

# THE IMPACT OF THE LACK OF TRANSPARENCY ON CORPORATE GOVERNANCE: A PRACTICAL EXAMPLE

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## Abstract

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The conceptual elements of transparency in the business sector and the transparent management of companies became even more desired features as a result of the rapid technological advancements we are witnessing especially after 2010. With the global spread of social media and online platforms, the networked and digital age is a new environment where companies have to adapt in order to be efficient, and their corporate governance policies have to be tailored to fit the new requirements. In such environment, the strengthening of the transparency principle is essential also through the examination and comparison of prominent cases, through which the conclusions drawn contribute in fostering the appropriate future use of corporate governance policies and increasing social responsibility with respect to the functioning of the participants of the business sector. The aim of the paper is to highlight the possible adverse effects of the lack of transparency exerted on corporate governance.

**Keywords:** Corporate Governance, Transparency, Governmental Transparency, Transparent Management, Corporate Scandals

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## 1. INTRODUCTION

Companies holding a strong position on a given market while being managed without the necessary degree of transparency and prudent corporate governance policies are exposed to be the hotbeds of abusive market practices. If abusive market practices are followed by leading business participants with strong market positions, the consequences will most likely hurt competition as well (Lim & Min, 2016). As a result, the foundations of the free market and the right to free competition are shaken by these types of corporate conduct, not to mention the harm caused to the interests of certain individuals, let them be natural or legal persons, being subjected to both financial and moral damage in such situations, hence the viability of their very existence might be endangered. Even in the case of certain lawful techniques the social opinion can be adverse if the degree of transparency is lowered. For example, in the case of Snap Inc., the first company to go public on a USA stock exchange by issuing only nonvoting shares, thus avoiding certain otherwise applicable disclosure obligations. Even though Snap's 2017 IPO was a success, the initial reaction of the public

towards the structuring of the transaction was unfriendly (Lund, 2019). As stock prices can also be strongly affected by the disclosure of firm-specific information (Brogi & Lagasio, 2018), in the networked and digital age the degree of corporate disclosure and overall transparency are elevated to even more important level.

The increased appreciation for and new challenges of corporate governance in the networked age are not a matter of coincidence (Vermeulen, 2015). Emerging technologies, such as artificial intelligence, are expected to be game changers also in the case of corporate governance policies (Grove & Lockhart, 2019). Taking into account the inflexible nature of certain large, bureaucratic business corporations (Greenwood, 2018), adaptability might be the key to future success, of which transparent functioning is an essential component. The spread of demand for transparency and certain corporate scandals unearthed in the beginning of the 21<sup>st</sup> century, for example the Enron case in the United States or the Parmalat scandal in Europe (Ferencz, 2015), provided enough motivation to the legislators and the academic sphere of the United States and the European Union to deal with the topic in a detailed manner, thus the development of the

necessary regulatory background could begin (Tingle, 2018). In the European Union Commission Directive 2006/46/EC is an important legislation with respect to corporate governance, as it requires public companies to include in their annual report a corporate governance statement. The European Commission's Action Plan on company law and corporate governance, adopted in 2012, has to be mentioned here as well. The action plan and further harmonization projects set as one of their main purposes the increased level of transparency between companies and their shareholders (Hopt, 2015). Europe 2020, also a strategy of the European Commission, is aimed at increasing competitiveness and developing corporate governance practices and sustainability between companies in Europe (IFC, 2015). Directive 2004/25/EC on takeover bids has to be mentioned here as well, as it lays down certain requirements in the event of takeover bids (Kecskés, 2017). In the United States the Sarbanes-Oxley Act (SOX), enacted in 2002, is the main instrument regulating matters of corporate governance and requiring companies to strengthen disclosure and audit committees, provide accurate financial statements and determine the liability of directors and other executives; furthermore, SOX introduced stricter criminal penalties for securities, mail and wire fraud, and ultimately focuses on increasing financial transparency for investors by establishing rules requiring more accurate and reliable corporate disclosures.

The conceptual elements of corporate governance can be grasped with the following definition: the adequate governance system of companies, which covers the relations between the management, the owners, the employees and other persons concerned, and is based on the lawful, ethical, reasonable, efficient and socially useful solutions for profit oriented operation, and is regulated by statutory provisions and the self-regulating mechanisms of the market and the business sphere (Kecskés & Halász, 2013).

