted in a 5% increase in the factoring penetration of Hungary (i.e. the ratio of annual

factoring turnover compared to GDP). With this, the penetration of factoring in Hungary approached the 8% average of developed EU countries (and the 10-15% value in the largest economies).

In the past years, however, the expansion of factored turnover did not mean an additional possibility for liquidity expressly for the SME sector, as it has become much more popular amongst big corporations. The total share of micro, small and medium enterprises from the entire factoring turnover decreased from the 70% value in 2013 to 43% by 2017 and it increased once again in 2018 over 50%. While in the European countries with more than half of the world's turnover, it is specifically the SME sector that enjoys the fruits of factoring the most (MFSZ, 2018).

Short-term schemes are completely absent from the Hungarian corporate bond market, while commercial papers are wide-spread both in the eurozone and the United States of America. Currently, the bonds of one energy and one real estate development company are traded on the Budapest Stock Exchange, the remaining corporate bonds have been issued by financial institutions. The Central Bank of Hungary announced its Funding for Growth Scheme in 2019 for stimulating the corporate bond market. In the framework of this, the Central Bank of Hungary purchases bonds issued by corporations and securities created through the securitization of loans outstanding against corporations (MNB, 2019c).

The success of this scheme may allow and must allow the boosting of corporate bond markets in order to move forward, which could serve as a partial alternative to our corporate financing system built on bank loans. The financing of small and medium enterprises still needs the support of the central bank and state-owned credit institutions without the issuance and use of bills and notes and in spite of the more viable bond market. The boosting of the distribution of bills and notes and the reinforcement of their regulatory environment will serve the sustainability of the Bond Funding for Growth Scheme and overcoming any shortage of money resulting from a potential crisis starting organically from the SME sector. The next chapter will emphasize the significance of corporate bond markets meaning the support of current assets and longer term financing through international examples.

## THE ROLE OF CORPORATE BOND MARKET IN INTERNATIONAL EXAMPLES

The development of corporate bonds also has an invigorating effect on economic growth,

which carries out its effects through three channels according to *de Bondt* (2003):

- it stabilises the corporations' collection of resources through providing external funding possibilities outside the bank system to companies,
- it allows the reallocation of resources between sectors and companies having plenty of funds but decreasing economically and the ones on the rise,
- it can improve corporate governance and the market of corporate control, as it frees companies from bank funding, and thus allows corporate credit rating for a wide scope of market participants.

The corporate bond market can replace bank financing well during the time of restrictions in monetary policy, or if the companies operate in a weak profit cycle. It can demonstrably trigger production (the 'income elasticity' of short-term securities is especially significant) and it can serve as an appropriate resource for financing corporate mergers and acquisitions.

In the case of corporate debt instruments, collateral is not needed by all means as opposed to bank loans, as in this case, the company's own assets serve as the coverage. Their market builds on a more diversified investment base as opposed to bank loans, as institutional investors, other companies and even households can participate in their trade. Proper liquidity may reduce the interest rates through the spreading of risks and it can help improving the shock tolerance of the financial system. The example of developing countries should be mentioned here, from the period of the financial crises of the 1990s, amongst others (MNB, 2019d).

Out of the international corporate bond markets, that of the United States already stood out in the '90s. The introduction of the euro gave a new impetus to corporate bond markets in the eurozone, as well. While in 1999, the volume of corporate bonds of the

USA and Japan gave approx. 10% of the total liabilities, in the eurozone, this only amounted to 3%, which increased to 7% within two years, by 2001 (de Bondt, 2003).

