REGULATIONS AND PRACTICAL CONSIDERATIONS RELATING TO THE CLAWBACK OF BONUSES PAID OUT BY BANKS

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ABSTRACT

The financial crisis has brought the issue of the bank executives' remuneration into the spotlight. The absence of the appropriate corporate governance systems, a remuneration structure that encouraged excessive risk-taking, and an approach that disregarded the long-term consequences were important, if not the only, causes of the crisis. Important steps have been taken, both at global and EU level, to ensure that this situation cannot repeat itself. Among the regulatory changes, an important role has been given to the principle that, if it can be proven that the actions of an executive contributed to the losses incurred by the institution, then remuneration previously awarded to that executive should be reduced, and if necessary it should be possible to claw back bonuses that have already been paid out. This requirement is also stated in the domestic banking regulations, but the related labour-law and civil-law rules make it difficult to enforce these clawback provisions. This study explores the economic and legal background of bonus clawback, the related international guidelines and practical examples, and makes a proposal regarding what statutory amendments could make bonus clawback into a genuinely effectively means of improving the responsibility of bank executives in Hungary.

JEL codes: G21, G24, G35, K31

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1. INTRODUCTION

In many EU member states, if not in Hungary, the extent and composition of compensation paid to bank executives has become a central issue, especially regarding how proportionate they are with actual performance, and whether they provide the bank executives with the appropriate incentives. This has grown to become an important topic in several countries, not only in relation to financial stability, but also from a political perspective, especially at a time when the financial crisis has led to the deployment of bailout packages in several countries, which took place using taxpayers' money and significantly increased the countries' indebtedness.

Since 2009 numerous international organisations, especially the Financial Stability Forum (FSF), the Committee of European Bank Supervisors (CEBS) and the European Commission, have also given priority to the issue of remuneration, setting out detailed proposals in the interest of establishing a complex system of rules. The Financial Stability Forum's Principles for Sound Compensation Practice also established that an important factor leading to the crisis was the payment of exceptionally generous bonuses linked to the achievement of high short-term profit, with no consideration for the long-term impacts of such risk taking. The bad incentives led to even more risk taking, which thus began to threaten financial stability (FSF, 2009).

The excessive remuneration of bank executives has become a central issue primarily in Germany, France and the United Kingdom; and these countries have indeed started to develop a system of rules that imposes the appropriate constraints on compensation practices. The international regulatory bodies soon recognised that there would be damaging consequences if the rules on remuneration differed from country to country, and that instead a uniform framework, built on common foundations, is needed. The regulations based on uniform principles build at global level on the FSF's principles mentioned above and the report of the Financial Stability Board (FSB), supplementing it with explanatory notes (FSB, 2009), and at European level on the Capital Requirements Directive (CRD)[1] and the related implementation regulations, as well as the guidelines published by the European Banking Authority (EBA).

The recommendations drawn up by the FSF and FSB set out the expectations relating to bank remuneration systems primarily in terms of the basic principles. According to the FSF report, surveys showed that eighty percent of market participants agreed with the fact that the remuneration systems had contributed to the emergence of the crisis. The remuneration of bank executives, therefore, should be analysed and assessed not only as a form of salary payment, but also as an incentives system (FSF 2009). The FSF, and the more detailed FSB guidelines, primarily emphasise the need to operate a corporate governance system in which the management has a satisfactory overview of the incentives provided by the remuneration system, the remuneration is harmonised with long-term risk assumptions, and the remuneration system is regularly audited by the supervisory authority and the institution discloses detailed information about this available to the public (FSB, 2009).

The European Union has adopted all the main principles published by the FSF and FSB, but developed them further, both by setting far more specific require-

[1] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms

ments and by establishing a much more detailed system of rules. The EU rules focus in particular on the ratio of variable to fixed remuneration, the use of deferred payment, and remuneration in instruments; for these it also determines specific, accountable threshold values, and describes the detailed methods for calculating the threshold values. For the EU, the more specific and detailed rules were necessary because the common internal market demands a level playing field for all its members, and this can only be created with regulatory frameworks that are harmonised at a detailed level. When it comes to developing a uniform system of remuneration rules, however, serious problems are caused by the fact that, although efforts are clearly being made to achieve the unity of financial regulation, with respect to compensation practices the labour-law regulations providing the underlying rules, and the labour markets themselves, are far from heterogeneous.

