REPORT ON INSURANCE, FUNDS, CAPITAL MARKET RISKS AND CONSUMER PROTECTION

2023

'… after mature consideration we have made a decision for the good of the whole country, its peaceful state and for the benefit of its residents…'

(from the 'urban articles' of 1405 of King Sigismund)

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Pursuant to Act CXXXIX of 2013 on the National Bank of Hungary, the MNB is responsible for the supervision of the financial intermediary system with the aim of, inter alia, ensuring the smooth, transparent and efficient operation of the financial intermediary system, promoting prudent operation, identifying undesirable business and economic risks, protecting the interests of financial service users and strengthening public confidence in the financial intermediary system. The MNB has prepared the present Risk and Consumer Protection Report in accordance with this task and the requirement of Section 135(2) of the Act, which describes the main characteristics and risks of the markets for insurance companies, funds, intermediaries, non-bank financial undertakings and capital market participants. The aim of the "Report on Insurance, Funds, Capital Market Risks and Consumer Protection" is to inform the public and the institutions of the financial system about current prudential and consumer protection issues, thereby raising risk awareness and maintaining and strengthening confidence in the financial system. With its regulatory activities aimed at identifying and mitigating risks, as well as its awareness-raising and educational activities and its work to promote the development of Hungarian financial culture, the Magyar Nemzeti Bank's intention is to ensure that the right information is available to stakeholders for decisions affecting financial institutions and products, thus strengthening the stability of the financial system as a whole.

The report has been prepared in cooperation with the MNB's Executive Directorate for Prudential, Consumer Protection Supervision of Capital Markets and Insurers and Market Surveillance, the Executive Directorate for Prudential and Consumer Supervision of Money Market Institutions, the Directorate for Sustainable Finance and Supervisory Coordination, the Directorate for Fiscal and Competitiveness Analysis, the Directorate for Monetary Policy and Financial Market Analysis and the Directorate for Statistics.

The data used in this report and the analyses based on them typically pertain to the reference date 31.12.2022, based on information received by 31.03.2023. Data of different frequencies are updated in a different manner, hence the horizon of analysis may vary in some cases.

The report has been approved by the Financial Stability Council and the publication has been approved by Dr. Csaba Kandrács, Deputy Governor.

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Executive Summary

Economic performance was mainly determined by the Russia-Ukraine war as well as soaring food and energy prices over the past year. In 2022, domestic GDP grew by 4.6 per cent on an annual basis. Household consumption growth was boosted significantly by the government's household income support measures at the beginning of the year. Households' gross wealth, including financial assets and housing, exceeded HUF 148,000 billion by the end of 2022, an increase of 14.0 per cent compared to the previous year. The rise in the yield curve led to asset depreciation in the institutional investment sector.

The **insurance** sector's premium income in 2022 grew by 7.4 per cent to HUF 1,428 billion, reaching HUF 1,546 billion including the earned premiums of branches. Non-life premium income increased by 12.7 per cent compared to the previous year, while life premiums grew by only 1 per cent. Non-life growth was driven by household and commercial property insurance, fully comprehensive car insurance (casco) and MTPL. The combined ratio of the non-life insurance sector rose compared to the previous year. Among non-life products, the combined ratio of 96 per cent for MTPL represents a significant risk, while the loss ratio for the agricultural market, which often exceeded 100 per cent, is a threat to insurance activity. In 2022, the total assets of domestic insurers fell by 8.8 per cent, yet in the first quarter of 2023, market correction led to an increase. The sector-wide profit after tax dropped to 43 per cent of the preceding year, mainly due to the effects of drought and surtaxes. The sector-wide return on equity (ROE) stood at 9.5 per cent, which continued to paint a positive picture of the insurance sector from a stability perspective. At the end of 2022, the sectoral capital adequacy ratio was 172 per cent, more than one and a half times the regulatory level.

The **voluntary pension fund** sector achieved an average net return of minus 6.80 per cent due to the most significant risk of general asset depreciation, so by the end of 2022 the total balance of individual accounts had fallen to HUF 1,598 billion. In the last quarter of 2022, the positive investment performance of voluntary pension funds halted the negative return trend of the previous three quarters. Contributions to voluntary pension funds rose to an all-time high of HUF 123 billion, but the rising cost of living could restrain long-term propensity to save, whereas the risk of outflows is not expected to abate in the short term. Operating profit turned into a loss in 2022 for voluntary pension funds, but loss absorbency at sector level remained adequate. **Health and mutual aid funds** also saw an increase in assets, membership, the share of contributors and payments for services. In 2022, the health and mutual aid funds sector realised a positive operating income.

In 2022, four more insurers' home insurance products were awarded Certified Consumer Friendly Home Insurance (MFO) certification, bringing the number of institutions offering MFO products to eleven by the end of the year. In terms of premium income, ~90 per cent of the home insurance market offers MFO. In 2022, all insurance TCIs (total cost indicator) were below the limit set in the MNB recommendation.

As in previous years, there was further consolidation in the **intermediary** market, but this did not affect the performance of insurance intermediaries as both the number and the value of contracts brokered increased compared to the base. However, in addition to the drop in the number of employees, economic changes in 2022 also contributed to the decline in retail credit and loan mediation in the money market.

The balance sheet total of **non-bank financial undertakings** continued to rise in 2022.

Receivables from customers grew in 2022, mainly due to an increase in credit and loan operations and financial leasing activities. The receivables of non-bank financial undertakings remained highly concentrated with 15 per cent of the institutions holding 86 per cent of all receivables.

Apart from funding from domestic credit institutions, all other sources of funds increased in 2022. Despite the increase in equity, the sector's profitability declined in 2022, partly because of the extra profit tax first becoming due in 2022.

In the capital markets, the turnover of **investment service providers** also grew sharply by 59.5 per cent year on year (HUF 710,202 billion), mainly on account of a strong increase in derivatives turnover. Turnover on the Budapest Stock Exchange had been growing dynamically for the third year running, with total turnover up 19.5 per cent last year. The composition and ranking of the top three most traded stocks remained unchanged and the very high concentration continued to increase. Overall, holdings of client securities managed by investment service providers remained virtually unchanged due to the turbulence in the capital markets caused by the war between Russia and Ukraine and the interest rate hikes affected by major central banks. Investment firms' profit after tax of 51.5 billion was two and a half times higher than a year earlier.

The HUF 13,154 billion in assets managed by **investment fund managers** was 10.8 per cent higher than before last year. The net asset value of investment funds reached HUF 9,872 billion, primarily as a result of capital inflows into money market and short bond funds. Public real estate funds remained broadly stable in size. The after-tax profit of fund managers fell as one large institution was no longer supervised by the MNB.

In line with the MNB's supervisory strategy, the focus of **consumer protection** supervision in the **capital markets** was on the ex-ante and ex-post cost disclosure practices of investment service providers, cross-border CFDs, compliance with MiFID II product governance requirements, the calculation of success fees for fund managers and suitability assessment practices.

As regards **issuer supervision**, the central bank launched 5 targeted IFRS investigations of public offer issuers in 2022 and 1 targeted investigation on regular and extraordinary disclosures. The central bank held a total of 23 tailored issuer workshops and technical consultations in 2022.

In 2022, the MNB conducted 20 **market surveillance procedures** concerning market abuse and closed 20 of them, started 21 market surveillance procedures on suspicion of unauthorised, i.e. unlicensed or unreported activities, and closed 14 market surveillance procedures. In 2022, the MNB imposed market surveillance fines in a total amount of HUF 471.6 million.

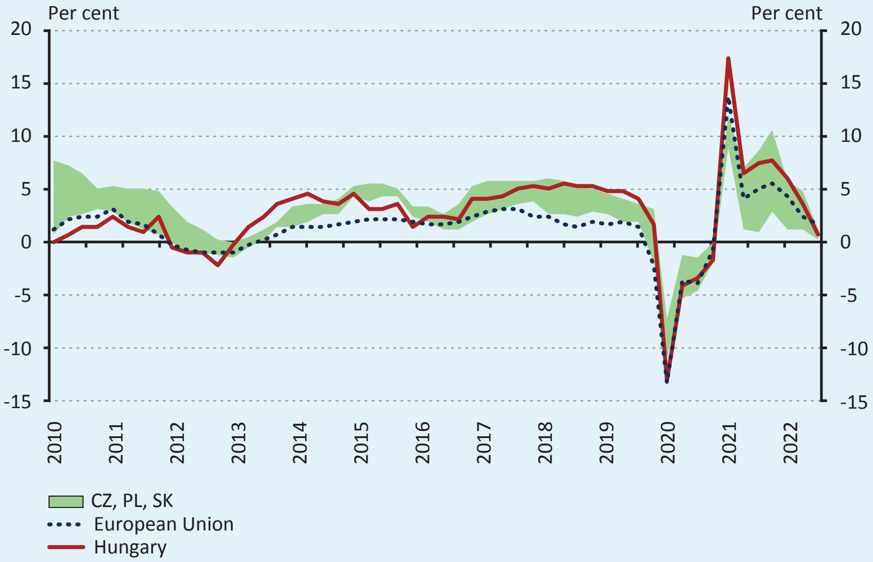
1 Macroeconomic environment and developments in household savings

1.1 INTERNATIONAL AND NATIONAL MACROECONOMIC TRENDS

1.1.1 The economy slowed down at the end of the year

Economic performance was mainly determined by the Russia-Ukraine war as well as soaring food and energy prices over the past year. Based on seasonally and calendar-adjusted data, in 2022, the United States and China recorded a growth of 2.1 per cent and 3.0 per cent, respectively, on an annual basis. GDP levels rose by 3.5 per cent in both the EU and the euro area. Our main trading partner's, Germany's economy expanded by 1.8 per cent overall. Among the countries in the region, GDP grew by 4.7 per cent in Romania, 5.1 per cent in Poland, 1.7 per cent in Slovakia and 2.5 per cent in Czechia in 2022 (Chart 1.1). However, the protracted Russia-Ukraine war, the related sanctions, heightened market uncertainty and the energy crisis in Europe remained downside risks to the growth outlook.

Chart 1.1
Annual change of GDP



Note: Based on seasonally and calendar adjusted data.
Source: Eurostat, HCSO

In 2022, domestic GDP grew by 4.6 per cent on an annual basis. Household consumption growth was boosted to a significant extent by the household income support paid out by the government at the beginning of the year (benefits for the armed forces and the police, income tax refund, 13th month pension), of which households spent around 70 per cent on consumption. Domestic investment rate equalled 28.4 per cent in 2022, the highest in the EU. Industrial production continued to expand, helped by the performance of the domestic automotive industry and a dynamic upturn in battery production.

The Hungarian economy will slow down in 2023 as domestic demand declines, driven by both falling real wages and rising corporate costs. This year, we expect residential consumption to moderate. Income deterioration is mainly attributable to high inflation. Real wages have been declining since September 2022, eroding the purchasing power of households' disposable income in real terms. Both the corporate and household sectors, as well as the public sector, contributed to the decline in investment. However, households' net financial savings could rise slightly this year.

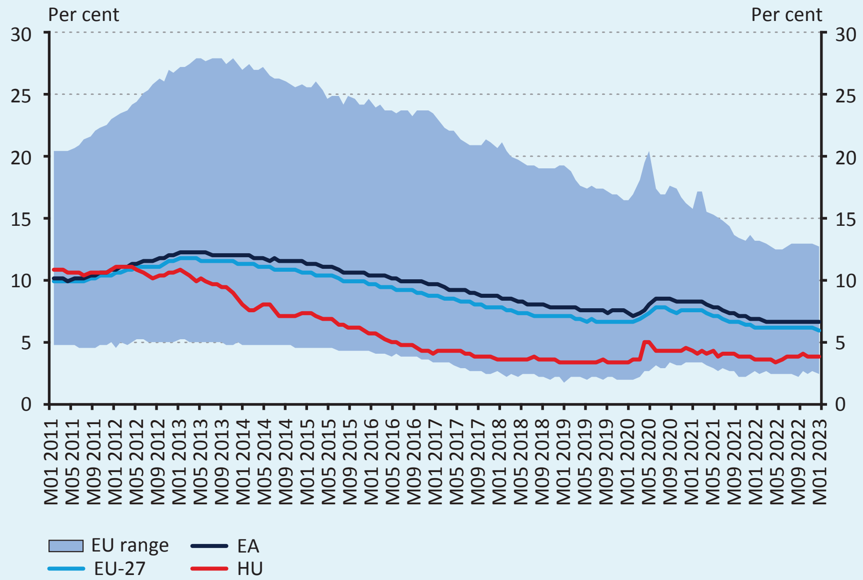
The current account balance worsened significantly, while accrual-based budget deficit turned out better than expected, reflecting the impact of soaring energy prices. The economy's external financing requirement had increased to 6.1 per cent of GDP by the fourth quarter of 2022, while the current account deficit rose to 8.1 per cent of GDP. The change in the external balance indicators was mainly triggered by a narrowing of the foreign trade balance, in particular, that of the energy balance linked to the deteriorating terms of trade. The services surplus, which is an important factor in the foreign trade balance, reached 4.8 per cent of GDP in the fourth quarter of 2022, the highest level since the outbreak of the pandemic. In addition, the surplus in the non-energy goods balance also increased in the fourth quarter. Budget deficit was 6.2 per cent of GDP in 2022, and the gross public debt-to-GDP ratio had dropped to 73.3 per cent by the end of 2022.

1.1.2 The domestic labour market was close to full employment

The Hungarian labour market proved resilient to the slowdown in economic growth. Employment in the national economy remained at historically high levels. While most sectors were characterised by strong demand for labour, the number of vacancies in the competitive sector decreased slightly in the fourth quarter of 2022 relative to previous quarters. The labour market continued to be tight. The unemployment rate approximated 4 per cent during 2022. The 3.9 per cent observed in Q4 2022 is favourable also by international standards.

The EU labour market is characterised by heterogeneity. In Greece and Spain, unemployment rates remained in double digits, while in Czechia the unemployment rate was only 2.4 per cent of the active population in February 2023. In the same month, the unemployment rate in the euro area stood at 6.6 per cent (Chart 1.2).

Chart 1.2
Unemployment rates in the European Union



Note: Seasonally adjusted data.
Source: Eurostat, HCSO

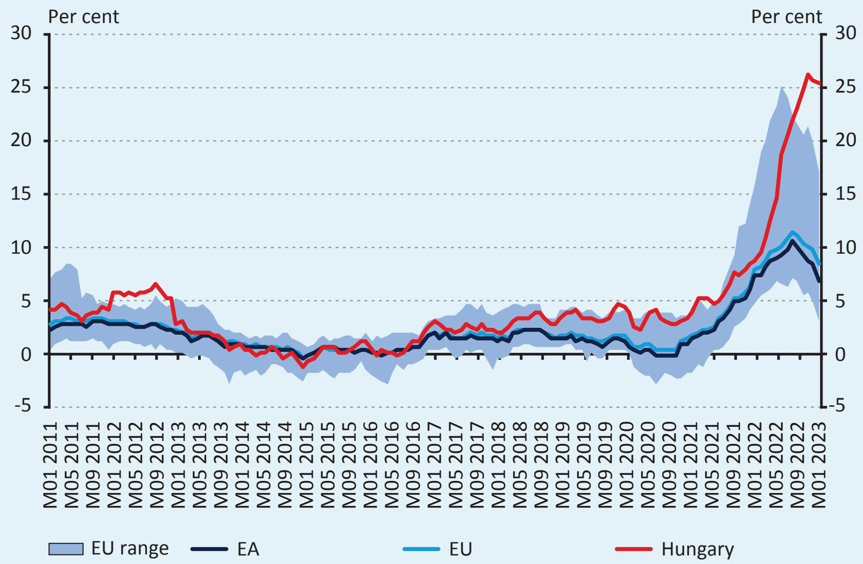
Real wages rose on an annual average basis in 2022, but within this, real wages have been falling since September. The competitive sector was characterised by vigorous nominal wage dynamics, with double-digit growth in most sectors. In addition to the tight labour market, strong wage growth was also supported by the large increase in the minimum wage at the beginning of the year: in 2023, the minimum wage increased by 16 per cent and the guaranteed minimum wage by 14 per cent. However, as inflation gradually rose, the pace of price increases exceeded nominal wage dynamics in both the competitive sector and the national economy from September 2022, leading to a decline in real wages.

We expect a slight adjustment in the labour market as a result of the economic slowdown. The unemployment rate may rise slightly and temporarily in the first half of the year, but we do not expect a substantial increase of the indicator.

1.1.3 Domestic inflation peaked in January

In the first months of the year, inflation in the euro area as a whole remained high and above the central bank's inflation targets. Over the past year, inflation in the euro area rose at an accelerating pace as energy and commodity prices soared. Although inflation remained at historically high levels in the world economies, in more and more countries saw inflation slowly declining. By March 2023, inflation in the euro area fell to 6.9 per cent, and to 8.3 per cent in the European Union as a whole (Chart 1.3). The slowdown in the global economy, weakening demand, the correction of global energy and commodity prices, and the decrease in international transport costs point to a further moderation in global price increases. The ECB expects inflation to be on a downward path in the course of 2023 as a result of falling energy prices. The easing of cost-side pressures and the ECB's monetary policy could bring the CPI back to the target of close to 2 per cent in the second half of 2025.

Chart 1.3
Annual change of the Harmonised Index of Consumer Prices, HICP



Source: Eurostat

Domestic inflation peaked in January 2023 and has been gradually declining since then. Domestic inflation fell to 24.0 per cent in April, while core inflation stood at 24.8 per cent. We expect inflation to decline in an accelerated manner from the second quarter as the downward pressure exerted by the tight monetary policy and global commodity prices becomes more pronounced, and the pace of price increases could reach single digits by the end of the year. Food inflation in Hungary remains high by historical and international standards, but the rate of price increases fell for the third month in a row in March, according to the Hungarian Central Statistical Office (KSH). Nevertheless, at the beginning of this year, higher than usual repricing was observed for market services, which was mainly related to specific repricing in the telecommunications sector.

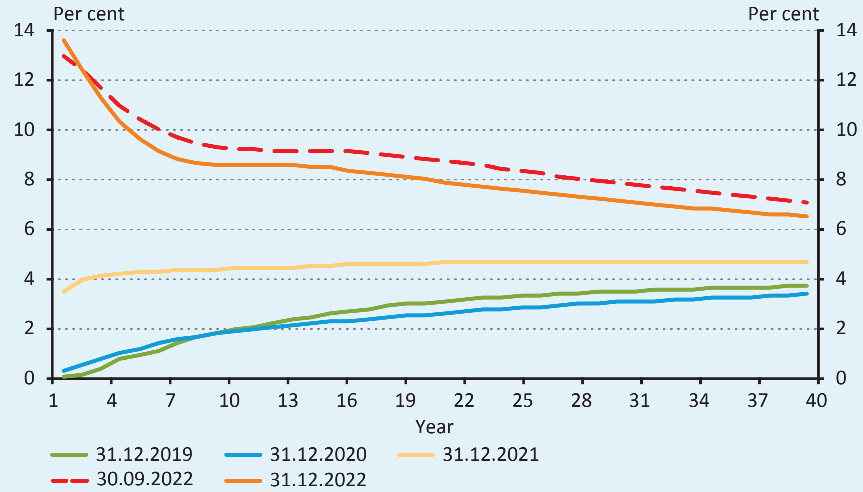
1.1.4 The yield environment changed dramatically

A key risk for the Hungarian insurance sector is the rising yield environment due to macroeconomic developments. Most of the risk arises from differing asset-liability maturities.

The calculation of the risk-free yield curve is based on government bond yields with a maturity of 1 to 15 years, given that they meet the deep, liquid and transparent criteria expected of them. From this last observation point, an extrapolation to the ultimate forward rate (UFR[1]) is used to calculate the curve. The value of the ultimate forward rate is influenced by two factors: the inflation targets of central banks and real interest rates. Therefore, the ultimate forward rate for the forint is 4.5 per cent.

The RFR of the Hungarian forint rose and flattened over the entire time horizon in 2021 (Chart 1.4), then the curve steepened after the beginning of 2022 as the shorter side[2] sharply increased, reflecting the impact of external events at the time. Since the end of the year, we have seen the short side rise and the longer side fall. The risk-free yield curve plays an important role in asset and liability valuation, and is used as a discount factor.

Chart 1.4
Shift in the risk-free yield curves of the Hungarian forint



Source: EIOPA

1.1.5 Changes in the sovereign debt market

While investor sentiment was still positive at the beginning of 2022 due to the easing of restrictions introduced because of the coronavirus pandemic, the Russia-Ukraine war added to market uncertainty to a great degree, and the tightening cycles of the central bank, which were triggered by rapidly rising inflation, increased the cost of funding for market participants. Interest rate hikes by major central banks and the phasing out of asset purchase schemes significantly boosted both short and long yields. German 1-year and 10-year government bonds rose by 320 and 270 basis points, respectively, over a year, while US government bonds rose by 440 and 210 basis points, respectively. Yields on long-dated government bonds grew by a similar degree in the region, with Hungarian yields rising by 10 percentage points at one-year maturity and 450 basis points at ten-year maturity. The rise in yields was boosted by the MNB's intense cycle of interest rate hikes, with the benchmark rate rising by 10.6 percentage points in the first 9 months of the year. Although secondary market government bond flows increased by almost a quarter in 2022, market liquidity remained below the historical average for most of the year. The daily average turnover was around HUF 400 billion, similar to the end of the previous year, with most of the trading taking place in the 3 to 5 year maturities, but the turnover of longer securities increased significantly in the last months of the year. Regarding the government bonds held by major sectors, the greatest change during 2022 is

[1] UFR (Ultimate Forward Rate): the ultimate forward rate that determines the extrapolation path of the risk-free yield curve
[2] RFR (risk-free interest rate) is the risk-free rate of return curve used to calculate technical provisions.

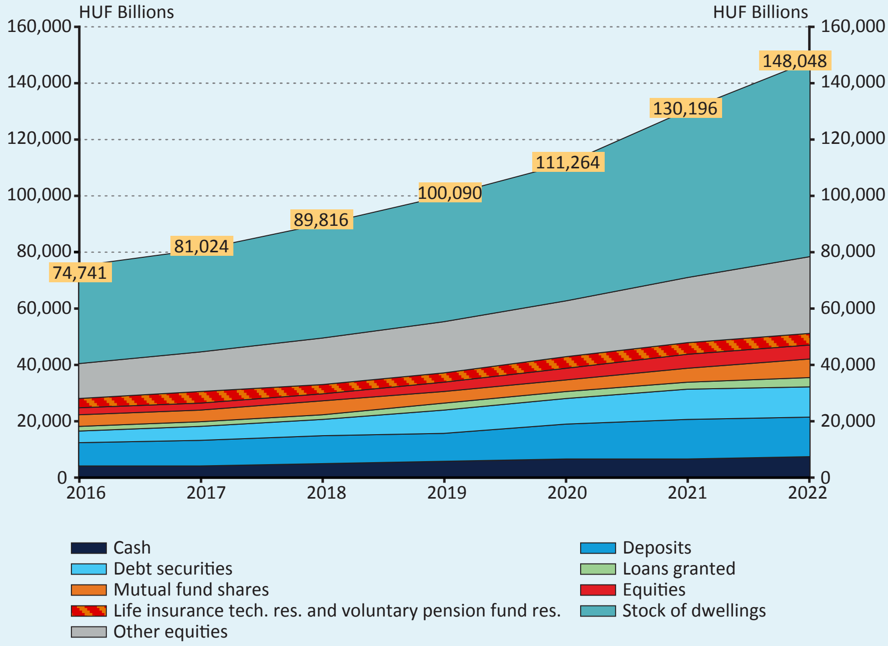
that non-resident investors increased their portfolio of HUF-denominated sovereign debt instruments by HUF 908 billion and domestic banks by HUF 719 billion.

1.2 CHANGES IN HOUSEHOLD SAVINGS

1.2.1 In 2022, household wealth growth was lower than inflation

Households' gross wealth, including financial assets and housing, exceeded HUF 148,000 billion by the end of 2022, an increase of 14.0 per cent compared to the previous year (Chart 1.5). The increase in wealth was below the inflation rate of 24.5 per cent at the end of 2022. Besides housing, a rise in the value of the credits and loans granted, other equity and investment fund shares contributed the most to the growth in wealth in the past year, totalling HUF 15,715 billion, accounting for 91 per cent of the total increase.

Chart 1.5
Developments in the gross assets of households



Note: The 2021 and 2022 data related to the stock of dwellings are MNB estimates.
Source: HCSO, MNB

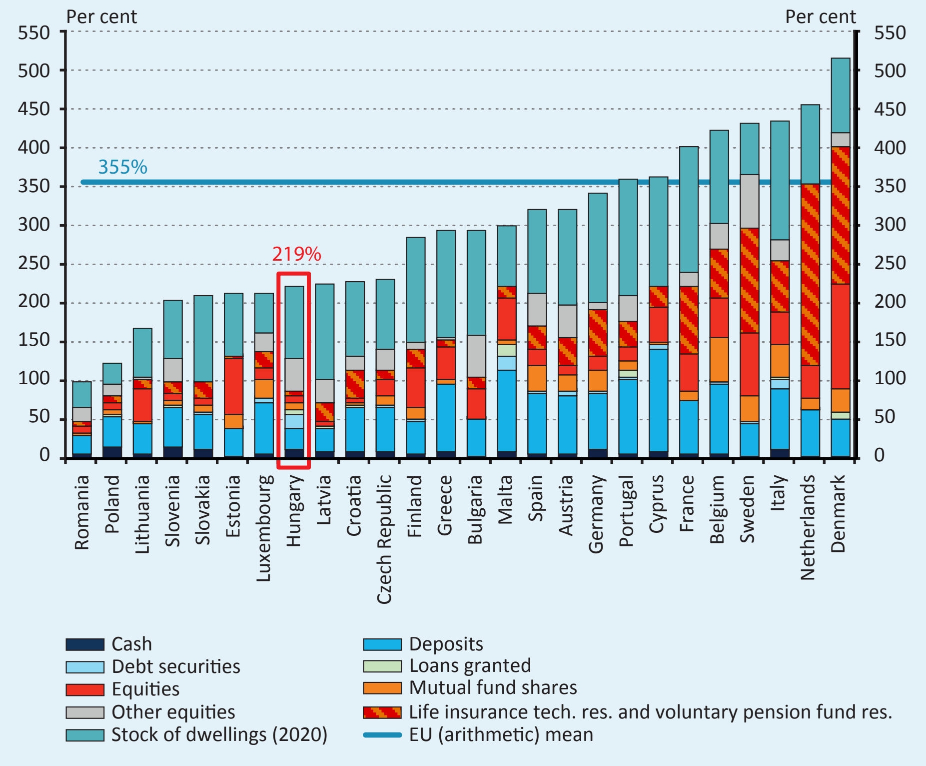
The most dynamic growth was seen in credits and loans (22 per cent), but investment fund shares and housing also expanded above average. The increase in the value of housing was mainly due to rising real estate prices. At the same time, the growth in cash, deposits, debt securities and equities was below average, while technical provisions and fund reserves shrank.

Premium income from life insurance and voluntary funds, which are vehicles of long-term wealth accumulation, increased slightly compared to the previous year. At the same time, premium reserves fell by nearly HUF 170 billion, reflecting rising payouts and, in particular, revaluation losses due to the significant rise in yields. The decrease from revaluation losses exceeded HUF 350 billion, life insurers and funds suffered larger revaluation losses only during the 2008 financial crisis. As a result of the decline in the portfolio, the share of this type of assets fell to 2.9 per cent of households' gross assets or to 5.4 per cent of households' gross financial assets.

1.2.2 Hungarian household assets as a share of GDP better than the regional average

The gross wealth of Hungarian households, including financial assets and housing, amounted to 219 per cent of GDP at the end of 2021 (Chart 1.6) and hence continued to be in the bottom quarter of the European Union according to Eurostat data. The average gross household wealth in the EU, calculated as the GDP-weighted average of countries, was 355 per cent. The average for the countries in the region (Czechia, Poland and Slovakia) equalled 160 per cent, so the wealth of Hungarian households relative to the level of economic development is higher than that of similarly developed countries as per the relevant statistical figures. At the same time, Western European countries (e.g. Sweden, Denmark, the Netherlands, Italy) continued to have significant surpluses compared to the Visegrad countries, with these four countries having the highest in the EU, an average surplus of 445 per cent. In terms of GDP shares for each category, Hungary ranks first for debt securities (mainly sovereign debt instruments). It is also among the leaders in holding cash and other equities. Domestic households ranked in the middle in terms of investment fund shares (rank 15) and housing (rank 17). In contrast, Hungary was at the bottom of the league in deposits, technical provisions, voluntary pension fund reserves and equities (ranked 25th, 23rd and 21st in 2021, respectively, out of the 26 countries reviewed). Overall, Hungarian households seem to prefer government bonds and cash compared to other EU nations while investing less in shares, deposits, life insurance and pension funds.

Chart 1.6
Gross assets of EU households as a percentage of GDP, at the end of 2021



Note: The stock of dwellings data related to 2020.

Source: Eurostat

2 The insurance market and its risks

2.1 OVERALL PICTURE OF THE MARKET

2.1.1 Number of insurers unchanged, market size continued to grow

Considering the Hungarian insurance sector as a whole, there was no change in the number of institutions in 2022 (Table 2.1). There were still a total of 33 supervised insurance companies and insurance associations, 22 of which are covered by Solvency II (S2). In terms of the institutional form of insurers, 21 institutions operated in the form of joint-stock company, 2 as a large mutual association and 10 as a small mutual association. There were also 13 insurance branches operating in the Hungarian market, these are covered by the powers of the MNB only in terms of consumer protection. Due to their size and activities, 1 joint-stock company and 10 small mutual insurance associations are not covered by S2. Regarding the segment of insurance, of the 22 institutions covered by S2 there were 4 life, 9 non-life and 9 composite insurers.

In 2022, with a 7.4 per cent increase compared to the previous year, sectoral premium income amounted to HUF 1,428 billion of which the non-life segment accounted for 57 per cent and the life segment for 43 per cent. Non-life premiums grew by 12.7 per cent year on year, one and a half times the average for 2013-21, while life premiums increased by only 1 per cent. Taking into account the Hungarian branch offices of insurers with registered office abroad, the premium income of the insurance sector amounted to HUF 1,546 billion. The share of branches in total premium income (7.6 per cent in 2022) increased by 0.8 percentage points relative to the year before.

Compared to the previous year, the growth in the number of policies was significantly lower than the growth in premiums in 2022 (+1.1 per cent). Life insurance decreased by 1.5 per cent, while non-life insurance increased by 1.6 per cent over the year.

The sector-wide profit after tax dropped to 43 per cent of the preceding year, mainly due to the effects of drought and surtaxes. The sector-wide return on equity (ROE) was 9.5 per cent (20.7 per cent in 2021), which continues to reflect positively on the insurance sector from a stability perspective. It falls minimally short of the fair and competitive target of 10 to 15 per cent set in the “10-year future of the insurance sector in 7 points”.

Table 2.1
Key data of the insurance sector

	2021	2022		
	Total	By institutions type		Total
Number of institutions*	32	Total S2 insurers	22 –	32 –
		Life	4 –	
		Non-life	9 –	
		Composite	9 –	
		Small insurance union	10 –	
	Total	**Life segment**	**Non-life segment**	**Total**
Gross written premium (HUF billions) *(including branch offices)*	1,329.6 *(1,426.2)*	608.9 *(649.9)*	819.0 *(896.1)*	1,427.9 (1,546.0)
Number of contracts (thousand pcs) *(number of contracts per capita) ** *	14,649 *(1.51)*	2,278	12,539	14,818 (1.53)
Technical provision (HUF billions)	2329.8	1,838.9	323.7	2,162.6
Balance sheet total (HUF billions)	3,402.2			3,367.1
Eligible own funds (HUF billions)	658.4			632.4
Capitalisation level (per cent)	195			172
Profit after tax (HUF billions)	80.2			35.8
Return on equity (ROE)	20.7%			9.5%
Return on solvency capital (S2-ROE) * **	12.2%			5.7%

Note:
** The number of institutions does not contain one supervised joint-stock company falling outside S2.*
*** For the insurance policies per capita ratio we calculated with the total population indicated on the HCSO website.*
**** The S2-ROE index compares the profit after tax to the available capital under Solvency II.*
Source: MNB

Table 2.2
Key data of the small insurance unions

	Small insurance unions	
	2020	2022 *
Number of institutions	10	10 –
Gross written premium (HUF millions)	702	747
Number of contracts - also shorter than 1 year (pcs)	2,570	2,272
Return on equity (ROE)	11.9%	12.5%

*Note: * The 2022 data of the small insurance unions is not yet available.*
Source: MNB

2.1.2 Market not yet set on a convergence path

The MNB published its vision for the insurance (and partly voluntary pension funds) sector in February 2018 under the title "10-year future of the insurance sector in 7 points" (hereinafter as "FIS"). The points of the publication set out trends and targets for catching up with mature markets, which can also serve as a sector-wide strategic plan and guidance for market players. As in previous years, this publication also shows the evolution of the FIS target figures by the 10-year targets and by the projected paths, which are summarised in Table 2.3.[3]

[3] Backtesting has been carried out in consideration of the changes in macroeconomic data.