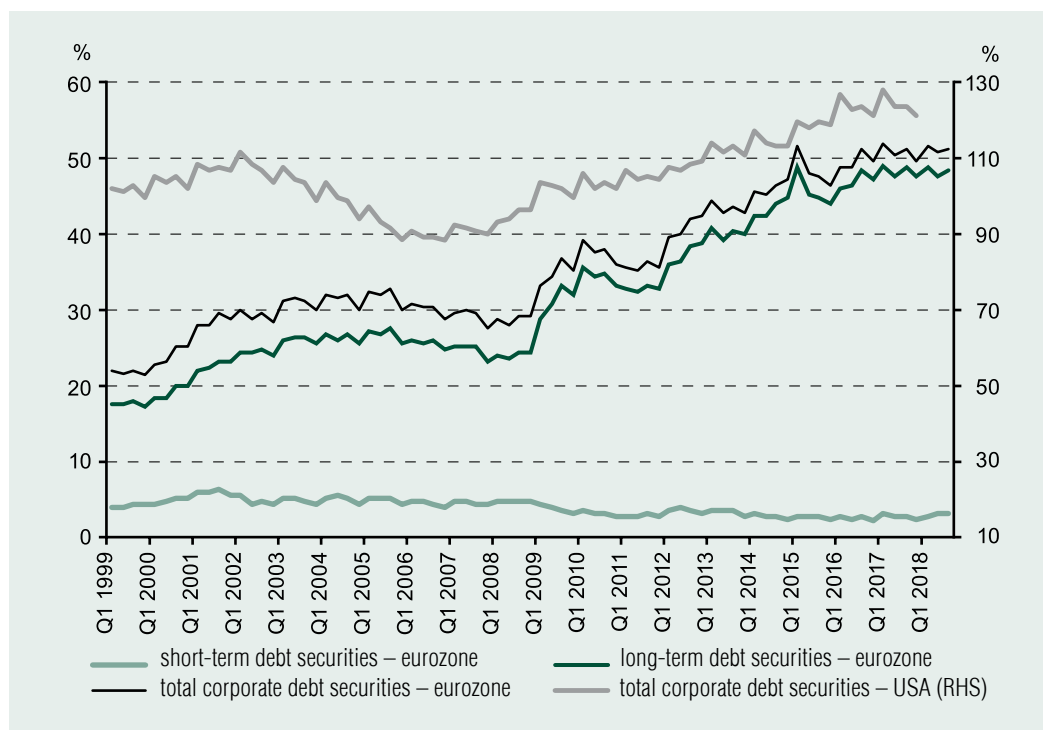
After the global crisis in 2007-2008, the non-financial corporate bond market of the eurozone gained new momentum, which was quite spectacular: the corporate bond market of non-financial companies showed a more rapid growth than that of the financial companies, indicating tendencies contrary to the previous ones. This was presumably a consequence of the turbulent economic relations. As a result of the balance sheet unwinding of credit

institutions, bank lending was in part replaced by the bond market, and the interest premia of corporate bonds decreased significantly. In certain cases, they dropped below the interest premia of state bonds, thus the preferences of investors shifted to the corporate segments in part, while the corporate managers more and more started to turn to the capital markets (Kaya-Meyer, 2013).

The GDP-proportionate data of *Figure 4* demonstrate the rise of the bond market in the eurozone in terms of the long-term segment well. The processes that occurred during the crisis in 2007-2008 and the subsequent

Figure 4

**THE VOLUME OF BONDS OF THE NON-FINANCIAL CORPORATE SECTOR IN GDP PERCENTAGE IN 19 COUNTRIES OF THE EUROZONE AND THE USA**



*Comment:* quarterly data series not adjusted seasonally, based on the time series available until 2017 Q3 in the case of the USA, which does not include a short and long term breakdown

*Source:* ECB, Fed, the authors' own compilation



sovereign debt crisis also exemplify well the anticyclic impact of the corporate bond market, and the stabilising effect of the same on the entire economy.

We cannot find time series in international statistics in terms of the turnover of bills and notes out of debt instruments separately, presumably as a result of the difficulties in reviewing them also referenced by the Central Bank of Hungary.

Besides, in developed economies, this security that has been used since the Middle Ages is still considered an important instrument today in corporate resource collection, with special regard to the SME sector and rural companies (Geiseler, 1999; Hügelow, 2006).

After our macroeconomic conclusions, the next chapter will review the most important advantages of bills of exchange and promissory notes from the point of this paper. We are convinced that in addition to the financial-instrumental conditions, the revitalisation of the issuance and use of bills and notes must also be supported through the enforcement of the legal framework.