2. POTENTIAL TOOLS FOR EX POST ADJUSTMENT

Both the general principles determined by the FSB and the specific rules prescribed by the EU give a prominent role to the ex post adjustment of remuneration based on actual gains or losses. There are three important tools for ex post adjustment: remuneration in instruments, the opportunity to reduce a deferred payment (malus), and the opportunity to recover bonuses that have already been paid out (clawback). The purpose of all three of these tools is to instil a long-term approach in key risk takers, and to discourage them from excessive risk taking.

a) With remuneration in instruments, instead of cash the executives receive shares in the bank, or rights associated with them, and thus in the event of a drop in the stock price the extent of their remuneration will also decrease.

b) In the case of malus, the executive does not receive the amount of the remuneration straight way, but instead it is spread over a period of three to five years, and if during this period it is proven that the actions of the executive concerned caused a loss for the bank, then the amounts actually paid out may be reduced or even cancelled in their entirety.

c) In the case of clawback, the bank stipulates in the employment contract that following establishment of the executive's responsibility for the losses, the executive is obliged to shoulder a part of them, and thus to pay back some, or all, of the remuneration previously awarded to him or her.

The applicability of the above three tools for ex post adjustment differs considerably. The EU and domestic laws stipulate that the variable remuneration of senior executives of a credit institution, and of its employees whose activities have a material impact on the credit institution's risk profile[2], may not exceed the amount of basic remuneration, and that at least 50 percent of the variable remuneration[3] must be granted in instruments (e.g. the bank's shares) that appropriately reflect the changes in the bank's credit quality. With the granting of such instruments, the ex post adjustment takes place automatically, because if the price of the bank's stock goes down, then the bank's executive also receives less income when selling the shares. Remuneration in instruments is often accompanied by a retention obligation; that is, a requirement for the executive concerned to refrain from selling the assets thus acquired within a predetermined period. In this way, the criteria of creating a long-term interest is also met. Because granting of bank's own shares often entails considerable additional cost, or is not technically feasible, the laws also permit the use of instruments that are linked to the shares (e.g. options or virtual shares). When providing remuneration in instruments, therefore, the ex post adjustment can be achieved without any steps that might lead to a legal dispute between the parties. Because remuneration in instruments is a statutory requirement for all credit institutions, this tool is used by every bank in Hungary – unless it has been exempted from the obligation to pay remuneration in instruments under the principle of proportionality – although there are relatively few examples of remuneration in the company's own shares, primarily due to the ownership structure of domestic participants.

Another important means of ex post adjustment is the payment of a part of the variable remuneration in deferred form. In this case, the person concerned does not receive an actual payment or benefit, but just a promise regarding the amount of remuneration they will receive, provided that it is subsequently proven that they have genuinely performed their work to the appropriate standard. Under the laws, for key persons at least 40 percent (or for key executives, 60 percent) of the variable remuneration should be paid out after a deferral period of three to five years. With this tool, a long-term interest is created by the period of deferral, because if it later transpires, during the period of deferral, that the person in question did not perform their work to the appropriate standard, or that they took on excessive risk or possibly caused a loss or committed a crime, then on these

[2] The detailed definition of this group of persons is provided in separate rules, especially Commission Delegated regulation (EU) No 604/2014 of 4 March 2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile

[3] The EU laws mention two categories of this type of remuneration, fixed and variable remuneration. These two terms have been transposed into the Hungarian laws using the terms "basic remuneration" and "performance-based remuneration". This categorisation differs from the designations of basic remuneration and performance-based remuneration used in the Labour Code.

grounds the bank will not pay them the promised amount. This step could cause legal disputes between the parties, but as long as the bank has properly set out the criteria for reduction of the deferred payment in the contract concluded with the employee, the payable amount can be reduced to as low as zero without any particular legal problems.

The EBA's report published in 2016 showed that, based on a study of the data from between 2010 and 2014, the share of remuneration in instruments within deferred payments has steadily increased relative to that of cash, possibly because when providing remuneration in instruments the ex post adjustment is achieved twice (firstly through the option to reduce the deferred benefit, and secondly through the change in the value of the instrument) (EBA, 2016a).

The reduction of deferred remuneration is not unprecedented in Hungary, although so far the number of banks that have made use of this tool at their disposal is still relatively low. The reduction of the deferred part of variable remuneration can be substantial. In 2013, for example, the Royal Bank of Scotland announced that it had been able to save more than GBP 300 million by cutting bonuses, in this case on the grounds of the substantial fine imposed on the bank in the wake of the LIBOR fixing scandal.

While remuneration in instruments and the reduction of deferred performance-based remuneration is legally sound and relatively easy to enforce, serious legal difficulties arise in connection with the clawback of bonuses, and the clarification of these issues is essential in order for this third tool to also work well in practice. In the remainder of this study, therefore, we only deal with the third tool for ex post adjustment, the clawback of bonuses that have already been paid out (granted).