Table 2.3
Target values and actual data of the insurance sector

Objective to be achieved	Target variable	2016 actual data	2022 target / optimal value	2022 actual data
1. Wide-ranging self-provision *More savings, greater security*	Life insurance and voluntary pension fund contracts/economically active persons	54% 2.46 million pieces	68% 3.13 million pieces	48% 2.33 million pieces
	Ratio of reserves as a percentage of GDP (life technical reserve + voluntary pension fund individual accounts)	8.7% 3,054 HUF Bn	9.3% 4,757 HUF Bn	5.7% 3,797 HUF Bn
2. Market size convergence *Back to the forefront of the region*	Penetration (gross written premium/ GDP)	2.5% 889 HUF Bn	2.8% 1,415 HUF Bn	2.2% 1,428 HUF Bn
3. Competitive market *Increasing competition*	Share of TOP5	60% HHI 8.9%	56% HHI 8.7%	61% HHI 9.7%
4. Efficient sales *Half of sales over an innovative channel*	Ratio of innovative channels	37%	above 50%	36% (2021)
5. Economies of scale *Institutions operating more cost efficiently with dropping margins*	ACR values of UL contracts	0.53 - 9.97%	0.5-5.75% steadily	0.6 - 5.7%
	Non-life combined ratio (net of tax)	81%	85-90% steadily	83%
	Cost ratio	30%	20-30% steadily	31%
6. Fair and competitive profitability *Long-term confidence and stability*	ROE	ROE 20% S2 ROE 11%	ROE: 10-15% steadily	ROE 10% S2 ROE 6%
7. Well-capitalised insurers *Safe and prudent operation*	Capitalisation level	215%	>150% steadily	172%

Note: Values linked to objectives 1 and 2 were evaluated compared to trends projected in the publication.
Source: MNB

The coverage of life insurance policies and voluntary pension contracts fell by 0.8 percentage points to 47.6 per cent in 2022: the number of contracts decreased by 1.2 per cent, while the number of economically active persons rose by 0.5 per cent over the year. The lag behind the convergence path projected in the FIS worsened further as the reaching of potential savers remained unsuccessful with neither the capital market downturn nor soaring short-term yields supporting the rise in long-term savings coverage.

With the number of life insurance policies and voluntary pension fund members declining, life insurance and voluntary pension fund reserves as a whole fell by 4.8 per cent (HUF 193 billion), and voluntary pension fund returns turned negative in 2022. The trend was driven by the depreciation of the underlying assets. Compared to a year earlier, the value of shares went down on the one hand, due to a decline of the major stock indices, and on the other, bonds in asset portfolios were also devalued as a result of the rise in yields. However, inflows exceeded outflows in both sectors, with both revenues and service volumes increasing. Of the three scenarios presented in the FIS, only the figure specified for the inflation-adjusted path is exceeded by self-provision savings, which had fallen from 7.25 per cent of GDP to 5.72 per cent by the end of 2022. The change in the value of the indicator was driven to a large extent by the significant increase in nominal GDP in 2022, and to a lesser extent by the fall in reserves.

Insurance premiums continued to grow strongly (7.4 per cent), exceeding only the inflation-adjusted path of the three projected growth scenarios, practically reaching the value initially set for the empirical trend, but lagging behind the upward penetration trend. At the same time, the GDP penetration rate fell to 2.15 per cent from 2.42 per cent in 2021, again driven by a significant increase in GDP in 2022. The indicator was 0.26 percentage points above the inflation-adjusted trend set out in the FIS, 0.15 percentage points below the empirical trend, and 0.55 percentage points below the upward penetration trend projected for 2022. To reach the latter penetration level, the sector would have needed an additional HUF 254 billion in premium income.

After a slight increase, the share of the top 5 market players (TOP5) exceeded the projected path by 5.1 percentage points in 2022. The Herfindahl-Hirschman Index (HHI) remained essentially unchanged, but moved away from the projected path of steady decline. There was no market share reallocation among the TOP5 players, the development of the indicator was driven by medium insurers' loss of market share.

The share of innovative channels[4] in the composition of insurers' sales channels stood at 36 per cent in 2021, which is still below the 2016 figure and drifts further away from the target of over 50 per cent projected in the FIS. It is likely that incentives to use these channels more actively are still not in place.

As in the previous year, the ACR values of unit-linked contracts[5] covered by MNB Recommendation No 8/2016 (VI. 30.) do not deviate from the limits set in the MNB Recommendation. The lowest and highest ACRs show a change of 0.3 percentage points, with values ranging from 0.6 per cent to 5.7 per cent.

The combined ratio of the non-life insurance sector rose compared to the previous year. This largely reflected the impact of high drought claims and claims inflation, so the 2022 indicator for the sector as a whole was higher than the 2016 value, but remained below the target range set in the FIS.

The cost ratio increased by 1.3 percentage points year on year to 30.6 per cent in 2022, putting the sector above the target range of 20 to 30 per cent. However, the cost ratio remained unevenly distributed between the insurance segments. While the life segment was characterised by a cost ratio of 21 per cent, the non-life segment was still well above 30 per cent.

The sector's profitability fell to 9.5 per cent in 2022, down from above 20 per cent in the preceding two years, still representing a return on equity (ROE) of 10 to 15 per cent, which was practically in line with the target range. Sector-wide profit after tax fell to 43 per cent of the previous year, mainly as a result of the effects of drought and surtaxes, yet most institutions remained profitable.

As in previous years, the target of over 150 per cent for the sectoral Solvency II capitalisation level was met. With two exceptions, the Solvency II ratio of institutions decreased, but with one exception, each institution met the 150 per cent target at the end of 2022. Thanks to effective supervisory communication, the institutions suffering a significant decline took the necessary measures to comply with the capital buffer recommendation.

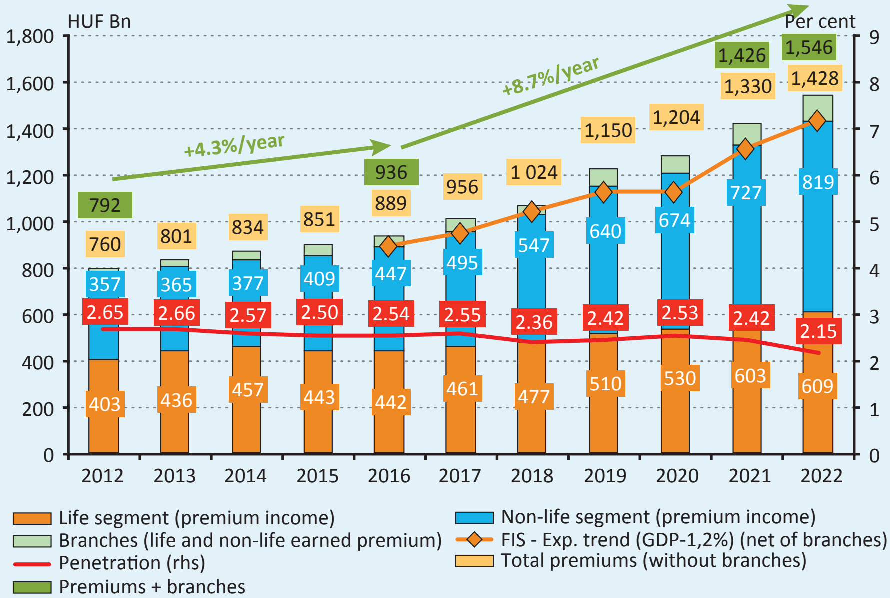
2.1.3 Premium income approximated the HUF 1,431 billion level projected by the MNB's FIS empirical trend

The total premium income of insurers in Q1-Q4 2022 was HUF 1,427.9 billion, which represents an increase of 7.4 per cent (HUF 98 billion) compared to 2021. Premium income was HUF 608.9 billion in the life segment and HUF 819.0 billion in the non-life segment, though the rate of premium increase slowed down compared to the above 10 per cent in 2021. With the expansion of the non-life and the regular-premium life segments, single-premium life insurance declined, it approached the premium income level of HUF 1,431 billion projected for the empirical path in the FIS for 2022. As the growth of the sector again lagged significantly behind the growth of the economy as a whole, insurance penetration, which continued to decline, moved from 2.42 per cent in 2021 to 2.15 per cent in 2022, further away from the MNB's target for the future. Premium income including branches also increased dynamically to HUF 1,546 billion.

[4] Innovative channels: bank insurance, direct sales, online mediation.

[5] Of term policies, this includes those with a 10, 15 and 20-year duration, of permanent policies, those with a duration of 15 years.

Chart 2.1
Gross written premium and penetration in insurance sector

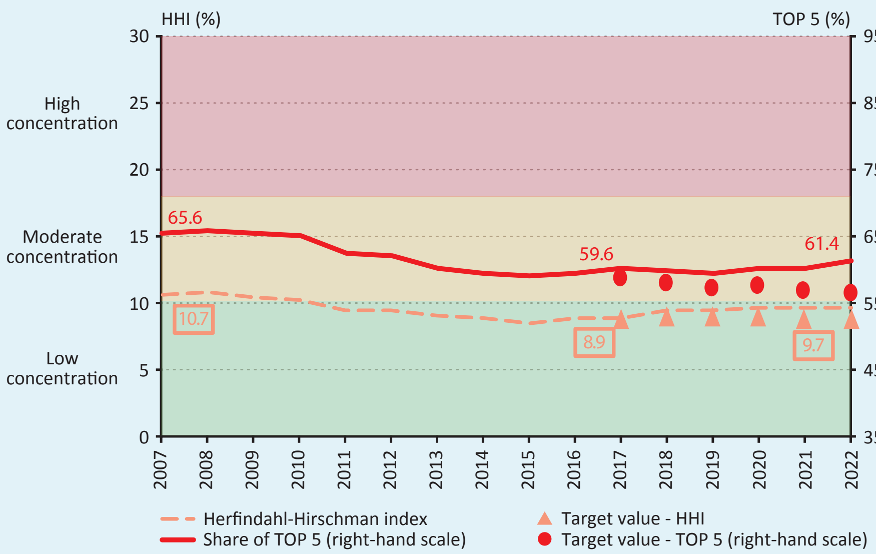


Note: Gross written premium in life and non-life segments, and gross earned premium for branch offices.
Source: HCSO, MNB

2.1.4 TOP5 market share did not change substantially from around 60 per cent

The share of the top 5 players (TOP5) increased by 1.5 percentage points to 61.4 per cent in 2022 (Chart 2.2). For the sector as a whole, the share of the TOP5 institutions increased in the life segment and remained practically unchanged in the non-life segment. In the life segment, the decline mainly affected medium-sized insurers. As a result, the HHI did not change significantly and remained at 9.7 per cent. As in previous years, actual data showed a substantially higher level of concentration than the scenario projected in the FIS, and the sector did not come near its values despite the changes in 2022.

Chart 2.2
Share of the five largest insurers (TOP 5) and Herfindahl-Hirschman index (HHI) of the entire sector based on gross written premium



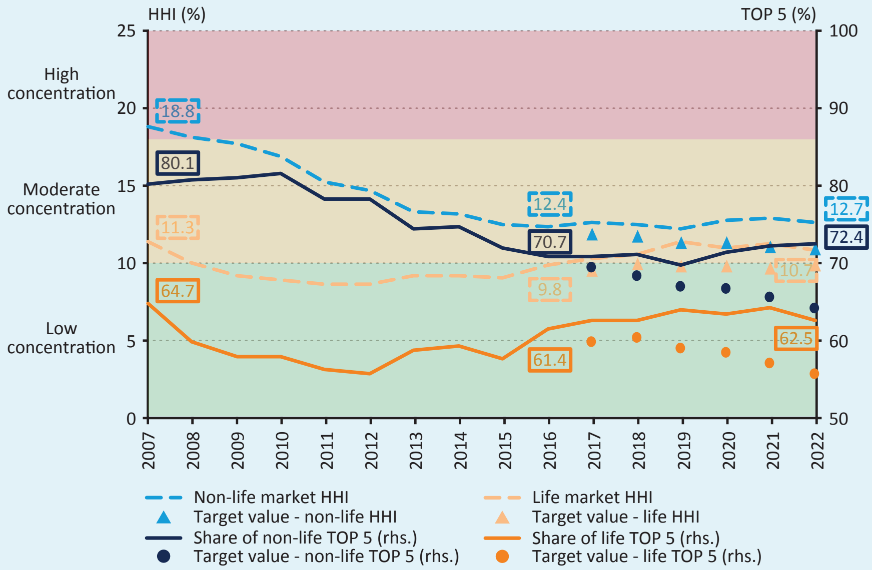
Note: The colour of the background illustrates the strength of concentration under HHI.
Source: MNB

2.1.5 Concentration decreased in the life segment, slightly increased in the non-life segment

There was a decrease in the life segment and a slight increase in the non-life segment in terms of concentration in 2022 (Chart 2.3). In terms of gross earned premiums, the five largest insurers (TOP 5) in the non-life segment had a market share of 72.4 per cent (up 0.2 percentage points since the end of 2021) and a Herfindahl-Hirschman Index (HHI) of 12.7 per cent in 2022. The share of the 5 largest institutions in the life segment fell by 1.7 percentage points to 62.5 per cent compared to the end of the previous year. In line with this, the life HHI decreased by 0.6 percentage points to 10.7 per cent in comparison with 2021. The fall in concentration ratios after the surge in single/ad hoc premiums in the first two quarters led to a significant reduction. There was no change in the market shares of the TOP5 institutions in any of the segments.

The actual data exceeded the figures of the life and non-life paths projected in the FIS. The vision has foreseen a continued increase in competition, which was still not typical of the market. The shift in 2022 in the non-life segment took a direction opposite the changes presented in the FIS for the same year, while the decrease observed in the life segment appeared to be more of a one-time effect of a one-off drop in premiums.

Chart 2.3
Share of the five largest insurers (TOP 5) and Herfindahl-Hirschman index (HHI) of the entire sector based on gross written premium by segment

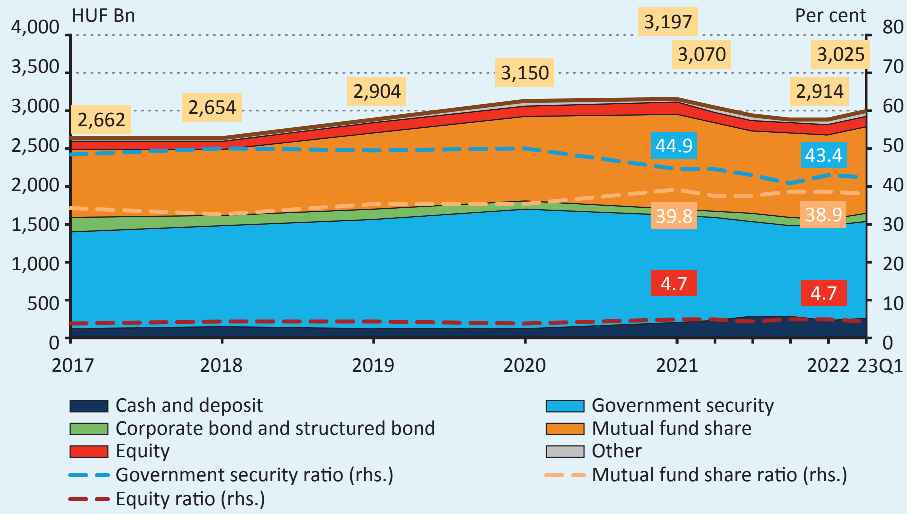


Note: The colour of the background illustrates the strength of concentration under HHI.
Source: MNB

2.1.6 Concentration of government bonds still high but decreasing

The value of total assets of domestic insurers fell by 8.8 per cent in 2022 following a 1.5 per cent increase in the previous year. Total assets amounted to HUF 2,914 billion of which 51 per cent was backed by unit-linked life insurance reserves, while the remainder was made up of instruments underlying traditional life insurance and non-life insurance, as well as the institutions' own assets (Chart 2.4). This ratio changed by 2 percentage points relative to the previous year, in favour of unit-linked life insurance reserves. Lower-risk, conservative assets (government bonds, cash and deposits) accounted for 51 per cent of insurers' total assets. This rate was 0.2 percentage points higher than in 2021. The remaining assets were mostly made up of investment fund shares, equities and corporate bonds (including structured bonds). There was a 2-percentage point shift in the composition of assets behind unit-linked reserves in 2022, moving from higher-risk equities, investment fund shares, corporate and structured bonds to lower-risk cash and deposits as well as government bonds which brought the latter's share to 20.8 per cent (with unit-linked insurance, the risk of exchange rate changes affecting the underlying assets is borne by the client). Sovereign debt instruments accounted for 75.7 per cent of the investments behind non-unit-linked reserves, which remained an outstanding ratio by European standards. In the first quarter of 2023, the value of the total assets of domestic insurers increased as a result of market correction.

Chart 2.4
Composition of assets of Hungarian insurers

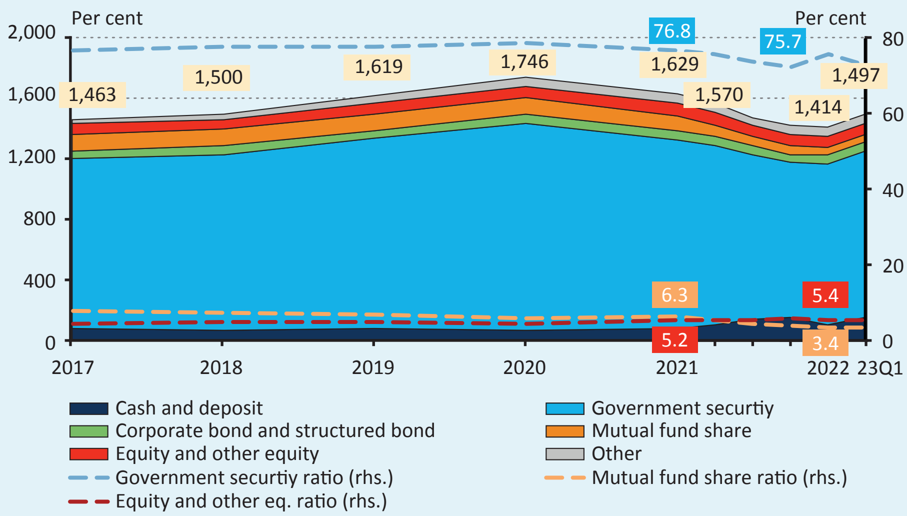


Note: Other includes: real properties, mortgage bonds, loans and other unclassified assets.
Source: MNB

2.1.7 Government bonds continued to account for a significant part of non-UL reserves

Until 2016, the insurance assets behind non-unit-linked reserves were characterised by a growing proportion of investment fund shares and equities as opposed to government bonds and corporate bonds (Chart 2.5). Non-unit-linked reserves saw a reallocation in their underlying assets which shifted away from government bonds and investment fund shares towards cash, bank deposits, mortgage bonds and real estate investments. The proportion of government bonds fell by 1 percentage point, while the ratio of investment fund shares dropped by 2.9 percentage points. The largest share increase was seen in the cash and deposits category where their ratio rose by 2.6 percentage points. In addition, the share of real estate increased by 0.9 percentage points, the share of mortgage bonds by 0.1 percentage points, the ratio of equities by 0.2 percentage points and the proportion of corporate bonds and structured bonds by 0.1 percentage points.

Chart 2.5
Composition of assets underlying reserves other than unit-linked reserves



Note: Other includes: real properties, mortgage bonds, loans and other unclassified assets.
Source: MNB

2.2 LIFE SEGMENT

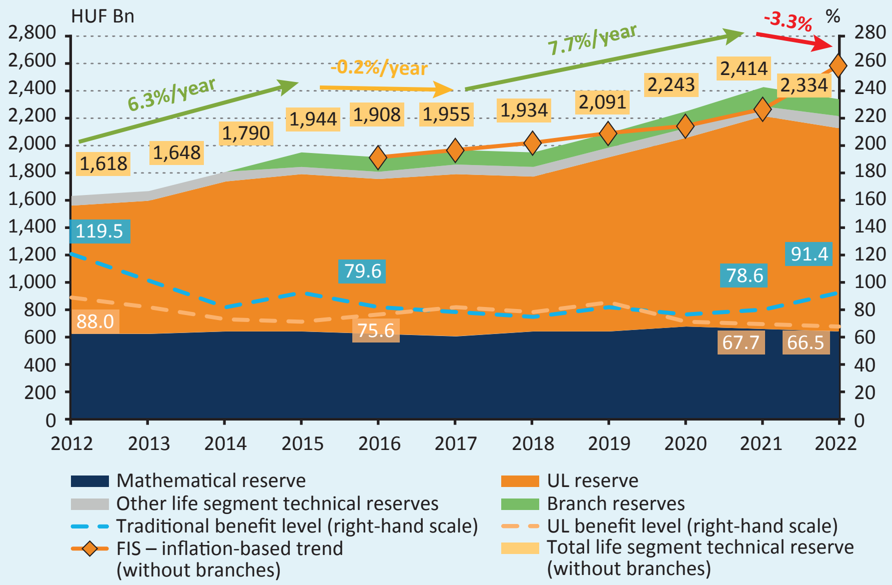
2.2.1 Reserves depreciation for unit-linked portfolios

The amount of technical provisions in the life segment amounted to HUF 2,199 billion by the end of 2022 (HUF 2,334 billion incl. branches), this represents a decrease of 3.6 per cent (3.3 per cent incl. branches) compared to the previous year. In particular, the reserves for unit-linked products, which accounted for a significant part of life segment reserves, decreased by HUF 62.6 billion, that is, by 4 per cent. The mathematical provisions for traditional life insurance also decreased, albeit to a lesser degree (by HUF 19.1 billion, 3 per cent).

In the two large life insurance groups, i.e. for unit-linked and traditional products, cash inflows exceeded payouts over the past periods. The benefit level of unit-linked products remained at the same level as last year, at 66.5 per cent, with claim payments growing in proportion to the growth in premium income. By contrast, traditional life insurance had a higher benefit level, 91.4 per cent, up 13 percentage points on the preceding year. Premium income from traditional products decreased slightly, while the benefit level rose mainly because of higher benefit payments relative to the previous year. A significant part of the payments were connected to one insurance company where cash outflow (liquidation of free investments) was higher than in the previous year.

Considering the above, life insurance premium reserves were positively affected by the fact that the cash inflows during the year exceeded payouts (change due to transactions), while the overall decrease in life insurance premium reserves was attributable to revaluation effects. The turbulence in the capital markets had a negative impact on the value of savings of customers with unit-linked products in particular. There is a risk that the negative returns achieved in a given year will lead to greater inclination to surrender. Such risk is lower if the clientele with this type of insurance is sufficiently informed and takes into account the expected market correction when making a decision, instead of immediate loss realisation. The MNB monitors surrenders on a monthly basis. In 2022, a slow growth started, both in terms of number and value.

Chart 2.6
Developments in life insurance reserves and the related insurance benefit levels

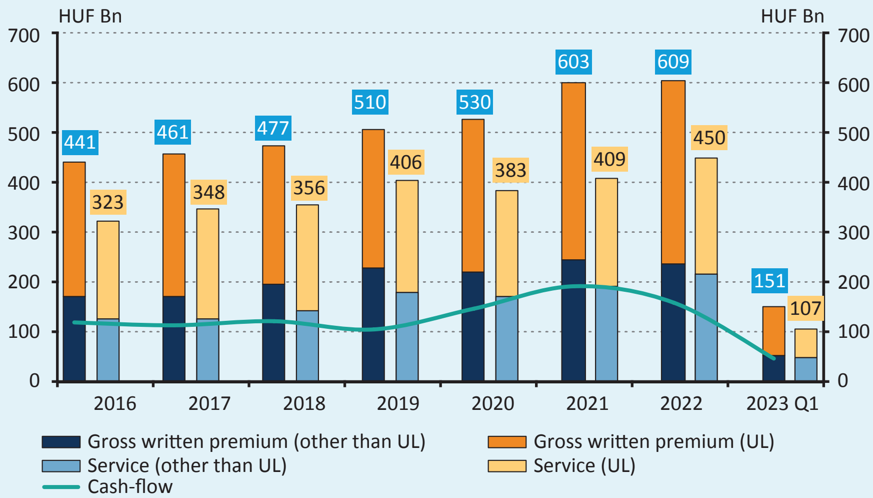


Note: From 2016, the benefit level (claim payment until 2015) is the ratio of the claim charges compared to the gross written premium. When calculating the benefit level, the gross written premium of branch offices has not been taken into consideration. Other life insurance reserves include the following reserve components: unearned premium reserve, outstanding claim reserve, reserve for premium refund depending on and independent of the profit, claim fluctuation reserve, extreme loss reserve, cancellation reserve and other insurance technical reserves.

Source: MNB

In recent years, life insurance premiums exceeded payments for services each year, resulting in a consistently positive net cash flow balance for life insurers (Chart 2.7). Net cash flow remained stable at HUF 100 billion until 2019, then increased in 2020 and 2021 as premiums outpaced payments, reaching around HUF 200 billion by 2021. In 2022, net cash flow returned to the 2020 level, given that payments for services outgrew premiums. The net cash flow balance of traditional life insurance was HUF 7.1 billion, while the benefit level equalled 91.4 per cent. As in previous years, the net cash flow balance of unit-linked life insurance was positive in 2022, with premiums written exceeding payments by HUF 152.3 billion, bringing benefit level to 66.5 per cent. In the first quarter of 2023, the net cash flow balance of unit-linked life insurance was HUF 51.5 billion, while payouts exceeded premiums in the traditional life insurance segment resulting in a negative net cash flow balance of HUF -7.4 billion. However, overall, premium income exceeded payments for services, so the net cash flow balance remained stable.

Chart 2.7
Cash flows in the life segment



Source: MNB

The high risk-free yield curve and the high-yield environment caused a depreciation of insurance assets of which the revaluation of fixed-income securities was the main factor affecting the Solvency II (S2) balance sheet of institutions. At the sector level, a large proportion of insurers' non-unit-linked assets was directly invested in government bonds, which can have a significant impact on individual institutions.

The considerable change in the yield environment was also reflected on the liabilities side. A rise in the risk-free yield curve, which is a key determinant for reserve calculation, may reduce the institutions' S2 provisions through the discount effect.

2.2.2 Regular premiums up, single premiums down

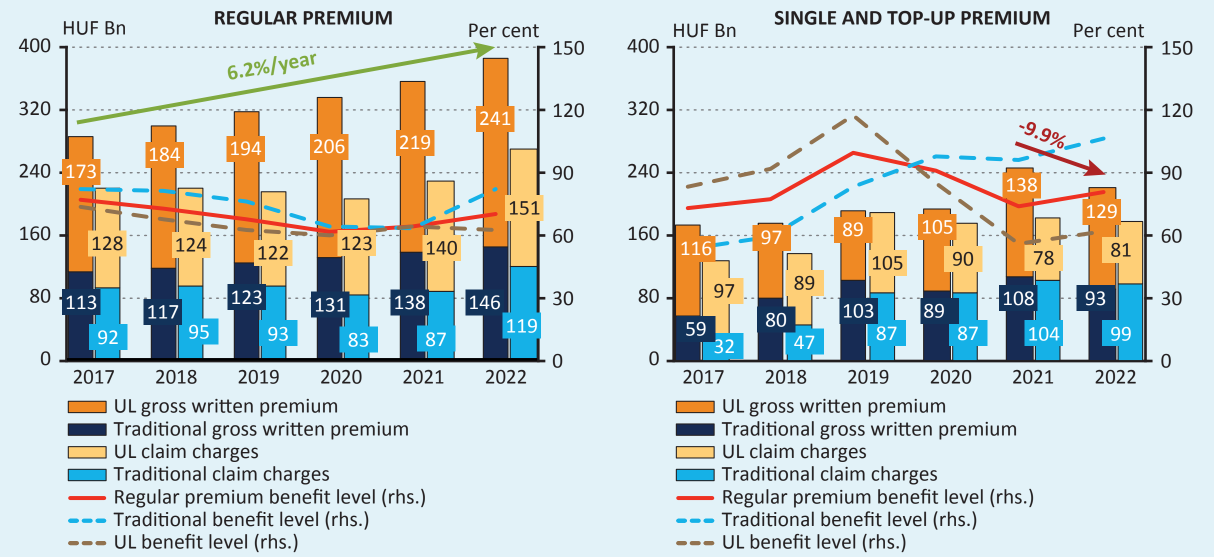
The premium income of the life insurance segment in 2022 amounted to HUF 608.9 billion of which 64 per cent came from regular premiums and the rest from single and top-up payments. Gross written premiums in life insurance had been on an upward trend since 2016 with a moderate overall increase (1 per cent growth on an annual basis) over the past year.

Revenues from regular and single premiums changed to various degrees relative to the preceding year. Premium income from regular fees continued to grow dynamically (9 per cent higher than in the previous year). Single and top-up premiums, on the other hand, fell sharply from an unusually high base in 2021 (10 per cent drop). Revenues from single and top-up premiums also decreased compared to the previous year. The drop in single premiums was in line with the decline in the growth of single premium products. The surtax levied on the insurance sector seems to have hit mainly single-premium policies whose cost structure was less able to absorb the extra tax burden. By contrast, top-up payments only decreased compared to the high level of the previous year, there were actually more top-up payments relative to 2020.

Premium income from regular premium policies increased in both main product segment (unit-linked and traditional). In the unit-linked segment, claim payments increased in proportion to premiums, leaving the benefit level essentially unchanged (62.5 per cent). In contrast, claim payments for traditional products were higher in 2022, primarily because of the higher withdrawals at one market player as mentioned above.

Regarding single-premium policies, the decrease in premium income had an immediate impact on the benefit level which increased in both the unit-linked and the traditional segments compared to the previous year, and was above 100 per cent for traditional products.

Chart 2.8
Developments of premiums written, claim charges and benefit level* in the life segment, by premium payment frequency

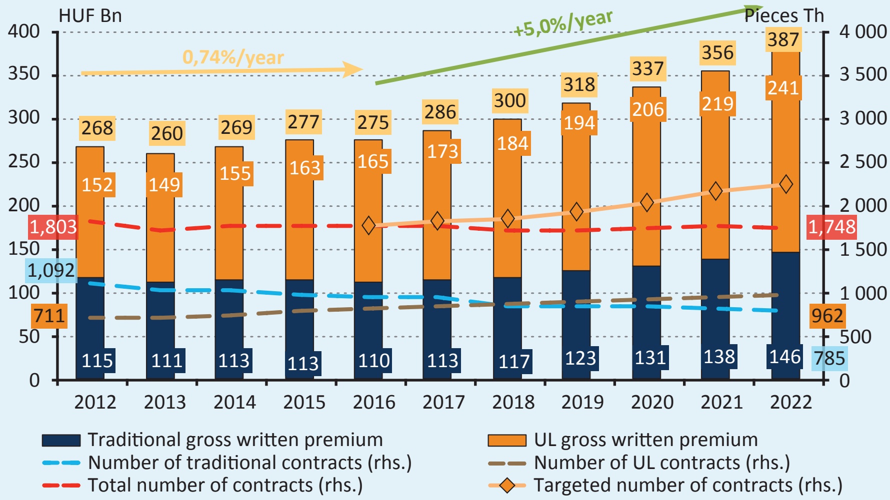


*Note: *The benefit level is the ratio of the claim charges compared to the gross written premium.*
Source: MNB

2.2.3 Steadily growing premium income in the regular life segment

The majority of life insurance policies were still in the regular premium portfolio where the sectoral premium income continued the growth trend of the preceding years in 2022, and exceeded the previous year-end figure by 9 per cent, equalling HUF 387 billion.