## THE ADVANTAGES OF THE DISTRIBUTION OF BILLS OF EXCHANGE AND PROMISSORY NOTES FOR CONCERNED PARTIES

Bills of exchange and promissory notes are payment promises supplied with specified requisites that must be managed as securities, with the basic quality that they break away from the underlying primary legal relationship. The claim can be enforced more quickly and effectively compared to the loan recovery process.

The law assists the payee of the bill or note with several court rules in enforcing its claim. In addition to the fact of priority, the duration

of the action, the deadline for lodging appeals, the periods between the different hearing dates are much shorter than in other cases. If the court orders for the payment of money, the performance deadline can be maximum three days. On top of it all, the payee of the bill or note fulfils its obligation to provide evidence by attaching the bill or note, and the burden of proof is passed on to the drawer of the bill or note, should the drawer deny the existence of an outstanding claim.

Bills of exchange and promissory notes are multifunctional financial instruments (Madarassy, 2015).

**AS A DEBT INSTRUMENT** (1), the drawer agrees to fulfil its obligation at a later date, and the drawee provides a payment extension for the payment of the service provided by the same.

**AS A GUARANTEE** (2), the strict laws on bills and notes allows the quick and simple collection of claims without the costs of drafting a notarial deed on the one hand, and the debtor does not need to register a lien for any property item on the other hand.

**BILLS AND NOTES ARE ALSO INVESTMENT INSTRUMENTS** (3), as they can be transferred and can be purchased by anyone, provided that the drawer of the bill or note has not precluded the possibility of transferring.

**AS A PAYMENT INSTRUMENT** (4), bills and notes are primarily useful for small and medium enterprises: in the case of economic recession and lack of liquidity, they serve the prevention of chains of debts among companies.

International examples show its important role in export financing. (In Hungary, the use of bills and notes sustained on this field for the longest time, too, in the years of Socialism.) Payment with bills and notes are many times incited by state guarantees in international transactions. A good example for this is the work of the state-supported organisations stimulating the internationalisation of the export activity of companies, for example

EKN (Exportkreditnämnden) in Sweden and Finnvera in Finland, as export credit agencies.

In order to sustain the issuance and use of bills and notes, financial organisations that carry out discounting are needed, which are not necessarily banks. These organisations ensure that the owner of the bill or note, if it cannot wait for the maturity, can get to liquid funds at any time in exchange for the claim.

In certain emerging and developing countries, non-banking companies also deal with the discounting of bills and notes, this way trying to provide resources to local companies, usually in rural areas. They consider bills and notes important financial instruments that help the acceleration of cash movement, free funds for the purpose of current asset investments and help grease business financing and the fulfilment of other obligations in general (Mahindra Finance, 2019).

In addition to the existence of the financial institution network carrying out the discounting of bills and notes, the network of legal institutions ensuring the rapid and effective enforcement of bills and notes is also important. The next chapter will review said network.

## LEGAL REGULARITY OF BILLS OF EXCHANGE AND PROMISSORY NOTES

The development and adoption of modern economic and financial regulations are indispensable for the safety and predictability of turnover for a developed market economy. In the course of this, it is also an issue of competitiveness that the rules must adjust to international trends, and a legal environment that complies with domestic economic relations which is appropriate for SMEs, too, must be established.

The success of a legal institution, or, more specifically, a commercial security or cash

equivalent does not only mean the adaptation of business practices, but depends greatly on the intention of the legislator, too. Regulation achieves the desired effect if it adjusts to social and economic conditions, takes into consideration the needs of economic operators, thus creating the necessary substantial and procedural guarantees. In the case of bills of exchange and promissory notes, additional buzzwords include simplicity and quickness.

