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„Defaulting on the obligations may give rise to establishing the employer's liability under civil

## Legal newsletter

# Whistleblowing in Hungarian practice

### How to operate the in-house fraud reporting system in a lawful and ethical manner?

Dear Sir/Madam,

**Deloitte Legal Szarvas, Erdős and Partners Law Firm, a member of Deloitte Legal's international network, provides its clients with a monthly newsletter on the most recent changes and newly adopted regulations in economic law and the most notable legal cases.**

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**With the entry into force on 1 January of Act CLXV of 2013 on Complaints and Public Interest Disclosures ("Law") the Hungarian regulation of fraud reporting ("whistleblowing") systems operated by employers have been changed considerably.** The new Law regulates the operation of whistleblowing systems in the private sector in more detail than the previous one and extends to data privacy issues.

**The provisions of the Law also cover existing whistleblowing systems, so in the interest of compliance we recommend the revision of alternative reporting systems introduced earlier.** In particular, it must be ensured that codes of conduct and ethics, as well as various internal policies and procedures should be revised in order to comply with the provisions of the Law, among others in terms of deadlines, the notification obligation and the scope of controllable data. It may also be necessary to train employees for the use of the whistleblowing system since it is in the interest of the employer, as well, that employees can use the system properly. At the same time, employers also need to make preparations for the adoption of the provisions of the Law, because they can be held liable for unlawful data controlling.

**Defaulting on the obligations defined by the Law may give rise to establishing the employer's liability under civil or, in more serious cases, even under criminal law.** In addition, the Hungarian National Authority for

or criminal law, and NAIH may impose a penalty in the amount of up to HUF 10 million for the violation of data privacy rules.”

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„One and perhaps the most important novelty of the new regulation is that the Law provides a legal ground for the employer to process personal data.”

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„As an important change, before the employers introduce the whistleblowing system they are required to register their intention of data controlling for this purpose with NAIH.”

**Data Protection and Freedom (a Nemzeti Adatvédelmi és Információszabadság Hatóság (NAIH)) of Information may impose a penalty in the amount of up to HUF 10 million for the violation of data privacy rules.**

Whistleblowing is not a new concept in business since it has almost become one with the idea of corporate governance. Most multinational, but also an increasing number of medium-sized enterprises have been operating similar alternative reporting hotlines, which is complement to the traditional in-house reporting systems. **The significance of whistleblowing systems lies in the fact that the employer operates a "safe" reporting system based on a thoroughly elaborate procedure so that employees can inform an expert team on actions or events perceived within the organization as unlawful or violating the organization's code of conduct.** This is necessary because based on practical experience employees are afraid to report such acts or events in the traditional way, i.e. by notifying their direct superior. The reason for this is that in many cases the person reporting the suspicious act is discriminated or may even lose his or her job because of making the report.

Former regulations on fraud reporting systems used in the private sector in Hungary failed to specify rules in sufficient detail, which lead to anomalies in the adoption of the law, particularly in the handling of personal data. The operation of whistleblowing systems raises a number of data privacy issues, since based on reports employers become aware of and manage personal data and may also forward them to further data controller or data processor. **One and perhaps the most important novelty of the new regulation is that the Law provides a legal ground for the employer to process personal data.** As a result, pursuant to the provisions of the Law, the employer is allowed to control the personal data of the suspected person without his or her permission. If data are processed in the territory of Hungary during the operation of the system the Hungarian data protection regulations are also to be applied as underlying law.

**As an important change, before the employers introduce the whistleblowing system they are required to register their intention of data controlling for this purpose with the Hungarian National Authority for Data Protection and Freedom of Information.** In addition, employers are also required to publish on their website a detailed, Hungarian-language guide on the operation of the system and the procedure of reporting suspicions, which must also cover the consequences of reports made in bad faith. The system allows reports to be made by employees, persons who signed a contract with the employer, as well as persons who have a reasonable and justifiable interest to put an end to any fraudulent act. If there is a works council at the employer's organization, the employer is required to consult with the employee representative organization on the introduction of the whistleblowing system prior to that.

The Law prefers non-anonymous reports in the first place but makes anonymous reports also possible, although the employer is not obliged to investigate the latter. Information coming to the employer's knowledge during the investigation of a report must be handled confidentially and may only be disclosed to people involved in the investigation. It is prohibited to handle sensitive personal data disclosed in

„The employer must investigate the case within 30 days of receipt of the report at the latest, or within 3 months in exceptional cases.”

whistleblowing reports. Sensitive personal data include information concerning a person's party preference, addictions, religious conviction, membership in representative organizations or criminal record. The employer must immediately delete such data that might appear in the system as a result of a reported case.

