european corporate governance institute

Directors' Remuneration in Listed Companies

Hungary*

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Hungary law, regulation and best practices are stated as they stood at October 2008.

Questionnaire

There is a relatively straight forward and simple regulation under Hungarian law.

1. General

Under Hungarian law essentially two types of rules address directors' remuneration: (1) the Companies Act (Act 4 of 2006) ("**Companies Act**"), and (2) the Corporate Governance Recommendations of the Budapest Stock Exchange adopted in March 2008 ("**Code**" or "**Recommendations**").

In addition, specific disclosure of share transactions by insiders and other matters are regulated by the Securities Act (Act 120 of 2001) ("**Securities Act**")

When this Note addresses directors' compensation, it refers to (1) directors as members of the board of directors (who may be (i) independent or outside directors, and (ii) non-independent directors), and (2) senior executives (who may or may nor serve as members of the board of directors).

2. Companies Act

2.1 Rules Applicable to Both Listed and Non-Listed Companies

The Companies Act sets out the basics for all companies, both listed and non-listed.

The starting point is Section 231(2) of the Companies Act, which sets out the exclusive powers of the general meeting of the shareholders. Under Section 231(2)(d) the general meeting must adopt the remuneration of the members of the board of directors. A simple majority is needed for all resolutions pertaining to director compensation.

There is a two-tier board system in Hungary. Members of both the board of directors and the supervisory board are elected and removed by the general meeting of shareholders. This regime is different from the German-Austrian model where the supervisory board is elected by the shareholders meeting and, in turn, the supervisory board elects members of the management board. In Hungary all the decision making power lies with the board of directors. Unlike the German-Austrian model the Hungarian supervisory board is a "lightweight" board, its authority is restricted to relatively weak oversight powers. For this reason your Question 3.1 should not relate to the Hungarian style supervisor y board, but rather the board of directors.

2.2 Specific Rules Applicable to Listed Companies

In addition, with respect to listed companies only, Section 302(c) provides that the exclusive powers of the general meeting include the adoption of either binding or non-binding resolutions with respect to setting the guidelines and parameters of the long term remuneration system and incentives of (1) members of the board of directors, and (2) senior executives.

A number of comments are in order in connection with Section 302(c).

- It is the company's articles of incorporation which fixes whether the resolution shall be binding or non-binding (typically it is non-binding, but this is a relatively new law and actual practice has not yet developed).

- The resolution of the general meeting sets guidelines and principles of "long-term" compensation structures and incentives, and not the specific level or amount of compensation of any board member of senior executive.

- The specific level and amount of compensation of all senior executives, including those who are non-independent directors is fixed and approved by the board of directors. This "detail" is never presented by the board to the general meeting. For individualized disclosure see Paragraph 3.3 of this Note.

3. Corporate Governance Recommendations

3.1 General

The Code or the Recommendations is a set of best practice rules, which operates on the "Comply or Explain" principle. The Code is not "binding law"; it is the recommendation of the Budapest Stock Exchange. It has first been adopted in 2004, and its present form has been approved in March 2008. The Code is not a stock exchange regulation, which pertains to listing requirements, though it has been prepared by the Corporate Governance Committee of the Budapest Stock exchange and approved by the Board of Directors of the Budapest Stock Exchange.

The Code is enforced through the "Comply or Explain" principle. Listed companies generally comply with a fair number of provisions of the Code. One striking area where the key listed companies do not comply, but rather "explain" is disclosure of individualized director and executive compensation (see Paragraph 3.3 of this Note).

The drafters of the Code studied, and in many respect relied upon, EU Recommendations 2004/913EC and 2005/162/EC.

3.2 Disclosure of Remuneration

Under Section 4.1.11 of the Code listed companies are to prepare a remuneration statement to be included in their annual report and the remuneration statement must be posted on the company's website. While not a cut and paste exercise, this rule is based on Sections 3 -5 of the EU Recommendation.

The remuneration report is prepared annually and is published on the company's website. It is also released to the Budapest Stock Exchange. The remuneration report, as part of the annual report, is also submitted to the Securities Regulator (the Supervision of Financial Services Providers). The Stock Exchange and the Securities Regulator collect these documents.

