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European Bank
for Reconstruction and Development

Corporate Governance in Transition Economies

Hungary Country Report

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The report is based on information available at the end of April 2015.

If you believe that the information has changed or is incorrect, please contact Gian Piero Cigna at cignag@ebrd.com

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Finally, the Legal Transition team would like to express its thanks and appreciation to Gabrielle Cordeiro and David Risser from Nestor Advisors Ltd for the assistance provided in relation to the analysis of countries and the drafting of the reports.

This Report – along with all other country reports prepared within this initiative – is available at: http://www.ebrd.com/what-we-do/sectors/legal-reform/corporate-governance/sector-assessment.html

Foreword

As part of its Legal Transition Programme, the European Bank for Reconstruction and Development ("EBRD") has been assessing the state of legal transition in its countries of operations. These assessments provide an analysis of the progress of reform and identify gaps and future reform needs, as well as strengths and opportunities.

In 2012, the Legal Transition team within the EBRD Office of the General Counsel (LTT) developed with the Assistance of Nestor Advisors a methodology for assessing corporate governance frameworks and the governance practices in the EBRD countries of operations. This assessment was implemented in 2014-2015 (the "Assessment").

The Assessment aims at measuring the state of play (status, gaps between local laws/regulations and international standards, effectiveness of implementation) in the area of corporate governance

The Assessment is meant to provide for (i) a comparative analysis of both the quality and effectiveness of national corporate governance legislation (including voluntary codes); (ii) a basis to assess key corporate governance practices of companies against the national legislation; (iii) an understanding whether the legal framework is coupled with proper enforcement mechanisms (e.g., sanctions) and/or with authorities able to ensure proper implementation; (iv) a support to highlight which are the major weaknesses that should be tackled by companies and legislators for improving the national corporate governance framework; and (v) a tool which will enable the EBRD to establish "reference points" enabling comparison across countries.

This country report is part of a series of 34 country reports. A general report synthesising all countries will close the Assessment.

Methodology

This Assessment is based on a methodology designed to measure the quality of legislation in relation to best practices requirements and the effectiveness of its implementation as evidenced by companies' disclosure, also taking into consideration the capacity of the institutional framework (e.g., courts, regulators) to sustain quality governance. The analytical grid developed for assessing the governance framework is based on international recognised best-practice benchmarks (e.g., OECD Corporate Governance Principles, Development Financial Institutions, EBRD, IFC and World Bank ROSC governance methodologies). The methodology is applied identically across all the countries reviewed. The process for gathering, analysing and reporting information is applied identically for each of the countries assessed, which allows comparing countries to each other across a long a set of benchmarking points.

For the purpose of the Assessment, the corporate governance framework and the practices were divided in five key areas: (i) Structure and Functioning of the Board; (ii) Transparency and Disclosure of company information; (iii) Internal Control; (iv) Rights of Shareholders; and (v) Stakeholders and Institutions. Each of these key areas is further divided in sections (for instance, the area "Structure and Functioning of the Board" is divided in five sections: Board composition; Gender diversity at the board; Independent directors; Board effectiveness; and Responsibilities of the board). Each section is further divided in subsections (for instance, the section "Independent Directors" is divided in three subsections: "Requirement to have independent directors"; "Definition of Independence"; and "Disclosed practices").

The assessment started by sending a questionnaire to law firms, audit firms, national regulator(s), ten largest (listed) companies, and stock exchange(s) in each country. Questions were different according to the respondents, which were asked to provide information on the legislation and on how they believe the legislation is implemented.

Responses were assigned to the corresponding subsection(s) and validated by the EBRD corporate governance specialists by looking at the applicable framework and at the disclosure offered by the ten largest (listed) companies in each country. In this respect, the working hypothesis was that the ten largest listed companies are those offering the best disclosure in each country. As such, we presumed that when certain practices were not disclosed by them, they were unlikely to be disclosed by smaller or unlisted companies. The ten largest companies were identified according to their market capitalisation. When a country did not have a stock exchange, there were less than ten listed issuers or there were no data on capitalisation of issuers, the ten largest companies were identified according to their revenues and size of the labour force. In case the largest companies were mostly of one sector (e.g., financial institutions), then the sample of ten companies was corrected to reflect other sectors of the economy.

The validation of responses was undertaken by the corporate governance specialists within the Legal Transition Team through desktop research. This research was conducted both on legislation and on the practices disclosed by the largest (listed) companies (e.g., companies' websites, annual reports, stock exchanges database etc.). In addition, the relevant reports by international financial institutions (e.g., IMF, World Bank, IFC, Transparency International, etc.) were analysed and taken into consideration. Answers received by respondents that were not grounded by specific references to legislation or consistent with the disclosed practices were not taken into consideration.

Following the validation process, each subsection was compiled by adding specific references to legislation and practices. Conclusions were then formulated for each subsection, each rated as per their adherence to international governance standards. The score ranges from 1 (very weak) to 5 (strong). The rating for each section was then calculated by averaging the ratings of the subsections.

Because understanding corporate governance requires a "holistic perspective", where each component needs to have a place in the overall picture – pretty much like a puzzle - in case one of the subsection was rated "weak" or "very weak", the resulting average was decreased by 0.2; in case more than one subsection was rated "weak" or "very weak", the resulting average was decreased by 0.5. This is because if just one component is not fitting well with the others, then all others are weakened. Similarly, the overall strength diminishes if there are more weak components.

Conversely, in order for the framework to be strong, all components need to be well fitting with each other. Hence, in case all subsections were scored "moderately strong" or "strong", then the resulting average was increased by 0.5. However, this "positive" adjustment was used with some care as the assessment looked at the top ten largest companies in the country, hence findings tended to be often overly optimistic.

Key areas were then rated according to the same criteria.

The ratings are presented through the colours detailed in the box below and they demonstrate the adequacy or need of reform in respect to each governance area and section.

Rating:

"Strong to very strong" (DARK GREEN) - The corporate governance framework / related practices of companies are fit-for-purpose and consistent with best practice.

"Moderately strong" (LIGHT GREEN) - Most of the corporate governance framework / related practices of companies are fit-for-purpose but further reform is needed on some aspects.

"Fair" (YELLOW) - The corporate governance framework / related practices of companies present some elements of good practice, but there are a few critical issues suggesting that overall the system should be assessed with a view of reform.

"Weak" (ORANGE) - The corporate governance framework / related practices of companies may present few elements of good practice, but overall the system is in need of reform.

"Very weak" (RED) - The corporate governance framework / related practices of companies present significant risks and the system is in need of significant reform.