Chart 2.9
Development of regular premiums and number of contracts in the life segment



Note: The "total number of contracts" does not include the policies with waiver of premium and the group life insurance policies.
Source: MNB

The increase in regular premium income was largely attributable to unit-linked products. Premium income increased for non-pension unit-linked products, which account for a large part of the regular segment, while the number of policies stagnated. Unit-linked pension insurance was also a considerable contributor, where the portfolio grew dynamically, as in recent years.

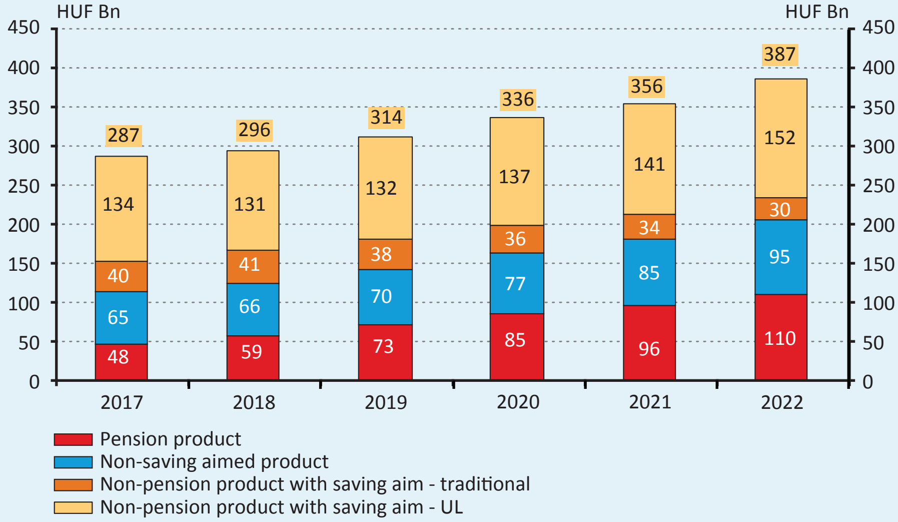
Regarding traditional products with regular premiums, premium income for savings-type endowment life insurance decreased in the non-pension portfolio, which was slightly compensated by the premium growth for pension savings. However, group life insurance products were the main contributors to the increase in regular premiums.

In terms of number of contracts, the portfolio of regular premium life insurance policies stagnated, with a total of 748,000 contracts in 2022 (excluding paid-up, suspended contracts). Unit-linked policies were the most dominant followed by the traditional death benefit and savings products. For group life insurance policies, analyses based on the number of contracts were not suitable to identify an increase in the portfolio. Overall, however, the upward trend projected in the FIS did not materialise, the number of regular premium policies reached 78 per cent of the target figure.

2.2.4 Pension and term insurance continued to strengthen

Premiums from regular life insurance had been growing at a slow, steady pace (6-9 per cent) since 2017, and exceeded HUF 387 billion in 2022. The growth in premium income continued to be driven mainly by unit-linked pension insurance, while the premiums from term life insurance also increased. Premium income from non-pension type savings had been growing slowly and steadily for years, with the declining premium income from the maturing traditional savings portfolio being firmly compensated by the increasing premium income of unit-linked policies (Chart 2.10).

Chart 2.10
Distribution of life insurance regular premiums by the nature of saving



Source: MNB

In 2022, the number of regular premium pension insurance policies approximated 450,000, of which 76 per cent were unit-linked. The gross written premiums from regular pension insurance policies developed in line with the composition and changes in the portfolio: in the year under review, premiums of HUF 83.3 billion were collected on the expanding unit-linked pension insurance portfolio. Growth in the segment of traditional pension insurance with a regular premium remained well below that of the unit-linked portfolio, and slowed down significantly since 2019. From 2021 to 2022, it increased slightly (6 per cent), while the related premium income rose by HUF 1.4 billion on an annual basis.

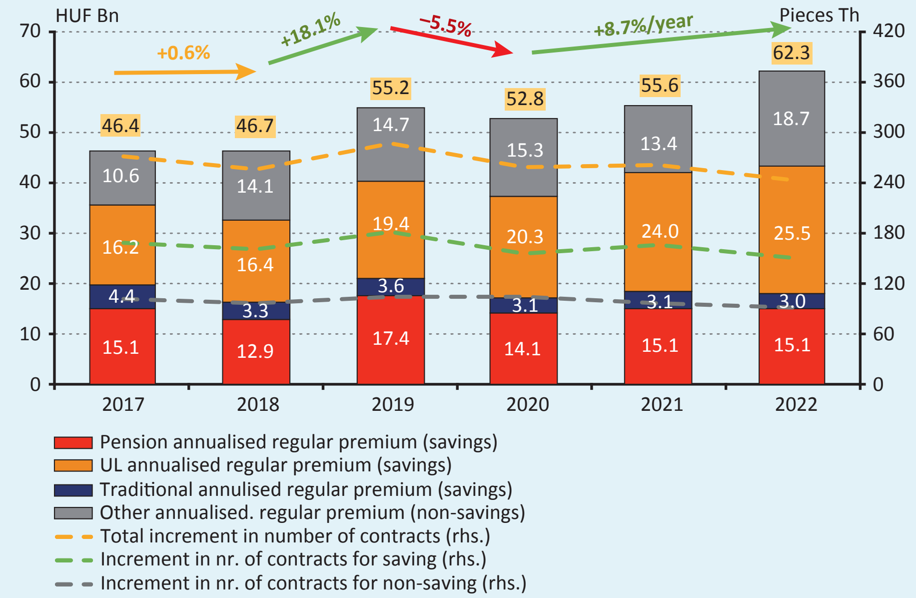
There were still 12 institutions active in the pension insurance market of which 2 offered only traditional products and 3 only unit-linked products. The biggest 5 players held 61 per cent of the premium income from regular pension insurance in 2022, a share that had been slowly but steadily increasing in recent years, leading to a gradually intensifying market concentration, but remaining essentially unchanged relative to 2021.

2.2.5 Increasing increment in regular premium life insurance

In the life segment, premiums earned on the increment in the regular premium policies rose by 12 per cent compared to the previous year. This increase was primarily attributable to other non-savings life insurance, which accounted for 30 per cent of the premiums of this segment, and to a lesser extent to savings-type UL life insurance, which delivered 41 per cent of the segment's premiums. The increment declined slightly, by 7 per cent in 2022 compared to the year before.

As in recent years, unit-linked and pension insurance products continued to be popular, and accounted for 65 per cent of the premiums earned on the total increment in the portfolio in 2022. The portfolio's premiums grew, for the most part, on account of other non-savings products (HUF 5.3 billion), and this growth was a record high. The increase was mainly attributable to 2 product groups, group life insurance accounted for 60 per cent of the rise (HUF 3.2 billion), while health insurance represented 31 per cent (HUF 1.65 billion). With regard to savings-type UL products, premiums earned on the segment's increment were also higher compared to the previous year (by HUF 1.5 billion), with growth in this product group also exceeding the level of the previous years. Premiums on the increment in traditional and pension savings products remained basically the same as in the preceding year (Chart 2.11).

Chart 2.11
Increment in regular premium life insurance products by regular premium and number of contracts



Note: The "other" category comprises the following insurance products: death, annuity, group, health and credit and suretyship insurance products with death cover
Source: MNB

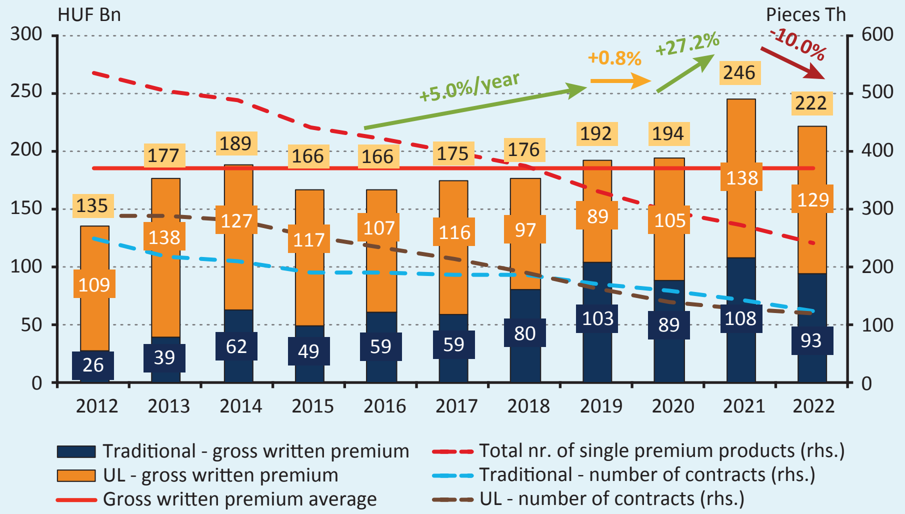
2.2.6 Single and top-up premiums shrank

As regards single and top-up premium income, there was a 10 per cent decrease in 2022 compared to 2021, while premium income remained above pre-COVID-19 levels (Chart 2.12). Of the HUF 106.4 billion in top-up premiums paid at sector level, HUF 66 billion was earned on non-pension unit-linked policies, 59 per cent of which was realised by two institutions. In addition, there were significant extraordinary payments of nearly HUF 22.7 billion related to traditional non-pension policies, almost all of which were attributable to the sales performance of a single insurance company. 68 per cent of top-up payments were received in the first half of 2022.

Gross premiums written in 2022 for single-premium life insurance amounted to HUF 115.5 billion, a decrease of 9 per cent compared to the end of 2021. 56 per cent of the single-premium income was generated from the traditional non-pension portfolio, while 42 per cent was earned from non-pension unit-linked policies.

The number of single-premium policies had been on a downward trend for several years, as the loss of portfolio, mainly due to high surrender rates, exceeded new acquisitions. Since 2017, growth in the single-premium unit-linked segment had steadily abated, but increased in 2022 relative to the year before, reaching nearly 14,000 contracts at the end of 2022, an increase of 5 per cent compared to 2021. The number of new traditional life insurance policies was 16,000 in 2022, down 27 per cent on an annual basis. There was still no market for single-premium, traditional pension insurance.

Chart 2.12
Development of single and top-up premiums and number of contracts in the life segment



Source: MNB

Box 2.1
Insurers may raise the guaranteed interest rate on life insurance policies

MNB Regulation No. 54/2015 (XII. 21.) on the maximum technical interest rate was amended in July 2020 prior to the 2022 review, but due to the substantial rise in government bond yields starting in autumn 2021, the MNB considered it appropriate to review the maximum technical interest rate. As a result, from 14 December 2022, the maximum technical interest rate (guaranteed yield) that insurers can pay has been increased in accordance with the MNB Regulation.

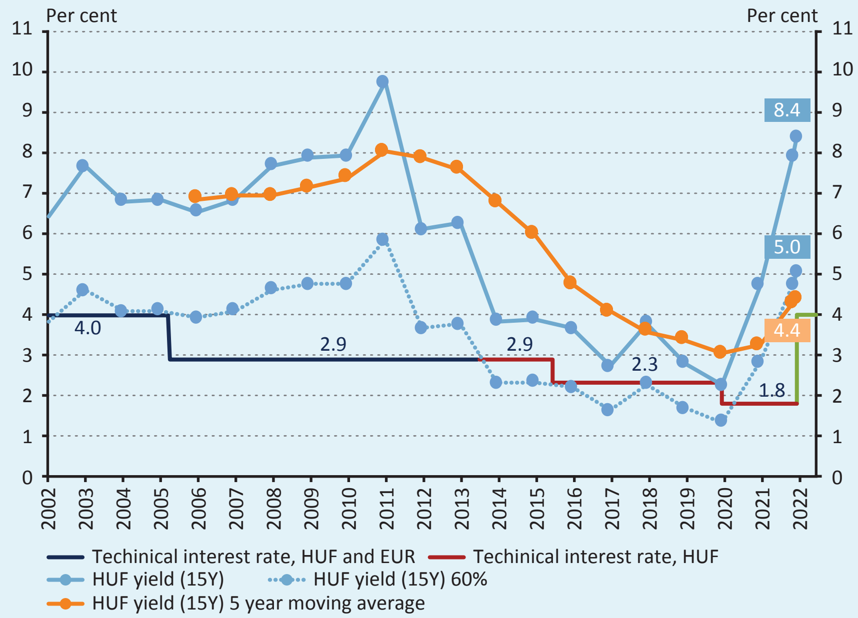
The technical interest rate is relevant in the prudent pricing of traditional life, health and annuity insurance products and in calculating technical provisions as well as excess yield returns. The technical interest rate is a kind of guaranteed rate of return, since the insurer must increase the reserve to cover the payment of services at least by an equivalent amount. The technical interest rate also determines the distribution of profit-sharing as the insurer must also give back at least 80 per cent of the difference between the investment return on the mathematical reserves and the technical interest rate (the so-called excess yield return) to the policyholder for products sold before 1 January 2016. For products sold after 1 January 2016, the regulation does not specify any requirement for the minimum excess yield return the policyholder is entitled to, but typically, 80 per cent continues to be the benchmark.

In setting the new maximum technical interest rate, the MNB took into account, with a strong focus on prudentiality, the long-term government bonds' yields, the 5-year moving average of past yields, the European Insurance and Occupational Pensions Authority's (EIOPA) ultimate forward rate (UFR)[6], and the minimum returns achieved by domestic insurers on the mathematical reserves over the past two decades. Accordingly, it increased the maximum guaranteed interest rate from 1.8 per cent to 4 per cent per annum for HUF-denominated life insurance policies with a regular premium, and to 7 per cent for single-premium policies with a term of shorter than 5 years. The interest rate cap for single-premium schemes with a term longer than 5 years is also 4 per cent. For EUR-denominated life insurance, this rate increased from 0.6 per cent to 1.5 per cent per year.

[6] UFR (ultimate forward rate): This indicator is published annually by the European Insurance and Occupational Pensions Authority (EIOPA) and is derived by EIOPA from the discount rates used to calculate the technical provisions, and is the sum of the expected real interest rate and the expected inflation rate.

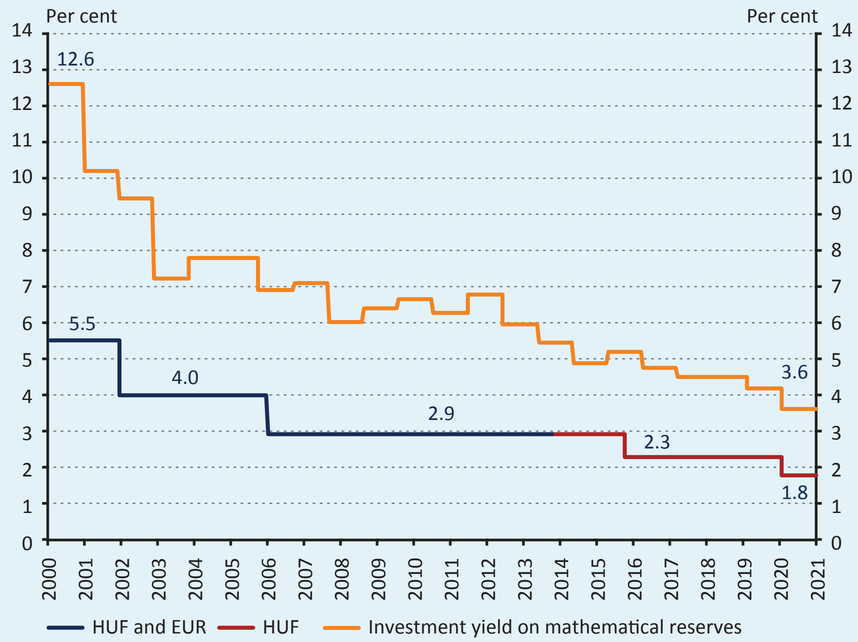
With traditional savings life insurance, the insurer bears the risk of investing the premiums. However, in unit-linked schemes, the investment risk is borne by the client which is why there is no government regulation for interest rates. The last decade or so saw a decline in traditional life insurance products and an increase in the proportion of unit-linked policies. However, without the risk of over-commitment by insurers with regard to their long-term liabilities that would jeopardise their safe operation, the interest rates that are now being promised could again lead to a return to traditional products, lower premiums for products that entail an insurance risk, and, overall, fiercer competition for insurers to attract customers.

Chart 2.13
Maximum of technical interest rates and the reference yields (15-year treasury bonds)



Source: MNB, ÁKK

Chart 2.14
Maximum of technical interest rates and the investment yields on mathematical reserves

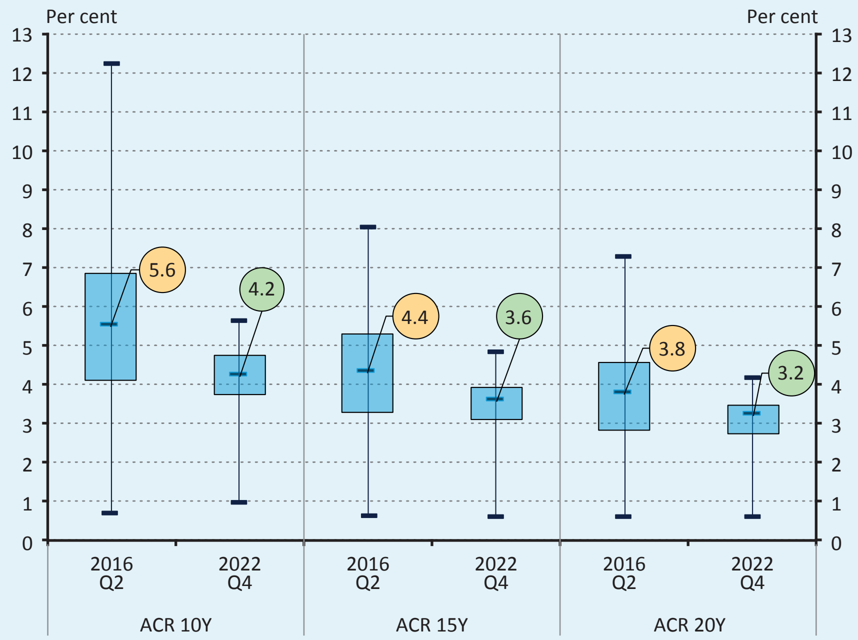


Source: MNB

2.2.7 Stable level of costs for insurers, effective ethical concept elements

The annual cost ratio (ACR), which expresses the cost of savings products as a percentage, had been present in the insurance market for 10 years, since 2010, with the aim of enabling the comparison of the cost level of individual products and increasing transparency. In order to achieve this objective, the calculation of ACR, which was originally introduced in the market as a result of self-regulation, has been regulated by the MNB in a decree as part of the Ethical Regulation Package from 1 January 2016[7]. The provisions cover all savings life insurance products, including mixed and unit-linked life insurance products and pension insurance. For the latter two product groups, the MNB formulated requirements with regard to the maximum ACR depending on maturity[8]. Compliance with the ACR limits has a key role in the cost regulation of savings-type life insurance, as it had the effect of removing products with an extremely high ACR that had been offered on the market before the ethical regulation. With the disappearance of extremely expensive products, the standard deviation and the average of ACRs also decreased. At the end of 2015, ACRs ranged between 0.5 and 13 per cent, while by 2022 this range had changed to 0.6 and 5.7 per cent with the median falling in all categories. The process mostly took place in 2017 and since then the cost level has been stable. The use of the ACR has increased transparency which, together with the MNB recommendations, led to a significant reduction in the cost of life insurance products. The figure below shows the ACRs of UL fix-term life insurance policies with a regular premium.

Chart 2.15
ACR values of regular UL fix term life insurances



Note: In the box plot the line in the middle together with the values belonging to it denotes the median of the ACR value in the individual categories. The lines on the top and in the bottom of the box show the smallest and greatest ACR values within the group. The boxes show the two middle quartiles within the ACR values of the institutional groups, i.e. 50 percent of the ACR values within the group fall between the bottom and top of the boxes.

Source: MNB

In 2015, the MNB developed the concept of ethical life insurance[9] as set out in its earlier supervisory strategy to restore and strengthen trust and to promote transparency along the lines of the principle of fair treatment. The elements implementing the objectives of the concept (tightened investment rules, cost transparency, stricter cost control) entered

[7] MNB Regulation No 55/2015 (XII. 22.) on the calculation and publication of the total cost indicator

[8] Recommendation No 8/2016 (VI. 30.) of the Magyar Nemzeti Bank on the application of prudential and consumer protection principles related to unit-linked life insurance

[9] The elements of the ethical life insurance concept are cost transparency, minimum limits of surrender value, ACR limits, the abolition of initial units for unit-linked products and the "principle of best execution".

into force gradually from 2016, and the MNB expects compliance with the related requirements from 1 January 2017. In order to strengthen the trust of customers in insurance products and thereby to build long-term stable portfolios, the MNB established its expectations concerning products, sales and investment management inter alia in its recommendation on unit-linked products. The recommendation also defines an expectation for the maximum ACR of unit-linked life insurance policies on various maturities, which play a key role in the cost regulation of savings-type life insurance.

As a result of compliance with the ACR limit, the fall in ACRs was spectacular which stabilised at current levels in recent years. While at the end of 2015 ACRs ranged from 0.5 to 13 per cent, by 2022 the spread shrank to 4.7 per cent, mainly due to the discontinuation of sales of products with extremely high ACRs. In 2022, the maximum ACRs of all products, for all asset funds, were also below the most stringent ACR limit[10]. At the end of 2022, the average ACR value also decreased compared to 2015, yet here the decrease is much smaller showing that already in 2015 only a few outliers "pulled up" the average.

Rising yield environment increase the value of ACR

Compared to 2021, ACRs increased on average in 2022, primarily because of the impact of the significantly higher yields on ACRs. The current method used to calculate the ACR has to take into account the risk-free interest rates as the ACR is in fact the potential loss of return on a given product compared to the risk-free return rate at the time of calculation, so even under unvarying product conditions, the ACRs calculated will change simply because of the changes in the risk-free return rates. The magnitude of this change is very small when there is only a slight change in the risk-free return rate, but a possibly more considerable change in the risk-free return rate, as seen in 2022, can trigger a more significant (0.3 to 0.6 percentage point) change in the ACR, resulting in rising ACR values with increasing rates of return. This illustrates the products' feature where a high initial cost deduction and a high return environment can lead to clients realising a higher loss of return.

The changes in the ACRs of unit-linked term insurance products with regular premiums and in the 15-year ACRs of permanent life insurance products show that the ACRs in 2022 rose compared to 2021, which was brought about by rising returns.

Insurers review ACRs every year and update them by 1 July of the same year, and are required to send the updated values to the MNB within 15 days of the calculation being completed. If the costs related to the products and investments change and necessitate a modification of the ACRs during the year, insurers recalculate the ACRs without delay. ACRs are published by insurers on their own websites and are also available on the websites of the MNB and the Association of Hungarian Insurers (MABISZ).

2.3 NON-LIFE SEGMENT

2.3.1 Commercial property and travel insurance showed significant premium growth

Non-life premium growth had been steady since 2012, its intensity in 2022 was again higher than the 7.9 per cent recorded in the previous year (Chart 2.16). The 12.7 per cent growth in 2022 represented an increase of HUF 93 billion in absolute terms, with casco (HUF 15 billion) and household property (HUF 15 billion) products contributing almost equally. Commercial property insurance was slightly higher (20 billion), just in line with the 20 billion increase in the motor third party liability (MTPL) segment. When looking at percentage growth rates, the highest growth rate was registered in commercial property, at 22.9 per cent, while the growth rate of MTPL stood at 7.9 per cent. At the same time, MTPL remained the most important sector, accounting for 34 per cent of the total non-life premium income in 2022, while its portfolio of 6 million contracts represented 48 per cent of the entire non-life insurance segment.

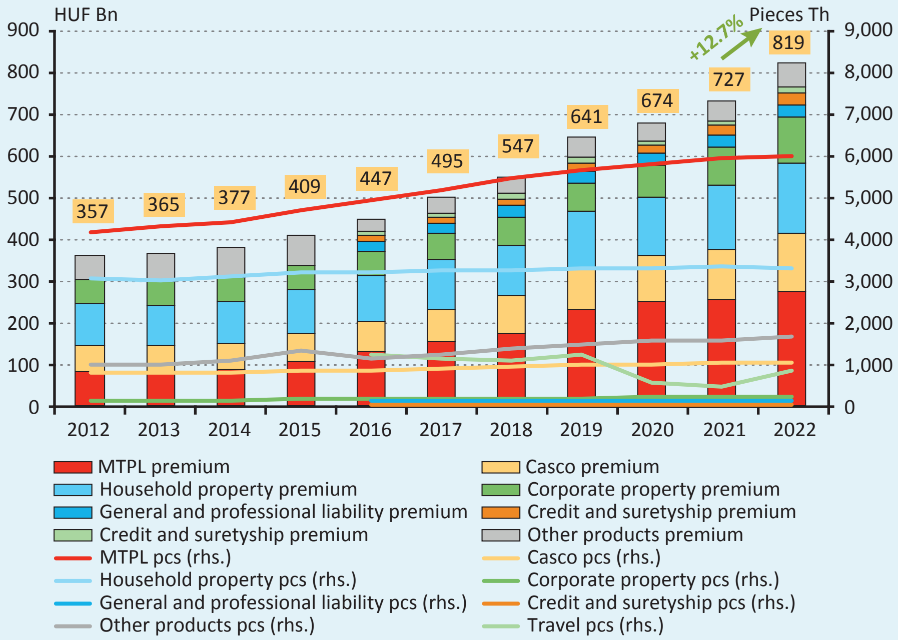
[10] ACR for the 10th year is 4.25 per cent (in justified cases with departure 5.75 percent).

As regards land vehicle casco, the number of contracts remained essentially unchanged, with an increase of only 4 thousand contracts. However, in terms of premium income per contract, the 6.6 per cent increase in MTPL products was significantly outpaced by the 13.7 per cent increase in casco. Overall, the increase in average premiums also resulted in a similar 13.7 per cent growth in casco premium income compared to 2021.

In household property insurance (mainly home insurance), a premium growth of 10 per cent was recorded in 2022, the most dynamic increase in 11 years. The number of policies in this product category decreased slightly, by 0.6 per cent in 2022 relative to the year before. Premium growth in commercial property insurance, which accounted for 13 per cent of non-life premiums, equalled 22.9 per cent, one and a half times the 15.5 per cent growth observed in 2021.

Anti-pandemic measures taken by the Hungarian and foreign governments included the imposition of curfews and travel restrictions, leading to a 58.6 per cent drop in travel insurance premiums in 2020. In 2021, the market corrected somewhat, but the 25 per cent increase could not offset the decline of the preceding year. 2022 saw some strong growth, passenger insurance premiums rose from 8 billion in 2021 to 15.7 billion, reaching the same level as in 2019. Nonetheless, the number of travel insurance policies sold did not rise to the level of 2019, there were only 843,000 policyholders as opposed to the 1.2 million in 2019. The increase in fees was also influenced by changes in the EUR exchange rate. The remaining additional products accounted for 7 per cent of the non-life market in 2022 and had a positive impact on premium income with a growth of 19 per cent.

Chart 2.16
Development of gross written premium and number of contracts of non-life segment by products



Note: The product category's loss of portfolio was also added to the number of travel insurances, as the parties usually conclude the contracts for a period less than one year. Categories belonging to the "other products" category, with a share of at least 3 percent: accident insurance, cargo and transport insurance, health insurance, surety and guarantee, extended warranty, various financial losses and legal expenses insurance.

Source: MNB

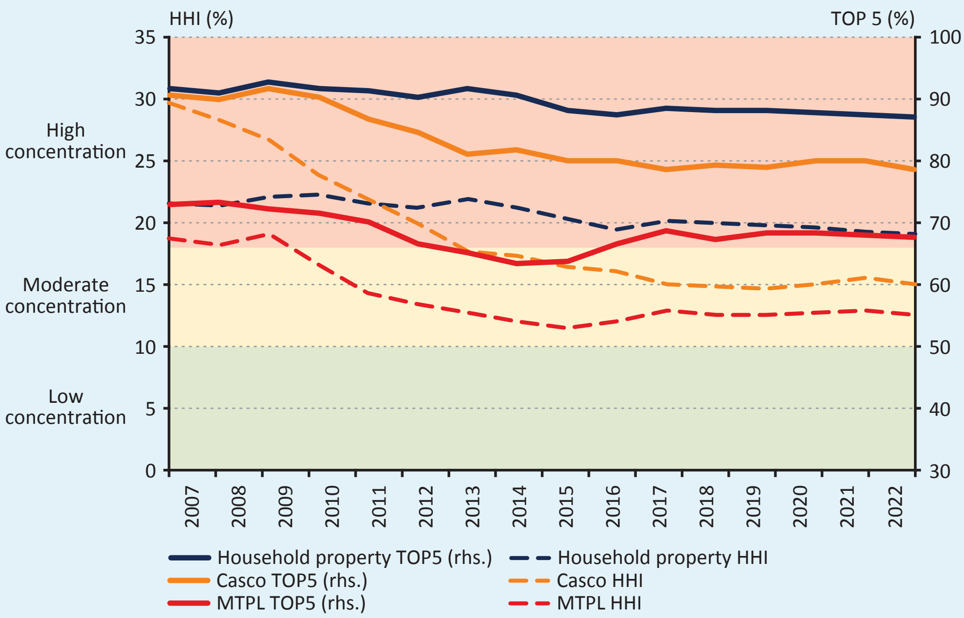
2.3.2 Concentration in major non-life insurance products remained high

No major change occurred in terms of concentration in any of the major non-life product groups in recent years as measured by the Herfindahl-Hirschman Index (HHI) or the weight of the five largest players in the market (Chart 2.17).

In the household property segment, the index remained in the high concentration range, above 19 per cent as per the HHI. Similarly to previous years, both the HHI and the share of the top 5 market players decreased only slightly in 2022, by 0.3 and 0.5 percentage points, respectively.

This high concentration meant high profitability despite the insurance tax, which may encourage more insurers to acquire a larger share in this segment. The Certified Consumer Friendly Home Insurance (MFO), which puts the interests of the customer first, was introduced by the MNB at the end of 2019. This new product has a number of advantages, including coverage for livelihood losses, digital administration and fast claims settlement. In 2022, MFO products were offered by 11 insurers. With the certification gaining ground, MFO criteria could also lead to a more consistent and comparable product range, which could foster competition and reduce market concentration.