3. REGULATIONS AND SUPERVISORY EXPECTATIONS RELATING TO CLAWBACK

The common European rules on clawback are set out in the CRD. As a general rule, the CRD states that, without prejudice to the general principles of national contract and labour law, the total variable remuneration must be reduced considerably if the institution's financial performance drops or is negative, taking into account both the current remuneration and any reductions in the payouts of amounts previously earned, including through malus or clawback arrangements. According to the CRD, the variable remuneration, including the deferred portion, may only be paid or is only due to the employee if it is sustainable given the financial situation of the institution as a whole, and as long as it is warranted on the basis of the performance of the institution, the given business unit and the individual concerned (CRD article 94).

The rules of the CRD were transposed into Hungarian law by the Act on Credit Institutions (Credit Institutions Act). Based on Section 118 (13) of the Credit Institutions Act, with respect to the full amount of performance-based remuneration, the malus option may be applied to deferred payment, or the clawback rules may be applied in relation to performance-based remuneration that has already been paid out. Credit institutions define the specific criteria for application of the malus or clawback rules in their internal regulations. Under the Credit Institutions Act, particular care must take to examine whether the senior executive or employee was a participant in, or responsible for, a practice that cause a material loss for the credit institution, and whether they complied with the requirements relating to fitness and propriety.

The statutory frameworks defined by the CRD and the Credit Institutions Act are supplemented by the EBA's guidelines on remuneration (EBA 2015), and the MNB guideline implementing them at domestic level (MNB 2017). The EBA guidelines contain detailed rules relating to the application of clawback, but it mentions at several points that the national civil law or labour law rules of the member states may hinder their implementation, and that the national legal systems must be respected at all times.

The EBA guidelines also recognise that the clawback tool is not certain to fit in with national labour law rules, and therefore it stipulates that institutions must be capable of applying malus or clawback agreements that relate to 100% of variable remuneration in accordance with the rules of the CRD, irrespective of the methods of payment, without prejudice to the general basic principles of national contract or labour law.

The MNB guideline based on the EBA guidelines defines clawback as an agreement under which the employee must, under certain conditions, return his or her right of ownership of the performance-based remuneration previously paid or vested to him or her.

The MNB guidelines also name clawback as one of the tools for ex post adjustment which, in accordance with the rules of the Credit Institutions Act, must be applied. The MNB deems the use of deferral to be especially important when the ex post reduction of deferred performance-based remuneration is applicable, but the use of clawback would come up against legal obstacles. The MNB guideline also states that the institution must be capable of implementing malus or clawback measures extending to 100% of total performance-based remuneration in accordance with Section 118 (14) of the Credit Institutions Act and Schedule 4, point 19 of the Investment Service Providers Act, without prejudice to the effective civil and labour law requirements, irrespective of the method of payment or the deferral or retention agreements used.

Clawback is especially applicable in cases where the identified employee contributed materially to the diminished or negative financial performance, or in the event of fraud or other wilful misconduct or gross negligence that has resulted in material losses.

The information disclosed publicly by the institution regarding the design and structure of the remuneration system must extend to the framework for application of ex ante and ex post performance-based adjustments, including the use of malus and clawback arrangements.

4. THE USE OF CLAWBACK IN INTERNATIONAL PRACTICE

According to a survey conducted on behalf of the European Commission (European Commission 2016a), in practice institutions do not use the clawback tool, but instead attempt to enforce their interests in indemnification lawsuits based on general civil law liability, but these tools were also available prior to the overhaul of the rules on remuneration.

The clawback of already paid bonuses, however, is also a good means for the institution to satisfactorily demonstrate to its customers and the supervisory authority that it takes the struggle against fraud and bad decisions seriously. *Schrage* (2012) proposes that the use of clawback represents a rare convergence of populist concerns and economic sense: the public wants assurance that large bonuses have not been paid out undeservedly, and the opportunity to claw them back reduces the propensity of managers to take excessive risk, which is also appreciated by shareholders. And what is more, it also sends out the right message to employees, because people who follow the rules and act prudently do not feel that higher bonuses could go to those of their colleagues who take excessive risks but don't necessarily have better qualities than them (Schrage, 2012).

The European Commission's report, based on a detailed survey, also examined the practical effectiveness of applying the remuneration rules. According to the study, which is based on the opinions of bank supervisors and bank executives, the reduction of deferred performance-based remuneration and the use of clawback are usually good tools, but in practice malus is easier to implement than clawback. Malus arrangements can be used primarily for reining in excessive risk taking, whereas clawback is best suited to cases of intentional damage, but both of these tools have only seen limited use so far. During the survey, several EU member states indicated that application of the clawback rules clashes with certain points of their national labour-law regulations, and credit institutions also provided information to the effect that they are incapable of enforcing the rules of clawback within the constraints of national law. Only two out of 15 EU member-state authorities indicated, based on the European Commission's survey, that they were able to full implement and apply the rules of clawback.