We believe corporate governance cannot be captured and measured simply by numerical values. Hence, alongside the "quantitative" assessment obtained according to the methodology described above, a "qualitative" assessment was also undertaken, by classifying our findings for each section as "strengths" and "weaknesses". Because understanding corporate governance requires a "holistic perspective", when the "quantitative" assessment was finalised, the assessment team compared it with the "qualitative" assessment, and when any inconsistency (i.e. material weaknesses or strengths) was noticed, the average scores of the sections were adjusted by up to ±0.5.

A preliminary version of the Assessment was made public for consultation. The comments and corrections received during the process were analysed by the corporate governance specialists. When confirmed, the corrections were reflected in the final ratings and in this Assessment.

Overview

Legislative framework

The primary sources of corporate governance legislation in Hungary are Act V of 2013 on the Civil Code; Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises; Act CXX of 2001 on the Capital Market; and Act C of 2000 on Accounting.

In 2004, the Corporate Governance Committee of the Budapest Stock Exchange issued the Corporate Governance Recommendations (i.e., the Hungarian Corporate Governance Code), which were later reviewed in 2007 and 2012. Pursuant to the Civil Code, public companies (hereinafter "listed companies") are required to disclose their compliance with the Recommendations (or any other national code that they take as a reference) in a corporate governance report, which must be published on the company's website (so-called "*comply or explain*" approach). Most of the companies' statements show a relatively high degree of compliance with the Corporate Governance Recommendations, hence explanations are limited. When present however, explanations tend to be quite formalistic and not always convincing. It is not clear if the compliance reporting by companies is monitored, as we could not locate any monitoring report illustrating how companies comply with the Recommendations.

Structure and functioning of the board

On paper, listed companies in Hungary can be organised under a one- or two-tier board system, however the "two-tier system" provided by legislation is in reality a "*hybrid*" system, where the supervisory board has no real power and all decision making is retained by the management board and general shareholders' meeting. All ten largest listed companies are organised under a two-tier system.

All companies with more than 200 employees must have a supervisory board unless the workers' council waived the employee participation in the supervisory board. Unlisted companies must have a supervisory board if so decided by at least 5% of shareholders while listed companies must have a supervisory board in case of a two tier system. Board of directors (in one tier system) and supervisory boards (in the two tier system) are required to be composed of a majority of independent directors. The definition of independence is provided by the law. The law assigns to the supervisory board a very limited and marginal role: it does not have any decision authority. The powers to appoint or dismiss the management board members or to define their remuneration are assigned to shareholders. The law is silent on the responsibility for adopting the budget and this task can be assigned either to the general shareholders' meeting or to the board, which seems to be more frequent in practice. In addition, shareholders can decide in the articles of association the allocation of powers within the company's bodies. Private companies (hereinafter "unlisted companies") may establish a so-called "*peremptory supervisory board*", vested with the responsibility to make or approve decisions which otherwise fall within the competence of the general shareholders' meeting or management. In such a case, supervisory board members are jointly and severally liable for damages caused to the company. If a decision is taken by the peremptory supervisory board contrary to the proposal of management, then management can ask the general shareholders' meeting to overturn the supervisory board decision. This solution raises a few doubts.

It appears that the new Civil Code – which entered into force in 2014 – grants a very flexible approach to companies. However, the resulting framework for companies organised under the two-tier system (the most common in Hungary) is a "hybrid" situation that leaves little space for proper checks and balance of powers. We believe the legislator should reconsider the distribution of powers between the supervisory board, the management board and the general shareholders' meeting so to assign to them clear functions and responsibilities and allow a "safe" level playing field.

Supervisory boards of the ten largest listed companies appear to be well-sized with an average of six members, whereas management boards tend to be quite large, with an average of nine members. In all companies, independent directors are the majority of the board. Legal entities cannot serve as board members. Gender diversity at the board is very low.

Qualification requirements exist only for banks' board members, however the Corporate Governance Recommendations provide some recommendations in this respect.

Listed companies must establish audit committees composed exclusively of independent directors from the supervisory board (two-tier) or board of directors (one-tier) and at least one person with expertise in accounting or auditing. The audit committee report to the supervisory board/board of directors. All ten surveyed companies disclose having an audit committee in place. However, given the marginal role of the supervisory board, we have doubts that the audit committee in the two-tier system is able to play the key control role that is expected to undertake.

Banks are required and companies are recommended to set up nomination and remuneration committees (banks are also required to set risk exposure and management committees). In the two-tier system, these committees should be made of management board members, a solution which raises some doubts.

The majority of the surveyed companies disclose carrying out board evaluations. Companies are not required or recommended to have a company secretary, and only one company in our sample disclosed having appointed one. Fiduciary duties, conflicts of interest and liability of board members are regulated by law, but case law on these matters is very limited.

Transparency and Disclosure

Disclosure of non-financial information is detailed in the legislation and companies seem to comply with these requirements.

All ten largest listed companies disclose a significant amount of information on their websites, including their articles of association or bylaws, minutes of the general shareholders' meeting, names and qualifications of their board members, information on their share capital and major shareholders. Conversely, disclosure on committees' meeting and activities, beneficial ownership and transactions in company shares is limited.

The law requires listed companies to prepare annual reports including both a corporate governance report and financial statements, which must be in line with IFRS. All ten largest listed companies appear to comply with these requirements.

Reporting to the market and to shareholders seems to be well-detailed in the law and generally implemented.

The law requires companies to disclose basic information on external auditors, and all ten largest listed companies appear to comply. Provision of non-auditing services by the external auditor is allowed, but when tis occur, it must be disclosed. Three companies in our sample provide this information.

Internal Control

Companies are recommended to have an internal audit function, whereas banks are required to do so. Nine of the ten largest listed companies disclose having an internal audit function in place. Banks are further required to have a separate compliance function.

Listed companies and banks are required to establish an audit committee. Members of the audit committee are appointed by the general shareholders' meeting from the board of directors'/supervisory board's independent directors. The audit committee reports to the board of directors/supervisory board. All ten largest listed companies disclose having such committee in place and the majority of them disclose its number of meetings. In most cases, audit committees are made up of independent directors, and they met between 1 and 6 times in person in the previous year. As mentioned above, the effectiveness of the audit committee in two-tier companies is questionable, due to very marginal role assigned to the supervisory board.

All listed companies must have their financial statements audited by an independent external auditor. The law assigns to the audit committee the authority to reviewing the external auditors' independence. The external auditors of the ten largest listed companies declared to be independent and they are all international firms. Provision of non-auditing services is allowed, under the audit committee's scrutiny. Companies receiving non-auditing services must disclose this information and auditors must submit separate invoices for such services. External auditors are not subject to rotation obligations.