Chart 2.17
Share of the five largest insurers (TOP 5) and Herfindahl-Hirschman index (HHI) of the entire sector based on non-life segment's gross written premium by major products



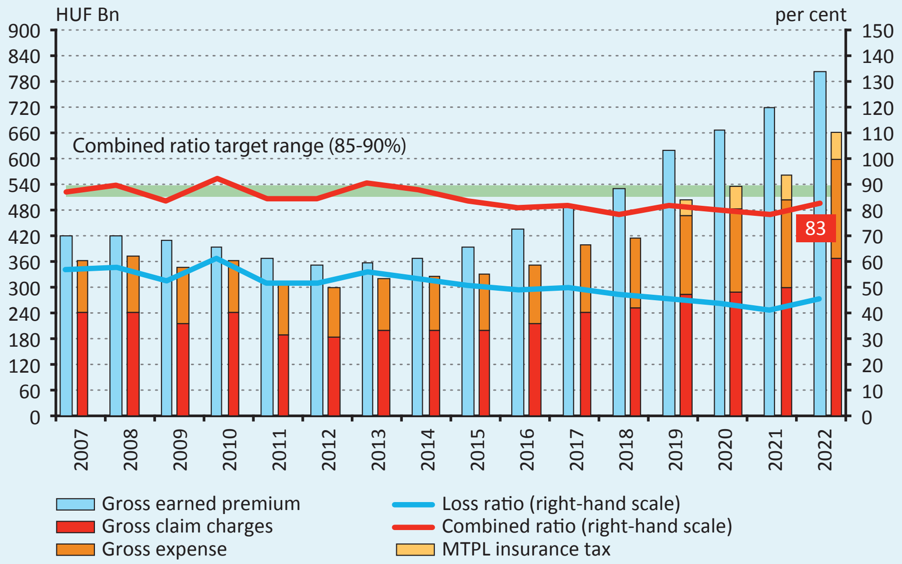
Note: The colour of the background illustrates the strength of concentration under HHI.
Source: MNB

1.3.3 Combined ratio close to target range (85 to 90 per cent)

The combined ratio of the non-life segment rose from 78.2 per cent in 2021 to 82.6 per cent in 2022 (Chart 2.18). Both claim charges and costs as well as the insurance tax increased by more than the earned premiums in 2022, resulting in a higher combined ratio. Claims increased by 23.7 per cent, costs by 11 per cent and insurance tax by 19 per cent, while earned premiums were only 12.1 per cent higher. The combined ratio was still relatively low, but it had been steadily increasing since the trough in 2018. The earlier trend continued in 2022, although it did not yet reach the 85 to 90 per cent target range presented as ideal in the FIS, but got closer to the lower limit.

The large increase in gross claim charges can be attributed to several factors. After the pandemic, travel appetite slowly returned and cars were used more extensively, which also increased the number of claims. Soaring inflation – also reflected in the KSH's consumer price index –, changes in foreign exchange rates, and drought damage, which hit 2022 very hard, all contributed to a rise in non-life damages. These changes and the increased damages are expressed in premiums with a delay, so the combined ratio could deteriorate further. If, due to price competition, non-life premiums do not follow inflationary increases, this could pose a serious risk to the profitability of the market. Among non-life products, the 96 per cent combined ratio of MTPL is already a significant risk, and the loss ratio for the agricultural market, which often exceeded 100 per cent, is a threat to insurance activity.

Chart 2.18
Development of non-life combined ratio



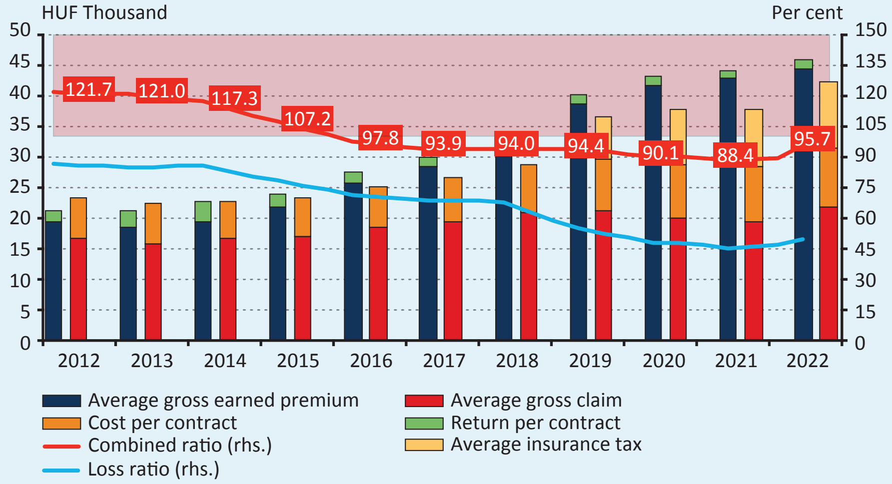
Note: The MTPL insurance tax is calculated from the expenditure data in the profit and loss accounts of insurers.
Source: MNB

2.3.4 Return on MTPL deteriorated again

In the post-pandemic vehicle traffic recovery, the number of claims started to increase in 2021 compared to 2020, and this growth continued to a lesser extent in 2022. The most significant change compared to 2021 occurred in the gross claim per contract, which stood at 12.4 per cent compared to only 3.6 per cent for premiums. The increase in claim was mainly driven by inflation, a 13 per cent rise in repair costs as published by the KSH, and exchange rate changes which were also reflected in the prices of spare parts and international claims. These so-called "adverse inflation effects" were well above the core inflation rate. Inflation also drove up costs by 7.6 per cent and the 15 per cent increase in insurance tax also added to total expenses. Together, these effects led to a higher combined ratio which rose from 88.4 per cent in 2021 to 95.7 per cent in 2022. This was already outside the 85 to 90 per cent target range, which certainly calls for prudence. With MTPL products, the increase in claims could only be reflected in the premiums with a delay as new premiums are calculated in view of past claims experience.

Looking ahead, the positive trends seen in the past are not expected to continue: loss ratios started to rise to pre-restriction levels already in the last quarter of 2021 as the MTPL index derived from the quarterly data suggests.

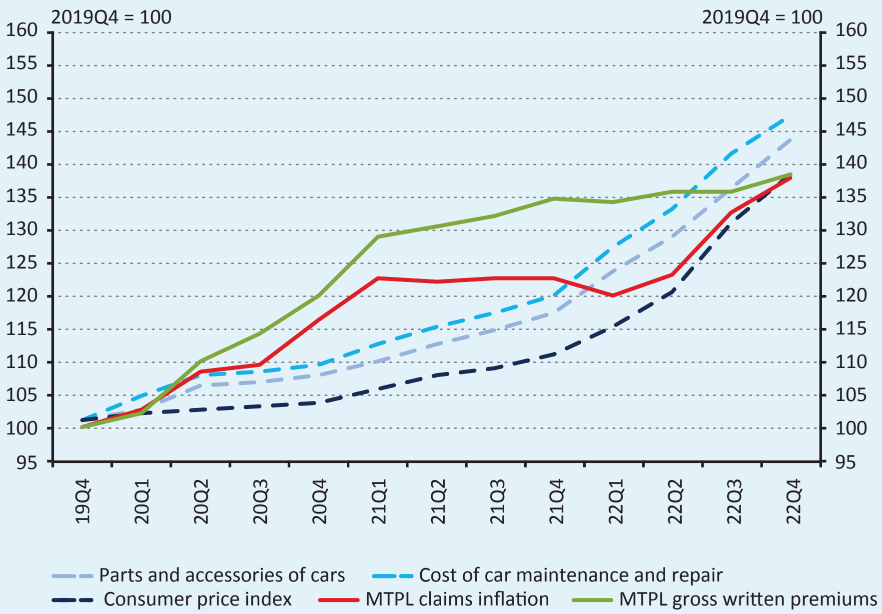
Chart 2.19
Development of combined ratio of motor third-party liability insurance in Hungary



Note: The loss ratio values were adjusted for the change in outstanding loss reserves. The pink area in the chart denotes the band of combined ratio exceeding 100 percent. The MTPL insurance tax is calculated from the expenditure data in the profit and loss accounts of insurers.
Source: MNB

Compared to the pre-pandemic situation, the growth in premiums in the MTPL market was higher than the growth in claim payments, which led to a sustained divergence between the two indicators during 2021 and 2022. The widening of the premium-loss gap was helped by a softer economic environment brought about by the pandemic, and this generated lower inflationary pressures and a premium growth above claims inflation. At the beginning of 2022, the reopening of the economy and uncertainties in the international area led to invigorated price dynamics, which in turn causing a rise in claims inflation, and, consequently, the premium-loss gap closed in Q4 2022 and returned to a level close to the end of 2019 level. The pace of these changes in general followed the evolution of the consumer price index over the period (2020-2022), but the indices for passenger vehicle categories showed a stronger dynamism outpacing the increase in claims inflation and premium income by the end of 2022.

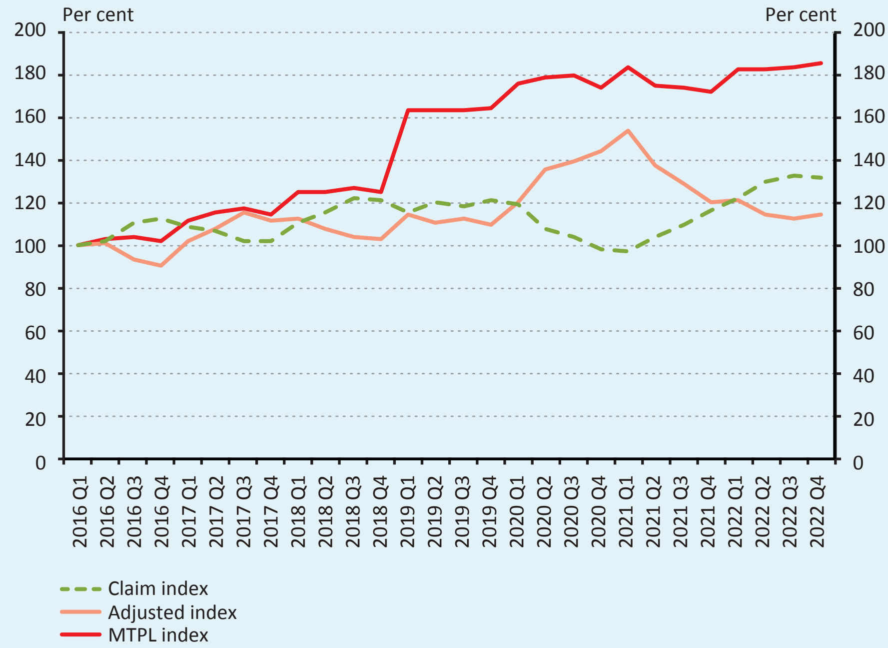
Chart 2.20
MTPL claims inflation with consumer price changes



Note: For claims inflation and premium income, the change in the value of the moving average per claim is shown in the Chart
Source: HCSO, MNB

The MTPL index, which is published regularly on the MNB website, is based on the Central MTPL Itemised Database (KKTA) which contains all domestic claims and policies data, and therefore provides a complete and up-to-date picture of changes in average market premiums. The average premium of standard passenger cars in Q4 2022 was HUF 47.3 thousand, 1 per cent higher than in the previous quarter. Compared to the same period in 2021, there was already an 8 per cent increase in both Budapest and non-Budapest fees. The upward trend in claim charges continued in the period under review, with a high annualised increase of 13 per cent relative to the last quarter of 2021. In addition to the previously reported increase in car use, this may have been due to higher service and spare parts costs, as claim frequency remained around 3 per cent, but average claim size increased. However, with average premiums slowly rising and claim charges increasing at a faster pace, the gap between claims and premiums was steadily narrowing compared to the large gap in Q1 2021 (Figure 2.21).

Chart 2.21
Passenger car MTPL index



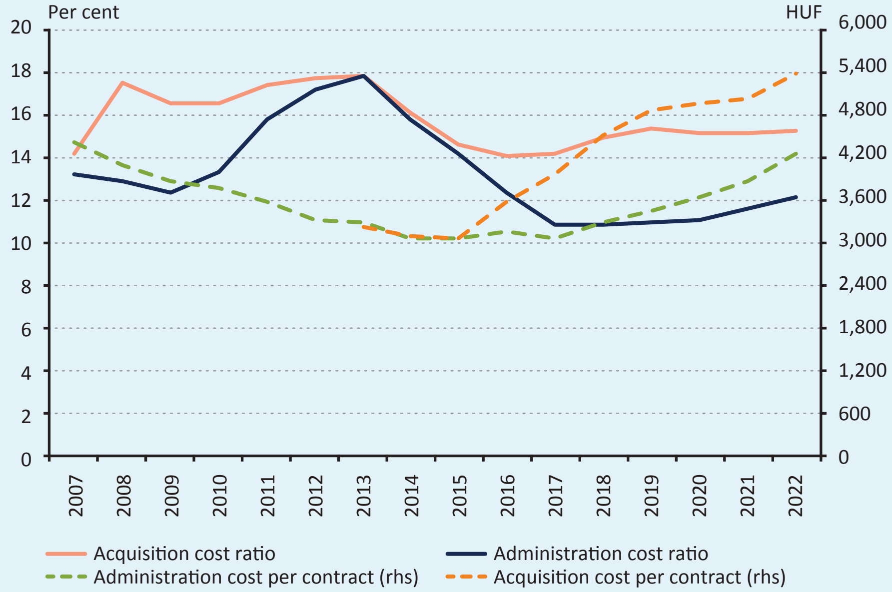
Source: MNB

2.3.5 MTPL claims continued to grow faster than premiums

The cost ratio (acquisition and administrative costs as a percentage of gross premiums) has been stagnating in recent years. The size of the cost ratio was in line with the ideal target of below 30 per cent set in the FIS for non-life insurance, and had been below the indicated level since 2015. In 2022, the indicator was 27.4 per cent, 15.3 per cent for acquisition costs and 12.1 per cent for administrative costs. The ratio barely changed compared to 2021, with a small increase in the share of administrative costs. Compared to the favourable cost ratios in 2017, a slow rise was visible, but the market essentially settled at 27 per cent.

The administrative cost per contract was HUF 4,269 in 2022, 10 per cent higher than in 2021 (Chart 2.22). The indicator shows a slightly fluctuating trend with actual values varying between HUF 3,000 and HUF 4,500 in the period from 2006 onwards. Based on the data, the administrative cost per contract is in line with the gross written premium trends, as demonstrated by the 2011-2018 trough. The number of policies increased during this period, so costs had to be adjusted to premiums. The increase from 2017 onwards also followed the growth rate of average gross wages, albeit at a lower rate.

Chart 2.22
Development of the cost ratios of motor third-party liability insurance in Hungary



Source: MNB

Box 2.2
The situation of small mutual associations

In 2022, the significant increase in risks and claims inflicted by drought in the Hungarian market resulted in substantial losses for the insurers concerned. The magnitude of drought damage fundamentally called into question the sustainability of small agricultural mutual associations' future operation.

The MNB verified the compliance of insurers with the provisions of Government Decree No 291/2022 (VIII. 8.) on introducing rules in derogation from Act LXXXVIII of 2014 on the Business of Insurance applicable in case of drought emergencies by requiring weekly data disclosure in the framework of continuous supervision. The MNB expected the data to be provided from 15 August 2022 15 November 2022. Overall, insurers' drought claim payments exceeded HUF 38 billion, resulting in an extremely high loss ratio of 247 per cent compared to the previous year's 8 per cent. Summarising the supervisory experience of agricultural insurers' drought damage payments, it can be said that increased supervision contributed to the fact that insurers paid special attention to drought damage notifications and complied with the provisions of the Government Decree

The mutual association sector was affected the most by the drought of 2022. On 26 October 2022, the MNB appointed a supervisory commissioner to a small mutual association. Since it was established that the association did not have the minimum own funds required to carry out insurance activities, and there was no real possibility of restoring the capital level stipulated by law by means of capital additions, the MNB decided to withdraw the institution's licence to operate in a decision of 1 March 2023.

2.4 PROFITABILITY AND CAPITAL POSITION

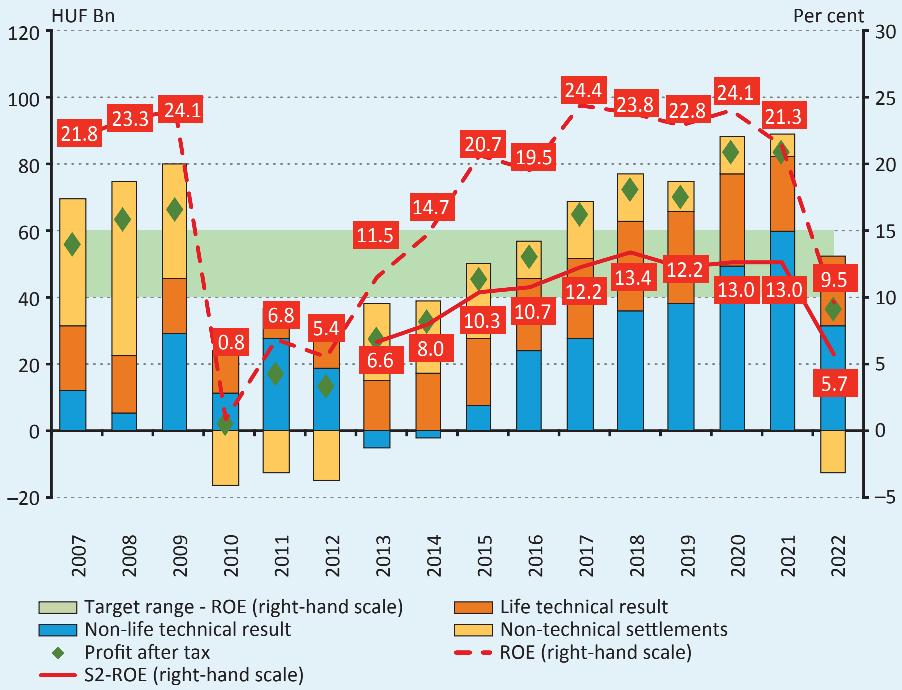
2.4.1 The sector is successful even in negative market conditions

After a strong year for the insurance sector in 2021, the income situation of insurers changed substantially in 2022. After a profit after tax of more than HUF 80 billion in 2021, the sector realised a profit of only HUF 36 billion in 2022. This after-tax result fell back to 2014 levels when a period of improvement from the 2010 trough took place.

The sector's return on equity (ROE) as per the national accounting rules also deteriorated significantly in 2022, falling to 9.5 per cent from 21.3 per cent in 2021. The value of the indicator showed a dynamic growth starting from the year after the global economic crisis of 2008-2009 until 2017, reaching 24.4 per cent in 2017. After that, there was no further increase, the indicator stagnated around 22 to 24 per cent until 2020, still exceeding the target range of 10 to 15 per cent.

Behind the 2022 metric, which is much worse than before, there is a significant decline in both non-life and life insurance technical results compared to 2021, which was accompanied by a massive loss of HUF 12.5 billion in non-technical settlements. The additional insurance tax introduced in 2022 in Hungary appears in this item, which insurers must pay in proportion to their premium income, while the increase in premium income in 2022 was well below the growth rate of claims expenses. This decline in 2022 can be very clearly perceived (figure 2.23.), although the level of ROE has not yet fallen to the lowest value of 2010, but it is approaching the level of 2013. Similarly to ROE, the return on eligible own funds (S2-ROE) also changed, it fell by less than half in 2022, which is the lowest value of the last 10 years.

Chart 2.23
Profitability of the Hungarian insurance sector and its composition

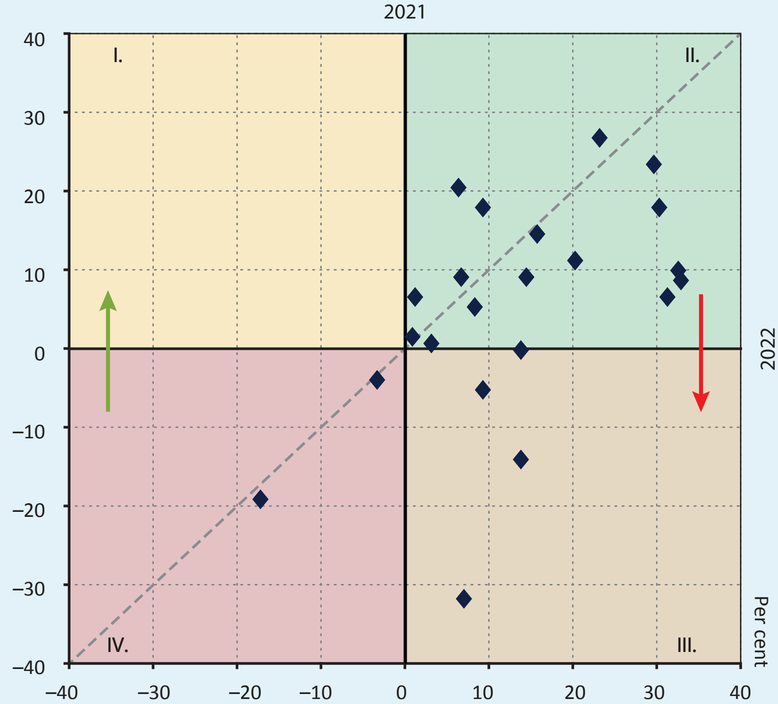


Note: The sector level ROE values (with the exception of 2022) were calculated on the basis of the annual audited data reporting, where equity does not contain the current year's dividend. In the case of the S2 ROE indicator the after-tax profit was compared to the eligible own funds (2013–2014 estimate).

Source: MNB

The return on equity (ROE) of different insurers showed a different picture at the institutional level. Of the 22 insurers, 5 insurers suffered a loss in 2022 as opposed to 2 in 2021. The two institutions continued to operate at a loss (Chart 2.24); in their case, this was mainly due to economies of scale problems. However, on the whole, the majority of institutions continued to generate profit.

Chart 2.24
ROE value of Hungarian insurers



Source: MNB

Box 2.3
IFRS 17

Among the factors affecting the operation of insurance companies, the effects of applying the International Financial Reporting Standards (IFRS) should be mentioned. In the Hungarian market, currently three institutions prepare their individual annual reports using IFRS (mandatory for listed companies, optional for non-associated insurers). In addition, the majority of Hungarian insurers are indirectly apply the standards. Institutions that belong to a European insurance group provide financial data for the consolidated reports of their parent company using IFRS standards.

The balance sheets and profit and loss accounts prepared for financial reporting purposes by insurers applying the IFRS so far have been only slightly affected by the application of international standards. The main reason for this is that until 2023, insurance contracts with the largest share on the liability side of the balance sheet were covered by IFRS 4 which was considered transitional. This standard defined the concept of insurance contract but did not provide specific guidance on their assessment, so institutions applied their former accounting policies.

IFRS 17, the comprehensive new standard for insurance contracts which now defines a uniform valuation, has been adopted by the EU and is mandatory from 1 January 2023. The IFRS 17 standard essentially requires fair value assessment using observable and current market prices (where possible). For the valuation of insurance contracts, the basic model is based on a best estimate valuation, taking into account the time value of money (discounting) and the uncertainty arising from the insurance risk (risk margin). The main elements of the methodology are familiar from the Solvency II calculations, but there are a number of differences.

The application of IFRS 17 standard requires complex actuarial calculations, and the accounting systems of insurance companies applying the standard will henceforth rely heavily on actuarial processes. The calculations require the storage and processing of detailed data (with appropriate granularity), often going back several years. The estimates are reassessed in each period. This calls for fundamental process and system improvements and significant financial and human resources by the insurance companies concerned. In addition, the transition may increase operational and management risks.

The MNB pays special attention to the expected impact of the transition to IFRS 17. For the three undertakings that prepare their individual accounts in accordance with IFRS standards, it monitors their readiness on an ongoing basis. The MNB consults regularly with management and with the auditors who have an insight into the preparation of the accounts. An impact assessment has been prepared on the basis of the opening balance sheets submitted to the MNB for the date of 1 January 2022, which were compiled according to IFRS 17, on the numerical impact of the transition on equity. Experience so far confirms that the value of technical provisions on the liability side calculated according to the IFRS 17 valuation principle is radically different from the value of provisions calculated in accord with the previous Hungarian accounting rules. In contrast to the latter prudent provisioning, IFRS 17 reserves – which are based on market valuation – produce a result closer to Solvency II reserves, thanks to the similar principles. Moreover, on the asset side, there is only a slight deviation from the Solvency II asset value. Overall, the equity of IFRS users is typically (but not always) closer to Solvency II own funds than to equity as per the domestic accounting rules.

For undertakings using IFRSs for group reporting purposes, it is also important to assess the impacts as their operational processes may be significantly affected, for example, through changes in the costs allocated to products, planning practices, key performance indicators used to monitor performance. The transition of insurers to IFRS 17 is therefore a key checkpoint in the comprehensive assessments.

The MNB's supervisory activities are also affected by the introduction of the new standard in other ways. With the entry into force of IFRS 17, insurers that prepare their individual accounts in accordance with the IFRS will draw up their balance sheets and profit and loss accounts in a completely different structure to those compiled as per the national accounting rules, and therefore a change in national reporting was necessary in 2022. New balance sheets and profit and loss tables for data reporting have been developed for the institutions concerned. The risk monitoring indicators related to profitability – which support ongoing supervision – have been revised. To support sectoral analysis[11], a methodology has been developed to ensure consistency of the insurance time series published on the MNB website.

2.4.2 Capital buffer recommendation saved the day

Capital adequacy at sector level was 172 per cent at the end of 2022, more than one and a half times the regulatory level (Chart 2.25). This level remained stable since the introduction of the Solvency II framework in 2016, with significant difference (32 percentage points) compared to the 204 per cent at the changeover on 1 January 2016. Since the start of the new regulation, the solvency capital requirement and own funds both increased steadily, in line with the increasing risks. Subsequently, the sector's capital surplus decreased as a result of external shocks. With a Solvency II ratio of 172 per cent, the sector continued to comply with MNB Recommendation No 6/2016 (VI. 14.) on maintaining a volatility capital buffer, while also fulfilling the vision outlined in the FIS, which aims to achieve a capital-strong insurance sector with a capitalisation level above 150 per cent.

Reflecting on the situation caused by the pandemic, the MNB issued several executive circulars recommending the limitation of dividend payments by insurance companies, which was lifted at the beginning of 2022. The impact of the circulars led to the sector's capitalisation level reaching a historical peak of 220 per cent at the end of 2020, which had already decreased at the end of 2021 with future dividend payments taken into account in the projections. The aim of the supervisory measure was to maintain the capital stability of institutions in order to better protect them against potential insurance risks and financial market fluctuations.

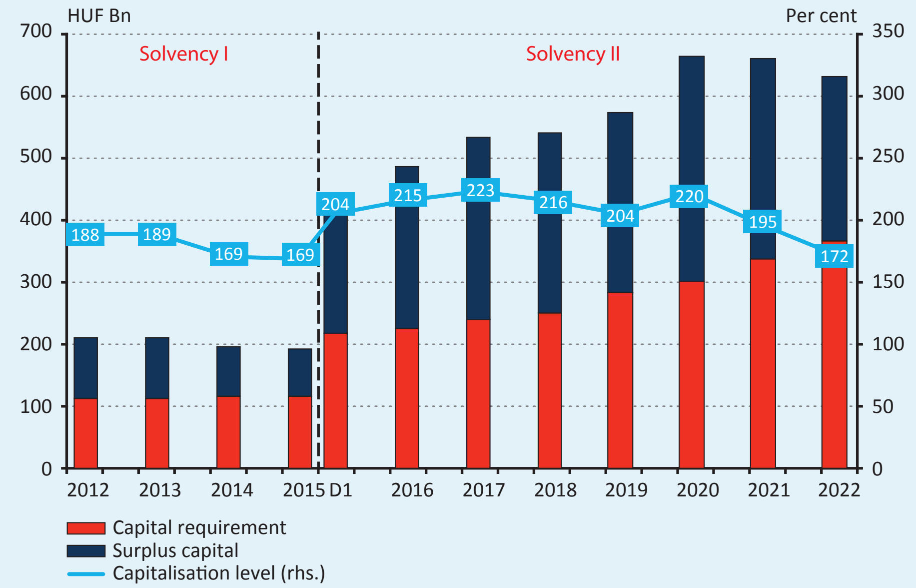
[11] Comparisons at sector level are complicated by the fact that the IFRS 17 methodology leaves more room for assumptions based on insurers' own judgment, which may result in significant valuation differences even among IFRS users. This may be counterbalanced by the need for reports to be easily understandable to investors, and a wide range of mandatory disclosures will help the assessment of the results.

Economic processes in the post-pandemic period resulted in gradually rising interest rate environment. For insurance companies, the biggest impact was the change of the risk-free yield curve due to the market-consistent valuation required by the Solvency II regulation. The yield curve rose by an average of 4.3 percentage points per year over the 50-year period to October 2022, mainly on the shorter side of the curve. After that it was adjusted back by an average of 1.1 percentage points during the last two months of the year.

Due to external economic circumstances, undertakings were affected by the obligation to pay an additional insurance amounting to HUF 48.5 billion in 2022. In addition, the undertakings had already taken into account, in part, the surtax advance for 2023 in the calculation of their capital adequacy at the end of 2022. During the year, the sector was unexpectedly hit by an extremely unfavourable agricultural year, which greatly increased the drought-related claim payments of crop insurers. The latter exceeded the premiums collected for drought damage by HUF 13.5 billion.

In order to offset the above effects, market participants took various measures (capital increase, dividend Waiver, use of loan capital) to strengthen their equity position up to HUF 56.2 billion. Without these, the sectoral capitalisation level could have fallen to 157 per cent by the end of 2022, dropping by 63 percentage points from the 2020 peak. Breaking down the latter decrease, the largest impact was due to the change in yields and the additional insurance paid and taken into account (both estimated at 22 percentage points), with a less profound impact of dividend payments (15 percentage points) and increased drought-related payments (4 percentage points).

Chart 2.25
Capitalisation rate at sector level



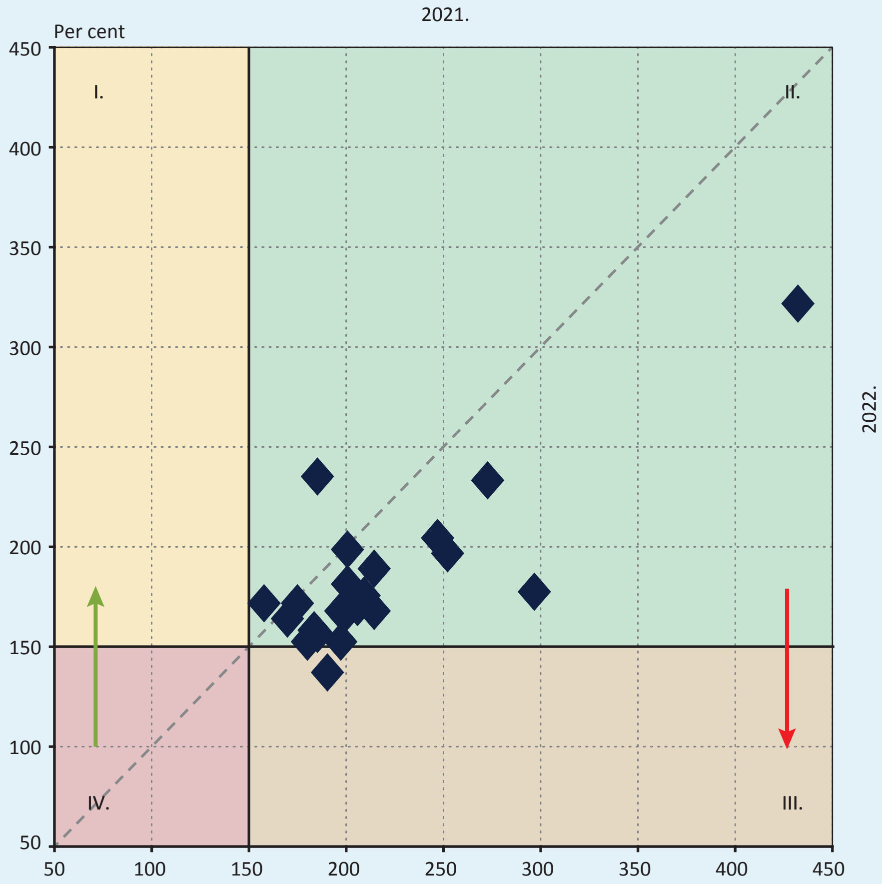
Source: MNB

2.4.3 Capitalisation level also stable at individual level

Individual capitalisation levels varied by an average of 41 percentage points around the sectoral average, which can be considered a significant difference. At the end of 2022, all but one supervised undertaking reported a capitalisation level above the 150 per cent required by the MNB's volatility capital buffer recommendation. However, even with the undertaking below 150 per cent, all companies met the 100 per cent required by law.

The capital adequacy of the vast majority of institutions decreased in 2022 compared to the previous year (Chart 2.26). The reasons have been explained earlier: lifting of dividend payment limits, rising yield environment, the additional insurance tax levied on the sector and the sharp increase in crop insurance claims due to extraordinary drought. The extent of this decrease varied according to the specificities of each institution (composition of assets, liability structure). For some undertakings, the impact of the changed yield environment was minimal, while the capitalisation level of undertakings particularly sensitive to interest rate risk had in some cases fallen more considerably relative to the levels seen in previous years.