As it is apparent, the essential and necessary development can be detected in the aspects of law and business touching the area of corporate governance. However, it has to be stated that while SOX carries a hard law character, the nature of the related European Union legislation remains mostly soft law (Bianchi & Peters, 2013). Taking into account the power concentrated in the hands of multinational corporations and interest groups shaping the policies of such entities (whether or not politically affiliated), development and an increased amount of hard law elements are more than necessary in order to facilitate reasonable and effective business decisions instead of ones that might appear to serve self-motivated interests only. The picture seems to be even more shaded for example in the case of mutual investment funds, where, among others, issues related to transparency and accountability are key factors of why prominent scholars suggest the disentangling of mutual fund governance from corporate governance (Roiter, 2016). Furthermore, the possible positive and negative effects of ownership transparency exerted on corporate performance are also highly debated among legal scholars (Lakhani, 2016).

Recently erupted corporate scandals in Hungary also highlight the adverse effects of the

lack of transparency. The Quaestor case, for example, that stirred up public opinion and produced negative effects on the business environment and society as a whole (Kecskés, 2018). Quaestor rightfully took over from Postabank the title of Hungary's ambassador of financial frauds. Below the Postabank case and its comparison with the Enron case will be presented, through which the impact of the lack of transparency will be highlighted; more precisely, how it can derail the management of high-profile companies and how it violates certain elements of good corporate governance. The conclusions elaborated on the basis of the thoughts presented throughout the research suggest the involvement of certain hard law elements for increased transparency with respect to the related Hungarian laws, however, the approach might also prove to be useful from an international perspective.

During the comparative analyzation of the two cases, several subtopics are identified and elaborated by the paper. The structure of the paper shaped by the subtopics can also be viewed as the anatomical structure of unethical corporate governance policies, as it highlights certain elements playing an integral part in the process. Point 2.1 describes the adverse effects and nature of the loosened board/ownership control over the management, while point 2.2 details particular methods through which illegal and unethical corporate activities were carried out. Point 2.3 focuses on the underlying relationship network assisting the process, which leads to points 2.4 and 2.5 where the nature and mechanisms of political and state-affiliated relationships are discussed. Point 2.6 details criminal proceedings while point 2.7 examines the relevant connections between the cases and presents how transparency had been hurt multiple times. In the Conclusions the author wishes to introduce certain ideas related to policy and legislation, elaborated on the basis of the research and aimed at strengthening the importance of a greater degree of transparency in the functioning of high-volume public companies, ultimately resulting in increased investor and shareholder trust and providing a possible guidance towards a more socially responsible model. However, it has to be taken into account that while the examination of fraudulent behaviours occurring in the business sphere can be approached from several different legal (and non-legal) perspectives, the present research and its conclusions are focusing exclusively on issues related to corporate governance, and examine the cases and introduce the findings in areas related to and playing an integral part thereof. Furthermore, the findings of the research mainly focus on the transparency aspect of corporate governance, and are relevant with respect to high-volume, publicly traded companies. From a geographical and methodological perspective, the research does not go beyond the comparative examination of United States and European Union trends.

## 2. POSTABANK I.E. THE HUNGARIAN ENRON

By the end of the 20<sup>th</sup> century the shadows of international corporate scandals have fallen over the territory of Hungary as well. The Postabank scandal

erupted in the second half of the 1990s and caused robust political, legal and social controversies as the first major white-collar crime to come before the public in Hungary. The judgment rendered and the sanctions imposed in the case by the Supreme Court of Hungary can be deemed rather mild. The case and its outcome carried the controversial nature of the economic and social changes Hungary went through during the 1990s, the effects of which are still being felt today. Apparently, the scandal was system-specific and not just one derailment. It was encoded into the system irrespective of the participating individuals, thus it seems reasonable to treat the Postabank case as a phenomenon rather than one isolated case. Uncertainty after the fall of the communist regime and the forced transition from centrally planned to market economy provided favourable grounds for the management to carry out decisions without supervision. The management acted in favour of self-motivated interests and without actual limitations or oversight (Perczel, 2003).