Hungarian legislation on bills and notes has long traditions, out of which Act XV of 1840 adopted in the Reform Era and Act XXVII of 1876 adopted in the era of Dualism are worth mentioning, as they proved to be successful since the economic actors soon realized the significance of bills and notes, and the volume of acceptance credits increased dynamically (Eckhart, 1941; Babják, 2007a). For the sake of international harmonisation of laws, three international treaties on bills and notes were adopted in Geneva in 1930, which also allowed certain deviations and the creation of national regulations. Decree Law No. 1 of 1965 (Decree Law on Bills of Exchange and Promissory Notes) announced the treaties with mechanic translation. The Central Bank of Hungary promoted the establishment of the favourable rediscounting conditions of bills and notes in the 1990s (Antal, 1989; MNB, 1989). Many people saw it as a new possibility for the corporate sector to acquire loans (Béda, 1992). In certain sectors it also played a role following the 2000s, for example in financing agricultural companies as the guarantee of the so-called integration contracts (Nagy, 2015; Varga-Sipiczki, 2015).

Legislature took the regulation of bills and notes back on the agenda a few years ago. For the uniform domestic regulation of the law pertaining to bills and notes, the Parliament created Act CLXXXV of 2017 (the Act on Bills of Exchange and Promissory Notes) by consolidating the Decree Law on Bills

of Exchange and Promissory Notes and the supplementing rules applicable in Hungary, which preserves the logic of the Decree Law on Bills of Exchange and Promissory Notes of 1965, it also keeps the numbers of its parts, chapters and sections, and the text of the first, second and fourth part is identical to that of Appendix 1 and Articles 2-9 of Appendix 2 of the Decree Law on Bills of Exchange and Promissory Notes (Ministry of Justice, 2017). The rules of the related Decree of the Minister of Justice No. 1/1965. (I. 24.) were incorporated into the act and the decree was repealed effective as of January 1, 2018. The Act on Bills of Exchange and Promissory Notes contains the substantive and procedural rules at the same time. The national character of the regulation does not deviate from the Geneva treaties, as they only set forth the most important substantive provisions of the law on bills and notes, and hardly any procedural rules. All of this shows that the creation of a modern law on bills and notes adjusted to the needs of

business life is also important for legislature, which could bring new opportunities for the SME sector, as well.

In business, bills of exchange are used typically, which means that the drawer designates a third party obligor (drawee), usually a credit institution, to pay the amount specified upon the order of the obligee (payee). The regulation is simplified by the fact that the provisions applicable to bills of exchange must be applied to promissory notes, too. The payment and settlement relationships based on bills and notes between companies is simplified and made cheaper by the fact that the issuance of bills and notes is not subject to any formalities: no attorney, counsel or notary public is required, the existence of the requisites of the bills and notes are sufficient in themselves. Resulting from its security nature, the transfer of bills and notes is fast and simple, and another advantage is that the holder of the bill or note and the chain between them does not require official registration.

Table 1

**THE REQUISITES OF BILLS OF EXCHANGE AND PROMISSORY NOTES**

Accessories	Bill of exchange	Promissory note
Name	The name of the bill or note in the text of the document, in the language the document has been issued in	
Subject	Unconditional order for the payment of the specified sum	Unconditional assumption of obligation for the payment of the specified sum
Drawee	The name of the person obliged to pay (drawee)	N/A
Date	The specification of the maturity	
Place of payment	Specification of the place of payment	
Payee	The name of the person to whose behalf the payment must be effected	
Issue date	The specification of the date and place of the issuance of the bill or note	
Signature	The signature of the drawer	The signature of the issuer

Source: Edited by the authors

Business relationships require flexible payment possibilities, therefore, bills and notes can be issued in accordance with the rules pertaining to setting the due date: at sight, at a fixed period after sight, at a fixed period after the date of drawing and on a fixed day. The versatility of the use of bills and notes in cash movement can help the liquidity of SMEs, thus, for instance, in the case of its transfer, the holder or the simple bearer of the same can present it until the end of its maturity to the drawee for acceptance. (The difference between holder and bearer is that the holder holds the bills of exchange with legal grounds, while the bearer holds it without legal grounds.) In addition to flexibility, the final deadline is also an important aspect for the appropriate short-term cash flow, for that reason, for example, the bill or note issued at sight must be presented for payment within one year from its issue date, but the drawer may also set a deadline shorter or longer than that. Cash movement discipline is strengthened by the fact that the holder of the bill or note issued on a fixed day and at a fixed period after sight must present the bill of exchange for payment on the payment date or on either of the two subsequent working days. A related matter is that if the bill or note is not presented for payment within the deadline, every debtor can deposit the amount of the bill or note at the risk and costs of the holder of the bill or note at the competent court. This way, the drawer's and drawee's side can also prove that it fulfilled its payment obligation in due time. Therefore, the bill or note helps to reduce or prevent the development of chain debts from both sides. The difficulties and costs arising from distance are reduced by the fact that as a main rule, the actions related to bills and notes must be carried out at the domestic registered office of the payee.