The FSB regularly makes reports on the extent to which the remuneration guidelines that it published are adopted by the institutions. In its most recent (fourth) such report, the FSB concluded that the tool of clawing back remuneration is not yet really tried and tested in practice. Bank groups operating in several countries at the same time may experience major problems because, due to the differing national labour law rules, they are unable to manage the clawback agreements relating to executives in a consistent manner. The FSB has listed the triggers set out in the contracts used by the banks, enabling them, if the conditions are met, to start reducing the deferred bonuses or clawing back those already paid out. These generally include situations such as the breaching of a law or internal regulation, intentional damage, a finding of liability by a supervisory or internal investigation, causing damage to the institution's reputation, inadequate risk management, the publication of false information in a public report, the leaking of confidential information, activities leading to a substantial increase in the number of complaints or lawsuits filed against the bank, contributing to an unfavourable change in the institution's risk profile (FSB, 2014).

Accordingly, it can be concluded that there are significant problems with the use of clawback not only in Hungary, but at international level as well. It is no coincidence that only a few cases are reported in which a bank has attempted to use the tool of clawback, and it is even rarer for a bank to succeed in this. Virtually the only positive example was when the head of JP Morgan Chase, *Jamie Dimon*, announced in April 2013 that the bank had managed to recover more than USD 100 million in bonuses previously paid out to certain executives of the bank, after they succeeded in clearly proving the responsibility of the executives concerned for the occurrence of the losses (JP Morgan 2013).

Besides this, there are a few known cases in which certain bank executives voluntarily waived a part of the bonus due to them, recognising their responsibility for the occurrence of losses or supervisory fines (e.g. Royal Bank of Scotland Group), but even this was more in response to pressure from public opinion, as opposed to being enforced in a substantiated legal procedure.

In November 2016, it was announced that the supervisory board of Deutsche Bank had engaged a law firm to investigate the possibility of freezing the deferred, but as yet unpaid performance-based remuneration of 11 of its executives, in order to prevent those concerned from receiving it. The clawback of already paid bonuses was also mooted, but according to the bank's former executives there are no legal grounds for doing so (*Financial Times*, 2016). For the time being, how Deutsche

Bank will act on the legal opinion is not publicly known, but it is remarkable that a legal opinion should be needed at all for the ex post reduction of deferred performance-based remuneration based on existing contracts with managers, which in principle should be a far simpler procedure than clawing back the already paid bonuses, which the bank is not even attempting.

Overall, therefore, we can conclude that although the laws do contain an obligation for banks to stipulate the possibility of clawback in their employment contracts with key executives, in reality, the enforcement of this in practice is difficult and costly to achieve.

5. INTERNATIONAL DEVELOPMENTS RELATING TO CLAWBACK

In the United Kingdom, the Prudential Regulation Authority (PRA) approved new regulations in 2014, which brought a further tightening of the remuneration rules applicable to banks, including the requirements relating to deferral and clawback (PRA, 2014). Under the new requirements, banks must conclude agreements with persons who have a material influence on risk assumption, based on which the bonuses previously awarded as variable remuneration can be clawed back for a period of seven years following their payment. The right of clawback must be enforced, in compliance with the CRD, if the person in question participated in or was responsible for an activity that led to significant losses or did not conform to the requirements of good professional standing and fitness. Because it was clear that the banks are unable to apply these rules retroactively, the new requirements only have to be applied in respect of contracts concluded after 1 January 2015. In 2015, the PRA further tightened the requirements by making it compulsory to extend the seven-year period by a further three years if any supervisory or internal-audit investigation is in progress that might establish the complicity of the person concerned in losses.

In the USA, the Security and Exchange Commission drew up a regulatory proposal in 2015, based on the Dodd–Frank Act, to the effect that if a listed institution's financial statements need to be retrospectively modified, then the bonuses paid to executives in the past should also be reviewed. If, based on the revised financial statements the executives deserved lower bonuses, they would have to pay back the difference. The SEC's proposal came in for much criticism, mainly because too many executives would have come under its scope. The proposal is pending approval by Congress, but this has not materialised in the past year and a half, and it is doubtful whether the new Republic leadership wants to have it accepted at all. Certain companies in the US, however, already apply such clawback agreements on the basis of the Sarbanes-Oxley Act, although these only relate to cases in which the executive concerned has committed a criminal offence (*Seelig–Kalten*, 2017).