Whistleblowing protection is addressed by law. Regulation on related party transactions and conflicts of interests are regulated; nevertheless, there is little evidence that these rules are well implemented in practice.

Rights of Shareholders

Shareholders in Hungary have access to comprehensive financial and non-financial information. Minority shareholders are entitled – the shareholding thresholds to exercise these rights vary - to call a general shareholders' meeting (GSM), add items to the agenda, and start derivative claims. Shareholders are provided with timely online notifications and materials to prepare for the GSM. Furthermore, shareholders are endowed with general inspection rights.

Voting caps and multiple voting rights are allowed.

Supermajority is required to approve major corporate changes, but not to increase the share capital. Pre-emptive rights are granted by law, but their exercise must be detailed in the articles.

Cumulative voting is not foreseen for listed companies and does not seem to be used in practice.

Self-dealing is regulated, insider trading is prohibited, and few insider trading cases have been investigated in the past five years. Related party transactions and conflicts of interests are regulated by law. Significant shareholding variations must be disclosed.

Shareholder agreements are considered enforceable, but there are no obligations to disclose them. The share register of companies – including listed ones – is to be maintained by the management board of the company. However, in listed companies such outsourcing and the person maintaining the share registered must be published. Except for series of shares listed on the Budapest Stock Exchange, transfer of shares may be restricted by the articles of associations and depends on the company's consent.

Stakeholders and Institutions

The institutional framework supporting corporate governance practices in Hungary seems to be relatively well developed, however room for improvement exists.

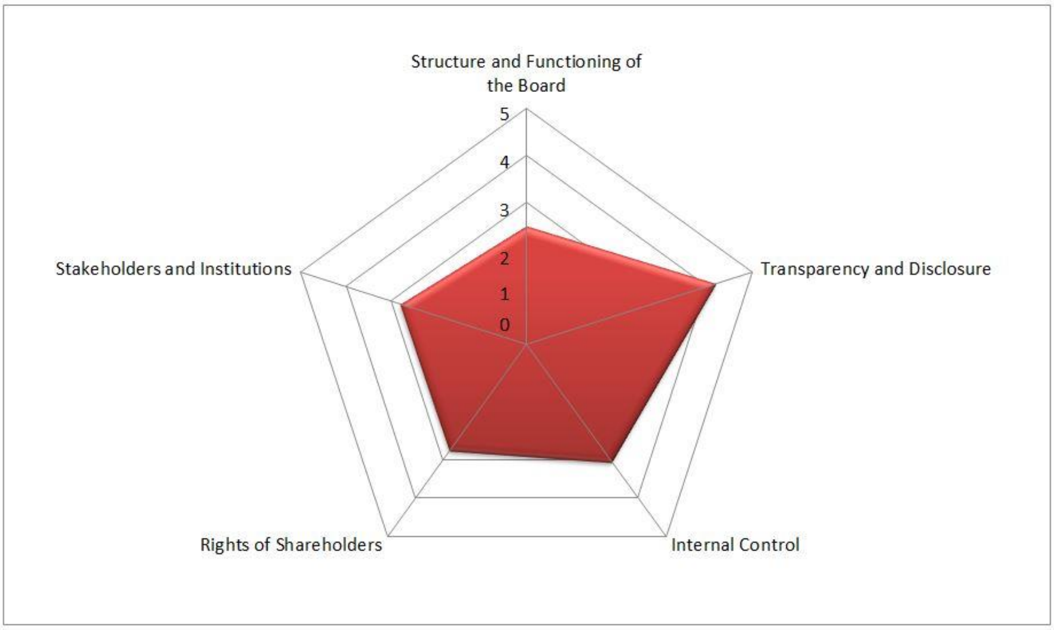
The Budapest Stock Exchange (BSE) is the main local stock exchange in Hungary. BSE's market capitalisation is around 16% of the country's GDP, and the market seems to be fairly liquid. There are three listing tiers at the BSE: the Prime Market Segment, the Standard Market Segment and the T Market Segment. Companies in all three listing tiers are expected to implement the Corporate Governance Recommendations on a "*comply or explain*" basis. The BSE website contains a comprehensive summary in English of listed companies' profiles.

International rating agencies are not very active within the country, and only one surveyed company has been assessed by an international rating agency.

Since 2013, the Hungarian Central Bank has assumed all competences from the former HFSA, and now is the regulator and supervisor of all financial sector entities, as well as capital markets.

When looking at the indicators provided by international organisations, Hungary ranks moderately poorly in terms of competitiveness, investor protection and corruption.

Corporate Governance Legislation and Practices in Hungary



Source: EBRD, Corporate Governance Assessment 2016

Note: The extremity of each axis represents an ideal score, i.e., corresponding to the standards set forth in best practices and international standards (e.g., OECD Corporate Governance Principles). The fuller the 'web', the closer the corporate governance legislation and practices of the country approximates best practices.

Key: Very weak: 1 / Weak: 2 / Fair: 3 / Moderately Strong: 4 / Strong to very strong: 5