The special payment guarantees pertaining to bills and notes are important from the point of business and favourable from the point

of the payee company. The payment of the bill or note can be guaranteed by guarantee of payment of a debt by bill of exchange or promissory note either in part or in full. An advantage of this that can also be observed in the SME sector is that the guarantor's payment obligation is not even concerned (as it does not share the fate of the principal debtor) if the entity for whom it assumed the guarantee is dissolved without legal successor, and the bill or note issued prior to the bankruptcy proceeding does not form part of the estate subject to bankruptcy (Béda, 1992). The holder of the bill or note can enforce a claim for compensation against the issuer and the other drawers if

- its future bills receivables are jeopardised, because the bill or note has been dishonoured either in part or in full;
- if an insolvency proceeding or proceedings resulting in dissolution without legal successor is initiated against the drawee or the drawer; and if
- payment was not fulfilled upon maturity.

The situation of the payee company is further strengthened by the fact that the drawers, acceptors, indorsers and guarantors of the bill of exchange are held liable against the holder jointly and severally, regardless of the order of their commitment. For the sake of valorisation, not only the unaccepted or unpaid amounts and interests can be claimed, but also additional late payment interest, as well as the costs of protesting and notifications pursuant to *rigor cambialis*, as well as the 1% fee calculated based on the amount of the bill or note. The justification of dishonouring or acceptance is stricter in terms of form, as it must be done in the form of a notarial deed (protesting as a result of the absence of acceptance or payment) for easier verification. The protesting is recorded in both cases by a notary public (Havasi, 2012). The notarial deed form and the protesting as a result of

its easier enforceability may incite the earlier performance of the compensation obligation, and may serve as an appropriate means to avoid an action on bills or notes (Ministry of Justice, 2017). Mediation means that the drawer or either assignor or guarantor may designate a person who accepts or pays the bill or note if necessary. Consequently, the fulfilment of the payment obligation is also ensured in exceptional cases.

Legislature set a statute of limitations shorter than the average with regard to the safety of turnover and the payment discipline, therefore, every claim arising from the bill or note against the accepting entity will expire after 3 years from the due date of the bill or note, while the claims of the holder of the bill will expire after 1 year against the assignors and the drawer. However, the expiry of claims does not preclude the enforcement of the claim for compensation against the drawer or the assignor, on the legal ground of their unjust enrichment.

Any legal dispute arising from the use of bills or notes are generally settled via litigation, which falls into the competence of the regional court regardless of the value of the action, as bills and notes are special instruments the specific closed system of which requires special expertise (IM, 2017). In the actions based on bills or notes, the rules of civil procedure must be applied with the deviations set out in the act on bills of exchange and promissory notes.

For the sake of quickness, the court will handle the matters with priority, and the deadlines are also shorter. For example, any deadline set by the court may not exceed 30 days, the deadline for submitting the written statement of defence and the document containing setoff is 15 days, the period between trial dates is 8 days, and the deadline for setting the first trial date is 1 month. The quick administration would not be effective without the short deadline set out in the order,

therefore, the court sets a 3-day deadline for fulfilling the obligation ordered by the same. For the earliest effect and the acceleration of legal remedies, the appellate hearing date must be set so that it can be held within 1 month. The deadline for the petition for review and the approval of review is 30 days. No certificates justifying failure to meet the deadline will stay the proceeding.