## 2.1. Turning off actual board and ownership control

In order to understand the mechanisms that led to the scandal it is worth examining the events via the agency theory first (Macey, 1991). The exercising of certain ownership rights, especially in the case of public and / or state-owned companies, to an extent, but still concentrates necessarily in the hands of the management. In theory the executives, for example the CEO, are acting on behalf of the shareholders and represent their interests as their authorised agent. However, the essence of the agency theory is that the agent - due to his position - always possesses more knowledge with regard to the company's operations and transactions than the shareholders. There might be a possibility that the agents, by taking advantage of their information surplus, start shaping the company's business decisions contrary to the shareholders', and in support of their own interests.

To eliminate the possibility of such misbehaviour, the owners install monitoring mechanisms (e.g. supervisory board) in order to exercise oversight over the management. However, the monitoring mechanisms can also be composed of agents, who may once again act in support of their own interests, thus a collaboration between the two agent groups might be formed. This type of collaboration was evidently happening in the Postabank case.

The owners of Postabank installed a monitoring mechanism serving as a device for the supervision of the management. It has to be noted that the Hungarian state, as co-owner, was also present in the ownership structure of Postabank. In order to loosen and avoid ownership supervision, the management and certain members of the supervisory board in affiliation with the co-owner Hungarian state collaborated for the purpose of self-motivated interests. The facts have indicated that serious cover ups and breaches of corporate discipline were everyday practices in the bank's business policy. Certain credit and investment decisions were not adopted by the designated body of the bank, but solely by the CEO, who was acting within his discretionary authority and was able to

decide alone on the lending or investing of hundreds of millions of forints, without the opinion or actual decision of the shareholders or board of directors (Ószabó, Sipos, & Vajda, 2003).

Postabank was established in 1988, primarily as a retail bank, however, by 1992 it had already built a portfolio consisting of doubtful high-volume debts. The initiating cause was capital shortage. The results of Postabank's banking operations had deteriorated continuously, the starting point of which emerged by the combined effects of greatly decreasing interest rate differentials and significantly increasing operational costs. Postabank focused heavily on attracting new investments by promising high returns for those who would consider investing in its portfolio. A new business policy was adopted and followed, according to which an intense expansion of retail clientele, aggressive investment policy and the massive involvement of external resources became main objectives (Sándor, 2012). Postabank, as a retail bank, exploited its market advantage of being known to the public and having easily accessible services through its extensive client network. Until 1995 the bank had engaged in subtle investment attraction, but then left the cautious business policy behind and offered significantly higher return rates than its competitors in order to attract larger-scale investments. Postabank had the chance to invest the incoming amounts into government securities or other safe investments available at the time, as its competitors have done (Szalay, 2017).

## 2.2. Ponzi scheme<sup>1</sup> and the Hungarian pyramid

Postabank had engaged in a particularistic Ponzi scheme. Let us call it a special Hungarian pyramid, however, not nearly as miraculous as the ones found in Egypt. It offered to investors short-term interest rates which were significantly higher than the market average, while on the other hand it had to reduce the interest rates on long-term loans. This led to instability. The diminution of the gap between the interest rates on deposited and loaned amounts resulted in continuous difficulties, since it meant a decrease in Postabank's income as well. This type of situation could cause difficulties even if the repayment of loans is secured adequately, as the profits generated from continuously repaid loan interests (unproblematic repayments) serve as a source for covering payments due towards investors. The repayment of loans by the debtors of Postabank was far from the ideal, thus the bank had to take additional risk and recoup the losses generated by

<sup>1</sup> The Ponzi scheme, or pyramid scheme, is a type of investment fraud that promises to investors the possibility of high rates of return paired with small risk. This type of investment-attracting behaviour originates from Charles Ponzi, who coordinated the first notorious pyramid scheme in 1919 in the United States. Companies engaging in a Ponzi scheme attract new investors and use their money to pay the "original" or "older" investors their promised return. In other words, the new income that flows into the company from new investors, attracted by misleading marketing policies, is marked as profit flowing in from legitimate transactions. But legitimate profits in such situations exist in theory only. Therefore, for the Ponzi scheme to be successful, the company needs the continuous flow of new investments. If the flow becomes exhausted, the scheme collapses. A notorious case in which a Ponzi scheme was orchestrated unearthed in late 2008 in the United States. The famous „Wall Streeter” Bernard L. Madoff (portrayed by Robert De Niro in the crime drama ‘The Wizard of Lies’) defrauded the clients of his investment firm of an estimated USD 50 billion.

nonperforming loans by drawing further and further investments under the above-mentioned unhealthy conditions (Szalay, 2017).