Key Areas and Rating	Strengths and Weaknesses
1. Structure and Functioning of the Board *Weak*	*On paper, listed companies in Hungary can be organised under a one- or two-tier board system, however the "two-tier system" provided by legislation is in reality a "hybrid" system, where the supervisory board has no real power and all decision making is retained by the management board and general shareholders' meeting. All ten largest listed companies are organised under a two-tier system.* *All companies with more than 200 employees must have a supervisory board unless the workers' council waived the employee participation in the supervisory board. Unlisted companies must have a supervisory board if so decided by at least 5% of shareholders while listed companies must have a supervisory board in case of a two tier system. Board of directors (in one tier system) and supervisory boards (in the two tier system) are required to be composed of a majority of independent directors. The definition of independence is provided by the law. The law assigns to the supervisory board a very limited and marginal role: it does not have any decision authority. Further, the powers to appoint or dismiss the management board members or to define their remuneration are assigned to shareholders. The law is silent on the responsibility for adopting the budget and this task can be assigned either to the general shareholders' meeting or to the board, which seems to be more frequent in practice. In addition, shareholders can decide in the articles of association the allocation of powers within the company's bodies. Unlisted companies may establish a so-called "peremptory supervisory board", vested with the responsibility to make or approve decisions which otherwise fall within the competence of the general shareholders' meeting or management. In such a case, supervisory board members are jointly and severally liable for damages caused to the company. If a decision is taken by the peremptory supervisory board contrary to the proposal of management, then management can ask the general shareholders' meeting to overturn the supervisory board decision. This solution raises a few doubts.* *It appears that the new Civil Code – which entered into force in 2014 – grants a very flexible approach to companies. However, the resulting framework for companies organised under the two-tier system (the most common in Hungary) is a "hybrid" situation that leaves little space for proper checks and balance of powers. We believe the legislator should reconsider the distribution of powers between the supervisory board, the management board and the general shareholders'' meeting so to assign to them clear functions and responsibilities and allow a "safe" level playing field.* *Supervisory boards of the ten largest listed companies appear to be well-sized with an average of six members, whereas management boards tend to be quite large, with an average of nine members. In all companies, independent directors are the majority of the board. Legal entities cannot serve as board members. Gender diversity at the board is very low.* *Qualification requirements exist only for banks' board members, however the Corporate Governance Recommendations provide some recommendations in this respect.* *Listed companies must establish audit committees composed exclusively of independent directors from the supervisory board (two-tier) or board of directors (one-tier) and at least one person with expertise in accounting or auditing. The audit committee report to the supervisory board/board of directors. All ten surveyed companies disclose having an audit committee in place. However, given the marginal role of the supervisory board, we have doubts that the audit committee in the two-tier system is able to play the key control role that is expected to undertake.* *Banks are required and companies are recommended to set up nomination and remuneration committees (banks are also required to set risk exposure and management committees). In the two-tier system, these committees should be made of management board members, a solution which raises some doubts.* *The majority of the surveyed companies disclose carrying out board evaluations. Companies are not required or recommended to have a company secretary, and only one company in our sample disclosed having appointed one. Fiduciary duties, conflicts of interest and liability of board members are regulated by law, but case law on these*

<table>
<tr><th>Key Areas and Rating</th><th>Strengths and Weaknesses</th></tr>
<tr><td></td><td>matters is very limited.</td></tr>
<tr><td>1.1. Board Composition
Very Weak (two tier system)
Fair (one tier system)</td><td>Strengths:
• The majority of the supervisory board (in the two-tier system) and of the board of directors (in the one-tier system) must be composed of independent directors. All companies with more than 200 employees must have a supervisory board unless the workers' council waived the employee participation in the supervisory board. Unlisted companies must have a supervisory board if so decided by at least 5% of shareholders while listed companies must have a supervisory board in case of a two tier system. All companies in our sample adopted the two-tier system and all have a supervisory board composed of a majority of independent directors.
• The supervisory boards of the ten largest listed companies are in general well-sized. On average, they have six members (the law provides that the board of directors should have 5 members. However it seems that the articles can provide for a higher number. The law also provides that supervisory board shall have three members). Evidence has shown that smaller boards tend to perform better, provided that they have the right mix of skills and support (e.g., corporate secretary).
• Legal entities cannot serve as board members.
• In banks, board members are required to have at least three years of experience in banking or business management. The Corporate Governance Recommendations suggest that management and supervisory boards should possess an adequate level of professional experience.
• In listed companies, audit committees must be composed exclusively of independent directors from the supervisory board, one of whom must have competence in accounting or auditing. All companies disclose their board members' qualifications. In five out of the ten largest listed companies, at least one member has competence in either of these fields.
Weaknesses:
• Given the marginal role assigned to the supervisory board, it is questionable whether independent directors can play a key role in companies organised under the two-tier system.
• The requirement to have the majority of the board made of independent directors does not apply if the listed company is a controlled company belonging to a "recognized group". We think there might be cases where the subsidiary is of strategic importance and as such, it might deserve to have independent directors in the board. Further, it is not clear how this provision is implemented and who is in charge of determining whether a group is "recognized".
• The Corporate Governance Recommendations suggest that the management body (which in the two-tier structure is the management board) should be comprised of both executive and non-executive directors. This recommendation is somehow strange, as we would expect the management board in a two tier system to be made of executives only. However, considering that the Recommendations are antecedent to the new Civil Code, the marginal role of the supervisory board and the extensive role that the law assigns to the management board in companies' decision-making, this mixed composition might be beneficial. However, in our opinion a better solution would be to re-balance the functions and responsibilities of the supervisory board.
• In the one-tier system, the roles of the CEO and the chair of the board can be combined. In such cases, the Corporate Governance Recommendations advise that the company should disclose the strategies they have adopted to ensure the board makes objective assessments of the executive management's performance.
• The Corporate Governance Recommendations suggest that nomination and remuneration committees should be composed respectively of a majority an exclusively of independent members from the management body. One company in our sample disclosed having a nomination committee and five a remuneration committee (one of which has been discontinued). It is worth noting that the disclosure by companies that we analysed referred to a period antecedent to the entry into force of the New Civil Code. Under such disclosure, most of the remuneration committees were made of members of the board of directors (and not the supervisory board) as – pursuant to the precedent Civil Code – companies could have a supervisory board, a board of directors and a management board (i.e., a sort of "three-tier system"). However, it seems that that solution is applied in practice even within the new framework as well, which raises a few concerns.</td></tr>
<tr><td>1.2. Gender Diversity at the Board (7.33%/8.27%)
Very weak</td><td>• All ten largest listed companies disclose the composition of their supervisory and management boards. Supervisory and management boards of only four companies in our sample include women. Among these companies, female representation averages 18.33% and 20.7% respectively.
• In total, there are 5 women out of 61 supervisory board members, and 6 women out of 89 management board members.
• Overall, when counting all the ten companies in our sample, the average of gender diversity per supervisory board is 7.33% and per management board is 8.27%.</td></tr>
<tr><td>1.3. Independent Directors
Fair</td><td>Strengths:
• The law requires the supervisory board (two-tier) and the board of directors (one-tier) to be made up of a majority of independent directors, except in cases where the company is a controlled company belonging to a "recognized group".
• The definition of independence is found in the New Civil Code, in force since 2014. The Corporate Governance Recommendations generally refer to the EC Recommendation dated 15 February 2005 on the role of the non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board.</td></tr>
</table>