The Law also includes safeguards for the protection of the rights of the suspected person. Accordingly, when the investigation starts, the suspected person must be informed of the report made concerning him or her, his or her rights, as well as the rules applying to the handling of his or her personal data. If the notification of the suspected person would frustrate the investigation of the case, it may take place later. **The employer must investigate the case within 30 days of receipt of the report at the latest, or within 3 months in exceptional cases.** If the investigation finds that the suspicion is not reasonable or if there is no need to take any further action, the data must be deleted within 60 days after completion of the investigation. Should the investigation find the suspicion reasonable, the data may be handled until the necessary procedures are completed with a binding decision.

We find the codification of the institution of whistleblowing systems useful, although the Law raises a number of questions. For instance, the Law requires the employers to remind the reporting person of the consequences of reports made in bad faith while the sanctions that may be lawfully imposed are entrusted entirely to the employers' discretion instead of being provided for in detail by the Law. In order to enable companies to form regulations that are in compliance with Hungarian laws but also with the international practice (typically designed by foreign parent companies), it is recommended to revise their internal policies or engage a legal expert to prepare an elaborate and practice-oriented reporting system.

We hope you will find our newsletter thought-provoking, and we look forward to receiving your remarks. **Please address any questions or comments to our experts on the left.**

Best Regards,

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„As of 15 March 2014, with the amended Civil Code entering into force, the responsibilities of executives are widened.”

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„Since the amended Criminal Code's entry into force last

## Legal newsletter

# Drastically stricter liability for executive officers in New Hungarian Civil Code

Dear Sir/Madam,

**Deloitte Legal Szarvas, Erdős and Partners Law Firm, a member of Deloitte Legal's international network, is providing its clients with a monthly newsletter on the most recent changes and newly adopted regulations in economic law and the most notable legal cases. As the new Civil Code, the first one drafted since the regime change, will enter into force as of 15 March 2014 and will affect nearly all areas of the economy, in the coming months we will devote several editions of our newsletter to the rules of the new Code.**

**The current newsletter deals with the stricter liability for executive officers in the New Hungarian Civil Code.**

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**As of 15 March 2014, with the amended Civil Code entering into force, the responsibilities of executives are widened in the companies they lead in cases within their control. They may be liable for warranty claims, late performance, bad financial decisions (investments) or bad business decisions (pricing, supplier selection) with their personal wealth.**

Furthermore, under the amended Civil Code, **in certain cases the executives of companies may bear joint and several liability with the company they lead, with their personal wealth to third parties for damages caused**, such as the breach of environmental, consumer protection or competition laws as well as claims arising in relation to work accidents.

**Since the amended Criminal Code's entry into force last year, the executive may be punishable with imprisonment if he fails to meet his control and**

year, the executive may be punishable with imprisonment.”

supervisory obligations being responsible for the payment, administration and filing of taxes, contributions and budgetary aids and such default results in a budgetary fraud.

### Case studies

**The below case studies highlight examples where the executive may be liable for any intentional or unintentional malpractice, accident or damage caused:**

- 1) A company guest leaves his car in the company parking lot and a large pile of snow falls under from the building as nobody took care of snow prevention during the sick leave of the cleaning person.
- 2) Several faulty products are supplied due to the obvious negligence of an employee. Hundreds of customers keep filing warranty complaints and claims through months, causing serious material damage to the company.
- 3) The CFO, responsible for tax filing at the company commits fraud in the company's VAT reclaim. As he is fully responsible at the company for taxes and contributions and their administration, the CEO fails to control his work day by day.
- 4) One of the company's managers agrees upon a price cartel with a competitor without the CEO knowing, and consequently, the competition authority condemns the company.
- 5) Due to the breakdown of a piece of old equipment, a work accident occurs at the company and several workers are seriously injured.

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„Based on a comprehensive risk analysis, development of codes and policies and set-up of a more secure corporate governance system is desired to be planned”

### Companies should be paying attention to the following

First of all, **information gathering** and processing the text of the law and the nature and scope of the new rules is needed. Based on that it is necessary to **analyse the specific risks arising at your company**. After a comprehensive risk analysis, **development of codes and policies** and set-up of a **more secure corporate governance system** is desired to be planned.

**Executive liability insurance contract** may be taken out, many Hungarian and multinational insurers offer these products. Insurers reimburse the aggrieved party those financial losses that are caused by insured executives or board members.

**Review or preparation of some contracts** is also essential:

- **Management and indemnity contracts** in the light of the new liability.
- **Amendment of the Articles of Association** with a view to the detailed regulation of executive indemnities as more widely allowed by the new Civil Code.
- Review of **the company's key customer and supplier contracts**, advisory pertaining to the application of limitations of liability as allowed by the new Civil Code.

To minimise the personal responsibility of executives to third parties and criminal liability proceedings, **review of internal policies, reporting and control lines as well as the development of the appropriate documents** is also necessary.

We hope you will find our newsletter thought-provoking, and we look forward to receiving your remarks. **Please address any questions or comments to our experts on the left.**

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