### 2.3. In the captivity of the network

Dramatic changes occurred during the second half of the 1990s, as the aggregate amount of nonperforming loans and unsuccessful investments placed by Postabank elevated from 9 billion to 100 billion forints. The most likely reason of these dramatic changes can be found in the relationship network that surrounded the bank and the CEO. In other words, if Postabank's downfall drags down other important persons and organisations as well, the protection from downfall is ensured if the bank and its executives are rooted deeply enough in the network. This presupposed the existence of a higher layer of political and corporate leadership that served the purposes of the relationship network, encompassing loyalty towards the then prevailing political regime and the relationship capital that held the network together (Perczel, 2003).

The so-called advantage of the relationship network was that with support received from the relationship capital, the bank was rescued over and over again through debt and bank consolidations offered by the Hungarian state, which was financed from the central budget of course. With such support the network was able to operate flawlessly. The desire of Postabank and its management to satisfy the demands of the network was the main reason why certain loans and other investment activities contrary to economic reasonableness had become common practice (Sándor, 2012).

### 2.4. The state repays to itself for the benefit of the laughing third

A perfect example of the existence and operation of the network was a transaction that involved the company named Dunaholding. Dunaholding was a minority shareholder of Postabank. By 1996 Postabank had already amassed 50 billion forints made up of nonperforming loans and other unsuccessful investments. The bank sold to Dunaholding the right to collect certain debts under the condition of paying the purchase price for the right in instalments within a 10-year period. Dunaholding did not even pay the first instalment of the purchase price, but gave back to Postabank the above-mentioned right, which was sold again by the bank under the same conditions, however, this time to a company named G Modus. The interesting thing about G Modus is that it was owned by Postabank and Dunaholding, and it was operating as one of the subsidiaries of the parent company Modus, which was again owned by Postabank. G Modus did not use its own assets to purchase the portfolio, but a loan received from Postabank. Meanwhile, the Hungarian state undertook a guarantee with respect to the loan G Modus received, but requested counter-guarantee from the shareholders of Postabank. Some of the shareholders, including Dunaholding, refused to bind themselves by undertaking the counter-guarantee, however, the municipal social security funds, as minority shareholders of Postabank, accepted and undertook these terms. Postabank received the instalments of the purchase price via

the guarantee given by the Hungarian state, the Hungarian state then turned to the municipal social security funds on the basis of the counter-guarantee, while these funds were standing liable and were actually paying the instalments. Finally, the losses of the municipal social security funds that arose from payments due on the basis of the counter-guarantee were compensated from the central budget by the Hungarian state (Szalay, 2017).

The strategy worked with the support of the network. The Hungarian state was bearing the adverse consequences, while the laughing third, Postabank, was collecting the benefits. Such hidden and state-subsidised capital injections could only be accessed through the members of the network, and for that purpose, the interests of the network had to take priority over economic reasonableness.

The following case was another fictitious increase of profits: Postabank owned a real estate worth 300 million forints, which was revalued by the bank in order to determine its "fair price", and entered into the books with a market value of 900 million forints. Then the bank contributed the real estate to a company and in exchange acquired an ownership share worth 900 million forints. This appeared in the bank's balance sheet as a profit of 600 hundred million forints. Afterwards, the bank sold the acquired ownership share (that means the contributed real estate) to another company with the condition of paying the purchase price in instalments. And how was that company able to pay the instalments of the purchase price? The answer is easy: Postabank rented back the freshly sold real estate and the company paid the instalments from the rental payments. The purpose of the transaction was to orchestrate the impression that the real estate was sold to an independent party with beneficial conditions for Postabank, while in essence the bank granted hidden loan (instalments and rental payments) to the company in order to enable it to purchase the real estate on the revalued price. A win-win situation. The bank generated profits in its balance sheet, while the purchaser company was compensated for the higher purchase price by the bank's rental payments (Perczel, 2003).