Key Areas and Rating	Strengths and Weaknesses
	• *The Corporate Governance Recommendations suggest companies to disclose their guidelines on the independence of the board members and the applied criteria for independence on their website. The Recommendations also suggest that "at regular intervals, the board of directors / supervisory board should request confirmation of independence from those of its members who are considered independent. It is recommended that members confirm their independence in connection with the preparation of the annual report on corporate governance".* • *The (supervisory) boards of all ten largest listed companies are composed of a majority of independent members. Three companies affirm that their supervisory boards are made up only of independent directors, while in seven other cases, they represent a majority.* ***Weaknesses:*** • *The definition of independence found in the New Civil Code (in force since 2014), seems to only include negative, i.e. "non-affiliation" criteria. It should be pointed out that the concepts of "non-affiliation" and "independence" are different. While non-affiliation can be established by negative criteria only, independence necessarily needs objectivity of mind and character, which is a positive character that should be demonstrated, disclosed and explained in practice.* • *Most companies name the directors/supervisory board member which are considered independent (in some cases there is just a general sentence affirming that directors/supervisory board members are independent, without identifying them) but none of the companies makes an effort to explain why these directors/supervisory board members are considered independent. As explained above, independence is not just a matter of non-affiliation. We do not think the provided disclosure is enough to assure stakeholders about the real independence of these directors/supervisory board members.* • *In the two-tier system – the most common in Hungary - the supervisory board has only a marginal role. We have doubts that independent directors in the supervisory board can play a key control role in the company.* • *The Corporate Governance Recommendations suggest the establishment of nomination and remuneration committees, which should be composed respectively of a majority and exclusively of independent directors of the management body (which in the two-tier system is the management board). This is quite peculiar (and it seems a contradiction in the terms) as it is unusual to see independent directors in the management board of two-tier companies. In fact, the law only requires independent directors in the board of directors (one-tier) and in the supervisory board (two-tier) and not in the management board. In practice, only one out of the ten largest listed companies disclosed having a nomination committee. Five companies disclosed having a remuneration committee; in one of them, the CEO is a member, which is not a good practice.*
1.4. Board Effectiveness *Very Weak (two tier system)* *Fair (one tier system)*	***Strengths:*** • *Listed companies and banks are required to set up audit committees which must be composed of independent members of the supervisory board/board of directors, one of whom is required to possess expertise in accounting or auditing. All ten companies in our sample disclosed having an audit committee in place made of a majority of independent directors (more details below).* • *All ten largest listed companies disclose the number of their board meetings. Supervisory boards and management bodies met between 6 and 14 times last year. Half of the meetings were held in person and the other half, in absentia. Audit committees met between 1 and 6 times in person.* • *The Corporate Governance Recommendations suggest boards to evaluate their performance annually. Nine of the surveyed companies disclose having carrying out board evaluations, and in one of those companies the exercise was conducted by the nomination committee. One of them disclosed the results of the exercise.* ***Weaknesses:*** • *In the two-tier system the supervisory board has only a marginal role. All largest listed companies are organised under two tier system and we have doubts that the supervisory board can play a key direction role in the company.* • *When a "peremptory supervisory board" is established, the general shareholders' meeting can overrule its decisions. This is a major weakness.* • *Banks which have a market share of at least 5% of the balance sheet total are required to set up nomination, remuneration, and risk exposure and management committees. All these committees must be composed of "members of the management body in its managerial function whom are not engaged under employment contract with the credit institution concerned". Only if there are less than three non engaged members of the management body, independent supervisory board members can sit on these committees. We do not think it is the right approach. In our opinion, it would be appropriate for the legislation to establish which committees perform a strategic role (like the nomination and remuneration committees, - whose activities are highly potential for conflicts of interest - which should be composed of independent supervisory board members) and those that have more an executive role (as it might be the case for a credit committee or ALCO) so to be clear in establishing composition and independence requirements.* • *Similar considerations as above apply to the Corporate Governance Recommendations related to the nomination and remuneration committees.* • *Having a company secretary is neither required by the law nor recommended by the Corporate Governance Recommendations. Only one company in our sample discloses having a company secretary in place.*
1.5. Responsibilities of the Board	***Strengths:*** • *Fiduciary duties, conflicts of interest and liability of directors are addressed by the law, with limited case*

Key Areas and Rating	Strengths and Weaknesses
Very Weak (two-tier system) *Fair (one-tier system)*	*law available. (For a detailed analysis see: http://ec.europa.eu/internal_market/company/docs/board/2013-study-reports_en.pdf).* ***Weaknesses:*** • *Only in banks, the law spells out the responsibilities of the supervisory board. However, none of these functions is strategic. The law endows the management body in its managerial function (i.e., the management board) with authority to decide on strategy and risk appetite and does not even require endorsement by the supervisory board of these key documents. Without "ownership" by the supervisory board of these key documents, it is unclear how the supervisory board can provide effective monitoring over executives. The law is silent on the responsibility for adopting the budget and this task can be assigned either to the general shareholders' meeting or to the board, which seems to be more frequent in practice.* • *It appears that the supervisory board plays a minor role within companies. It does not have authority to appoint and dismiss the management board members, or define their remuneration – these powers are assigned to the shareholders. Moreover, in listed companies, the law expressly prohibits supervisory boards from having any decision-making powers. It seems that the supervisory board's main function is to report issues to the shareholders. In practice, the management board looks like a board of directors (in a one-tier system), being in charge of managing conflicts of interest situations and of taking operational decisions without the need to seek approval from the supervisory board, whereas the supervisory board resembles a "revision commission", a body which is quite notorious for its ineffectiveness.* • *The law does not assign non-delegable functions to supervisory and management boards and allows shareholders to define the allocation of powers within a company in the articles of association. The Corporate Governance Recommendations are also not clear in assigning key responsibilities to the board, and do not clearly define the division of roles of the management board and the supervisory board in the two-tier system.* • *The powers to appoint audit, nomination and remuneration committee members are assigned to the general shareholders' meeting, which is unusual.* • *There is limited case law covering liability of directors in Hungary.* • *The law provides for joint and several liability of supervisory board members only in case a "peremptory supervisory board" is established. In all other cases, members of the supervisory board are only liable for omission of their supervisory responsibilities.*