In 2015 the EBA drew up an opinion for the European Commission, in which it drew the Commission's attention to the fact that application of the CRD's remuneration rules is too expensive, and in some cases unfeasible, for small institutions. For this reason, the majority of EU member states apply various derogations in respect of small institutions, and these need to be standardised. In its opinion, the EBA advised the Commission that the CRD should exempt small institutions from the rules on the payment of performance-based remuneration in a deferred manner and in instruments (EBA, 2015b). Later, at the Commission's request, the EBA prepared a specific impact study on how the number and market shares of institutions applying the remuneration rules in a narrower scope would change in response to various limits based on proportionality (EBA, 2016b).

Taking the EBA's opinion into account, in 2016 the European Commission drew up its proposals for amendment of the CRD, which includes a stipulation that in the case of institutions with total assets of less than EUR 5 billion, and employees for whom annual performance-based remuneration does not exceed EUR 50,000, the rules on deferral and remuneration in instruments do not have to be applied (European Commission (2016b). If the European Parliament and the Council accept this proposal by the Commission, then in the case of small institutions (and in Hungary, due to the differences in scale, the medium-sized banks as well), an important means of ex post adjustment will not be applied. This will further increase the value of clawback, and it will become more important than ever before to ensure that the right to claw back bonuses that have already been paid out becomes a genuinely enforceable legal tool for the institutions.

6. THE DOMESTIC LEGISLATIVE ENVIRONMENT RELATING TO CLAWBACK

6.1 Legislative environment

The possibility of the reduction or clawback performance-based remuneration can only function well and serve its intended purpose if the related legislative environment sets out the conditions under which it is applicable transparently, clearly and in sufficient detail. In order to gain an overview of the legislative environment relating to clawback, we first need to review the relevant EU legal regulations, the domestic laws, the regulatory instruments issued by the MNB, and domestic case law. Based on these, it is clear that the common European rules on clawback are set out in the Capital Requirement Directive, the provisions of which have been transposed into domestic law by the Credit Institutions Act (Hpt.) and the Investment Service Providers Act (Bszt.). In view of the fact that the sector-specific laws are at the same level of the statutory hierarchy as the Labour Code, and that the Labour Code is the most important system of rules governing employment relationships, but nevertheless a general one that does not set out to define sector-specific rules[4], the clawback of performance remuneration falling within the scope of the Credit Institutions Act and Bszt. takes place primarily on the basis of sector-specific laws. Consequently, the main objective is for the rules set out in these to determine the requirements clearly, in sufficient detail and in harmony with the terminology and logic of the labour law and civil law provisions. Besides this, the provisions of the Labour Code, the Civil Code that underpins it, the guidance given by the MNB guideline, and the case law serving as a frame of reference, also need to be taken into consideration; however, the **sector-specific laws** are taken as the starting point in every case.

Table 1
The legal environment relating to clawback

Labour Code	The most important, but not the only law governing employment relationships. (Part II: Employment Relationship)
Employment contract	May only depart from Part II of the Labour Code, other laws or the collective bargaining agreement in the case of derogations *in meius* (in favour of the employee).
Civil Code	The "underlying law" of the Labour Code: it stipulates which rules of the Civil Code may be applied in labour law, and some of its paragraphs determine the applicability of certain civil-law rules (e.g. reimbursement of damages).
Sector-specific laws: Credit Institutions Act, Investment Service Providers Act	Positioned at the same level of the hierarchy of laws as the Labour Code, while the Labour Code also permits other laws to establish special requirements, differing from the general rules of the Labour Code, in a given sector or profession. (Section 118 of the Credit Institutions Act, Schedule 4 of the Investment Service Providers Act, Schedule 13 of the Public Procurements Act.)

[4] The Labour Code gives authorisation for other laws (in view of sector-specific and professional characteristics) to establish special requirements, differing from the general rules of the Labour Code, in a given sector or profession. (Section 298 (3) of the Labour Code)

EU law: CRD	The provisions of the Capital Requirement Directive have been transposed into domestic law by the Credit Institutions Act and Investment Service Providers Act (the directive sets out the common European rules on clawback).
MNB guideline on remuneration	A non-binding supervisory regulatory instrument promoting consistent application of the law (supplementation of the framework provided by the Investment Service Providers Act and Credit Institutions Act, definition of the detailed rules related to application of clawback), implementing the EBA's guidelines issued on a similar theme.
Case law	Created in the course of judicial practice (e.g. repayment of advance commission).

6.2 What is the performance-based remuneration payment: a premium, commission or bonus?

To understand the detailed rules and the relevant case law it is essential to first determine the legal definitions of the different types of performance-based remuneration payment. Although the Credit Institutions Act does not distinguish between the individual categories of remuneration on this basis, in labour law and case law this is also an important consideration.