Chart 2.26
Individual capitalisation rates of insurers (2021 and 2022)



Source: MNB

Box 2.4
Reverse stress test

The economic environment changed massively in 2022 requiring insurance companies to adapt quickly. The period of low returns that had dominated investment decisions for years came to an end, with interest rates starting to rise strongly from the end of 2021. This had a negative impact on the market-consistent Solvency II capital position of most undertakings.[12]

Assets are reported at current market value in the balance sheets of insurance companies, and the rise in the yield curve led to a depreciation of government bonds which were a dominant element of investment portfolios. On the liabilities side, this effect was partly offset by a decrease in the value of technical provisions, caused by the discounting effect of risk-free rates of return. However, for most undertakings, the surplus of assets over liabilities and economic own funds decreased leading to a sharp drop in the capitalisation level. For the undertakings, a rapid up-to-date assessment of the capital position became a priority.

Capital risk arising from the yield environment affected undertakings to varying degrees primarily because of the different nature of the lines of businesses involved, their asset-liability management policies and maturity mismatches. To assess the risks, the MNB asked institutions to carry out a reverse stress test in July 2022. In doing so, it requested insurance companies to calculate how large shift in the yield curve would make their Q2 2022 solvency ratios drop below the 150 per cent specified in the capital buffer recommendation and the statutory 100 per cent.

Based on the results of the survey, none of the undertakings would have been at high risk of breaching the 100 per cent capital adequacy requirement even if the yield curve had risen by 600 basis points. However, nearly half of the undertakings were at significant risk of breaching the 150 per cent capital buffer (a 100 to 350 basis point shift in the yield curve would have had such a negative impact). Following the monitoring of capital risk, four institutions considered it necessary to conduct an extraordinary ORSA (own risk and solvency assessment)[13] during 2022 where they analysed their expected capital position in detail.

The risk management activities of insurance companies and the measures they took to stabilise their capital position in essence proved to be effective. Despite a further upward move of the yield curve, during 2022, only four institutions saw their capitalisation level fall slightly below 150 per cent and a further five got close to the 150 per cent minimum capitalisation level requirement from above.

The request for information on the reverse stress test supported the supervisory work of the MNB in 2022 to a great extent. It also made it possible without any further data request to obtain more precise information on which undertakings were most likely to breach the capital buffer recommendation against the actual yield curve, given that in the second half of the year the risk-free yield curve soared at heights not seen since the introduction of Solvency II. The MNB engaged in closer dialogue with undertakings with a higher exposure to risk, requesting additional information where necessary.

[12] This adverse situation was somewhat relieved by the fact that this risk was regularly monitored by insurers, as according to MNB Recommendation No 3/2016 (VI. 06.) on the evaluation regime for the assessment of own risk and own funds, all institutions were required to assess the impact of a 500 basis point shift in the risk-free yield curve on their capital position at least annually.

[13] Own risk and solvency assessment under Article 45 of Directive 2009/138/EC

2.5 RISKS IN THE INSURANCE MARKET

2.5.1 Stability preserved despite the risks

Table 2.4
Risks of the insurance market

Risk category	Risk groups	Risk rating	Risk prospects	Evaluation in words
Business model	Environment Strategy, business plans Profitability	●	↘	Asset devaluation, inflation, sectoral tax changes. Significant decrease of net incomes (mainly due to drought claims and surtaxes), majority of the institutions remained profitable. Due to draught claims viability of small insurance unions has been called into question. *Improving outlook based on 2023 economic forecasts.*
Corporate governance	Exercise of owner's rights Internal governance Risk assessment system and ORSA Internal control	●	↑	Mitigating external environment risks is appropriate and internal control is operating efficiently. Material risks have been identified, stress tests were predominantly implemented into the risk management systems of the institutions. *Material organizational and management changes.*
Financial and operational risks	Insurance risk Market risk Credit risk Operational risk Other relevant risks	●	↘	Single and top-up premiums dropped in life segment. Increase of yields has led to devaluation of government bond-heavy portfolios. Combined ratio of MTPL is increasing, non-life segment profitability is worsening. *With decreasing inflation and better yield conditions risk would fall in the future.*
Capital and reserve risks	Capital Reserves	●	→	Solvency ratio decreased, all institutions except one over 150 percent. *Due to claims inflation increase of reserves is expected in non-life segment.*
Market entry risk	Products Customers	●	↘	EIOPA warning for credit protection insurance. Bad value for money for some products. Deficiencies in claims management processes. Worsening profitability, increasing but not material outflow. *Supervisory measures may reduce risks.*

Legend:
Degree of risks — *high* ● *significant* ● *moderate* ● *low* ●
Direction of risks — *increasing* ↑ *stagnant* → *decreasing* ↓

Source: MNB

As regards the external market and the regulatory environment to be taken into consideration when assessing business models, the Hungarian economy expanded by 4.6 per cent on average in 2022.

Annual inflation on an upward path averaged 14.5 per cent in 2022, while core inflation also rose to 15.7 per cent. Within the change in the CPI, the price of food and household energy increased the most.

The MNB defined a fair and competitive level of profitability in the FIS as a sustainable sector-wide return on equity (ROE) of 10 to 15 per cent. After a strong year for the insurance sector in 2021, the income situation of insurers changed substantially in 2022. After a profit after tax of more than HUF 80 billion in 2021, the sector realised a profit of only HUF 36 billion in 2022. This after-tax result fell to the level of 2014, when the period of improvement starting from the low point of 2010 took place.

Ownership and internal governance system was ensured through good quality internal controls to manage increased environmental risks with appropriate actuarial and strategic guidance and action. To this end, there were control systems in place to support the sound functioning of the undertakings, and these were operational. Insurance companies' risk management systems adequately identified material and significant risks, and stress tests were largely integrated into the institutions' risk management systems. In addition to the stability of the organisational structure and the standard of governance, organisational and management changes were prepared. Supervisory investigations identified specific risks and errors in internal regulations and controls. According to the MNB's expectations, a change in the moderate risk level is not expected in the short term, but it is assessed with increasing risk prospects.

The underwriting risk increased significantly in 2022. Drought damage and higher claims charges reduced profitability. This was compounded by the loss of single and top up premiums due to the impact of the additional insurance tax, but both segments continued to operate with stable profitability. There was a steady increase in the portfolio and the gross written premium of the non-life insurance segment, but this may prove insufficient given the increase in claims charges. The combined ratio of MTPL could pose a risk already in the medium term. With a slight decrease in the number of life insurance policies, gross written premium rose by 1 per cent compared to the previous year. There was a slow increase in surrenders in terms of number and value. Given the uncertain macroeconomic and financial environment, the potential rise in surrenders remained a risk, just as the development of life insurance sales was surrounded by considerable uncertainty.

The depreciation of yield-sensitive investments led to a reduction in Solvency II own funds for some market participants. In addition, the solvency capital requirement typically increased, which was necessitated by the higher capital requirement calculated for the market risk module. Overall, the change in the yield environment had a negative impact on the capitalisation level in 2022. The evolution of the sectorial capitalisation level at the end of 2022 was significantly influenced by the fact that the MNB lifted the restriction on the payment of dividends introduced during the epidemic situation. Several undertakings decided to pay the dividends that had formerly been deferred, thus lowering their capitalisation level. The solvency ratio dropped also because of the additional insurance tax and drought damages. Nonetheless, the sector's capitalisation level continued to comply with MNB Recommendation No 6/2016 (VI. 14.) on maintaining a volatility capital buffer.

In 2022, the MNB identified a number of consumer protection risks with regard to credit protection insurance sold through banking channels, including in particular the risk of low customer value, i.e. the unfavourable value for money ratio of insurance. The results of the EIOPA thematic study confirmed that this area needed more attention, and therefore credit protection insurance is a priority audit target area for 2023.

Investigations into product oversight showed that significant product failures could occur in some undertakings due to a failure to comply with POG (product oversight and governance) rules, for example, assumptions used in the product design made it likely that the product would cause damage to a significant proportion of customers. Detecting and correcting these errors form an ever more important part of supervisory activity, granting consumers more and more protection step by step.

In 2022, the MNB completed a thematic study on the implementation of the new provisions of the Insurance Act concerning claims settlement with regard to non-life insurance products. This investigation showed that insurers needed to improve the quality of the information they provide when settling claims so that sufficient justification is given as to what amounts insurers establish for what claim, or why they refuse to cover a service. The discovery and elimination of these errors are an increasingly important part of the supervision activity, providing consumers with greater protection.

In the past year, the Hungarian economy was hit by a number of adverse effects – just as the global economy as a whole – that had a significant impact on the situation of the capital market. Of all insurance products, unit-linked life insurance was the most directly affected as with this type of insurance the policyholder bears the risk of changes in the value of the underlying assets placed in the asset funds. The sharp fall in the price of some portfolios had a negative impact on the maturity and surrender amounts paid, while negative returns can discourage consumers and prompt them to make decisions, such as surrender, that are motivated by the state-of-play instead of their long-term interests.

Just like before, the MNB issues management letters and recommendations to help undertakings and make its expectations clear. These tools, complemented by "harder" supervisory tools, can significantly reduce consumer risks associated with products.

3 The funds market and its risks

3.1 OVERALL PICTURE OF THE MARKET

3.1.1 Despite rising risks funds sector remained stable

New and emerging risks over the past two years – which were intensifying in 2022 – had a strong impact on the investment performance and reserves of the funds sector. Voluntary funds had sufficient reserves to operate safely and firmly in the face of current environmental challenges, such as general asset depreciation, in particular the fall in the price of government bond portfolios due to the significant rise of the yield curve. With a high share of sovereign debt instruments in funds' portfolios, overall asset depreciation had reduced the aggregate balance of individual accounts of voluntary pension funds to HUF 1,598 billion by the end of 2022, representing a change of more than HUF 100 billion compared to the previous year's closing balance. In addition to bond devaluation, shrinking coverage reserve were also the result of the payments (HUF 127.2 billion) being 31.9 per cent higher in 2022 than in 2021, primarily due to the increase in lump-sum pension payments and exits. In 2022, voluntary pension funds achieved a net return of minus 6.80 per cent – weighted by closing assets – on average. The average sector-wide net return rate, weighted by assets calculated from the average 15-year return rates, equalled 4.63 per cent. The number of institutions in the voluntary pension funds sector decreased to 30 in 2022 following the merger of three smaller institutions.

Despite the extraordinary global market environment, the amount of contributions credited to the individual accounts of voluntary pension funds increased (HUF 117.2 billion), exceeding the highest level ever in 2021 (HUF 115.9 billion). Although individual contributions fell by 2.3 per cent, this was offset by a 9.6 per cent increase in employer contributions. In 2022, 20 out of 30 institutions had a negative operating results, and the sector also recorded an operating loss. This was in a large part because due to weak returns, the rate of deduction for unpaid standard contributions fell considerably, to 12 per cent (HUF 149 million) of the 2021 value (HUF 1,247 million). However, the sector's loss-absorbing capacity remained at an appropriate level.

There was no change in the number of institutions in the health and mutual aid funds sector, but contributions credited to the individual accounts increased substantially in 2022. Employer contributions (HUF 8.1 billion) stagnated, while individual contributions increased by 23.8 per cent (from HUF 41.9 billion to HUF 51.9 billion), representing an overall growth of 20 per cent (HUF 10 billion) compared to 2021. The figure for 2022 is remarkably higher than the annual contributions of the 2016-2020 period, and is the highest ever. A positive development, reflecting the strengthening of self-provision, is that the increase was driven by a significant rise in individual contributions. In 2022, the sector achieved a positive operating income with 10 out of 16 institutions being profitable on an annual basis. Following an increase of HUF 7.1 billion, the assets of health and mutual aid funds amounted to HUF 79 billion at the end of 2022, of which HUF 73 billion were assets in individual accounts. Although the amount of contributions paid to the individual accounts was exceeded by the amount of payouts, the amount of tax credits claimed was able to offset this effect, thus increasing the balance of individual accounts.

Table 3.1
Key data of the voluntary funds sector

	Pension funds		Health and mutual aid funds	
	2021	2022	2021	2022
Number of institutions (pcs)	33	30 ↓	16	16 –
Number of members (thousand persons)	1,105	1,092 ↓	1,055	1,068 ↑
Number of members paying membership fee (thousand persons | %)	576 52.2%	573 52.4% ↑	358 33.9%	387 36.3% ↓
Total funds portfolio (HUF billions)	1,729	1,615 ↓	72	79 ↑
Of this: Coverage reserve (HUF billions)	1,710	1,598 ↓	67	73 ↑
Asset value per contract (HUF thousands)	1,547	1,463 ↓	64	64 –
Membership fee payments (HUF billions)	121	123 ↑	53	64 ↑
Of this: Membership fee payments allocable to coverage reserve (HUF billions)	116	117 ↑	50	60 ↑
Claimed tax credit (HUF billions)	17	16 ↓	11	9 ↓
Payments against the coverage reserve (HUF billions)	96	127 ↑	60	65 ↑
Operating profit/loss (HUF billions)	0.30	-0.58 ↓	0.35	0.61 ↑
Reserves for operational purposes (HUF billions)	16.3	15.6 ↓	4.6	5.4 ↑

Source: MNB

In both sectors, the amounts transferred by the tax authority were lower than in the previous year. This was because some members could benefit from the tax credit on contributions only to a lesser degree as a result of parents' income tax refund.

After reducing the voluntary pension funds sector by 478 members in 2021, the sector's membership decreased by 12,972 in 2022. Young new entrants can only slow down the ageing of the membership, but they cannot stop it or maintain a balance which continues to pose a risk to the future sustainability of funds.

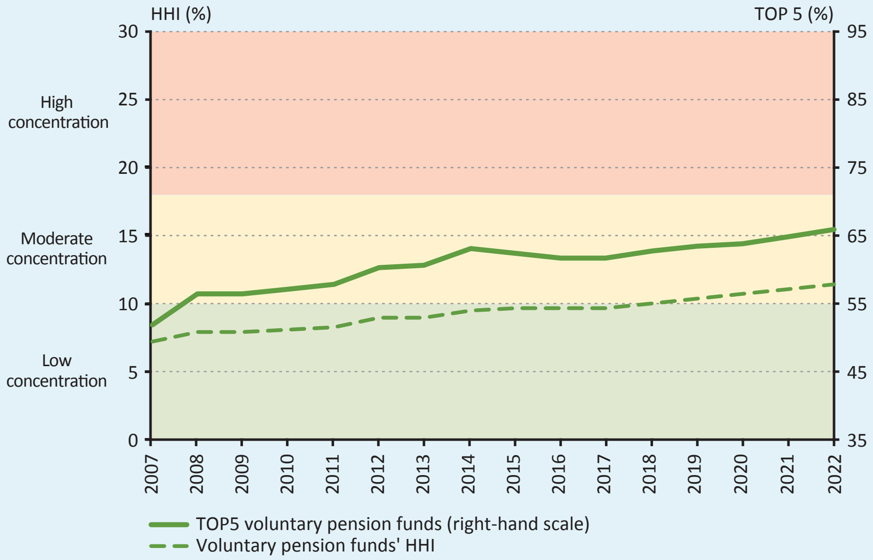
In contrast, the number of members increased by 13,516 in 2022 in the health and mutual aid funds sector, which was less than the increase of 30,145 in the year before. Nonetheless, the fact that this growth trend is maintained is certainly positive. Some 61.5 thousand new members joined these funds which is more than the 15.7 thousand who exited, the 4.8 thousand who died and the 26.2 thousand whose membership was terminated for not paying contributions. 66 per cent of new entrants were enrolled by client recruiters. Despite the improvement, due to the high share of non-contributors, exclusions and thus membership cleanup is expected to continue in the coming years.

3.2 VOLUNTARY PENSION FUNDS

3.2.1 Increase in pension fund concentration

The voluntary pension funds sector saw the number of institutions shrink to 30 in 2022 due to the merger of 3 smaller institutions. Decisions to cease independent operation were driven by factors related to economies of scale, efficiency and business models. As a result of the mergers, the Herfindahl-Hirschman Index (HHI), a measure of market concentration based on the contributions paid, increased slightly in 2022 (Chart 3.1). The market share of the 5 largest (in terms of the contributions paid) funds also increased relative to 2021. An analysis of the concentration of contributions shows that 65.9 per cent of the sum of members' contributions and employer contributions paid to the voluntary pension funds sector were made by the 5 largest institutions.

Chart 3.1
Developments in voluntary pension fund concentration

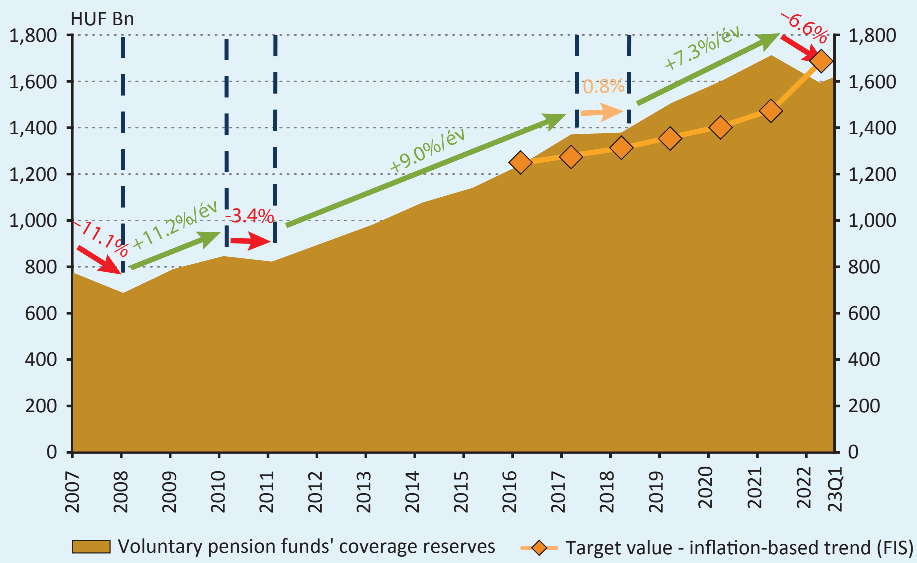


Note: The colour of the background illustrates the strength of concentration under HHI. Contrary to the practice of previous years, this year quarterly data were used only in respect of 2021. The figures of previous years were updated with the annual audited data. Due to this, the chart may differ from that published last year.
Source: MNB

3.2.2 Asset growth trend halted, correction starting at the end of the year

At the end of 2022, individual accounts of voluntary pension funds stood at HUF 1,598 billion, 6.6 per cent lower than at the end of the previous year (HUF 1,710 billion). The decline was the result of two major effects. On the one hand, the rise in the yield curve led to a massive depreciation of the government bond portfolios managed by the institutions, while payments made from individual accounts (HUF 127.2 billion) were 31.9 per cent higher in 2022 than in 2021, primarily because of the increase in lump-sum pension payments and exit payments. A market correction started in the fourth quarter of 2022 and continued in the first quarter of 2023.

Chart 3.2
Developments in the voluntary pension fund coverage reserves

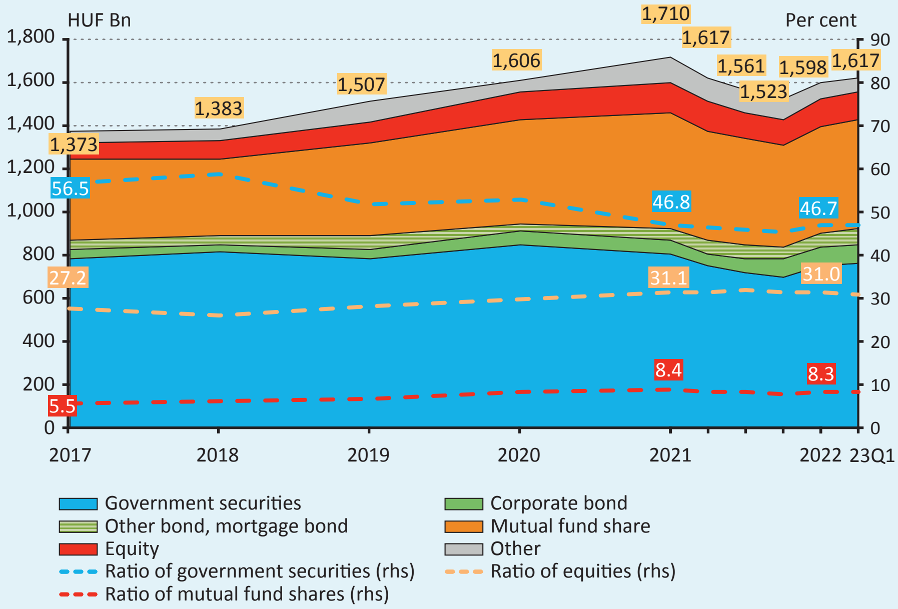


Source: MNB

3.2.3 General asset devaluation had a significant impact on funds' reserves

Hungarian government bond investments continued to account for the largest share of voluntary pension funds' savings with direct exposure being almost the same (46.7 per cent) as the end-2021 level (46.8 per cent) (Chart 3.3). The ratio of direct investments in equities within the funds' portfolios also remained broadly unchanged compared to last year. At the end of 2022, exposure equalled 8.3 per cent of which 5.3 per cent consisted of domestic equities and 3 per cent of foreign equities. The ratio of investment fund shares within the groups of investment assets did not change drastically, it decreased from 31.1 per cent at the end of 2021 to 31.0 per cent. Of this, domestic investment fund shares accounted for 19.8 per cent, foreign investment fund shares for 11.1 per cent. Classifying indirect investments by underlying assets, we see that equity funds make up the majority (22.63 percentage points) of the 31.0 per cent. The share of corporate bond investments increased by 1.5 percentage points, from 3.8 per cent at the end of 2021 to 5.3 per cent. The share of real estate investment funds in funds' portfolios grew from 1.8 per cent in 2019 to 2.7 per cent by the end of 2022 at an accelerating pace year by year, while the ratio of direct real estate investments remained stable at 0.7 per cent at the end of 2022. Total real estate exposure (direct and indirect combined) equalled 3.4 per cent at the end of 2022. The share of mortgage bonds rose by 0.4 percentage point. Corporate bonds, other bonds, mortgage bonds, term deposits and current accounts show some change in their proportions. The share of term deposits decreased by 2.3 percentage points. After Money from term deposits flowed into the current account, corporate bonds and other bonds, and mortgage bonds. the trend of steady growth seen in the previous years, the value of individual accounts started to decline in Q1 2022, reaching its annual low in the third quarter of 2022, which was even lower than the value at the end of 2020. A market correction started in the fourth quarter of 2022 and continued in the first quarter of 2023. In Q1 2023, despite a negative cash flow balance, individual accounts increased, driven by a positive sectoral investment performance.

Chart 3.3
Distribution of the voluntary pension funds' investments by asset groups



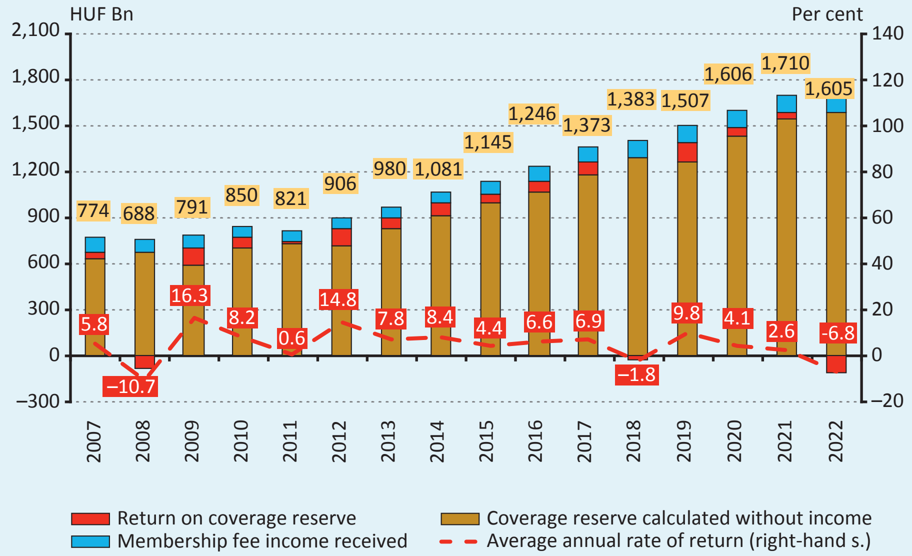
Note: Other includes: bank accounts, fixed deposits, forward contracts, direct real estate investments, equity loans, other securities listed at the stock exchange or other regulated markets, receivables from securities lending and the net value receivables and payables from securities transactions.

Source: MNB

3.2.4 Negative returns due to extraordinary global market environment

In 2022, voluntary pension funds achieved an average net return of minus 6.80 per cent, weighted by closing assets (Chart 3.4). In the last quarter of last year, the positive investment performance of voluntary pension funds halted the negative return trend of the previous three quarters, and 12 out of 73 fund portfolios ended last year with positive returns. Annual net returns varied widely, from 8.5 to minus 14.5 per cent. It was mainly lower-risk portfolios that performed better. The performance of funds last year was largely driven by a general depreciation of all asset classes as a result of the economic and inflationary environment becoming more uncertain in the wake of the Russia-Ukraine war. The rise in the bond market yield curve affected longer-dated government bonds in particular – which make up a major part of the portfolios – because of the investment horizon of funds, but the significant price falls in the capital markets also weighed on investment performance in the short and the medium term.

Chart 3.4
Developments in voluntary pension fund coverage reserve, membership fee income, volume of yields and net annual average rate of return



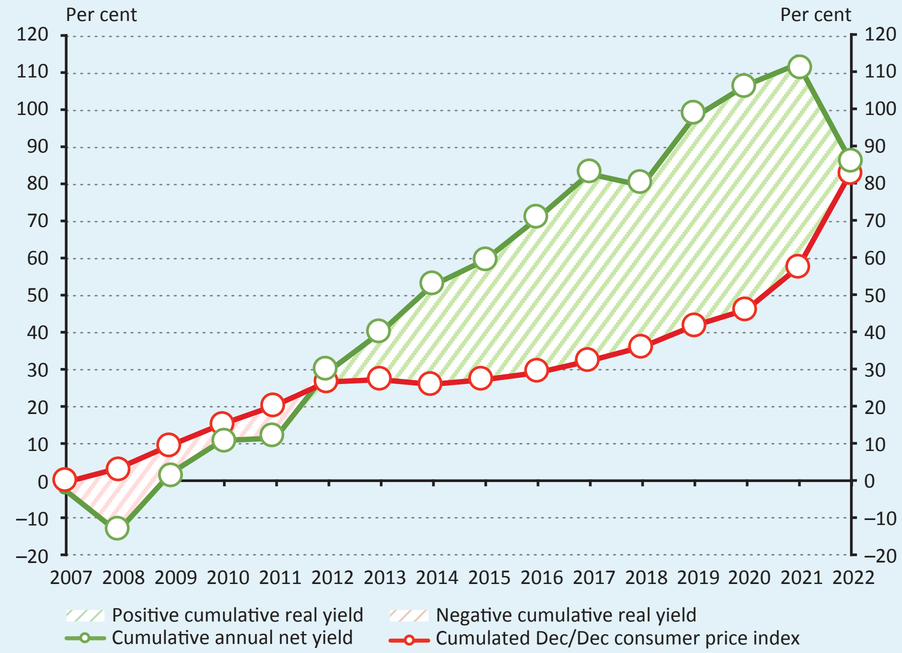
Source: MNB

Over the past 15 years, there were only two occasions (2008, 2018) when the average annual net rate of return of voluntary pension funds fell in the negative zone, and once (2011) the rate of return was just above zero per cent.

3.2.5 Long-term nominal returns in the positive range, low cost level

The purpose of pension savings is to supplement old-age state pension in a meaningful way, so it is worth looking at their development in the longer run. Based on the data provided by the funds, the MNB publishes its 15-year average rates of return of the pension funds sector for the eighth year in a row, showing the performance of the sector over the long term. The 10-year and 15-year average net returns weighted by closing assets equalled 4.37 per cent and 4.63 per cent, respectively, based on 2022 data. Despite the low returns in 2022, funds continued to have the potential for long-term value creation. The strict statutory cost limits for voluntary funds and investment performance over the longer term suggest that pension funds remain a favourable form of retirement savings.

Chart 3.5
Long-term cumulated net yield of the voluntary pension fund sector

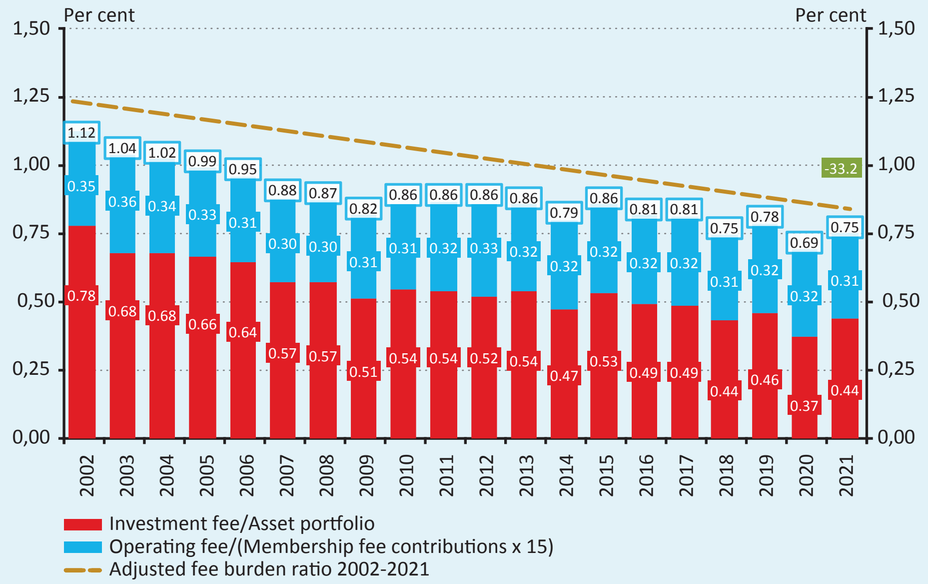


Source: MNB

Voluntary pension funds cover their operating costs from fees deducted from the contributions of members and employers, and the expenses of asset management activities from fees charged on members' savings. The adjusted charge ratio does not relate the operating charge to pension fund assets, but to a hypothetical average amount of assets accumulated over a period of 30 years from total contributions by a member with an average accumulation period of 30 years. The adjusted indicator's operating part reflects the development of the ratio of the contributions deducted for operation and liquidity to total contributions, and is not affected by changes in the assets of the funds.

The ratio of voluntary pension funds' contributions deducted for operation relative to the total contributions paid decreased by 7.8 per cent from 2002 to 2020. The decrease is not even, following a decline between 2002 and 2007, the ratio of the charge deducted from contributions for operation increased between 2008 and 2012. The impact of the global economic crisis of 2008-2009 led to a decline in the contributions paid to funds during 2008-2012. Funds that applied contribution brackets subtracted a larger ratio of lower member contributions to cover their operating costs. However, over the period of 2012 to 2018, contributions paid rose by an average of 8.4 per cent year on year before they fell in 2019 due to the change of the rules pertaining to the taxes and contributions payable by employers in 2019. In 2020 and 2021, funds benefited from the fact that the coronavirus outbreak did not have a negative impact on the contributions paid by members. In both years, contributions paid increased year on year by almost 3 per cent in 2020 and 7 per cent in 2021. In 2021, the ratio of charges deducted from contributions for operating and liquidity purposes to total contributions did not change significantly. The modest decrease in 2021 was because more funds applied brackets to allocate contributions where proportionally less is deducted from higher contributions for operation, so the operating charges adjusted for an increase in contributions paid fall even if the contribution allocation ratios remain unchanged. The difference between the investment performance achieved by funds and the benchmark return of a portfolio can have a significant impact on the charge ratio. Generally speaking, under a success fee scheme, if the return realised by the fund exceeds the benchmark return and is positive, the trustee partner is entitled to a success fee. In the volatile market environment of 2021, trustees sought to maximise returns by underweighting or overweighting individual investment vehicles relative to the targets set out in the investment policies. In 2021, the returns achieved by trustees exceeded the benchmark index set out in the funds' investment policy on average by more than in the previous year. As a result, the success fee paid by several funds was higher than in 2020.