Key Areas and Rating	Strengths and Weaknesses
2. Transparency and Disclosure *Moderately Strong*	*Disclosure of non-financial information is detailed in the legislation and companies seem to comply with these requirements.* *All ten largest listed companies disclose a significant amount of information on their websites, including their articles of association or bylaws, minutes of the general shareholders' meeting, names and qualifications of their board members, information on their share capital and major shareholders. Conversely, disclosure on committees' meeting and activities, beneficial ownership and transactions in company shares is limited.* *The law requires listed companies to prepare annual reports including both a corporate governance report and financial statements, which must be in line with IFRS. All ten largest listed companies appear to comply with these requirements.* *Reporting to the market and to shareholders seems to be well-detailed in the law and generally implemented.* *The law requires companies to disclose basic information on external auditors, and all ten largest listed companies appear to comply. Provision of non-auditing services by the external auditor is allowed, but when tis occur, it must be disclosed. Three companies in our sample provide this information.*
2.1. Non-Financial Information Disclosure *Moderately Strong*	***Strengths:*** • *Companies are required to prepare and publish their annual reports (pursuant to the Law on Accounting), as well as a corporate governance report (pursuant to the New Civil Code). The Corporate Governance Recommendations further recommend companies to prepare and publish a corporate governance report. This report should contain the management board's conclusions on the company's governance, as well as indicate any derogation from its recommendations.* • *In line with the Corporate Governance Recommendations, all companies in our sample disclose their annual reports, reports on corporate governance and forward-looking strategic statements on their websites.* • *Overall, disclosures made by the ten largest listed companies are of good quality. Their websites are complete and up-to-date. Information is quite easy to find.* • *All ten largest listed companies disclose their articles of associations or bylaws, their directors'/supervisory board members' names and qualifications, number of board meetings, their major shareholders, information on their share capital on their websites. Nine companies disclose information on their board activities in their annual reports, but information on the committees' activities and number of meetings is found less frequently. Only five companies disclose such information.* • *The law requires listed companies to "make their general meeting resolutions available to the public" and all companies in our sample disclosed the minutes of their general shareholders' meetings on their websites.* • *The Corporate Governance Recommendations suggest companies to disclose their "ethical guidelines" and six companies in our sample disclosed their code of ethics.* ***Weaknesses:*** • *Only three of the surveyed companies disclose transactions of company shares made by members of the supervisory board or management board, and only two provide details of their main beneficial owners.* • *Overall, the largest listed companies appear to have a high level of compliance with the Corporate Governance Recommendations. In case of non-compliance, explanations should be provided. We have seen that only very few explanations are well detailed, meaningful and convincing.*
2.2. Financial Information Disclosure *Strong*	***Strengths:*** • *The Law on Accounting requires companies to prepare annual reports on their operations and financial and earnings positions. Annual reports should also include a business report.* • *Listed companies must prepare their financial statements in line with IFRS and disclose their audited annual reports. All ten largest listed companies seem to comply with these requirements.*
2.3. Reporting to the Market and to Shareholders *Moderately Strong*	***Strengths:*** • *The quality of financial and non-financial information is generally robust, and all ten largest listed companies provide a large amount of information on their websites.* • *Annual reports are largely disclosed and, in addition to financial information, they include non-financial information and reports on their corporate governance practices.* • *Failing to comply with disclosure rules is punishable with fines.* • *Listed companies are required to make timely disclosure of price sensitive events.* ***Weaknesses:*** • *Overall, the largest listed companies appear to have a high level of compliance with the Corporate Governance Recommendations. In case of non-compliance, explanations should be provided. We have seen that only very few explanations are well detailed, meaningful and convincing.*

Key Areas and Rating	***Strengths and Weaknesses***
2.4. Disclosure on the External Audit *Moderately strong*	***Strengths:*** • *Companies that are required to have their financial balance sheets audited are required to disclose their auditors' names. All ten largest listed companies disclosed their auditors' names and reports, and declared that their auditors are independent.* • *Provision of non-auditing services is allowed, under the audit committee's scrutiny. However, listed companies are required to disclose information on these practices. Three of the surveyed companies disclosed having received non-auditing services from their external auditors.*

Key Areas and Rating	Strengths and Weaknesses
3. Internal Control *Fair*	*Companies are recommended to have an internal audit function, whereas banks are required to do so. Nine of the ten largest listed companies disclose having an internal audit function in place. Banks are further required to have a separate compliance function.* *Listed companies and banks are required to establish an audit committee. Members of the audit committee are appointed by the general shareholders' meeting from the board of directors'/supervisory board's independent directors. The audit committee reports to the board of directors/supervisory board. All ten largest listed companies disclose having such committee in place and the majority of them disclose its number of meetings. In most cases, audit committees are made up of independent directors, and they met between 1 and 6 times in person in the previous year. As mentioned above, the effectiveness of the audit committee in two-tier companies is questionable, due to very marginal role assigned to the supervisory board.* *All listed companies must have their financial statements audited by an independent external auditor. The law assigns to the audit committee the authority to reviewing the external auditors' independence. The external auditors of the ten largest listed companies declared to be independent and they are all international firms. Provision of non-auditing services is allowed, under the audit committee's scrutiny. Companies receiving non-auditing services must disclose this information and auditors must submit separate invoices for such services. External auditors are not subject to rotation obligations.* *Whistleblowing protection is addressed by law. Regulation on related party transactions and conflicts of interests are regulated; nevertheless, there is little evidence that these rules are well implemented in practice.*
3.1. Quality of the Internal Control Framework *Weak (two-tier system)* *Moderately Strong (one-tier)*	***Strengths:*** • *Banks are required to have an internal control function. The Corporate Governance Recommendations suggest listed companies to create a separate and independent function in charge of the internal control procedures, which should report directly to the audit committee at least once a year. Nine of the ten largest listed companies disclosed setting up an internal audit department.* • *Banks are required to establish a compliance function.* • *Listed companies and banks are required to set up an audit committee, members of which must be appointed among the independent directors. At least one of the audit committee members is required to possess expertise on accounting or auditing. All ten companies in our sample disclosed having an audit committee.* • *The Corporate Governance Recommendations suggest companies to adopt a code of ethics, and the majority of the surveyed companies disclose having one.* • *Whistle-blowers protections are provided by law.* • *The Corporate Governance Recommendations suggest companies to disclose their "ethical guidelines" and six companies in our sample disclosed their code of ethics.* ***Weaknesses:*** • *Given the marginal role assigned to the supervisory board, it is questionable whether the audit committee can play a key role in companies organised under the two-tier system.*
3.2. Quality of Internal and External Audit *Weak (two-tier system)* *Moderately Strong (one-tier)*	***Strengths:*** • *Banks are required to have an internal audit function, whereas listed companies are recommended to do so. Nine companies in our sample disclosed establishing such function.* • *The Institute of Internal Auditors operates in Hungary.* • *All listed companies are required to have their financial statements reviewed by an external auditor appointed by the general shareholders' meeting. The law requires external auditors to be independent, and that the audit committees are in charge of ensuring their independence. All ten largest listed companies declare their auditors to be independent and disclose their names – they are all international accounting and auditing firms.* • *Provision of non-auditing services is allowed; however, listed companies are required to disclose information on this. Three of the surveyed companies disclosed having received non-auditing services from their external auditors, but do not disclose in great detail the reasons why they still consider them to be independent. Auditors are additionally required to submit a separate invoice for non-auditing services.* ***Weaknesses:*** • *There are no requirements for listed companies to regularly rotate their external auditors.* • *Given the marginal role assigned to the supervisory board, it is questionable whether the audit committee can play a key role in companies organised under the two-tier system.*