A **premium** is paid by employers if a predetermined additional performance target is met, based on an agreement between the parties or a unilateral commitment undertaken by the employer. Based on case law, this is classed as salary. **Commission** is a type of performance-based pay, where the employee usually receives a percentage of the value of the transactions brokered or concluded by him/her. These need to be differentiated from a **bonus**, which is paid to a recipient and at a time chosen entirely at the employer's discretion, in subsequent recognition of the employee's work. Unlike a premium, it is not contingent on achievement of a predetermined additional performance target (*Dudás* et al., 2016).

The amount paid out as performance-based remuneration, therefore, can primarily be classified in the bonus category, although it does share some of the characteristics of a commission, because although the employer decides on it based on its own assessment and grants it in recognition of work performed, the institution's financial situation and the employee's performance must also be taken into consideration.

These factors also give rise to the question of whether Section 70 (4) of the Labour Code[5] applies with regard to the possibility of clawing back bonuses. This provision of the Labour Code governs exemption from working and, in connection with this, the conditions under which paid wages may be clawed back; but as the bonus does not constitute a part of the salary, and also because the possibility of clawback is provided by the sector-specific law, in our opinion Section 70 (4) of the Labour Code is not applicable in respect of performance-based remuneration. However, to make this entirely clear and avoid legal uncertainty for the parties concerned, it would be sensible to supplement the sector-specific laws or the Labour Code with a provision to such effect.

The relevant case law is very important, and it too supports the premise that a transparent legislative environment and appropriately worded employment contracts, taking these laws into account, are exceptionally important when deciding legal disputes arising with regard to the aforementioned compensation categories. Every form of compensation serves as a performance incentive for employees if, employers have full discretion – within the constraints of the laws and employment contracts – to determine the details of such awards and their payment, and, in certain cases, the opportunity to impose conditions and demand the return of payments already made. Court decisions also suggest that if there are no mandatory statutory provisions that the employer has to follow, then it may determine the criteria for compensation within the scope of its own authority, as it sees fit.[6] All this is important because, although the labour-law regulations essentially assume that the employee is in a weaker position and seek to rectify this, in our opinion the right of discretion enjoyed by the employer with regard to the categories of compensation, as well as the provisions of the Credit Institutions Act and Bszt. relating to performance-based remuneration, are more protective of the employer's rights.

Based on case law, for example, prior to the start of performance the premium can be withdrawn in the event of a material change in the employer's circumstances, due to which performance of the obligation has become impossible or would represent a disproportionate burden[7] (for example a change in business circumstances [Dudás et al., 2016]). Besides this, we know of several examples where a board of directors has stipulated that payment of the premium or bonus, or the setting of premium tasks, was contingent on achievement of a certain operational efficiency

[5] (4) Paid-out wages cannot be clawed back if the employee has been permanently exempted from working and a circumstance precluding payment of the wages arose after the exemption from working.

[6] Mfv.II.10.727/2013/6.

[7] BH 1996, 342.

or profit target.[8] Overall, although the bonus is usually paid in recognition of past work, in this case it cannot be ruled out that the employer will subsequently learn of a circumstance that warrants its clawback. Besides the grounds for clawback mentioned above, the relevance of unjust enrichment[9] could also come under consideration. Salary paid without legal basis may be clawed back on the basis of the Labour Code after sixty days (within three years) if the employee should have recognised the lack of grounds for payment, or if the employee caused it him/herself (that is, in principle, the employee had an opportunity to recognise the error). In our opinion, unjust enrichment cannot be cited as the grounds for clawback of a bonus, because there was a legal basis for the payment, regardless of whether the associated decision-making carried a risk. The use of such grounds might be relevant if it subsequently transpires that the institution's financial statements contained false data, and the payment would not have been legitimate based on its actual financial situation.

6.3 Cases of liability originating from the employment relationship, and the consequences thereof

The two main cases of liability originating from an employment relationship are disciplinary liability and the employee's liability for damages. In view of the fact that, in the former case, the breach giving rise to the liability does not necessarily cause damage, for the purposes of the clawback of variable remuneration the liability for damages also needs to be examined, because the occurrence of a material loss, as mentioned in the sector-specific law, clearly causes damage for the institution concerned (and indirectly for other third parties). A closer study of the details of liability for damages reveals many points of interest and questions, which are also extremely important from the perspective of terminology in the Credit Institutions Act ("responsible for, or a participant in, a practice that..."). The table below shows these in detail, exclusively in relation to the possibility of clawback.

[8] Mfv.II.10.788/2007/3.

[9] Pursuant to the Civil Code, a person who gains financially at the expense of another without legal basis is obliged to return the gain.