### 2.5. Politics, power and money

The facts have indicated that instead of a professional attitude within the framework of economic reasonableness, the bank's CEO and management were being driven by political and self-motivated interests.

Political affiliation can clearly be traced in other loan transactions as well, namely the one that involved a limited liability company named Budai Hengermalom. Based on the CEO's personal instruction, Postabank purchased for 300 hundred million forints a portfolio worth only 179 million. Following certain loans granted to Budai Hengermalom – of which the interest was repaid only by the company but not the principal amount – the bank purchased its shares for a price significantly higher than its fair value. The purchase price for the shares landed on the bank account of a person close to the then governmental party. The purposes for which this person utilised the amount will probably remain a mystery for eternity (Vajda, 2004).

## 2.6. The criminal charge as the best defence

Criminal proceedings were initiated in 1999 by the police, and finally in 2003 the CEO Gábor Princz and three of his companions within the management of Postabank were indicted with misappropriation of funds. According to the prosecutor, the violation of law that arose from the faulty business practices and the financial loss caused this way jointly constituted the act of misappropriation of funds. Pursuant to Hungarian criminal law this criminal offense can only be committed wilfully, i.e. the perpetrator's intention has to include the breach of his obligations as well as the result thereof, i.e. the financial loss. If, with respect to the result, the perpetrator is liable only because of negligence, but had no direct intention in this regard, then only defalcation can stand, which is a misdemeanour not a felony under Hungarian criminal law.

Surprisingly, the expansive investment-attracting policy (4% increase) was the central element of the indictment, and was presented by the prosecutor as the cause triggering all troubles. In reality, the 4% interest income was not flamboyant at all, because the market interest rate was skyrocketing at the time. Postabank and its management only exploited their market advantage (extensive client network). With respect to establishing the felony of misappropriation of funds, the indictment was never convincing. Proving that Postabank engaged in an expansive investment-attracting policy with the purpose of causing damage amounting to billions of forints seemed impossible as well. In this sense the indictment was a professional defence orchestrated for the accused rather than an adequate criminal charge (Sándor, 2012).

The first instance court hearings front of the Budapest-Capital Regional Court was led by a judge specialised in economic crimes. CEO Gábor Princz denied the charges brought up against him, and emphasised that the situation of Postabank was known to state authorities, however, until 1995 none have raised any issues in connection with it. In accordance with preliminary expectations, the criminal indictment of misappropriation of funds – already doomed to be a failure from the beginning – seemed to collapse, as the judgment in the first instance acquitted the accused in the felony subject to prosecution. The acting judicial council expressed its doubts with respect to the lawfulness of the charge, according to which the prosecutor did not base the indictment on individual transactions, but tried to prove the criminal liability of the management on the basis of the bank's business strategy. The charge therefore could not be proved beyond reasonable doubt (Vajda, 2004).

In the second instance court hearings the Budapest-Capital Regional Court of Appeal found the accused guilty in the misdemeanour of defalcation, and sentenced Princz to a fine of 3.6 million forints and each of his companions to 1.5 million. The judgment can be characterised as mild. According to the court's reasoning the prosecutor chose an unusual solution when presenting the bank's business policy as the subject of the indictment, as that includes both the possibility of earning profits and the risk of suffering losses. The reasoning pointed out that so far no one has

invented how to fully secure the earning of profits in a market economy, and faulty business policies do not qualify as a felony. Wilfulness was excluded thus misappropriation of funds could not be established, however, its milder form, defalcation, which requires negligence only, stood its ground. In the third instance the case was reviewed by the Supreme Court of Hungary, but it upheld the judgment of second instance (Ószabó, Sipos & Vajda, 2003). The judgment was criticised by many. It is indistinct why the prosecutor chose the bank's business policy as the central element of the indictment, since in that respect the accused had unbeatable advantage due to their information surplus. Why was he trying to evidence an intentional criminal act already doomed to be a failure from the beginning, instead of presenting certain individual transactions and the lending practices of Postabank as the subject of the indictment. Several newspapers foresaw the outcome before the judgment was even published. The main significance of the Postabank case, the subsequent criminal proceedings taking more than ten years and the final judgment was that the Supreme Court of Hungary expressed its opinion in matters such as the possibility of establishing criminal liability on the basis of managerial decisions, which had importance with respect to certain aspects of corporate governance as well.