The remuneration statement is to set out the company's policy on directors' remuneration.

In respect of the members of the board of directors, senior members of the management, the remuneration statement must set out, at least, the following information:

- Explanation of the relative importance of the variable and non-variable components of remuneration,
- Performance criteria on which entitlement to share options, shares and other variable components are based.
- Description of the linkage between remuneration and performance.
- The main parameters of the annual bonus scheme or other non-cash benefits.
- Description of the supplementary pension and early retirement schemes.
- Terms and conditions (termination, severance) of employment agreements with members of the board of directors.
- Description of the process and decision making (remuneration committee, composition, use of outside consultants, decision making by board and general meeting).

It is also recommended that the remuneration statement sets out separately for the individual directors and senior executives the following:

- The total amount of fees, salaries, including attendance fees, remuneration in the form of profit sharing.
- The same received from members of the group.
- Severance payments due to executive directors that are members of the board of directors.
- Loans, guarantees, advance payments received from the company and any of its affiliates.
- The total estimated value of the non-cash benefits other that the above.

In addition, the remuneration statement must set out the terms and conditions of the share options or other rights convertible into shares granted to the members of the board of directors and the supervisory board, and the executive directors. As to share options and other share rights, must set out:

- The number of share options offered or shares granted by the company during the relevant financial year.
- The number of share options exercised during the relevant financial year, the exercise price, and the share interest so acquired.

- The number of share options non-exercised during the relevant financial year, the exercise price.
- Any changes in respect if the terms and conditions of the existing share options during the financial year.

As to supplementary pension schemes, if any, the following information must be presented:

- The director's accrued benefits under the scheme during the relevant financial year.
- Contributions paid by the company in respect of the director during the relevant financial year.

3.3 Individualized Disclosure of Director Remuneration

Sections 2.7.7. and 4.1.11 specifically contemplate the individualized disclosure of directors remuneration.

The initial review of the disclosures filed by the listed companies before the prescribed deadline (April 30, 2008) show that listed companies generally do not comply with these recommendations and chose to explain their actions.

By way of example, MOL, the Hungarian oil and gas conglomerate, disclosed the following explanations.

Section 2.7.7: "*In the corporate governance section of its annual report the company provides detailed description of the principles of the remuneration system of the board of directors, the supervisory board, and management, and in a separate part of the report discloses the amount of the aggregate compensation paid to managers in key positions (top and mid-level positions)*".

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In other words, most listed companies do not provide individualized disclosure and, as shown above, the explanatory disclosure is rather brief and obscure.

4. Other Questions

Since a number of questions of the Questionnaire could not be addressed in the Note's structure, we take on these questions individually.

Q 2.5: Certain insiders (directors and executives) must disclose conflicted transactions and specific “insider transactions.”

Q 2.6: Prospectus requirements do not pertain to individualized director’s remuneration.

Q 3.1: The general meeting fixes board of directors’ remuneration. Resolutions are prepared by the board of directors itself and are reviewed by the supervisory board.

Q 3.2: Director compensation for board attendance is typically equal, the chairperson typically gets more. Other elements of remuneration are individualized.

Q 3.3: Personal loans are not prohibited, but are not customary.

Q 4.1 The executive director’s remuneration is fixed by the board of directors. The remuneration committee of the board works out principles and proposals.

Q 4.2 Under the Code the board is required to create a remuneration committee. It is possible for listed companies to create a combined nomination and remuneration committee. It is recommended that the remuneration committee be composed of only non-insiders and the majority be composed of non-independent directors.

Q 4.3 All of these benefits are permitted. A common form of compensation is through special convertible bonds.

Q 4.5 For termination of senior executives special severance payments are set out in the employment agreements.

Q 4.5 Neither duration nor disclosure requirements exist.

Q 5.1 Non-executive directors get paid for board attendance and committee attendance. They may get profit share or share based compensation, but no stock options.

Q 5.2 While there appears to be no prohibition, this is very unusual.