

Legal update

September 2016

Weinhold Legal

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The information in this newsletter is correct to the best of our knowledge and belief at the time of going to press. Specific advice should be sought, however, before investment and other decisions are made.

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Legislative Changes

Adoption of a new Consumer Credit Act

A new Consumer Credit Act (addressed in detail in January's Legal Update) was promulgated in the Collection of Laws under No. 257/2016 Coll. on 5 August 2016 and enters into effect on 1 December 2016. The Consumer Credit Act follows up Commission Delegated Regulation (EU) No. 1125/2014 of 18 September 2014, implementing the applicable European Parliament directives.

The law is designed to considerably strengthen the position of consumers on the financial market and bring greater transparency to the credit market. The law, imposing stricter requirements on the credit business for non-bank entities, applies to consumer credit of up to CZK 5,000 (microloans). The legislators intend this law to coordinate the granting of authorization for the respective activities and Czech National Bank oversight. Credit providers must duly assess whether the consumer is able to repay credit, otherwise the contract between the credit provider and consumer will be deemed invalid from the moment it is made and the consumer will only be obliged to repay the principal to the credit provider, assuming the consumer invokes contract invalidity within the 3-year limitation period that begins upon contract execution. The aggregate maximum of all contractual fines may not exceed 50% of the total amount of the consumer credit (as opposed to the originally proposed 70%).

Under the new law's transitory provisions, rights and obligations ensuing from a consumer credit contract executed prior to the law's effective date shall be governed by the current legislation. However, the new law provides for the subordination of rights and obligations ensuing from such contracts to the new law as of its effective date. The Czech Trade Inspectorate shall oversee entities authorized to provide and broker consumer credit on the basis of a trade license prior to the law's effective date until such time as the Czech National Bank decides to grant authorization for activities pursuant to the law, however no later than 18 months from the day on which the law enters into force.

Bill amending the Insurance Act

On 29 March 2016, the Government submitted a rather extensive bill amending the Insurance Act (the "Bill") to the Chamber of Deputies as Parliamentary Bulletin No. 750. The Chamber of Deputies approved the Bill on 1 July 2016 and on July 28th passed it to the Senate, which approved it on August 24th. Finally, the President signed the Bill into law on September 6th.

The proposed legislation harmonizes the requirements for conducting insurance and reinsurance business and exercising Czech National Bank oversight of these activities with the latest EU legislation.

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The stated main objective of the proposed changes is to strengthen the financial stability of these entities and in so doing protect consumers of insurance services.

Effective 1 January 2016, the European Parliament directives on which the current legislation governing the insurance business is based, and which were replaced by the Solvency II Directive that introduces fundamental changes in the operation of the insurance business and reinsurance activities, were abolished. The purpose of the EU legislation is to create an insurance and reinsurance market that uses the Single European Passport for Insurance.

Under the proposed amendment, insurers and reinsurers with their registered offices in non-EU countries may only carry out activity in the Czech Republic via a branch that is a company subject to entry in the commercial register. In compliance with the requirements of the Solvency II Directive, the institute known as associated activities, which was at variance with the principle of single authorization for the operation of insurance or reinsurance activities, is newly omitted. Thus, an insurer or reinsurer may only carry out insurance, reinsurance and directly related activities based on a single authorization and should prove to the oversight body that such activities arise directly from the authorized insurance or reinsurance activities.

The proposed amendment is also a response to Regulation of the European Parliament and of the Council No. 1094/2010 Establishing a European Supervisory Authority (EIOPA), amending Decision No. 716/2009/ES and Repealing Commission Decision 2009/79/ES. The purpose of this supervisory body is to foster an improved internal market function, primarily by ensuring an effective and consistent level of regulation and oversight reflecting the various interests of Member States and differing natures of financial institutions. This supervisory body would also ensure a level playing field on the market and strengthen the coordination of oversight activity on an international level.

Bill amending the Act on Insurance Brokers and Loss Adjustors and on amending the Trade Licensing Act

Together with the above mentioned bill amending the Insurance Act, the Government sent the Chamber of Deputies a bill amending the Act on Insurance Brokers and Loss Adjustors (the "Bill") on 29 March 2016 as Parliamentary Bulletin No. 751. The Chamber of Deputies approved the Bill on July 1st and on July 28th sent it to the Senate, which approved it on August 24th. Finally, the President signed the Bill into law on September 6th.

The Bill's objective is to restrict certain negative aspects of the life insurance market such as excessive switching of

insurance policies by a policyholder (at the suggestion of a broker) as a result of the high amounts of compensation enjoyed by brokers for brokering life insurance policies and the low surrender value due to clients in the event of early cancellation of a capital assurance policy (typically, whole life insurance and capital life assurance).