## 2.7. Specific similarities between the Postabank and Enron case

Concealment of losses and creative accounting were evident in both the Enron and the Postabank case. These methods ultimately served the purpose of misleading investors and shareholders. In both cases so-called SPEs (special purpose entities) were created in the form of subsidiary companies, with the intention to hide and convert the losses of the parent companies. In the Enron case the names of the subsidiaries can be traced back to acronyms created from the initials of executive officers' family names (for example: LJM), while Postabank's method was that it created a network of subsidiaries named Modus, and each subsidiary added to his name the first letter of the city in which it was established. In both cases the purpose of converting losses to the subsidiaries was to maintain the picture of the parent company's positive balance sheet towards the public. Similarly, the subsidiaries were used for sham contracting, masking the actual fact that the parent company had entered into contracts and transactions with itself. Fictitious, non-existing profits were created, capable of increasing the trust of investors. A further similarity was that gatekeepers (accounting and law firms, etc.), who in theory should have supported investor protection while assisting the work of the company's management as external and independent experts (Pargendler, 2016), were not trying to stop the management from carrying out its illegal activities, but rather helped creatively.

In Hungary, mainly as a reason of the particular way how privatisation and the conversion from the communist model to capitalism occurred – through the existence of the above-mentioned relationship networks for example – the scandal was not just an isolated phenomenon, but rather a direct consequence of the system. As examined above,

Postabank was unable resist the demand of the relationship network, thus entered the vicious circle where it fed the network by drawing riskier and riskier investments with less and less profit, while in exchange the network balanced the financial position of the bank time and time again with the involvement of more and more state funds (Perczel, 2003).

In both the Enron and Postabank cases the transparency principle was hurt multiple times, as by distorting the content of the balance sheet the companies misled shareholders and investors with respect to certain financial results (Root, 2019). An increased volume of transparency, or basically the existence of a certain amount of transparency could probably have been a restraining force for non-independent parties with respect to their agreements and transactions, which were never in compliance with standard and fair market practices.

### 3. CONCLUSION

In connection with corporate governance there is a wide and global palette of conflicts, problem areas and scandals, originating mainly from the United States and reaching Hungary through Europe. Following the Enron scandal, SOX, also known as the Public Company Accounting Reform and Investor Protection Act, was enacted in 2002 in the United States. The creation of this strict federal law was greatly influenced by the scandals that emerged in connection with the ex-energy industry giant and other companies, as well as by the great social outcry that followed (Kecskés, 2016). The European Union regulated corporate governance-related matters in multiple steps (Ferencz, 2016), and in the form of directives and recommendations. The foundations of these regulations were laid down in an action plan announced in 2003. The important factors of the action plan with respect to the present research are the requirement set for public companies to include in their annual report a corporate governance statement, and certain accounting-related standards.

Following the Postabank case, regulatory responses were detectable in Hungary as well, as in 2004 the Budapest Stock Exchange (BSE) created its Corporate Governance Recommendations (CGR). The scope of the CGR covers companies that are listed on the BSE (CGR, 2018). It should be noted, however, that while SOX is a law with extraterritorial effect, i.e. it has to be applied outside the borders of the United States as well, CGR is merely a soft law recommendation, and serves as a guideline for companies listed on the BSE. The two are not equal in strength. The extraterritorial effect of SOX means that regardless where the seat of a company listed on a US securities market is, the strict rules of SOX will be applicable to it (Falencki, 2004).

Act IV of 2006 on Business Associations (Companies Act) was the first corporate-related law in Hungary that involved corporate governance. The appearance of such US and EU laws, furthermore, certain corporate / bank scandals occurring within the borders of Hungary provided enough external and internal motivation to the legislators. Section 312 of the Companies Act determined certain requirements towards companies listed on the BSE, according to which in addition to the annual report

presented in compliance with the accounting act, the board of directors have to present to the annual general meeting and the supervisory board a corporate governance report as well, in which they summarise and publish the applied corporate governance practices of the company for the given business year, and indicate and provide reasoning with respect to any derogations made from the CGR. This regulation was created to make the operations of listed companies more transparent and increase the trust of investors. Since the entering into force of Act V of 2013 on the Civil Code (Civil Code), the part of Hungarian corporate law that regulates matters of corporate governance can be found in Section 3:289 of this act.