For the sake of simplicity, the court is required to take into consideration *ex officio* if the requisites or the protest necessary for the claim for compensation is missing, setoff is precluded and/or not enforceable; and the complaint based on bills or notes cannot be joined up with a complaint that is not based on a bill or note, no interventions, joinder or counterclaims may be filed. A certified copy of the bill or note must be attached to the complaint, and later the court will call on the plaintiff to present the original bill or note at the hearing. Therefore, the payee must be in continuous possession of the bill or note physically during the enforcement of its claim via legal means, as it manifests the right and claim subject to the action; furthermore, it is only possible in this case that the bill or note is returned to the debtor of the same if the obligation is fulfilled so that it will not be exposed to the risk of multiple enforcements of the claim (Gárdos et al., 2019).

The current business practice has realized the applicability of bills and notes on some occasions, but the lack of experience can be sensed in some of the solutions. This way, for example, the support and project agreements set out that the beneficiary issues a promissory note at sight for the entire amount of the subsidy at latest upon the signing of the subsidy contract. This is good on the one hand, as it serves as a collateral for the sponsor to enforce its claim pertaining to the repayment of the subsidy in a quick and simple manner, yet it is not compatible with the true nature of

promissory notes to provide payment coverage for a potential violation. The banking practice includes the specific claim for compensation that if the bills or notes discounted with a recourse claim are not paid upon presentation, then the bank is entitled to recharge the amounts paid and the claims outstanding based on the recourse claim to the client who discounted the bill or note at the bank, and may enforce its claim based on bills or notes by applying an instant payment method against any bank accounts of the client insufficiently amongst the general terms and conditions applicable to retail clients. A shortcoming related to this provision is that pursuant to Section 44 of the Act on Bills of Exchange, the bank must certify the fact of acceptance or the denial of payment with a notarial deed, and, therefore, debt collection cannot take place automatically. In other cases, we meet such unfair contractual provisions when the bank is unilaterally entitled to recharge the bills of exchange discounted by the same to the client prior to maturity, if the bank obtains any information that the economic and legal standing of the client, or the drawees of the bills or notes or the indorsers of the bill or note has deteriorated to such extent that it jeopardises the payment of the obligation materially. The problem here is that the rights and obligations arising from the contract are determined by violating the requirement of good faith and fairness unilaterally and unreasonably to the detriment of the consumer, as the company is unilaterally entitled to interpret the provision of the contract [Subparagraph a) of Paragraph (1) of Section 6:104 of the Civil Code].

However, the safety of turnover is not only an economic aspect, but also an important social issue. For that reason, Act C of 2012 on the Criminal Code specifies as a separate criminal offence the following facts: forgery of cash equivalent payment instruments, abuse of cash equivalent payment instruments,

facilitating the forgery of cash equivalent payment instruments. The upper limit of the penalty – adjusted to the gravity of the criminal offence – is imprisonment for one, two or up to three years (Belovics, 2019). Therefore, the turnover of bills and notes are also protected through criminal law.

## ARGUMENTS FOR THE USE OF BILLS OF EXCHANGE AND PROMISSORY NOTES IN HUNGARY

Based on the foregoing, the arguments for the more intensive and renewed use of bills and notes in Hungary can be summarised as follows.

The sound legal framework already provides an appropriate background for the widespread use of bills and notes. In line with the act on bills of exchange and promissory notes, the act on notaries public and rules pertaining to the law for cheques were also amended.

Bills of exchange and promissory notes are principally one of the means of small and medium enterprise lending, which could help managing high levels of corporate chain debts. Its application would balance the swings of lending cycles.

The issuance of bills of exchange and promissory notes would indirectly support the financing of working capital. Its function as a contractual collateral should also not be disregarded, as it is much easier to transfer and to interpret than the independent liens.

Another advantage of the issuance and use of bills of exchange and promissory notes is that they would (could) contribute to the development of the short-term corporate debt securities market. This essentially does not exist in Hungary, as only the long-term or perpetual instruments have a market, which also provides an opportunity primarily for funding to financial companies.