Chart 3.6
Development of the adjusted fee burden ratio 2002-2021



Source: MNB

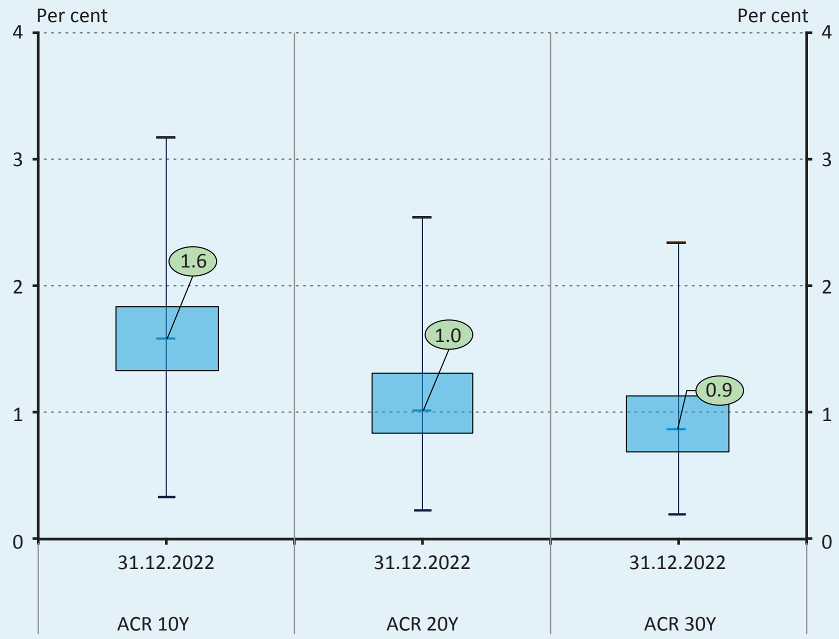
The annual cost ratio for pension fund products (ACR_{PF}) introduced by MNB Recommendation No 20/2019 (IX. 20.) expresses the charges deducted from a member's contributions and savings in a single figure. The ACR_{PF} is comparable to the same indicator of life and pension insurance which enhances transparency and competition within the funds sector and across the different sectors.

Voluntary pension funds calculated the ACR for the first time at the beginning of 2020 based on the MNB's recommendation. The MNB introduced the ACR for funds through a non-binding regulatory instrument, a recommendation, which has proved to be successful in the sector as the ACRs of all operating pension funds is currently available in the MNB's ACR search application. It is recommended that funds review the ACRs at least annually (or on a case-by-case basis in the event of significant changes in key cost parameters) and submit the updated ACR to the MNB. The updated ACRs submitted in 2022 did not differ significantly from the figures submitted in 2020.

Based on the revised data submitted, the average 10-year ACR_{PF} in 2022 was 1.57 per cent; the average 20-year ACR_{PF} was 1.08 per cent. The cost ratios calculated with different methodologies show that the cost of savings provided by voluntary pension funds is below 1 per cent in the long run: the sectoral adjusted charge ratio is 0.75 per cent, the classical charge ratio is 0.71 per cent and the average 30-year ACR_{PF} is 0.92 per cent.

Funds' cost ratios also confirm that voluntary pension funds are a cost-effective long-term investment also when compared to other financial products.

Chart 3.7
ACR values of the voluntary pension fund sector

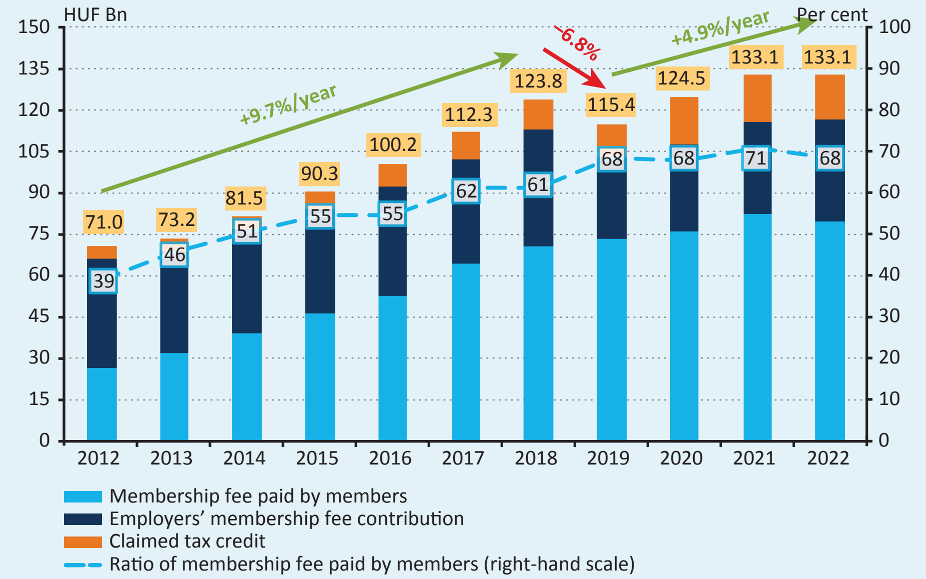


Note: In the box plot the line in the middle together with the values belonging to it denotes the median of the ACR value in the individual categories. The lines on the top and in the bottom of the box show the smallest and greatest ACR values within the group. The boxes show the two middle quartiles within the ACR values of the institutional groups, i.e. 50 percent of the ACR values within the group fall between the bottom and top of the boxes.
Source: MNB

3.2.6 Outstanding voluntary pension contributions of 117 billion in 2022

Despite the extraordinary global market environment, the amount of contributions credited to the individual accounts of voluntary pension funds equalled HUF 117.3 billion which exceeded the highest level ever in 2021, HUF 115.9 billion a year (Chart 3.8). In 2022, individual contributions in the voluntary pension funds sector fell by 2.3 per cent, but this was offset by employer contributions which increased by 9.6 per cent. Individual contributions continued to dominate the inflow, accounting for 68.4 per cent of the annual income from contributions. The shares of individual and employer contributions in the sector reversed over the last 10 years, but employer contributions remained important because they are stable due to contractual commitment, while individual contributions are more likely to fall in a rough economic year. This was also evident in 2018 when we saw negative investment performance. The tax credits on contributions amounted HUF 15.8 billion in 2022, HUF 1.4 billion less than in 2021.

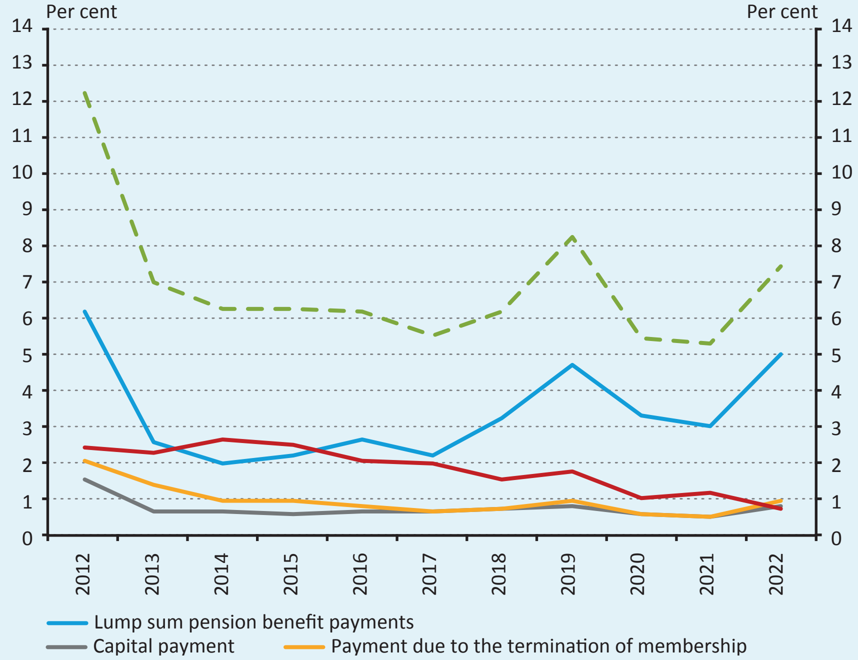
Chart 3.8
Membership fee income credited to the voluntary pension funds' coverage reserves, broken down by payers and claimed tax credit



Note: Data have been modified retrospectively back to 2016.
Source: MNB

Box 3.1
Evolution of voluntary pension fund contributions and payouts

Chart 3.9
Payments against the coverage reserve of voluntary pension funds



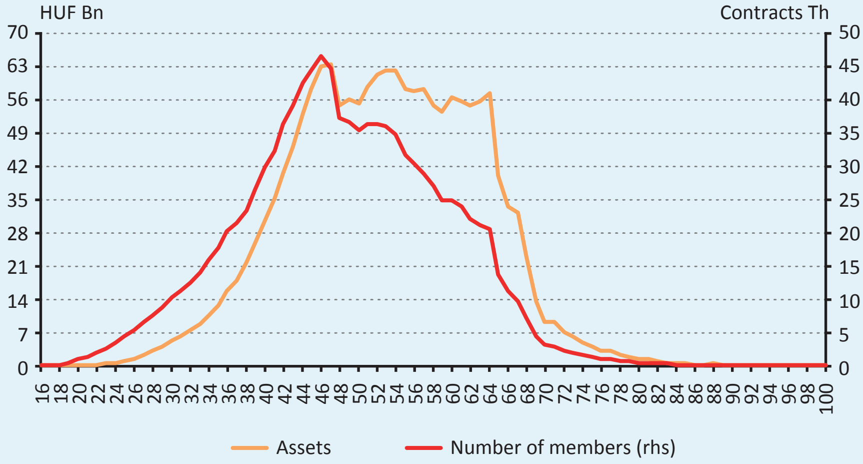
Note: Total payment contains Lump sum benefit payments, Payments after the end of the waiting period, Capital payment, Payment of yields and Payment due to the termination of membership.
Source: MNB

The 2008 financial crisis and its lingering economic effects also affected pension fund members' decisions in 2011-2012: in 2012, the magnitude of benefit payments and exit rates were determined by, among other things, the option of repaying foreign currency loans at a preferential rate, which some pension fund members took advantage of using their long-term pension savings. Pension fund payments stabilised at a lower level since 2013. Lump-sum payments for services equalled around 2 to 3.5 per cent of individual accounts. Rising benefit payments and the increase of its ratio to individual accounts is a natural process as the system of voluntary pension funds matures. Those with longer savings of 20 to 25 years who joined the funds between the ages of 35 to 45 in the years after the sector started are now eligible for services of a higher amount. However, certain economic events may influence the decisions of members. In 2018, after a period of favourable returns from 2012 to 2017, several funds saw their individual accounts or, within that, the net rate of return of some portfolios, turn negative. In 2019, this led to an increase in lump-sum payments for services which almost reached 5 per cent of individual accounts. However, it should be borne in mind that some pension fund members kept their membership even after retirement, and most of them did not withdraw their savings as pension benefits or withdrew them only in part. These members do not exhaust their pension savings as soon as they have the opportunity to do so, but see them as some sort of provisions and a profitable investment product. At the end of 2021, for example, almost 6 per cent of fund membership was over 65 years of age, and the balance of the individual accounts of these members amounted to HUF 199 billion, which is almost 12 per cent of the total of all individual accounts. The number of members with a waiting period of 10 years or reaching it within one year is 831,151, a decrease of 0.8 percentage points compared to the end of 2021, and corresponds to 74.4 per cent of the total number of members. Individual account claims of members with a waiting period of 10 years or reaching it within one year amounted to HUF 1,378.3 billion, which also represents a decrease of 0.8 percentage points compared to the end of 2021 and corresponds to 86.3 per cent of individual accounts.

Exit payments fell from an average of 2 per cent of the average of individual accounts in 2012 to less than 1 per cent in 2014, and remained between 0.5 and 1 per cent of the average of individual accounts ever since. The effects described for benefit payments (adverse returns in 2018 and economic difficulties in 2022) were also observed to a lesser extent with exit payments, but exit payments in 2022 did not exceed 1 per cent of the average of individual accounts.

The economic difficulties resulting from the extraordinary global market environment in 2022 also influenced the choices of voluntary pension fund members. The majority of members are now able to monitor the performance of their individual accounts on a daily basis, so they could witness the impact of adverse global market conditions on their savings almost immediately. The changed environment, such as higher cost of living, which members could cover by withholding part of their usual contributions, affected individual contributions already in the last quarter of 2022, and the weak investment performance in the first three quarters could have lessened members' willingness to save. The changed environment and the associated uncertainty could effect changes in savings patterns in the short term, and several retired members may have decided to take out their savings. Lump-sum payments for services in 2022 reached 5 per cent of the average of individual accounts.

Chart 3.10
Distribution of the assets and number of members of the voluntary pension funds by age

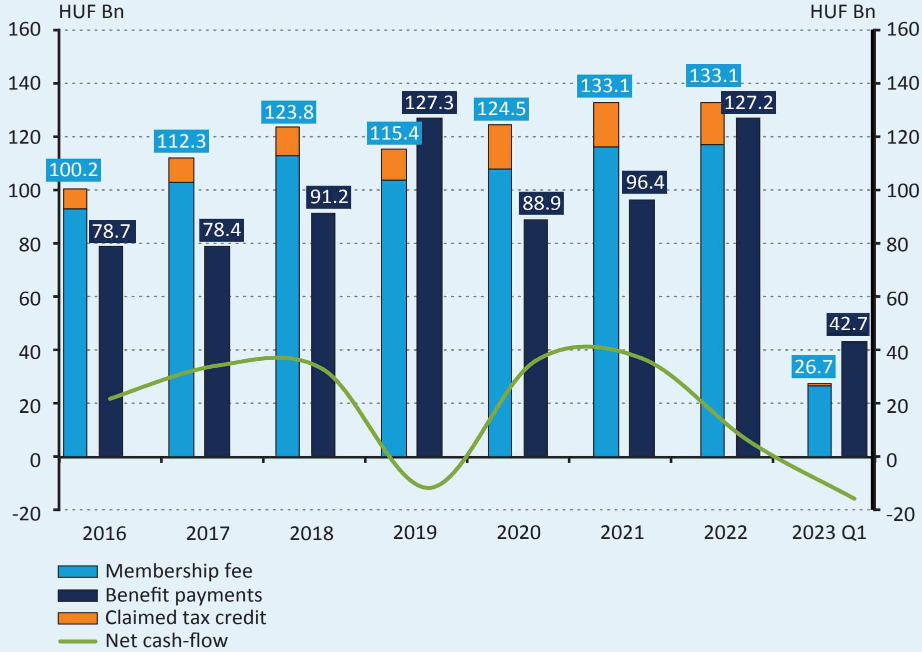


Source: MNB

Lump-sum pension payments and exit payments which started to rise in 2022 continued this trend in the first quarter of 2023. After negative fund returns in 2018, 2019 could see higher payouts, but negative returns in 2022 resulted in increased payouts already in the same year.

As shown in Chart 3.11, the cash flow balance of the voluntary pension funds sector was in the negative zone in 2019, presumably due to the higher payouts caused by the negative returns in 2018. The cash flow balance also turned negative in the first quarter of 2023, which may be related to the weak investment performance in 2022. Income from individual contributions was 6 per cent lower in the first quarter of 2023 than in the same period a year earlier, while employer contributions increased by 20 per cent. Overall, due to the higher weight of individual contributions, contributions were up 1.4 per cent in the first quarter of 2023 compared to the same period last year. The amount of payments made from individual accounts in the first quarter of 2023 was 40.5 per cent higher than in the same period of the previous year. In addition to lump-sum pension payments, capital payments also showed a significant increase, but in terms of proportions, the largest increase was recorded for exit payments. However, it is also important to note that voluntary pension funds have always been in surplus in the years shown in Chart 3.11, so in the long run the negative swings even out. The MNB will continue to closely monitor the cash flows of institutions and the risks they may pose.

Chart 3.11
Cash-flow development of the voluntary pension fund sector



Source: MNB

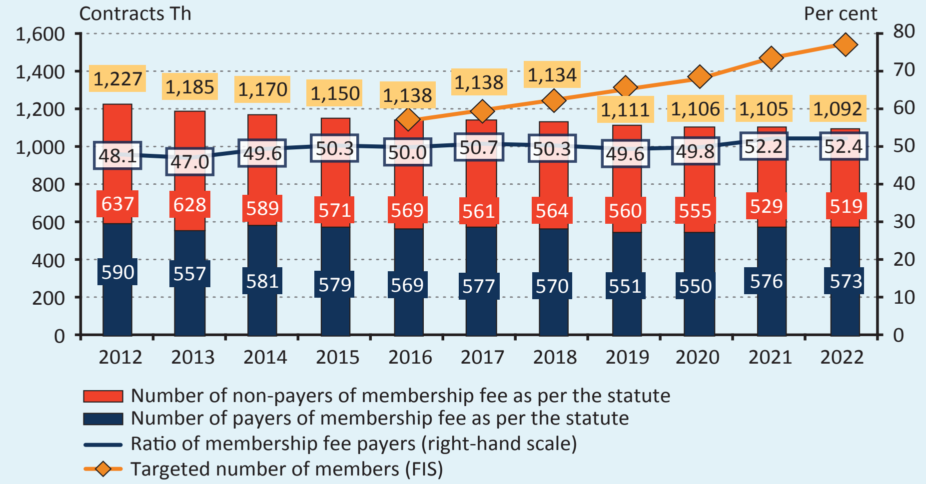
3.2.7 Declining member headcount, move away from target

In 2022, the ratio of voluntary pension fund members paying contributions stood at 52.4 per cent, 0.2 percentage points higher relative to the previous year and the highest in the last 10 years (Chart 3.13). The slight decline in the membership of voluntary pension funds indicates a move away from the ideal path presented in the FIS with an outlook on self-provision. Priority continued to be given to membership recruitment and reaching out to non-paying members and encouraging them to be active.

In 2022, 31,971 new members joined voluntary pension funds, but this could not compensate for, among other things, the number of beneficiaries (22,828); deceased members (3,344); leavers (16,061) and members excluded for not paying contributions (1,842) resulting in a decrease of membership by 12,972 members. Three quarters of the new entrants (24,112 members) were enrolled by client recruiters. The trend in the number of new members is positive in itself, but to maintain and increase the number of members, a larger number of new members, preferably under 30, is needed. The average age of membership was 48 years in 2020 and 48.4 years in 2021, so attempts to stop the increase in the average age of membership failed. The institutions need to reach out to the under-30 generation in order to stop the rising trend in the age of membership and to keep it at a constant level.

In the voluntary pension sector, together with the average age of members the number of members eligible for pension benefits is also on the rise, so the number of members who will probably cancel their membership to claim the benefits is also expected to increase. This effect may be mitigated by the fact that the legislative changes effective from 1 January 2016 have considerable expanded the range of options for members reaching retirement age. Members eligible for pension can leave the rest of their savings in the fund while withdrawing part of their individual account and see their savings as a form of investment.

Chart 3.12
Ratio of payers of the voluntary pension fund membership fee



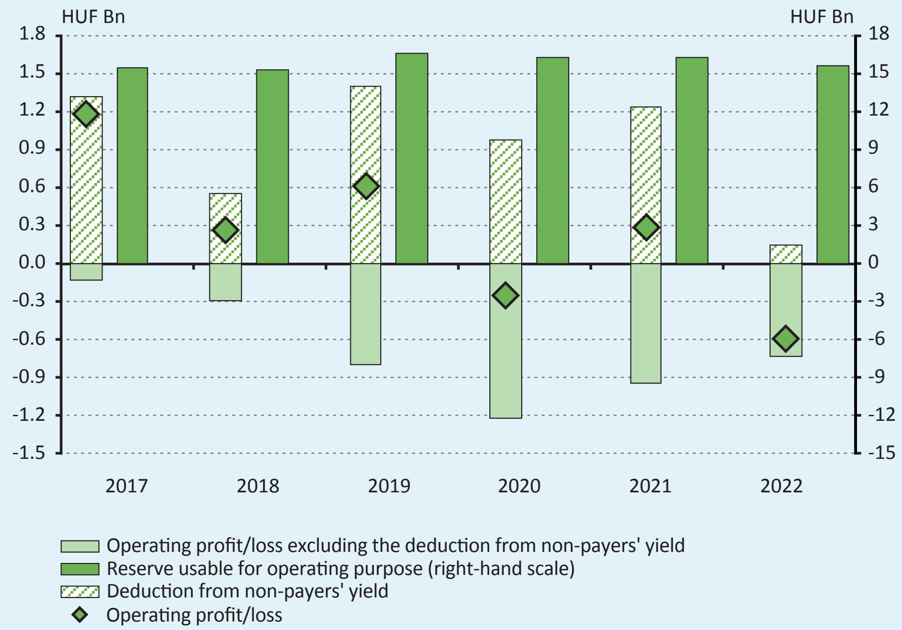
Source: MNB

The proportion of non-payers fell since 2020, but is still considered high and poses a risk to the long-term viability of funds. The business model for voluntary funds is that operating expenses should be covered by a share of the costs deducted from members' contributions, which can be supplemented by donations for operating purposes. However, non-payers do not contribute to the sustainability of operation in this primary way or to the extent required. Under the applicable legislation, from the date of the beginning of the default in payment of the contribution, the fund is entitled to reduce the member's return on the investment of their individual account by an amount equal to the share of the current standard contribution of the fund dedicated to operating and liquidity purposes, but not exceeding the amount of the return, and to credit this amount to the operating or liquidity fund. This solution helps finance the operation of the funds and allows non-paying members to contribute to the sustainability of operation, yet it does not fully cover the risk of non-payment of contributions. If the savings of a non-paying member do not yield sufficient return – because the balance of the member's individual account and/or the unfavourable money and capital market environment result in a low return – the fund cannot deduct this charge. The majority of funds also try to encourage non-paying members to contribute in a positive way, by raising awareness, providing information and organising promotions, so some of the passive membership are seen as potential contributors.

3.2.8 Operating profit turned into loss after last year's profit

In 2022, 20 out of 30 institutions had a negative operating results, and the sectoral operating result also turned negative in which a significant role was played by the fact that because of marginal returns, the deduction of returns due to unpaid standard contributions reached only 12 per cent (HUF 149 million) of the figure in 2021 (HUF 1,247 million), so this narrow room for return deduction brought about by the global market environment could not push the operating result at sector level into the positive range in 2022. Funds with a negative operating results in the longer term need to rethink their operational characteristics (more specific targeting of non-payers, transformation of the operating cost model). The MNB places particular emphasis on monitoring the operational situation of funds, both in the course of ongoing supervision and of supervisory inspections. If, due to persistent operating losses or other reasons, funds' operating reserves approach or fall below the prudential minimum, the MNB can take or takes various measures (prudential meeting; requesting an action plan; requiring an operation-liquidity report; launching a targeted investigation) with regard to the institutions concerned. At the end of 2022, voluntary pension funds' reserves for operating purposes at sector level decreased by 4.4 per cent compared to the end of the year before (Chart 3.13), but the level of reserves remained adequate.

Chart 3.13
Development in operating profit/loss of voluntary pension funds



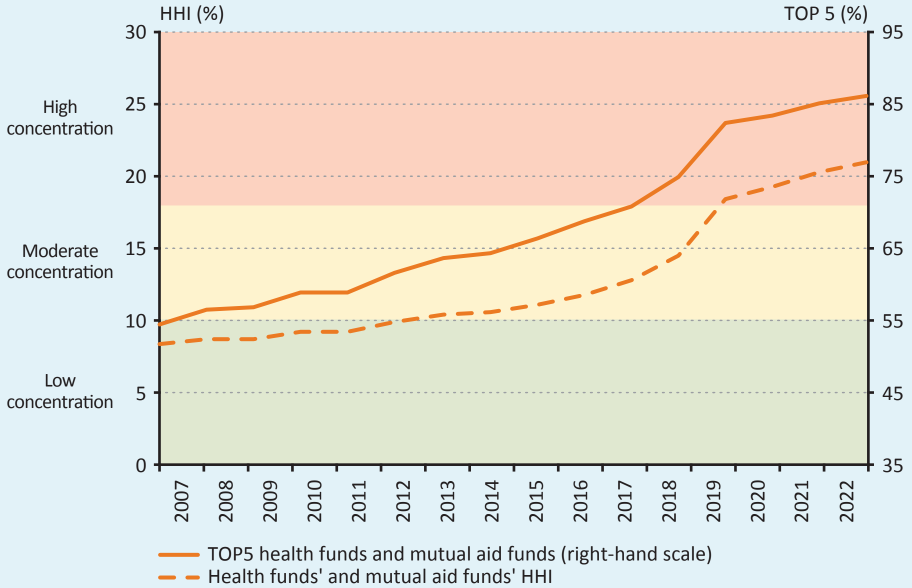
Source: MNB

3.3 HEALTH AND MUTUAL AID FUNDS

3.3.1 Concentration levels continued to rise

The level of concentration in the health and mutual aid funds sector continued to increase (Chart 3.14). An analysis of the concentration of contributions shows that 86.4 per cent of the sum of members' contributions and employer contributions paid to health and mutual aid funds were made by the 5 largest (in terms of contributions) institutions. It is difficult for smaller funds to compete with institutions of at least medium size with national coverage in terms of service provision and the related amenities (e.g. innovative health funds services, rebates available in private health care institutions). Health and mutual aid funds backed by banks and insurance companies are better placed to attract members than smaller institutions with limited capacity for innovation.

Chart 3.14
Developments in the health and mutual aid funds' concentration

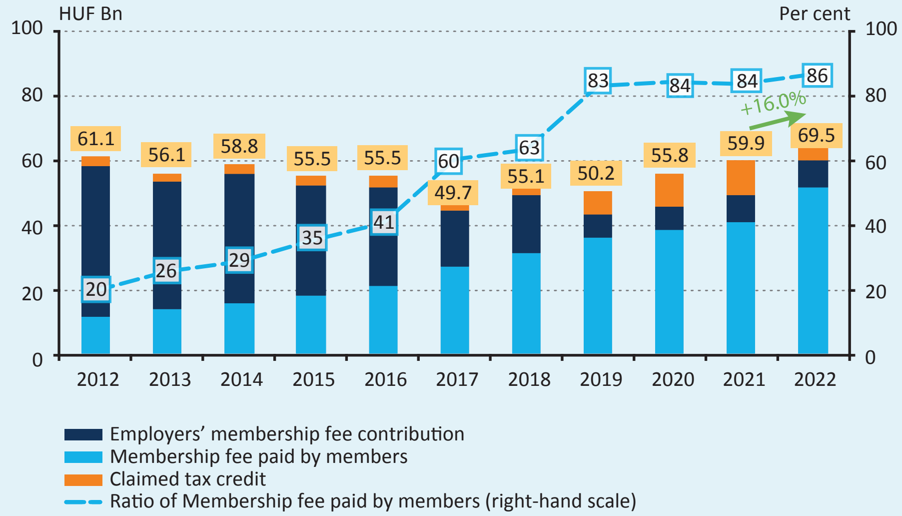


Note: The colour of the background illustrates the strength of concentration under HHI. Contrary to the practice of previous years, this year quarterly data were used only in respect of 2021. The figures of previous years were updated with the annual audited data. Due to this, the chart may differ from that published last year.
Source: MNB

3.3.2 Peak payments in the health and mutual aid funds sector

Contributions to health and mutual aid funds credited to their individual accounts increased significantly in 2022. Employer contributions (HUF 8.1 billion) remained unchanged, while individual contributions increased by 23.8 per cent (from HUF 41.9 billion to HUF 51.9 billion), representing an overall growth of 20 per cent (HUF 10 billion) compared to 2021. The figure for 2022 is remarkably higher than the annual contributions of the 2016-2020 period, and is the highest ever. A positive development, reflecting the strengthening of self-provision, is that the increase was driven by a significant rise in individual contributions (Chart 3.15). Individual contributions at the sector level were more than four times the amount of a decade ago, and were rising steadily. Compared to 2012, the shares of individual and employer contributions in the sector reversed, with strong emphasis on individual contributions from members. The uneven distribution of contributions between quarters during the year (seasonality) continued to be typical, a considerable part of the contributions paid concentrated in the last quarter, also as a result of funds' campaigns. Almost half of individual annual contributions are paid in the last quarter to health and mutual aid funds, while employer contributions are less volatile in each quarter. The tax credits on contributions amounted HUF 9.5 billion in 2022, HUF 1.1 billion less than in 2021.

Chart 3.15
Membership fee income credited to the health and mutual aid funds' coverage reserves, broken down by payers and claimed tax credit



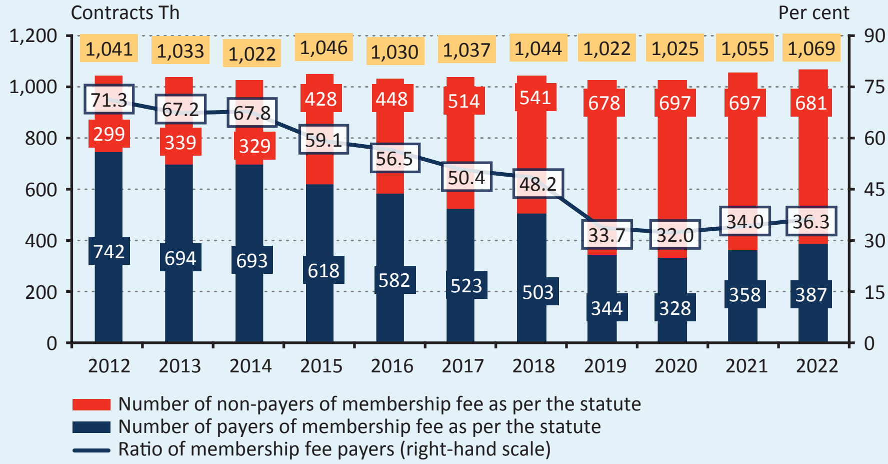
Source: MNB

3.3.3 Member headcount up again, moderate improvement in willingness to pay contribution

Despite exits (15,722 persons) and exclusions due to the non-payment of contributions (26,222 persons), the number of members grew by 13,516 in 2022 in the health and mutual aid funds sector, which was less than the increase of 30,145 in the year before. Nonetheless, the fact that this growth is maintained is certainly a positive trend. The almost 61.5 thousand new members were sufficient to increase membership. Of the new entrants, 40.5 thousand members were enrolled by client recruiters. The proportion of contributors increased by 2.3 percentage points by the end of 2022 as a significant number of non-payers (26,222) were excluded in 2022. A positive development is that individual contributions had been on the rise for two years (Chart 3.16).

Thanks to the 80 per cent employer contributions, in 2012, 71.3 per cent of the membership was considered payers as per the statutes of the funds. By 2022, this almost halved (36.3 per cent) with employer contributions making up 14 per cent. The last 2 years saw an increase in the ratio of contributors, halting the downward trend seen in previous years. The statutes of each fund determine the consequences of non-payment (e.g. deduction of the operating charge from the return). Several funds believe that it is not worth retaining non-paying members with low balances by financing their costs from the contributions paid by active members. They will therefore, if their statutes allow, terminate the membership of these members. However, a considerable number of funds also weigh the possibility that non-payers may become contributors again when their income, health or family circumstances change, and this may have a positive impact on the operation of the funds in the future.

Chart 3.16
Developments in the number of members not paying health and mutual aid fund membership fee



Source: MNB

3.3.4 Soaring payments for services by health and mutual aid funds

In Hungary, the health care system is financed from the central (government) and municipal budgets, the budget of the Health Insurance Fund, direct payments by households and payments by the voluntary health care financing subsystems. The bulk of the voluntary health care financing subsystems is made up of the health-related expenditure of voluntary health funds and mutual assistance funds which have been in business since 1994.