Table 2
Conjunctive requirements

1. Employment relationship	An employment relationship must exist between the executive/employee and the employer
2. Breach of obligation	Excessive risk-taking, decision resulting in losses, criminal act
3. Attributability	Did not act in the manner generally expected in the given situation
4. Damage	Material loss, deterioration of financial performance, supervisory fine, etc.
5. Causal relationship	The damage on which the clawback claim is based is caused by the breach of obligation

An important consideration is that, when establishing liability for indemnification, the burden of proof is on the employer with respect to every criteria, which clearly favours the employee. The identification of executives and employees mentioned in the first point is determined by the sector-specific laws, which, by also designating employees, has created a two-tier structure. This ensures accountability not only for the persons who make the decisions, but also for those responsible for preparing the documents on which the decisions are based. Therefore, if it transpires that an executive's decision was based on an expert opinion that contained bad calculations and conclusions, the employee responsible for this can also be held to account. Although the Labour Code's definition of an executive differs from that of the sector-specific laws[10] (and the range of key risk takers subject to the sector-specific laws is also broader), based on the case law the bad economic or business decisions made by them do not give rise to liability for damages provided that they fall within the realm of the rational assumption of risk and, in the absence of other incriminating circumstances, they cannot be regarded as unlawful conduct.[11]

[10] Under Section 208 (1) of the Labour Code, an executive employee is defined as employer's director, and any other person under his direct supervision and authorised – in part or in whole – to act as the director's deputy.

[11] BH 2004. 9. 372.

Besides this, the question of blame, or attributability, which also features among the criteria, could also be a "sticking point". The Labour Code examines attributability when establishing liability for damages, and culpability (intent, negligence) when determining the extent of liability, thus mixing the approaches of civil law and criminal law. In our opinion, the liability of the executives or employees mentioned in the sector-specific laws should be based not on attributability, but on culpability. The sector-specific laws themselves also expect such persons to display the appropriate specialist knowledge and experience, in view of the fact that their decisions have a material impact on the institution's financial situation and performance; and consequently, their decisions should not be made as generally expected in the given situation, but as expected of the person concerned in the given situation. At present, the term "responsible for, or a participant in" is not clear based on the terminology used in the Labour Code and Civil Code, since we do not know precisely what responsibility means: attributability or culpability?

With respect to the employee's liability for damages, the provisions of the Civil Code only apply in matters not regulated by the Labour Code ("in other matters" in Section 177 of the Labour Code[12] indicates that the Labour Code is the special rule system), so although the Labour Code refers to Section 518-534 of the Civil Code with respect to damage compensation, certain paragraphs of these are not applicable. In connection with this, when examining the reasons for exoneration, the issue of foreseeability is interesting, because while the Labour Code does not stipulate compensation for damages that were not foreseeable at the time of the tort, the Civil Code takes a stricter approach with the phrase "*that the tortfeasor [the party causing the damage] could not and should not have foreseen.*" (Kártyás, 2014) In our opinion, because both the Labour Code and the Civil code regulate this area, but without being entirely consistent in their wording, with regard to employment relationships the Labour Code, which functions as a system of special rules, should take precedence.

Based on these considerations, the Credit Institutions Act and the Bszt., taking into account the rules and terminology of the Labour Code and the Civil Code, need to provide clear rules, relating to the clawback of performance-based remuneration, that can serve as a suitable frame of reference in a lawsuit and create a predictable environment, because the present wording and level of detail does not encourage institutions to apply the institution of clawback.

[12] Compensation for damages shall, in other matters, be governed by the rules of Section 6:518-534 of the Civil Code.

Table 3
Proposal for determining
the responsibility and involvement of executives or employees

Cases	Example	Consequence
Criminal offence	Embezzlement, fraud, etc.	Bonus clawback
Breach of obligation	Breach of a law, internal regulation, employment contract	Clawback of the bonus upon occurrence of all elements
Culpability	Intent (direct intent, *dolus eventualis*) or negligence (deliberate negligence, carelessness).	
Tort	Materialisation of the consequence named in the sector-specific law	
Causal relationship	Breach of obligation can be proven to have caused the damage.	
Foreseeability	Foreseeability of occurrence of the damage If the damage is caused not by the decision, but by a change in market circumstances, foreseeability cannot be established.	

It is important to underline that the simultaneous occurrence of the conditions in the table creates the conditions for clawback, but its application in practice, and especially determination of the amount of clawback, must be based on a case-by-case assessment of the conditions (e.g. the extent of the damage).