The Bill's basis is the regulation of the effects of early cancellation of a life insurance policy by introducing the insurance broker's obligation to return compensation paid by the insurer for arranging a life insurance policy and distributing the acquisition costs incorporated into the surrender calculation. This approach is designed both to motivate insurance brokers to negotiate long-term insurance policies and to ensure, in the event of early policy cancellation, that the greater part of paid premiums is returned to the policyholder in the form of surrender, where cancellation of a specific policy establishes the right to its payment.

The proposed legislation allows for a pro rata reduction of the insurance broker's right to compensation if a policy is cancelled within its first five years for any reason other than the occurrence of an insured event. The pro rata reduction should be calculated down to a given month such that for every month of insurance duration the broker is at most entitled to one sixtieth of the agreed compensation (or, if the agreed insurance period is shorter than five years, a proportional share). This obligation to distribute compensation only applies to compensation agreed between the insurer and the insurance broker, not compensation agreed between the policyholder and the broker. Insurance policies in which single premiums or the pay-as-you-go principle has been agreed are exempt from the pro rata compensation reduction mechanism.

Draft amendment of the Act on Bonds

A bill amending the Act on Bonds and other related laws (Act on Banks, Capital Market Act and Insolvency Act) drafted by the Ministry of Finance (the "Bill") is currently in an interdepartmental comment procedure. The Bill has been submitted in an effort to eliminate shortcomings in the current legislation on mortgage bonds, which in the words of the explanatory report has become obsolete.

The Bill, designed to replace the current legislation on mortgage bonds while endeavouring to maintain continuity, regulates mortgage bonds (or covered bonds) and covered blocks and their administration in the event of the issuer's bankruptcy. According to the Bill, covered bonds and covered blocks should be exempt from insolvency proceedings under the Insolvency Act.

In response to findings from actual practice, the Bill furnishes solutions for certain shortcomings in the regulation of bonds

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by newly addressing collateral agents, bonds exchangeable for shares that have not been securitized and mandatorily convertible bonds. The Bill also specifies the nature of customer assets in relation to insolvency proceedings and their release to customers. The Bill also enables the Ministry of Finance to sell government bonds via channels other than the Czech National Bank.

Recent Case Law

Joint authority to act of a member of a statutory body of a corporation and its procurator

(Judgment of the High Court in Prague of 4 August 2015, No. zn. 14 Cmo 184/2014)

In this judgment, the High Court in Prague dealt with the possibility of entering the joint authority of a member of a statutory body and procurator to act on behalf of a company as "the manner in which the statutory body acts on behalf of the business corporation."

The court adjudicated a case of the filing of a petition to make an entry in the commercial register related, inter alia, to a change in the manner in which a limited liability company's statutory body will act on its behalf, i.e. "At least two executives acting jointly, or one executive together with one procurator, shall act on behalf of the company. Should the company have just one executive, this shall exclude the joint authority of an executive and procurator to act."

The court rejected this part of the petition as this manner of acting on a company's behalf by its statutory body unacceptably positions a company procurator on an equal footing with an executive. In the court's view, the law clearly distinguishes between the statutory body of a limited liability company that has one or more executives and procuration as a type of contractual representation pursuant to which the procurator is authorized to effect legal acts carried out in the operation of a business. The legislation in effect since 1 January 2014 now stipulates that a member of a statutory body acts as a legal entity's representative *sui generis* (as the member acts as neither a statutory nor a contractual representative). According to the rationale of the court's decision, however, this conceptual shift does not mean the authority of a member of a statutory body to act would exist at the same level and be freely combinable with the authority to act enjoyed by a legal entity's contractual or statutory representatives. It is the court's view that the law, in its regulation of the authority to act on behalf of a legal entity, only anticipates members of a statutory body.

Tying statutory body members' authority to act to a procurator's authority to act is also prevented by the

statutory limits placed on a procurator's authority to act, whereas executive authorization of a statutory body is unrestricted. The court further explained its decision by citing the fact that the subject joint authority to act of a member of a statutory body and a procurator violates § 163 of the Civil Code, pursuant to which all powers are granted to the statutory body of a company, where these have not been entrusted to another of its bodies by a legal act of the company founder, by law or by a public authority's decision. The procurator is not a company body.

In summing up its rationale, the court states that the list of facts to be entered in the commercial register also works against the joint authority to act. The provision of § 25(1)(g) of the Act on Public Registries of Legal Entities and Natural Persons regulates the entry of a statutory body of a registered entity, including the manner in which such statutory body acts on behalf of the legal entity, while the provision of § 25(1)(i) separately regulates the entry of procuration and the procurator, including the manner in which the procurator shall act.

A statutory body member's authority to act may only be tied to a procurator's authority to act by an internal restriction on executive authorization of a statutory body or procuration within the statutory framework of § 46 of the Act on Business Corporations and § 453 of the Civil Code.

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