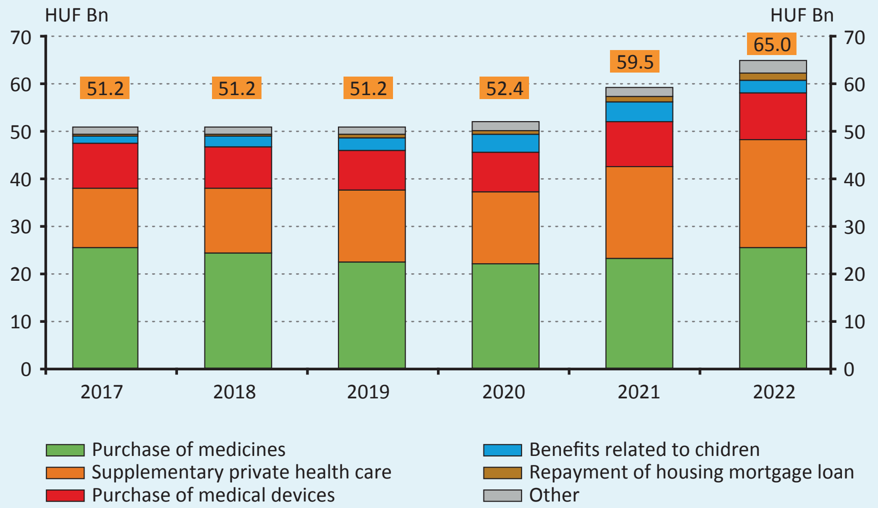
Payments for services (HUF 65 billion) increased by HUF 5.5 billion compared to the previous year. Of the services of health and mutual aid funds, the largest share of 39.5 per cent, an increase of 0.3 percentage points, was still accounted for by support for the purchase price of medicines, special nutritional products and vitamin preparations serving preventive purposes. These are followed by the financing of health services (e.g. dentistry, diagnostic imaging) with a share of 34.7 per cent and representing a growth of 2.2 percentage points, and subsidies for the purchase price of medical aids the ratio of which decreased by 0.3 percentage points to 15.7 per cent.

The ratio of payments for child-related benefits fell from 6.9 per cent to 4.1 per cent, with both payments for birth-related benefits and school enrolment support services decreasing relative to 2021. The share of the amounts paid out to support residential mortgage loan repayments increased from 1.8 per cent to 2.2 per cent in 2022.

Furthermore, in 2022, with the exception of child-related benefits, the amounts paid rose in the above categories of services compared to 2021.

From March 2023, substantial progress has been made towards the electronic settlement of health and mutual aid funds' accounts. A change in the law has made it possible for members to prove that they have used a health service by sending an electronic copy of the invoice. This means that electronic copies can now serve as proof of the use any service not only services covering pharmaceuticals and medical aids.

Chart 3.17
Developments in the health and mutual aid funds' benefit payments

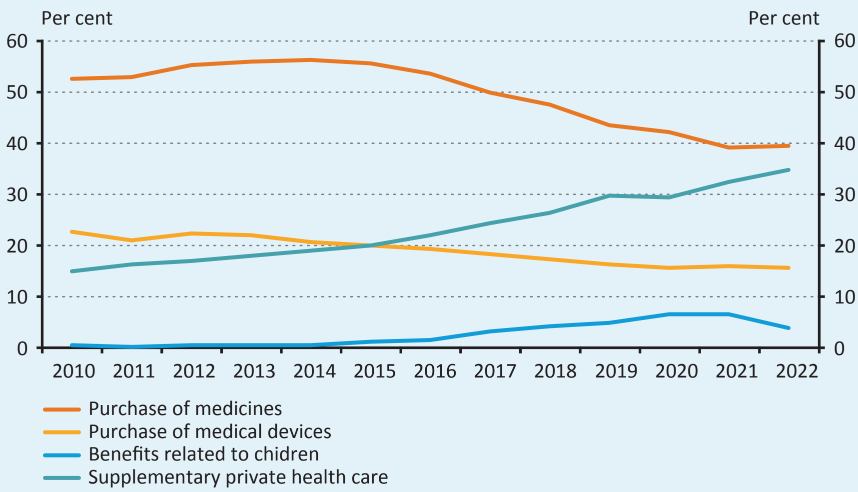


Source: MNB

Box 3.2
Evolution of health and mutual aid funds' services

Of the spending on the services of health and mutual aid funds, the purchase price, financing value and the share of medicines, special nutritional products and vitamin preparations serving preventive purposes decreased notably. From 2012 to 2015, members received a total of HUF 30-32 billion to support the purchase of medicines, which accounted for around 55 per cent of total expenditure. From 2016, this amount started to decrease and in recent years, the amount used to support the purchase of medicines equalled HUF 22 to 25 billion. The decrease is clearly due to members using less this service. While in 2012-2013 the number of cases reported by the funds was around 9 million, i.e. the more than 1 million members (or their beneficiaries) used this service on average 9 times per year, in 2020-2022 the number of cases fell to around 4 million for this type of service.

Chart 3.18
Distribution of the health and mutual aid funds' benefit payments



Source: MNB

Another striking trend in payments for services is the increase in the financing of private health care services. The size of this type of service was around HUF 10 to 11 billion in 2012-2015, but exceeded HUF 19 billion in 2021 and HUF 22 billion in 2022. This means that around a third of health funds' expenditure is spent on private health care. It is worth noting that take-up did not rise significantly, with around 460,000 cases per year reported by the funds for this type of service between 2012 and 2016. In 2020, the year of the COVID outbreak, when face-to-face doctor-patient encounters became fewer, the funds reported 425,000 cases in the category of private health care financing, with the size of expenditure rising further. In 2021, take-up increased significantly, presumably because patients also underwent the medical examinations and used the treatments postponed in 2020, and the number of cases rose to 522,000, with the amount of expenditure also increasing. By 2022, the number of cases of service use had exceeded 560,000. The increase in spending on private health care services may indicate that members use more expensive services and/or the price of services have gone up. The massive increase in the number of cases in 2021 and 2022 may also indicate that, following the COVID outbreak, some of the take-up of health services shifted from the public to the private health care system. Support for medical aids decreased with regard to both amount and the number of cases. Spending on this type of service ranged from HUF 12 to 13 billion in 2012-2013 to around HUF 10 billion in 2021-2022.

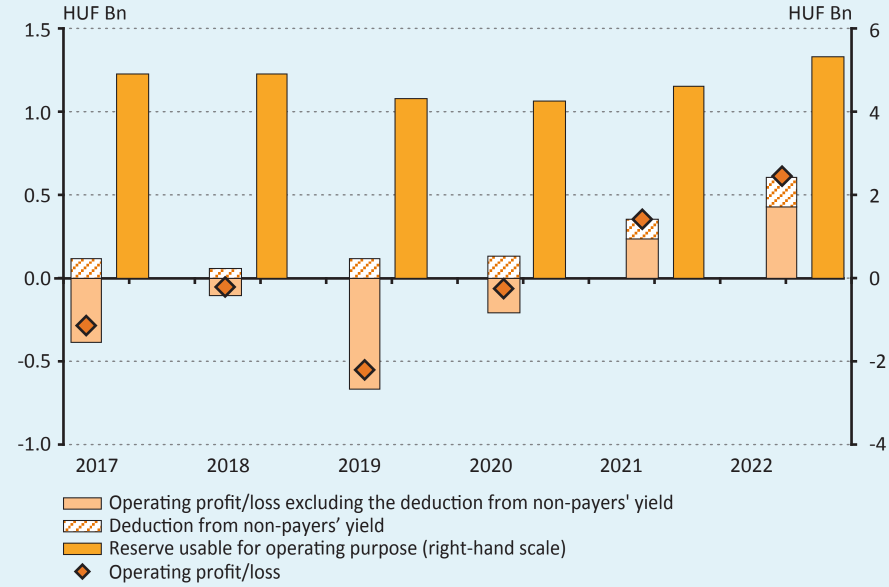
With the emergence of health and mutual aid funds, the use of self-provision type services started to increase from 2016. Of these, childbirth-related support grew the most, accounting for 6 to 7 per cent of expenditure in both 2020 and 2021. More than 5,400 members used this service in 2021. By 2022, the number of cases had fallen to 3,500 and the size of the service also decreased.

3.3.5 Health and mutual aid funds generated operating profit again

The sectoral operating result of health and mutual aid funds was negative in every year between 2017 and 2020. Some funds invested heavily to address the shortcomings identified by the MNB, especially with regard to IT infrastructure, and to reach out to younger generations. In 2021 and 2022, however, the sector earned a positive operating results with 10 out of 16 institutions being profitable on an annual basis in 2022. Funds with a negative operating results in the longer term need to rethink their operational characteristics (more specific targeting of non-payers, transformation of the operating cost model). If, due to persistent operating losses or other reasons, funds' operating reserves approach or fall below the prudential minimum, the MNB can take or takes various measures (prudential meeting; requesting an action plan; requiring an operation-liquidity report; launching a targeted investigation) with regard to the institutions concerned.

By building up adequate operating reserves, funds can ensure the conditions for their operation and continuity of operations in the event of an adverse period. At the end of 2022, the operating reserves of health and mutual aid funds at sector level exhibited a renewed increase, growing by 16.3 per cent compared to the end of 2021, almost double the increase of the previous year (Chart 3.19).

Chart 3.19
Development of operating profit/loss of voluntary health and mutual aid funds



Source: MNB

3.4 RISKS IN THE MONEY MARKET

3.4.1 Asset depreciation was the most significant risk

Table 3.2
Risks of the funds market

Risk category	Risk groups	Risk rating	Risk prospects	Evaluation in words
Business model	Environment Strategy, business plans Sustainability of operation			Willingnes to save may decrease due to rising costs of living. Operating profit in the health and mutual aid funds sector, operating loss at voluntary pension funds, but the loss absorbing capacity of both sectors is appropriate. *Improving outlook based on 2023 economic forecasts.*
Corporate governance	Exercise of owner's rights Internal governance Risk management system Internal control			Activity of audit committees are not comprehensive. Closer monitoring of asset management activity is necessary. At more institutions lack of strategy for increasing the number of new entrants and for reducing the average age of the members. *Risk is not expected to fall in the short run.*
Financial and operational risks	Insurance risk Investment risk of operational and liquidity reserve Operational risk			Inflow is at peak but material outflow (similar to 2019 level) at the same time due to negative yields in voluntary pension sector, risk of continuous rise in the average age. *Willingnes to save may decrease while outflow risk is not expected to decrease in the short run.*
Sustainability and reserve risk	Coverage reserve investment risk Capital Operating and liquidity reserve			Asset devaluation due to war affected increasingly inscure economic environment. Negative yield in 2022 but still positive cumulative yield over a period of 10 or 15 years. *Problems may rise with the sustainability of the special business model at some smaller institutions.*
Market entry risk	Products Customers			Voluntary fund products are cost efficient, the number of complaints is low. *Communication of negative yields is a risk, financial awareness should be raised.*

Legend:
Degree of risks — *high* — *significant* — *moderate* — *low*
Direction of risks — *increasing* — *stagnant* — *decreasing*

Source: MNB

The outbreak of the war caused a general depreciation of assets, the economic environment became uncertain, the cost of living rose significantly, so there is a possibility that long-term propensity to save will decline. At sector level, health and mutual aid funds closed 2022 with an operating profit and voluntary pension funds with an operating loss, but both sectors had adequate loss-absorbing capacity. At sector level, they had reserves sufficient for several years. There were risks to the sustainability of the business model at some – typically smaller – institutions. High non-payment rates continued to pose operational risks. Based on economic forecasts for 2023, we expect an improving outlook.

There are still weaknesses related to the internal control systems, the audit activities of the audit committees are not always well documented and internal audit findings are not always followed up on an ongoing basis. The control of outsourced activities is not always comprehensive. The quality of internal control at a significant number of funds still needs to be improved. The activity of funds' trustees needs closer monitoring. Several institutions lacked a comprehensive strategy to increase membership and rejuvenate their membership. We do not expect the risks to fade in the short term.

The amount of contributions credited to the individual accounts of voluntary pension funds was extremely high in 2022, exceeding even the highest level ever in 2021. Despite the exceptional global market environment, the contributions paid to pension funds increased reaching a record high in 2022. In addition to the general depreciation of assets, shrinking individual accounts were also the result of the payments made from individual accounts being considerably higher in 2022 than in 2021. The risk of outflows is not expected to decrease in the short term.

Voluntary pension funds achieved negative returns at sector level in the face of general asset depreciation, in particular a fall in the price of government bond portfolios which was driven by a significant increase in the yield curve. However, long-term (10 and 15-year) rates of return were positive. In the short term, there is still a risk to the sustainability of smaller institutions.

The MNB has identified problems with the quality of data reporting and the coverage of operations at some funds, and specific measures may be necessary for these institutions (e.g.: support from backup institutions; requiring liquidity reports; supervisory letter, targeted inspection).

The age of the membership of voluntary pension funds showed a steadily rising trend. The potential in member recruitment is yet to be fully tapped, and it is of utmost importance to reach out to the younger generations to at least halt the trend of membership ageing and to maintain the long-term sustainability of voluntary pension funds. Funds' products are cost-effective, but the conscious behaviour of members is essential to ensure that their savings are managed in line with the long-term objectives of pension funds.

Despite the extraordinary market effects, the number of complaints remained low and the institutions were able to handle customer enquiries effectively. However, negative returns could lead to an increase in the number of complaints.

4 Consumer protection risks in the pension funds market

4.1 A BROADENING RANGE OF TOOLS PROMOTING CONSUMER FOCUS

4.1.1 Product oversight and governance systems to be improved

The supplementing provisions of the Insurance Distribution Directive (IDD) on product oversight and governance requirements, i.e., Commission Regulation (EU) 2017/2358[14], applies from February 2018 to insurance undertakings and to insurance intermediaries that manufacture insurance products that are offered for sale to customers (manufacturers), as well as to insurance distributors that advise on, or propose, insurance products that they do not manufacture. The provisions apply to all products manufactured after 1 October 2018; however, all products must be monitored to detect any potential adverse effect regardless of the time of manufacturing. The provisions of the IDD also cover the product manufacturing and approval process; the definition of target market; product testing; product review; the actions expected after the review; distribution channels and the proper documentation of the whole process. The provisions are intended to ensure that the products meet the needs, objectives and characteristics of the target market at all times throughout the lifecycle of the products.

The topic was identified as a priority supervisory audit target area for 2022, so comprehensive audits included the assessment of product governance systems. In the course of its inspections, the Supervisory Authority found that insurers' product tests were standardised, there were no detailed assessments, and the narrative assessments were general in nature. Legislation stipulates that product reviews must be carried out regularly but at least once a year, but generally speaking, experience shows that reviews are conducted less frequently than once a year. It is important that insurers' tests of life insurance products include an assessment of premium waivers, surrenders, expected retentions, and that product testing focus on whether the product has any adverse effect on customers. In order to avoid adverse effects on customers, product oversight and governance systems need to be developed further, focusing on content rather than formal compliance.

4.1.2 Better positions for group insurance policyholders

The MNB continued to actively monitor group insurance policy sellers' activity to recruit and promote the entry of new insured persons, including the adequacy of the information provided to consumers. Group insurance can bring many benefits to consumers and market players alike, but proper information on the terms and conditions of the contract, in particular rights and obligations, before entering into a contract is very important to prevent consumer detriments.

In this context, the Court of Justice of the European Union (CJEU) made a number of important decisions in 2022. For example, the CJEU judgment of February 2022[15] clarified that, although pre-contractual information must be provided to the contracting party under the relevant provision of the fourth life insurance Directive, the applicable piece of legislation in the case in question, this rule must be interpreted as meaning that this information must also be communicated to consumers who subsequently accede to the group insurance contract concluded between the insurer and the undertaking which is the policyholder. The judgment also explained that, in the case of certain material information, failure to communicate it to the consumer acceding to a group contract is likely to constitute a misleading omission.

[14] Commission Delegated Regulation (EU) 2017/2358 of 21 September 2017 supplementing Directive (EU) 2016/97 of the European Parliament and of the Council with regard to product oversight and governance requirements for insurance undertakings and insurance distributors

[15] https://curia.europa.eu/juris/document/document.jsf?text=&docid=257989&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=10965217

The CJEU also addressed the issues of group insurance that (also) affect consumers in another judgment (see case C-633/20[16]) in which it concluded that a legal person whose activity consists in offering its customers membership (on a voluntary basis), in return for a payment that it receives from them, of a group insurance policy to which it has subscribed previously, is considered to be an "insurance intermediary" as defined in the IDD (Article 2(3)) and its practice that of an "insurance distributor" (Article 2(8)), even if not paid any remuneration by the insurer.

With regard to the Hungarian insurance market, the MNB has previously assessed group insurance contracting practices in a number of its resolutions, in which it developed and applied a set of criteria to determine when the activity of an undertaking concluding a group insurance contract with an insurer can be considered insurance mediation. In accordance with European trends, Hungarian regulations also adopted the definition of the activity in question, so it has become clear that facilitating accession to group insurance constitutes insurance distribution.

4.1.3 Strong supervisory focus on complaint handling

From a consumer protection point of view, one of the most important rights is the right to lodge a complaint because resolving disputes in any other procedure is much more costly and time consuming for customers. In 2022, the MNB received 291 insurance market-related and 17 funds sector-related consumer complaints requesting an investigation. A total of 3,882 customers contacted the Customer Service (in person, by phone, in writing), of these enquiries 3,702 concerned the insurance sector and 180 the funds sector.

As in previous years, the MNB paid particular attention to monitoring the complaints handling practices of insurers, both in its procedure upon consumer request and ex officio investigations. Shortcomings were mainly identified in relation to a narrowed interpretation of the concept of complaint, incomplete information on the possibilities of redress in the case of rejected complaints, and misinterpretation of the deadline for reply. In practice, insurers often have difficulties in determining whether a notification constitutes a complaint and, accordingly, the time limits and legal obligations applicable to their reply. In 2022, sharper supervisory focus was placed on this issue in the framework of examining insurers' complaint handling practices. Experience shows that insurers often narrow down the definition of complaint and do not consider some objections as a complaint. For example, enquiries disputing the legal basis or the amount of compensation or urging the payment of damages were at times not treated as complaints. An adverse outcome of this misclassification is that the time limit for dealing with complaints was not always respected and information on the possibilities of redress was not provided. Insurers must keep a record of the complaints received. Its role is twofold: on the one hand, it helps ensure that individual complaints are dealt with in a timely and appropriate manner, on the other hand, it enables the detection of recurring or systemic errors and the analysis of complaints. If complaints are only recorded in keywords with a sketchy description, the records will not be suitable for analysis. The MNB has therefore made the monitoring of records kept of complaints an integral part of its consumer protection inspections and found shortcomings in several cases.

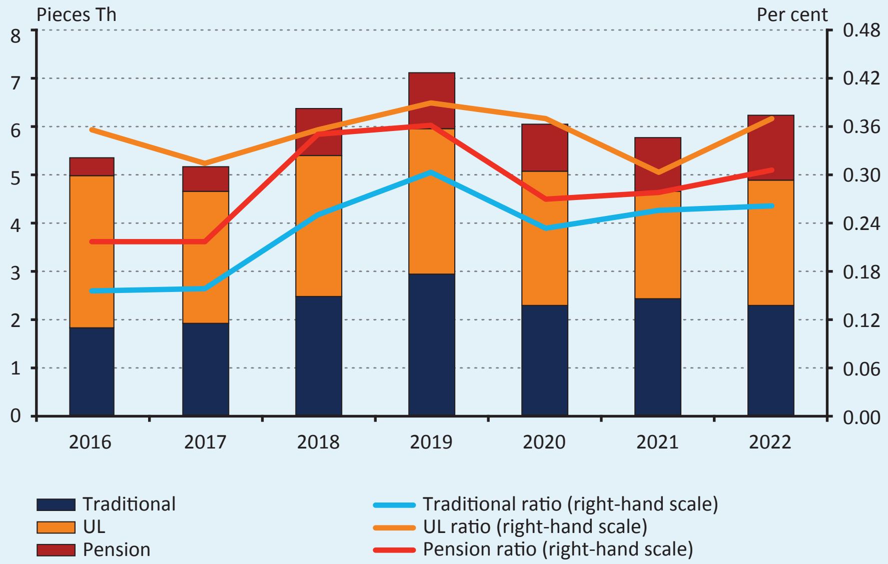
As in previous years, the number of complaints submitted to the MNB regarding the funds sector remained low. In addition, ex-officio inspections showed that the majority of the funds operated properly in terms of consumer protection, and that, with few exceptions, the shortcomings identified were not serious. This is largely due to the elaborate regulation of the funds sector and the fact that funds' products are one of the most accessible financial products. The majority of the shortcomings detected concerned the handling of complaints, in particular late or incomplete responses to complaints and, in the case of rejected complaints, incomplete information provided on remedies. As the ever more prevalent electronic solutions of the financial sector become increasingly widespread in our everyday lives, they also gain ground and become inevitable in the funds sector.

[16] https://curia.europa.eu/juris/document/document.jsf?docid=266563&mode=req&pageIndex=1&dir=&occ=first&part=1&text=&doclang=EN&cid=1884089

4.1.4 Moderate increase in life insurance complaints statistics

The ethical concept launched in 2016 continued to have an impact, with the number of savings-type life insurance policies with a recurring premium on the rise. In this context, unit-linked insurance and unit-linked insurance for pension purposes were gaining ground in contrast to traditional life insurance. However, the downward trend in the ratio of complaints related to life insurance halted in 2022, typically due to worse-than-expected investment results caused by the adverse environmental effects.

Chart 4.1
Number and ratio of life insurance complaints within the portfolio

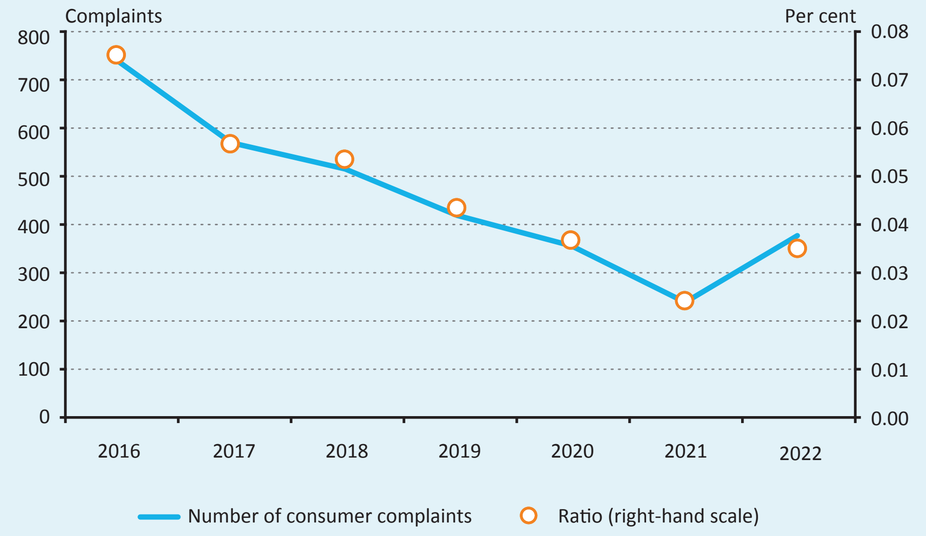


Note: Traditional and unit-linked (UL) categories net of pension insurances.
Source: MNB

Unit-linked (UL) insurance is arguably the most complex product in the life insurance market and the most difficult for consumers to understand. In addition to the complexity of the products, contracts are concluded for long periods of time which are difficult or impossible for consumers to plan for at the time of signing the contract. As before, the MNB continues to monitor complaints about UL products and the practical implementation of the ethical regulation.

As a result of the ethical approach, there was significant improvement in the number of complaints about UL products. However, this positive trend halted in 2022. The unfavourable investment climate, which raised the number of complaints concerning these products, contributed significantly to this phenomenon.

Chart 4.2
Number of consumer complaints related to the provided information prior to concluding the contract and to the intermediaries, and its ratio to the number of consumer contracts at unit-linked life insurances and unit-linked pension insurances



Source: MNB

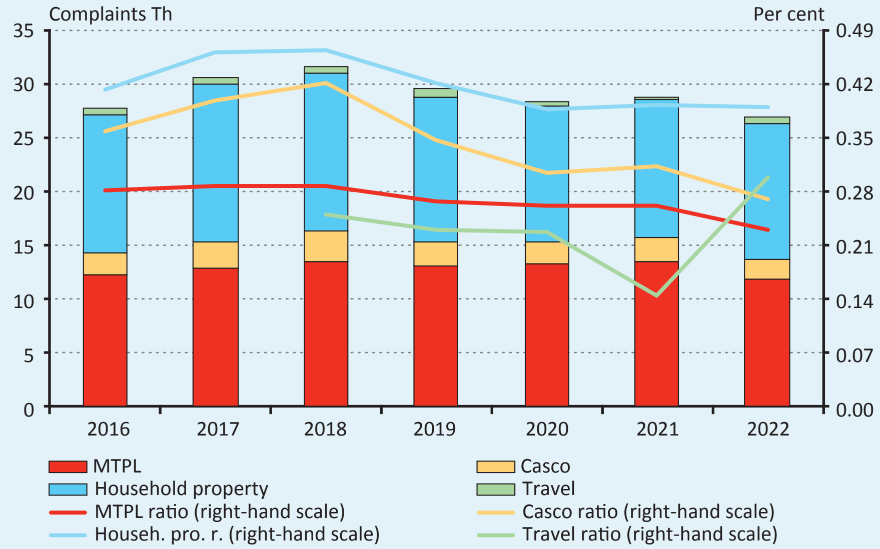
4.1.5 Non-life insurance continued to see a decrease in the number of complaints

As in recent years, the number of complaints in the non-life insurance sector continued to fall. This was facilitated by the MNB's regulatory activity and its extra-regulatory tools, such as recommendations, management letters and the qualified framework. Compared to the previous year, the number of complaints per policy for household property insurance stagnated in 2022, while the number of complaints per policy for MTPL and casco insurance decreased. The MNB consistently enforces and expects compliance with the law on information disclosure and claims settlement, and requires a consumer-friendly, consumer-oriented approach on the part of insurers.

In 2021, the Insurance Act was amended with a provision on claims settlement, similar to what had already been known with MTPL insurance. With the introduction of the claims settlement rules in legislation, the number of complaints registered in the non-life insurance sector is expected to decrease further, due to the tightened rules on information requirements.

For travel insurance products, the COVID pandemic caused a sharp drop in the number of policies in 2020-21, but with the lifting of restrictions in 2022 travel appetite returned. This also led to an expansion of the travel insurance market. This market expansion was accompanied by an increase in the number of complaints which exceeded the number of contracts. Customers typically complained about the rejection of claims and the size of compensation. These complaints were largely attributable to the fact that policyholders did not always understand under what conditions and what risks are covered by their insurance.

Chart 4.3
Number and ratio of non-life insurance complaints

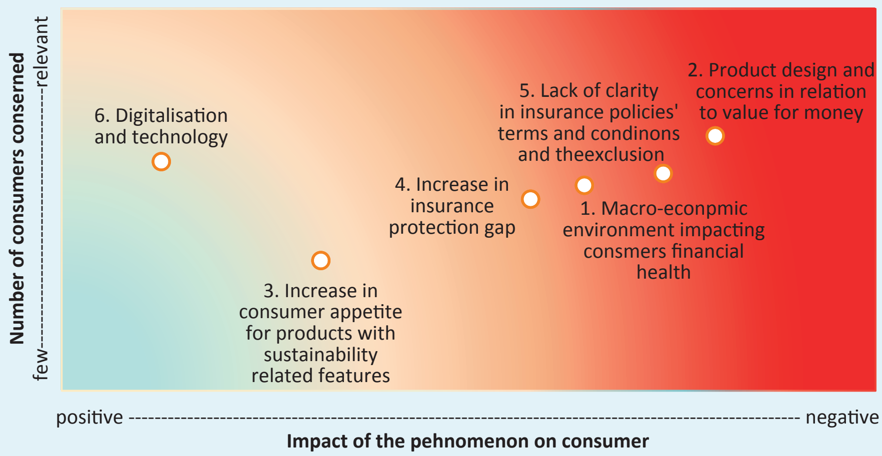


Source: MNB

4.1.6 Heat map on consumer risks and trends

From 2021, EIOPA complements its annual report on consumer trends with a visual heat map of the main issues identified by national authorities. This graphical matrix illustrates the impact of a given phenomenon on consumers, i.e. whether the impact is adverse or beneficial, or whether the outcome may vary depending on the circumstances. The map also indicates whether the risk or phenomenon affects a relatively small or large number of consumers. The annex to the Consumer Trends Report 2022[17] shows the risks identified in EU countries as follows.

Chart 4.4
Heat map of the key findings of the EIOPA's 2022 Consumer Trends Report



1. Macro-economic environment impacting consumers' financial health
2. Product design and concerns in relation to value for money
3. Increase in consumer appetite for products with sustainability related features
4. Increase in insurance protection gap
5. Lack of clarity in insurance policies' terms and conditions and the exclusions
6. Digitalisation and technology

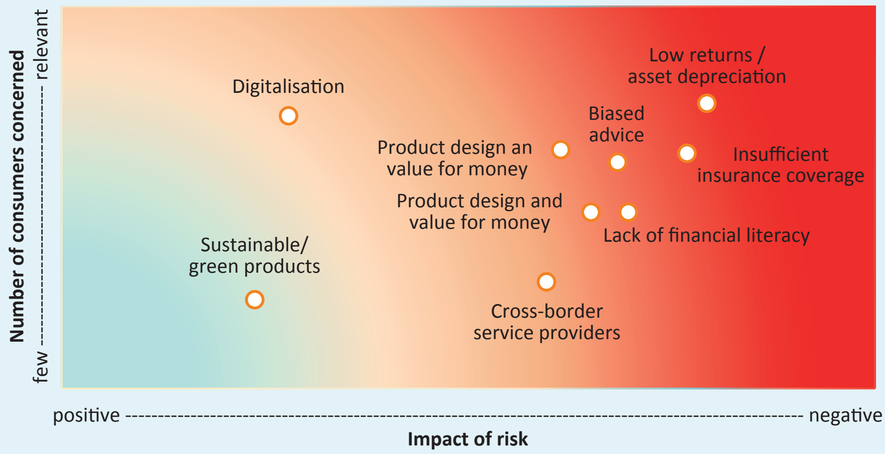
Source: MNB

[17] Heat Map of the key findings of the 2022 Consumer Trends Report: https://www.eiopa.europa.eu/system/files/2023-01/heat_map_of_the_key_findings_of_the_2022_consumer_trends_report.pdf

The EIOPA heat map, based on feedback from Member States, reflects the macroeconomic environment affecting consumers' financial situation, in particular the impact of inflation which has had a direct effect on consumers' daily lives and finances. Also well reflected at EU level are the continuing problems and risks related to insurance-based investment products, which, in some cases, have resulted in poor value for money products because of inadequate product oversight, particularly when coupled with high commissions. The experience of Member States has also shown a growing interest in sustainable investment, while several authorities have reported the phenomenon of greenwashing, which is harmful to consumers. Also problematic in many cases is the over-complexity of products, the lack of clarity of general terms and conditions, in particular as regards exclusions. Digitalisation has also had a significant impact on EU markets, with an overall positive impact for consumers by simplifying processes and decreasing costs, according to the EIOPA survey.

As the phenomena affecting consumers have different impacts and weights in the domestic insurance market, the MNB has also prepared a domestic heat map of the most relevant phenomena observed and identified in the recent period, which shows the risks involved and their significance along two dimensions.

Chart 4.5
Heat map of the risks affecting Hungarian consumers



Source: MNB

Based on the experience of the MNB, a significant number of consumers in Hungary have been adversely affected by the recent rise in inflation, which affected the return on savings and brought about an increase in the cost of living. It could also lead to underinsurance in some cases, in particular when insurance products are cancelled, their purchase is postponed or when insurance amounts are not adjusted appropriately.

In line with the Union-wide experience, concerns have been raised about the adequacy of insurers' product design and oversight practices and the design of products with acceptable value for money, and investigations have also found that consumers were not always fully aware of the covers and exclusions the insurance products they bought entailed. In this context, complex insurance products and overly complicated product terms and conditions continue to be a frequent problem, making it difficult to arrive at an informed decision on the purchase of insurance products, and sometimes (for example in the case of credit protection insurance) consumers may be sold products that offer poor value for money.