Key Areas and Rating	Strengths and Weaknesses
3.3. Functioning and Independence of the Audit Committee *Weak (two-tier system)* *Fair (one-tier)*	***Strengths:*** • *Listed companies and banks are required to set up an audit committee, members of which must be appointed by the general shareholders' meeting among the independent directors of the supervisory board, or the board of directors in case of a one-tier structure.* • *At least one of the audit committee members is required to possess expertise in accounting or auditing.* • *Pursuant to the New Civil Code, the audit committee reports to the board of directors/supervisory board "in supervising the financial report regime in selecting an auditor, and in working with the auditor". The law also requires the audit committee to be made of three members.* • *All ten companies in our sample disclosed having an audit committee. The audit committees of all surveyed companies are composed of a majority of independent directors and in five companies, at least one member is a financial expert.* • *It appears that the audit committees of the ten largest listed companies met between 1 and 6 times in person in the preceding year.* ***Weaknesses:*** • *Disclosure on the audit committee's activities is limited to a "copy and paste" from the corporate governance documentation without explaining what the committee has done in practice.* • *Given the marginal role of the supervisory board in companies organised under the two-tier system (to whom the audit committee report to), we have doubts about the effectiveness of the control function of the audit committee in the two-tier system.*
3.4. Control over Related Party Transactions and Conflict of Interest *Fair*	***Strengths:*** • *Related party transactions (RPT) are regulated by law. Certain RPTs are prohibited and others require approval by non-conflicted shareholders or board members, or specific permission provided by the articles of association. The Corporate Governance Recommendations further recommend that transactions involving board members or executive directors and the company should be conducted with stricter transparency. In case of transactions outside the normal course of the company's business, their terms should be approved by the supervisory board or in case of unitary boards, by the audit committee.* • *The law states that board members should avoid any conflicts of interests that may affect their judgement and the Corporate Governance Recommendations recommends that members of the management board should inform the other members of such board and the supervisory board or the audit committee if he/she has any significant interest in a transaction of the company.* ***Weaknesses:*** • *All ten largest listed companies disclose their RPTs in their financial statements on in their annual reports; however in some cases such disclosure appears incomplete.* • *We could not find evidence of RPT and conflicts of interest regulations being enforced; there seems to be no material sanctions for breaches to disclose on these matters.*

Key Areas and Rating	***Strengths and Weaknesses***
4. Rights of Shareholders *Fair*	*Shareholders in Hungary have access to comprehensive financial and non-financial information. Minority shareholders are entitled - the required shareholding thresholds vary according - to call a general shareholders' meeting (GSM), add items to the agenda, and start derivative claims. Shareholders are provided with timely online notifications and materials to prepare for the GSM. Furthermore, shareholders are endowed with general inspection rights. Voting caps and multiple voting rights are allowed. Supermajority is required to approve major corporate changes, but not to increase the share capital. Pre-emptive rights are granted by law, but their exercise must be detailed in the articles. Cumulative voting is not foreseen for listed companies and does not seem to be used in practice.* *Self-dealing is regulated, insider trading is prohibited, and few insider trading cases have been investigated in the past five years. Related party transactions and conflicts of interests are regulated by law. Significant shareholding variations must be disclosed.* *Shareholder agreements are considered enforceable, but there are no obligations to disclose them. The share register of companies – including listed ones – is to be maintained by the management board of the company and can be outsourced. However, in listed companies such outsourcing and the person maintaining the share registered must be published. Except for series of shares listed on the Budapest Stock Exchange, transfer of shares may be restricted by the articles of associations and depends on the company's consent.*
4.1. General Shareholders' Meeting (GSM) *Fair*	***Strengths:*** • *Shareholders representing 5% of the capital can call a GSM, while those representing 5% in a unlisted company or 1% in a listed company can propose new items to the GSM agenda.* • *The GSM announcement and agenda are required to be sent to shareholders or be made available on the company's website at least 30 days before the meeting.* • *All ten largest listed companies publish the GSM notifications and materials on their websites.* • *The law allows shareholders to vote electronically, by proxy, or by post.* • *Eight out of the ten largest listed companies provide information about voting rights and their exercise on their website.* ***Weaknesses:*** • *Shareholders can ask questions no later than eight days before the general shareholders' meeting on item placed on the agenda. Upon such request, the management board must provide answer. However, there is no explicit right granted by law to shareholders to ask questions at the meeting with corresponding obligation to management to provide answer.*
4.2. Protection against Insider Trading and Self-dealing *Moderately strong*	***Strengths:*** • *Insider trading is prohibited by law and may be punished with imprisonment for up to three years. A few insider trading cases have been investigated in the past five years.* • *It appears that transactions in company shares made by board members must be disclosed. Three companies in our sample routinely disclose transactions of their company's shares on an official website.* • *Conflicts of interest and related-party transactions are regulated by law.* ***Weaknesses:*** • *Related-party transactions conducted under unfair terms can be invalidated, but there is no clear and consistent judicial practice actively invalidating these transactions.*
4.3. Minority Shareholders Protection and Shareholders' Access to Information *Fair*	***Strengths:*** • *All ten largest listed companies publish their annual reports with financial and non-financial information on their websites.* • *Shareholders have general inspection rights. Additionally, shareholders have the right to call a GSM, ask questions before or on the GSM and add items to the agenda.* • *Supermajority is required for major corporate decisions. Minority shareholders may block major corporate changes with a 25%+1 vote.* • *Shareholders representing 5% of the capital can bring a derivative claim against any shareholder, member of the board of directors, member of the supervisory board or appointed auditor of the company, provided that the GSM previously voted against such proposals or did not bring a resolution on the matter. In the past five years, several derivative claims have been brought to court.* • *Companies' websites are generally informative; information is complete and easy to find.* ***Weaknesses:*** • *Pre-emptive rights in all cases of capital increases in cash are mentioned in the legislation, but their exercise must be provided by the company's articles. In particular, the law states that "the ranking of persons entitled to exercise preferential rights and the time limit for exercising preferential rights shall be*