7. PROPOSAL FOR AMENDMENT OF THE LEGAL REGULATIONS

It is clear from the above analysis that while the Credit Institutions Act and Investment Service Providers Act, as sector-specific laws, demand that banks and investment firms stipulate the right of clawback of paid bonuses in employment contracts, the domestic labour law regulations impede or prevent the enforcement of such clauses. Therefore, an amendment is needed in order to make the institution of clawback feasible in practice.

Given that the use of clawback represents a problem not only in Hungary, but also in several other EU member states, the best solution would be for the European Union itself to provide a standard system of labour-law and civil-law rules. Numerous elements of domestic labour-law regulation are already underpinned by EU harmonisation, so the development of such a common framework would not be unusual. The detailed labour-law and civil-law regulation of clawback is not only a domestic problem, the low number of successfully implemented clawbacks shows that applying this tool in practice is far from straightforward in other countries either.

However, because there is no intention to create such a common EU system of rules for time being, and the detailed elaboration of such a system would probably take years anyway, it appears sensible to resolve the legal issues at national level. The international examples above could also be used for the specific implementation of this. When drafting the specific wording of the law, it is advisable to agree on the following important questions:

a) *Should the necessary amendments be enshrined in the sector-specific laws or in the Labour Code?*
   In our opinion, the sector-specific laws (Credit Institutions Act, Bszt.) need to contain more detail in order for the legislative environment underpinning the clawback of bonuses to create a clear and transparent situation, and for the provisions of the sector-specific laws to provide a frame of reference for institutions that want to make use of this opportunity. Since the obligation to stipulate a clawback clause is stipulated in the sector-specific laws, for the time being this obligation applies only to credit institutions and investment firms, and therefore the further detailed rules on clawback also need to be resolved in these laws. It is still necessary, however, for the sector-specific laws and the Labour Code to be harmonised, and for this reason the Labour Code should be supplemented with a section that recognises clawback as regulated in the sector-specific laws, and states that the sections that presently hinder its practical implementation are not applicable in respect of them, especially Section 70 (4) of the Labour Code.

b) *In what cases can clawback be implemented?*
   To ensure that the statutory environment creates this situation without placing a disproportionately large burden on executives or employees, it is advisable to declare that the right of clawback is contingent on the occurrence of injury resulting from a criminal offence or breach of obligation, conjunctively with culpability and foreseeability. Furthermore, clawback should also be possible in cases where the employer and the employee are no longer in an employment relationship with each other.

c) *Within what period can the clawback be enforced?*
The aforementioned 7 + 3 years approach seems too long in the domestic labour market for the time being, and creates uncertainty for employees for an unjustifiably long time, so setting a shorter period would be advisable. It is important, however, that the clawback should be enforceable for longer than the present three-year general limitation period set out in the Labour Code. As a first approach, therefore, we recommend four years following payment of the bonus or termination of the employment relationship, with the possibility of extending this period by one year if the employee concerned is the subject of an ongoing supervisory or internal audit.

Another statutory amendment is needed because, at present, in Hungary only institutions with total assets of HUF 500 billion have to report to the MNB in detail on their remuneration practice. Given that the reporting takes place annually, and does not represent an insurmountable burden for the data providers, but would make it possible to check whether the institution is complying with the limits and ratios set out in the law, there is certainly a need for the reporting obligation to be extended to all credit institutions, and also to the larger investment firms. Beyond this, at present the data reporting only contains information relating to the ex post reduction of deferred remuneration, so the reporting obligation should be extended to also include the amount of already paid performance-based remuneration that has been subsequently clawed back.

8. SUMMARY

The study reviewed in detail the tools for the ex post adjustment of performance-based remuneration, the statutory regulations and guidelines relating to the clawback of already paid bonuses, the international developments and the contradictions existing in the domestic legal system. The main conclusion of the study is that although the sector-specific rules prescribe clawback agreements for banks, the application of these in practice is hindered by numerous legal obstacles. Based on all these considerations, in the study we also made a proposal regarding a concept for the development of the legal regulation of clawback, and regarding its place in the domestic legal regulations.

For the time being the use of clawback, as a tool, remains limited even at international level, but it could take on a more prominent role in the future, since there is demand for the ex post adjustment of performance-based remuneration from both the institutions themselves and from investors. Political players and public opinion also frequently express a desire for a bank's former executives to also share in the negative consequences of any financial problems that arise at that bank. Although the amount that can be clawed back is often far smaller than the loss caused by the executives, society's sense of justice also dictates that in such cases the executives should not receive money that they do not deserve on the basis of their performance.

As in the case of most laws, those relating to clawback also have a deterrent effect, as the mere presence of the rules would motivate executives to conduct themselves with greater prudence. In the present contradictory situation, however, this deterrent effect is highly limited. The proposals made in the study are aimed at strengthening a long-term approach and prudent management conduct at the institutions.

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