The existence of an appropriate corporate bond market would replace lending built on bank intermediation in part and would improve the economy's shock tolerance. Currently in Hungary, the regional credit institution system does not exist or operates with insufficient efficiency, which plays an important role in the financing of local small and medium enterprises in many developed countries (for example, in Germany). Therefore, the issuance and use of bills and notes could mean a big step in the stimulation of local economy by all means. In addition to state guarantee institutions, a trust for a well-known, transferable short term instrument issued by companies could be developed that is completely missing from the Hungarian securities market at the moment.

We know from *Helmecci's* study presenting the money turnover map of Hungary (Helmecci, 2010) that half of all transfers comes from somewhere closer than 46 kilometres, and in 40% the sender and the recipient live in the same settlement. Economic relationships are in the first place strong and intensive between participants that are close to each other in space, and, according to Helmecci, with the increase of distance, the number of relationships decrease.

This link sets out the dimensions of the use of bills of exchange and promissory notes. By creating a supplementary opportunity to grow, it could contribute to sustainability and to the prevention of a crisis. The largest part of cash movement is local. This is what must be greased, made cheaper and even more entrepreneur-friendly. By transforming chains of debts into credit circles, the SME sector could become resilient and shock resistant. The retention force of the concentric economy can be increased with the issuance and use of bills of exchange and promissory notes.

Another argument for the use of bills and notes is concluded from the paper of *Kajdi,*

*Sin, Varga* from the beginning of 2019, in which it was demonstrated that the relative bank costs of the residents of North European or Scandinavian countries are the lowest. However, Western European bank clients must calculate with higher costs with higher variance. They are followed by Mediterranean countries and the cash movement costs of the Eastern European region. The relative costs of Hungarian clients, however, are even higher than the cost levels of other Eastern European countries. We think this is another reason why we have to look for a cheaper way of the distribution of funds.

## RECOMMENDATIONS

Based on said facts, the authors are convinced that a utility cut is needed in the field of payment services, as well. According to their proposal, local-level automatic clearing houses must be established for the purpose of the distribution of bills of exchange and promissory notes. The guarantee organisations also included amongst the competitiveness points of the Central Bank of Hungary (which could be established independently from the commercial banks as capital funds under the supervision of the MNB) could also function as institutions discounting bills and notes.

The revitalisation of the use bills and notes should take place instantly and immediately in the form of an e-bill, based on the strengthening and increase of cash flow. The legal basis for this is that neither the Geneva treaties on bills of exchange and promissory notes nor the Hungarian laws specify the mandatory paper-based form, but list the mandatory content elements (requisites of bills and notes). The settlement possibilities in addition to or outside of bank systems could also be guaranteed by the creation of the new type of financial enterprise intermediating

the same. The system must combine the bank account system related to dematerialised securities with an interface where the e-bills and notes can be issued easily, in a manner fulfilling all formal requirements. Electronic signature also means adequate guarantee. Initially, a starting point may be the state-recognised e-invoice issuing program or the electronic payment orders. The institution of the payment order is already similar to that of bills and notes, as it significantly accelerates the enforcement of claims. The system does not affect the marketability and transferability of bills and notes, only the possibility of the empty indorsement is not applicable. However, in court proceedings, the evidentiary phase will be accelerated significantly.

The quick and simple proceeding, however, is only one important element of the enforcement of the claim. We consider the reinforcement of the severity of the payment

obligation assumed in bills and notes to be very important, too, which could be facilitated with the legal means related to the enforcement of the claim before courts. A solution for this could be provided by the provision of a guarantee of the same extent as the claim by the drawer (defendant) in the action. This would significantly facilitate not only the enforcement of the claim before courts, but the actual execution of the same, too.

Naturally, in addition to the foregoing, the privileged quality of bills and notes, as debt instruments and the quick and even quicker performance of legal remedy proceedings (presuming a digitized bureaucracy) must also be enforced.

Let's put the fire extinguishers and life belts in place before the crisis! And let's utilize the growth of the SME sector that can be induced by the mechanism of bills of exchange and promissory notes.

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#### NOTES

<sup>1</sup> The authors thank Dr. Géza Szathmáry, lawyer specialised in international law for his valuable advice.

<sup>2</sup> The opening of the APIs providing payment account access will be commenced at such time for new (account information and payment initiation) service providers.

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