Key Areas and Rating	***Strengths and Weaknesses***
	specified in the articles of association". Careful attention to the articles' wording must be paid as it might limit shareholders' ability to exercise this right. • *Shares with disproportional— such as golden shares— or multiple voting rights (up to ten times the ordinary shares) are allowed by law. The Corporate Governance Recommendations recommends companies to apply the "one share, one vote" principle.* • *The law does not provide cumulative voting or proportional representation mechanisms, and they are not used in practice.* • *The law seems to allow voting caps, but only few companies use them.*
4.4. Registration of Shareholdings *Weak*	***Strengths:*** • *Shareholders have to report to the Hungarian National Bank whenever their ownership exceeds or falls below 5% of the total company shares —and with every 5% change after that until reaching the 50% ownership threshold. After that, they must only file a disclosure if their interest exceeds or falls below the 75%, 80%, 85% and 90% thresholds. After ownership exceeds 90%, shareholders must report any fluctuations in 1% of their votes. Furthermore, acquiring more than 75% of the total shares triggers a reporting requirement to the court of registration.* ***Weaknesses:*** • *Shareholder agreements are enforceable, but the case law on this matter varies. Furthermore, agreements are not required to be registered or disclosed.* • *The share register of companies – including listed ones – is to be maintained by the management board of the company and can be outsourced to a subcontractor. However, in listed companies such outsourcing and the person maintaining the share registered must be published.* • *Except for series of shares listed on the Budapest Stock Exchange, transfer of shares may be restricted by the articles of associations and depends on the company's consent.*

Key Areas and Rating	Strengths and Weaknesses
5. Stakeholders and Institutions *Fair*	*The institutional framework supporting corporate governance practices in Hungary seems to be relatively well developed, however room for improvement exists.* *The Budapest Stock Exchange (BSE) is the main local stock exchange in Hungary. BSE's market capitalisation is around 16% of the country's GDP, and the market seems to be fairly liquid. There are three listing tiers at the BSE: the Prime Market Segment, the Standard Market Segment and the T Market Segment. Companies in all three listing tiers are expected to implement the Corporate Governance Recommendations on a "comply or explain" basis. The BSE website contains a comprehensive summary in English of listed companies' profiles.* *International rating agencies are not very active within the country, and only one surveyed company has been assessed by an international rating agency.* *Since 2013, the Hungarian Central Bank has assumed all competences from the former HFSA, and now is the regulator and supervisor of all financial sector entities, as well as capital markets.* *When looking at the indicators provided by international organisations, Hungary ranks moderately poorly in terms of competitiveness, investor protection and corruption.*
5.1. Corporate Governance Structure and Institutions *Moderately Strong*	***Strengths:*** • *The Budapest Stock Exchange (BSE) is the main local stock exchange in Hungary. BSE's market capitalisation is around 16% of the country's GDP, and the market seems to be fairly liquid.* • *There are three listing tiers at the BSE: The Prime Market Segment, the Standard Market Segment and the T Market Segment. Companies in all three listing tiers are recommended to implement the Corporate Governance Recommendations on a "comply or explain" basis, but are required to disclose the level of their compliance through a corporate governance report. Among other additional capital and financial requirements, companies in the Prime Market Segment are instructed to present a Corporate Governance Report upon being listed.* • *International audit and law firms have a significant presence in the country.* • *The BSE website (http://bse.hu/topmenu/issuers/issuerslist) contains a comprehensive summary of companies' information, including governance reports and board composition.* • *There appear to be a few institutions providing training courses for company directors/supervisory board members.* • *The rulings of regulatory agencies are documented, publicly available and easily accessible.* • *Since 2013, the Hungarian Central Bank has assumed all competences from the former HFSA, and now is the regulator and supervisor of all financial sector entities, as well as capital markets. The Central Bank website (https://www.mnb.hu/en) includes a repository of laws and regulations relevant to corporate governance.* ***Weaknesses:*** • *International rating agencies are not very active within the country; only one surveyed companies has been assessed by an international rating agency.* • *Judicial practice on some corporate governance issues seems to be limited.*
5.2. Corporate Governance Code *Fair*	***Strengths:*** • *In 2002, the Corporate Governance Committee of the BSE drafted and issued the Corporate Governance Recommendations, which were later reviewed in 2007 and 2012. The Corporate Governance Recommendations includes various annexes detailing how compliance reports should be structured, and the type of information they should include.* • *All listed companies are required by the Civil Code and the BSE Listing Rules to disclose whether they comply with the Corporate Governance Recommendations (or any other national corporate governance code that they take as a reference) or explain the reasons for non-compliance (so-called "comply or explain" approach). They are additionally expected to provide brief disclosures of corporate governance and internal control practices with each annual report.* • *All ten largest listed companies in Hungary disclosed their "comply or explain" statements on their websites. Most of the companies' statements show a relatively high degree of compliance with the code taken as a reference.* • *In 2013, the Hungarian National Asset Management Company issued the Corporate Governance Recommendations for State Owned Enterprises (http://www.mnv.hu/felso_menu/tarsasagi_portfolio/eljarasi_dokumentumok/vallalatiranyitasi_ajanlasok/ajanlas_allami_tulajdonu_tarsasgok_szamara.html), which are available in Hungarian only.* ***Weaknesses:*** • *The structure of the Corporate Governance Recommendations is quite complex. Provisions are divided in "R" – recommendations; "S" – suggestions; and "E" – explanations. Companies have to indicate their compliance with the recommendations (R) and indicate whether they apply different suggestions (S). Explanations (E) serve to give directions regarding the relevant recommendations or suggestions. This approach is not intuitive.*

Key Areas and Rating	***Strengths and Weaknesses***
	• *The Corporate Governance Recommendations are shaped on the law in force; given the recent substantial change in the Civil Code, a revision of the Recommendations is needed.* • *Some provisions in the Corporate Governance Recommendations (e.g., composition of committees) are not aligned with best practices and should be revised.* • *It is unclear which body (if any) is responsible for monitoring listed companies' compliance with the Corporate Governance Recommendations. We could not locate any monitoring reports in this respect. As the "comply or explain" approach is essentially a dialogue between companies and the market, it is essential that – upon companies' reporting – the owner of the corporate governance code comes back to the market with a monitoring report, so to provide pressure on companies and guidance to the market.* • *Due to the disclosed high level of compliance with the Corporate Governance Recommendations, explanations are limited. Only few are logical, informative and convincing.*
5.3. Institutional Environment *Weak*	***Strengths:*** • *Case law is fairly accessible and regularly updated.* ***Weaknesses:*** • *We have seen a few inconsistencies in laws and regulations concerning corporate governance issues.* • *When looking at the indicators provided by international organisations, Hungary ranks moderately poorly in terms of competitiveness, investor protection and corruption.*