In summary, the application of the CGR is not mandatory, but derogations made from it have to be reasoned in the report presented to the general meeting of shareholders and published in order to provide shareholders / investors a review of the followed (or un-followed, and then reasoned) corporate governance practices. However, apart from the obligation to provide a reasoning, derogations made from the CGR do not entail any sanctions. The CGR serves merely as a guideline for listed companies. Yet if the shareholders voluntarily wish to set it forth as a mandatory regulation, by including it in the company's instrument of incorporation, the CGR can become mandatory and thus enforceable (Bujtár & Kecskés, 2017).

Since the time of the Postabank case, despite the CGR, there has been no substantial change with respect to fraudulent behaviours in Hungary. The recently erupted Questor scandal is a perfect example, proudly succeeding Postabank as Hungary's ambassador of fraudulent behaviours. What seems to be evident is that strategies favoured by the prosecution in fraudulent cases (misappropriation of funds) - for example in the Postabank case, or against Miklós Tátrai in the Bábolna case, or in the Hunvald case, etc. - do not seem to be an effective weapon. Most of these cases ended with the collapse of the prosecution. Leading away the accused in handcuffs and acquitting him later on in the trial phase can only serve political interests. It is necessary to mention that for example in the first instance criminal proceedings carried out in the Sukoró case the attempt of misappropriation of funds - with a result causing particularly substantial financial loss - was proved against Miklós Tátrai, the former CEO of the Hungarian National Asset Management Inc., however, he was acquitted in the second instance proceedings. In the third instance he was found guilty of the attempt of misappropriation of funds, and was sentenced to a prison term of 3 years. The significant difference between the perception and assessment of such cases within Europe cannot go unnoticed. While in Italy Calisto Tanzi was sentenced to an 18-year long prison term in the Parmalat case, in the Postabank case Gábor Princz, the "main accused", got away with a fine of 3,6 million forints, and his companions with 1,5 million. With respect to defence lines the assessment of law enforcement activities is not a subject of the research, but by taking into account the judgments rendered in similar cases, the picture of how differently the societies of certain European countries relate to and approach such issues becomes cruelly visible

(Szalay, 2017).

As a summary of the research, the author sees the strengthening of defence mechanisms in civil law as the easiest step forward, with taking into account the importance of other defence lines as well, such as law enforcement or external supervisory organs. The implementation of European Union (or other federal) laws is necessary, however, not nearly enough. It is essential to take into consideration national characteristics and customs as well, and apply a mixture of those. Within the framework of this it would be worthwhile to immerse more boldly in certain Hungarian legal traditions.

It is worth examining Act XXXVII of 1875 and the related legal literature for example. This act regulated the representation and management of companies, and as soon as in the 19<sup>th</sup> century it already determined a generally expected conduct, according to which the board members had to proceed with reasonable care when carrying out business activities. The following, for example, were deemed as culpable conduct and gave rise to board members' liability for damages:

- unfavourable transactions causing damage to the company;
- unfair tendering practices;
- board members exceeding the limits of their mandate;
- preparation of incorrect balance sheet, etc.

In certain cases, the executive officers' exemption from liability was excluded. Such cases were, for example, if the executive officer failed to prepare the company's register of members, or if accounting was carried out in a careless or inappropriate manner, or the failure to prepare the balance sheet in time and in accordance with the applicable laws. Selecting from these rules and obligations the ones carrying a certain type of liability which only allows limited possibilities for exemption should be considered (Szalay, 2017).

Under the current law in force - Section 3:289 of the Civil Code - only upon the failure to publish the corporate governance report may any sanctions be imposed (Bodor, 2014). In such cases the supervisory proceedings of the Court of Company Registration may be initiated. A stricter rule, for example one that in the event of such behaviour would entail the delisting of the company's shares from the stock exchange should be considered. It would provide more efficient protection if publishing certain important information determined in the CGR would appear as a mandatory norm instead of a mere recommendation. As a conclusion, it can be said that the wider application of the CGR would increase transparency and consequently the trust of investors and shareholders as well.

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