Adequate information and financial awareness are essential for prudent financial decisions, the lack of which can also have a negative impact on consumers, especially in the case of complex insurance coverage and insurance-based investment products, a phenomenon that is also felt in the domestic market. Biased sales due to intermediary conflicts of interest and high commissions, as well as mis-selling continue to be a problem for consumers. Financial service providers offering cross-border services can significantly diversify the range of available products and stimulate competition. This can bring many benefits for domestic consumers, but there may also be risks and disadvantages in choosing a foreign provider that require particular attention, especially if any dispute arises between the parties.

4.2 LIFE INSURANCE

4.2.1 New EU rules: taking sustainability preferences into account in suitability assessments

Insurance distributors have to take into account customers' sustainability preferences when offering insurance products from 2 August 2022. This is when the EU regulation amending two delegated (level 2) regulations of the Insurance Distribution Directive (IDD) came into force, requiring insurers and insurance distributors to take into account sustainability factors, risks and preferences.

Sustainability considerations need to be taken into account when complying with product oversight and governance requirements, when designing and approving products, and when testing and backtesting them. As a result, assessing the satisfaction of sustainability preferences has become part of the sale of insurance-based investment products through advising, including the rules pertaining to the suitability assessment.

Suitability assessment is one of the key requirements of the IDD's consumer protection provisions, which ensure that insurers and insurance intermediaries providing advice are able to provide the best quality advice and recommendations to their customers as to which products are (the most) suitable for them based on their personal circumstances. The new legislative provisions aim to ensure that retail investors can invest and save in a sustainable way and to facilitate their more effective participation in the transition to a more sustainable, resource-efficient and circular economy, in line with the EU's sustainable development goals.

As a third-level regulatory tool, EIOPA has developed guidance[18] with recommendations for market participants and competent supervisory authorities, including on how insurance distributors advising on insurance-based investment products should help customers understand the concept of their "sustainability preferences" and the decisions to be taken in this respect, how and when to assess the customer's sustainability needs and update information on customers' sustainability preferences.

It is important to note that regulatory initiatives are underway to identify and properly disclose investments in sustainable economic activities, while at the same time market participants are expected to responsibly fulfil their sustainability disclosure and information obligations based on the data currently available, and to do their utmost to ensure good data quality.

4.3 NON-LIFE INSURANCE

4.3.1 Efficient, customer-friendly claims handling still expected

The new provisions of the Insurance Act on claims settlement entered into force on 26 June 2021. Accordingly, the insurer must make a duly substantiated proposal for compensation to the person entitled to the service within 15 days of receipt of the documents necessary for the settlement of the claim, or, failing this, within 1 month of the submission of the claim at the latest. If the insurer does not acknowledge the obligation to provide the service, or it is not clear or has not been quantified yet, a reasoned reply must be given to the injured party within the time limit referred to.

In order to check whether market participants have properly incorporated the new legal provisions introduced in close cooperation between the legislator and the central bank, the MNB conducted a thematic inspection at six insurers. The inspection covered the settlement of claims for non-life insurance products during which the MNB reviewed the documents that provide information on claims settlement and the information provided to injured customers. During the inspection, the MNB found that the new legislation had been integrated into the claims settlement practices of insurers, and for the most part the information required was provided within the statutory deadline. The overall picture was found

[18] Guidance on the integration of sustainability preferences in the suitability assessment under the Insurance Distribution Directive (IDD): https://www.eiopa.europa.eu/publications/guidance-integration-customers-sustainability-preferences-suitability-assessment-under-idd_en

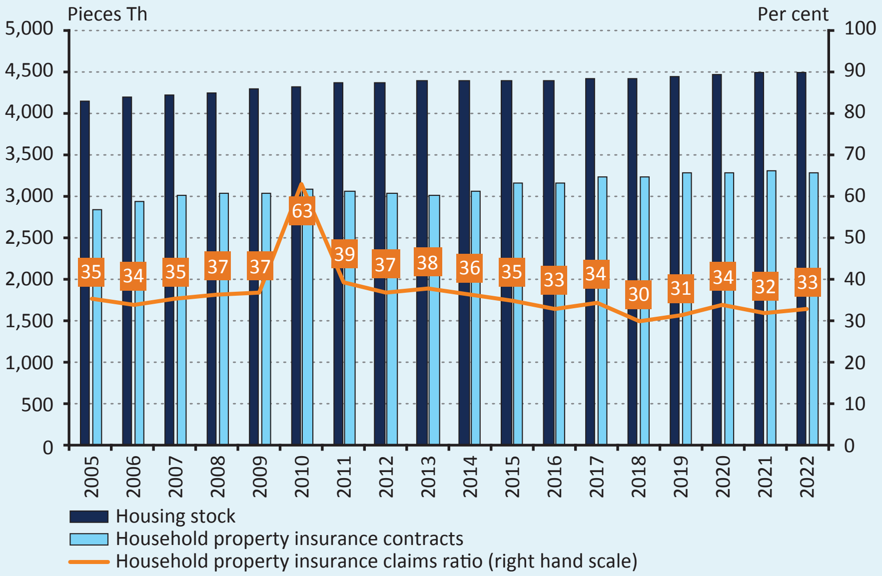
to be positive, with claims settlement basically being appropriate, but there were differences in adaptation to the new legal environment, preparedness and implementation. The MNB's main objections were related to the quality of the information provided by insurers to injured customers, as in several cases the information did not contain sufficiently detailed compensation proposals, and sometimes the injured parties were only informed about the final amount of compensation. However, it is essential that the information also include sufficient justification to make it clear to the customer what amounts the insurer has established per claim. The MNB also raised concerns about insurers not giving the required justification when not acknowledging the obligation to provide the service or not quantifying the service. In such a case, the insurer must provide a reasoned reply to the policyholder presenting the facts and data discovered by the insurer and the conclusions it draws from them. The customer can make an informed decision on whether or not to seek redress in other forums, based on the reasons given. In several cases, the MNB also found that insurers sought to fulfil their obligation to provide information by sending a letter inviting the customer to provide additional information or clarification within a short timeframe after the claim had been filed, and only specified the documents to be submitted but did not give the justification required by law. The MNB considers it to be very important that insurers not only comply with the statutory information requirements during a lengthy claim settlement, but also maintain continuous contact to ensure that injured customers are kept up to date on the settlement process.

Based on the findings of the inspection, the MNB believes it necessary to develop a set of practical expectations in support of the statutory claims settlement rules, which will assist insurers in their claims settlement procedures, facilitate an understanding of the legislation and clarify the structure of a claims settlement process the MNB considers to be good practice.

Box 4.1
Certified Consumer Friendly Home Insurance (MFO) to improve the home insurance market

The home insurance market is inefficient because of weak competition. The persistently low loss ratios and high cost ratios are indicative of weak competition. The loss ratio averaged around 32 per cent over the last five years, implying a poor incurred claim ratio compared to the past and also by international property insurance standards.[19]

Chart 4.6
Trend of the claims ratio for household property insurance

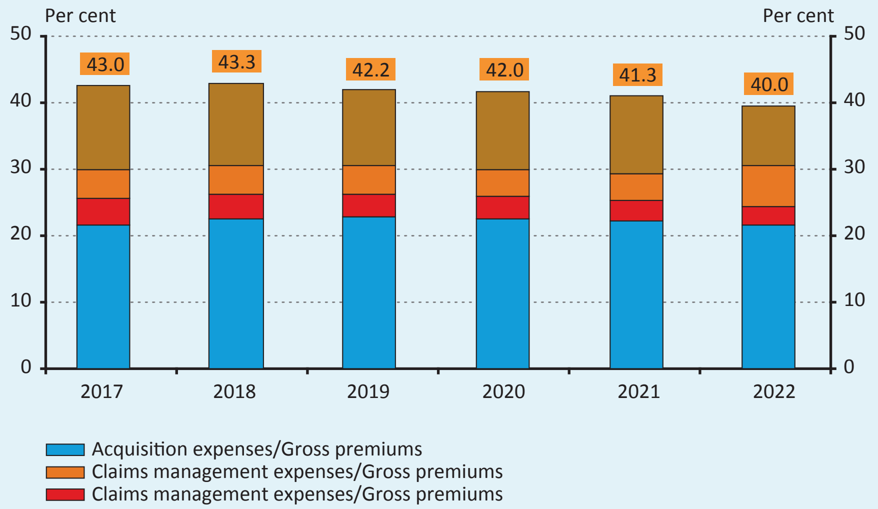


Source: HCSO, MNB

[19] In 2010, the very high loss ratio of 63 per cent was due to the damages caused by extreme weather conditions (stormy winds that swept across the country) in that year.

With the average cost ratio of 42 per cent over the past five years exceeding the incurred claim ratio, running these products is costly relative to their social benefits. Since the introduction of the rating scheme in 2019, competition has intensified encouraging the uptake of products with a higher customer value.

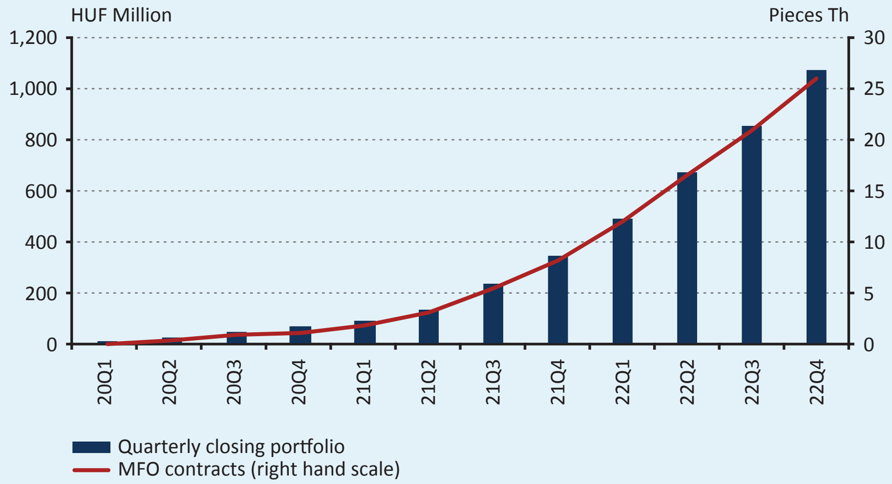
Chart 4.7
Fire and any other household property expense ratios



Source: MNB

2022 was another significant year for Certified Consumer Friendly Home Insurance (MFO), with four institutions receiving MFO certification during the year. By the end of 2022, a total of eleven insurers offered MFO products on the market, so in terms of premium income, a good 90 per cent of the home insurance market offers MFO. According to year-end data in 2022, there were a total of 26,006 MFO policies held by insurers offering such certified products, which represents HUF 1,076 million in premiums and HUF 1,097 billion in insured assets.

Chart 4.8
Trends of MFO (Certified consumer friendly household insurance) contracts and closing portfolio



Source: MNB

Weak competition in the home insurance market was also noticed by the legislator and measures were taken to increase it. In this context, from 30 April 2023 a government decree[20] regulates the rate of commissions earned for home insurance (up to 20 per cent), and the legislator also introduced the possibility of cancellation once a year, during March, in addition to the insurance anniversary. In the case of home insurance policies taken out at the time of mortgage lending by banks, the policies taken out practically centred around the products of the strategic partner insurer, so the Government Decree requires that the customer be presented with the MFO calculator available on the MNB website[21] when taking out a mortgage loan, thus stimulating competition in the banking sales channel as well.

4.4 CHALLENGES FOR CROSS-BORDER SERVICES

4.4.1 Gradually phased out portfolios after Brexit

In recent years, monitoring compliance with the MNB's expectations for 2020 in the context of the UK's exit from the European Union (Brexit) has become a regular supervisory task. In the specific legal situation that emerged after Brexit, the MNB has sought to find a solution that ensures that the interests of domestic consumers are protected and their contractual rights are fully respected.

The MNB's expectations are as follows:

– a ban on new contracts and on extending the duration of and the scope of services covered by existing contracts with full respect of consumer rights under the existing contracts;

– termination of existing contracts upon the first opportunity under the contractual terms;

– native language customer service and complaint handling maintained throughout the duration of contracts;

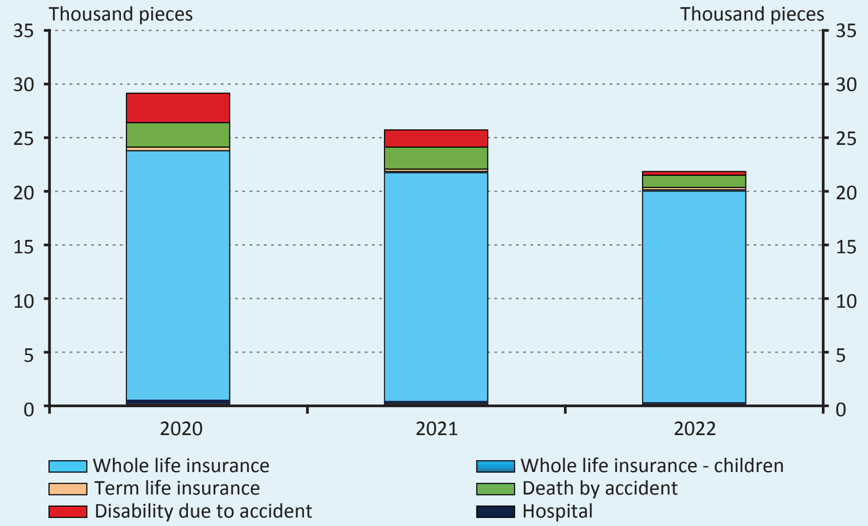
– regular data reporting to the MNB from the beginning of 2021.

The MNB is in contact with all UK-based insurers that are present on the Hungarian market through cross-border services. The MNB's main objective is to ensure the orderly phasing-out of the contract portfolios which it monitors on an ongoing basis through regular data reporting.

Experience of recent years shows that the number of insurers managing Hungarian consumer contracts – initially 20 in the year of Brexit – and the number of their contracts of Hungarian concern is gradually decreasing. Importantly, thanks to the MNB's continuous monitoring activities, the legal framework changed due to Brexit did not have a direct and significant negative impact on Hungarian consumers in 2022.

[20] Government Decree No 25/2023 (II. 1.) on certain contingency rules applicable to property insurance contracts
[21] https://minositettotthonbiztositas.mnb.hu/mfo/kalkulator

Chart 4.9
Reduction in the number of contracts at the insurer with the largest portfolio



Source: MNB

Only 6 of the institutions concerned had consumer contracts, a total of 21,930 contracts and a premium income exceeding HUF 2.1 billion in 2022. In terms of both number of policies and premiums, almost all contracts are determined by the portfolio of one insurer. For all these reasons, the MNB is keeping a close eye on the activities of the largest cross-border insurer which continues to manage a significant consumer portfolio of 20,000 contracts even after Brexit, but the MNB has not identified any consumer protection risk for this insurer in 2022.

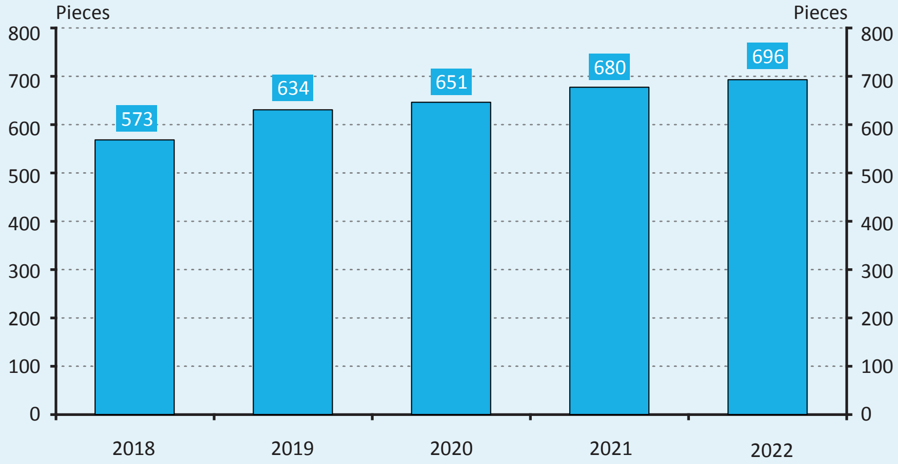
4.4.2 Findings regarding the activities of cross-border insurers

In the case of cross-border services, if an insurer established in another Member State violates the statutory consumer protection rules in force in Hungary, the MNB will require the insurer to rectify the irregular situation.

The MNB examines the activities of cross-border insurers to determine whether they comply with the consumer protection provisions in force in Hungary, i.e., among others, the provisions of the acts listed in Article 39 of the MNB Act and of their implementing pieces of legislation which establish the requirements of conduct towards consumers using the service, and the provisions of the Act on the Prohibition of Unfair Commercial Practices towards Consumers. Overall, the MNB checks whether the insurer satisfies the legal requirements of this activity, the so-called General Good[22] rules, which fall under the concept of public good or public interest. The MNB uses the notifications sent by consumers to the MNB Customer Service for the purpose of its consumer protection supervision. Changes from 2018 to 2022 in the number of cross-border service providers registered with the MNB and involved in the so-called notification procedure is illustrated in the chart below. The chart shows that the number of insurance companies that are registered in Hungary and thus may provide insurance services is steadily increasing.

[22] Information on the conditions of providing services in Hungary (general good) (mnb.hu)

Chart 4.10
Trends of the number of insurance institutions providing with cross-border services



Source: MNB

The MNB will continue to pay particular attention to consumer complaints about cross-border service providers. In several cases, the MNB received notifications from customers that raised suspicion of breach of consumer protection provisions, and started investigating them in a procedure initiated upon consumer request or, where appropriate, in a targeted consumer protection inspection. In 2022, the Supervisory Authority carried out targeted consumer protection inspections at three cross-border service providers and one branch in response to customer notifications.

Customers complained with regard to several service providers claiming that they did not meet the legal requirements of complaints handling, such as failure to meet the statutory deadline for responding to complaints, to fully investigate complaints, or to inform customers for months if their claim has been accepted or rejected in disregard of the provisions of the Business of Insurance Act.

The MNB also identified inappropriate practices regarding information on the modification of the terms and conditions by an insurer providing cross-border services and the fulfilment of obligations to provide information during the period of insurance. In some cases it was not clear to the consumer before entering into an insurance contract who the cross-border service provider was or that the service was provided under an insurance contract.

In addition to the above problems, many ex-officio inspections also focus on identifying misleading commercial practices to ensure that service providers provide accurate and clear information to consumers in accordance with the relevant legislative provisions and that their practices are in compliance with the law.

During 2022, the MNB closed one targeted inspection in which it examined a branch of an insurer and imposed a consumer protection fine also requiring the branch to end its unlawful practices regarding the information provided to customers and complaints handling. The inspection found that the insurer did not properly carry out a needs assessment when selling unit-linked life insurance products. The Supervisory Authority also found shortcomings in the provision of information to customers and in registering and handling complaints.

4.5 INTERNATIONAL CONSUMER PROTECTION ACTIVITY

As a member of the EIOPA Committee on Consumer Protection and Financial Innovation (CCPFI), the MNB monitors updates that are relevant from a consumer protection point of view.

In both domestic and Union-wide supervision, there is a growing emphasis on supervisory tools that enable the gathering of information on market practices from a wide range of sources and allow rapid and effective intervention in the financial markets. To further support effective enforcement and to facilitate enhanced cooperation between the national authorities, EIOPA was given a new mandate in January 2020 to carry out coordinated mystery shopping, and a general approach to implementing a coordinated cross-country exercise has been developed[23].

4.5.1 EIOPA Consumer Trends Report

As in previous years, EIOPA published its Consumer Trends Report[24] (CTR), which was innovative in that in addition to a report with comprehensive analyses and a heat map, the visual representation of the most significant phenomena, it also included the aggregated results of a Eurobarometer survey. The 2022 report focused on the various trends affecting financial health which has become an increasingly important priority due to recent crises (COVID19 outbreak, increase in the frequency of natural disasters, the situation in Ukraine, inflationary conditions).

Current macroeconomic trends (notably inflation) have a direct impact on the financial situation of consumers, especially that of vulnerable groups. The rising cost of living reduces disposable income, so some groups of consumers may find it difficult to pay recurring premiums, forgo protection or buy back their savings. The report concludes that the potential pension gap could increase due to the low penetration of occupational pension institutions and personal pension products (PPPs) as well as the current macroeconomic environment.

Surveys show that consumer demand for sustainability investments continues to grow, with insurers and pension providers increasingly presenting their products as sustainable. Eurobarometer results indicate that around a quarter of European consumers have heard of sustainable or “green” insurance products. A problem can arise if these claims are misleading or unsubstantiated, leading to greenwashing. In some Member States, evidence of greenwashing has also been found.

Regarding the insurance protection gap, national reports and the Eurobarometer survey have strongly highlighted the phenomenon that natural disasters, cyber attacks, pandemics and other systemic events have increased the risk of the protection gap, both for consumers and SMEs. According to a Eurobarometer survey, more than 1/3 of European consumers have no savings products, including insurance-based investment products and other savings for retirement. Although the proportion of EU consumers who do not have an insurance product is significantly lower (8%), this figure is significantly improved in all Member States by compulsory motor insurance (58%) and household insurance (63%). One of the key findings of Eurobarometer is the gender gap, i.e., that female consumers tend to have less access to insurance and pension products.

The lack of clarity of the contractual terms for certain products, in particular as regards exclusions, remains a problem. A lack of financial literacy can further complicate the understanding of the terms and conditions and exclusions, and can also widen the protection gap through unclear, opaque contractual terms and the terms and conditions of exclusions. Problems of poor value for money also persist. Insurance distributors play a vital role in assessing consumer needs and ensuring that products offer real value to consumers, but past mis-selling and poor advice can have a significant impact on consumer confidence. According to surveys, in June 2022, almost 65 per cent of European consumers thought it was difficult to get unbiased advice.

[23] https://www.eiopa.europa.eu/browse/consumer-protection/mystery-shopping-tool-conduct-supervision_en
[24] EIOPA Consumer Trends Report 2022: https://www.eiopa.europa.eu/publications/consumer-trends-report-2022_en

Member States reported that there have been a number of digital initiatives in recent years where the pandemic acted as a catalyst. While the increasing digitalisation of the insurance and pensions sector could lead to a positive and improving financial situation, an analysis of the phenomena raises concerns about discriminatory pricing practices, the exclusion of less tech-savvy consumers, data protection and cyber risks.

Box 4.2
EIOPA warning – better value for money needed for credit protection insurance

The European Insurance and Occupational Pensions Authority (EIOPA) has issued a warning to national insurers and banks about consumer protection issues related to the sale of Credit Protection Insurance (CPI) products. The aim is to ensure that credit protection insurance products offer consumers fair value for money. The warning is based on an EU-wide thematic inquiry into the functioning of the EU market for CPI products sold together with mortgages, consumer credit and credit cards. The investigation revealed a number of practices that are harmful to consumers and do not serve their interests. Many of the findings stem from inadequate underwriting and sales practices and insufficient safeguards to avoid conflicts of interest.

Limited choice and restrictions on **sourcing multiple offers**: 83 per cent of banks link credit protection insurance to their main loan product. Cross-selling practices, which have become widely popular, empty the theoretical rule that consumers are free to combine credit products offered by banks with credit insurance products from any provider.

Large product range and price differentiation: From a consumer protection perspective, there is a significant risk that there are significant differences in the features, terms and conditions and coverage of individual CPI products. This makes it difficult for consumers to compare products and make informed decisions. Prices for similar CPI products vary widely not only between countries but also within countries.

Problems related to cancellation and switching: Consumers find it difficult to switch supplier and the subsequent cancellation process for existing CPI contracts. According to 43 per cent of insurers, consumers must ask the bank for consent and meet certain conditions to cancel their contract.

High remuneration and conflict of interest: The sale of CPI products is a highly profitable business for both insurers and the banks that distribute them. A significant proportion of the gross premiums paid by consumers are passed on to banks and insurers in the form of commissions, while consumers receive little compensation. High commissions can lead to significant and damaging conflicts of interest and bad business practices aimed at maximising profits.

Such practices carry the risk that insurers and banks may not properly apply the basic regulatory principles set out in the Insurance Distribution Directive (IDD). EIOPA expects all insurers and banks operating as insurance distributors to fully comply with the IDD, including product oversight and governance (PoG) requirements, and to take measures to address high remuneration issues and prevent harmful conflicts of interest. EIOPA expects the industry to improve the consumer outcomes of CPI products by ensuring that these products meet the needs of the target market. EIOPA has called on national supervisory authorities to monitor the actions taken by insurers on this issue as well as their effectiveness, and to take appropriate action where necessary.

4.5.2 Summary of the EIOPA supervisory statement on differential pricing practices

EIOPA has produced an own-initiative supervisory statement on differential pricing practices (EIOPA Statement[25]), which addresses the insurance sector's practice of charging different prices for consumer contracts with similar risks (and cost structures for the same or similar services). The EU authorities have so far approached the issue of price optimisation with caution, given the freedom of contract and the fact that while many jurisdictions still have a system of prior approval of premiums, this practice was abolished in the EU by the third generation of insurance directives in the 1990s.

The EIOPA Statement focuses on differential pricing practices for non-life insurance products for retail customers, irrespective of risk and cost. The impact of the practice on consumers is mainly that the use of artificial intelligence (AI) and Big Data will allow insurance companies to increasingly tailor the premiums paid by consumers to their personal behaviour and characteristics, which may be of particular concern for the most vulnerable groups of consumers. Low willingness to switch or buy often results in "punitive" pricing for customers (so-called "price walking").

The document stresses that insurers are free to set their prices and give discounts to consumers and that risk-based pricing practices, including risk equalisation/risk sharing practices, are not covered by the statement. However, under the EU legal framework, they can only place on the market products that are in line with the needs, objectives and characteristics of the target market and do not unfairly discriminate between consumers within the target market. The following expectations/proposals are put forward to market players:

– The use of thresholds to keep tariff differentials within limits, as well as transparent information on the possible level of tariff increases, the use of the AI mechanism and the provision of human oversight of the process.

– Prior to product approval, it is necessary to define the appropriate target market and product testing is also expected when the product is renewed.

– Product monitoring and review should include appropriate metrics to monitor the adverse impacts on consumers, including vulnerable groups, and measures to mitigate adverse impacts are expected to ensure that pricing practices do not lead to unfair outcomes for consumers.

– Documentation of product oversight processes should be sufficiently detailed to ensure accountability, especially for AI applications.

4.5.3 EIOPA Costs and Past Performance Report for retail investment products

To enhance transparency and improve investor protection, the European Supervisory Authorities (ESAs) publish an annual report on the performance and costs of the retail investment products under their responsibility (Costs and Past Performance Report[26]).

For the analysis, EIOPA used data on costs and performance over the previous five years (2017 to 2021) provided by national institutions, including data on the costs and revenues of more than 1,000 insurance-based investment products (IBIPs), the products of 170 companies, more than 200 personal pension products (PPPs), around 1.7 million contracts, and more than 162,000 products marketed by more than 1,400 European Institutions for Occupational Retirement Provision (IORPs). The main findings and conclusions of the report are the following:

[25] Supervisory statement on differential pricing practices in non-life insurance lines of business: https://www.eiopa.europa.eu/publications/supervisory-statement-differential-pricing-practices-non-life-insurance-lines-business_en

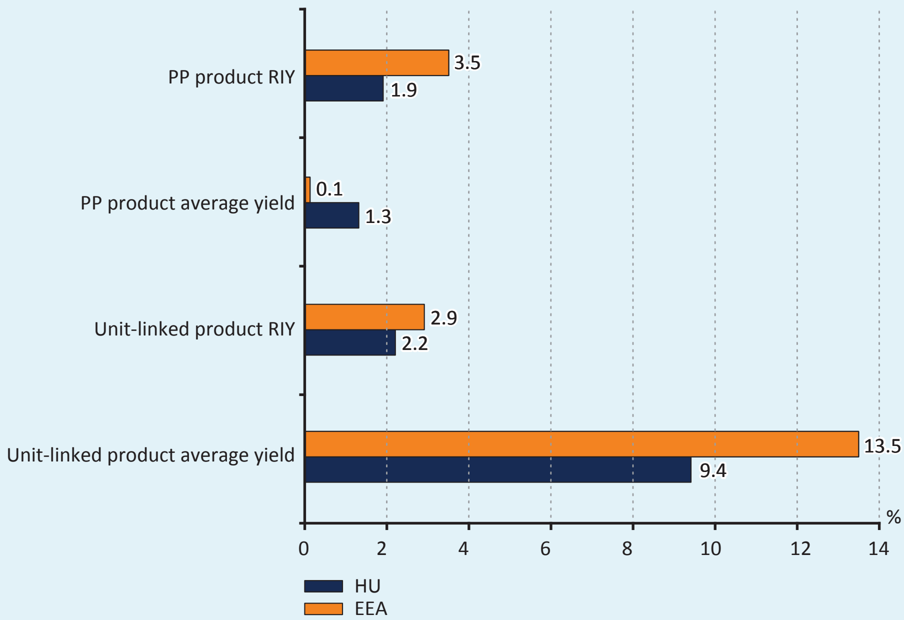
[26] EIOPA's Costs and Past Performance Report 2023: https://www.eiopa.europa.eu/publications/costs-and-past-performance-report-2023_en

– In the European Economic Area (EEA), insurance-based investment products performed positively, with unit-linked (UL) products averaging a net return of 9.4 per cent, hybrid products averaging 4.0 per cent and profit-sharing (PP) products averaging 1.3 per cent, adding to the results that UL products are significantly more volatile and therefore outperform when market trends are favourable;

– Demand for sustainable products is growing and, based on the sample and the surveyed insurers' own assessment, products with sustainability features (ESG products) currently performed slightly better, while being cheaper overall than non-ESG products: the 226 unit-linked ESG products in the sample collected in 2021 had a weighted net return of 11.2 per cent compared to a weighted net return of 9.4 per cent for non-ESG UL products, and despite a more significant difference in some countries, the overall reduction in yield (RIY) ratio was 2.1 per cent compared to a non-ESG RIY of 2.3 per cent.

– However, products sold across borders (based on a narrowed sample) were on average more expensive than products sold on the domestic market, which the report attributed to the cost of building distribution networks.

Chart 4.11
Reduction in yield (RIY) for the unit-linked and profit-participation products (PP) in the EEA and in the domestic market (in 2021)



Source: EIOPA's Costs and Past Performance Report 2023, Table 3, 5, 17, 19

Box 4.3
EIOPA statement on exclusions for risks arising from systemic events

Recent events (pandemics, climate change, war, cyber attacks) have highlighted the potential for the emergence or growth of financial risks that could be detrimental to consumers and ultimately to the sector as a whole. Some covers may be excluded from insurance, making them unavailable in the future or become extremely expensive, which can increase both the lack of protection and financial vulnerability. The complexity of insurance products and sometimes the lack of clarity of contractual terms can also create additional risks. Following an analysis of the emerging risks and a public consultation on the issue, EIOPA has summarised its proposals in a supervisory statement[27] (EIOPA Statement2) to indicate its expectations to product manufacturers on the development and review of products.

The main expectations set out in the EIOPA Statement2:

– Product manufacturers are expected to assess the terms and conditions of insurance and the scope of existing cover in the event of systemic events, with particular regard to the needs, objectives and characteristics of the target market.

– Vague, difficult to understand wording about the actual cover provided should be avoided, and the definition of excluded events should not be too general, but should be presented in a way that (lay) consumers can clearly understand the exact scope of exclusions.

– In the course of the sale, it is necessary to properly and duly assess what exclusions are included in the contractual terms of the product offered in relation to the consumer’s needs and requirements.

– In the case of new product development or significant changes, particular care should be taken to ensure that the definition of target markets is at least as detailed as the presentation of exclusions from cover.

– It is also necessary to test the effectiveness of the planned customer communications and the different sales channels in the light of the characteristics of the target market.

– Regular reviews of products should monitor changes in the risk profile of the target market, as well as monitor the phenomena arising from exclusions (e.g. rates and reasons for claim rejections, evolution of the number of consumer complaints, etc.) and adjust product terms and conditions, information practices and sales strategy accordingly.

[27] EIOPA Supervisory statement on exclusions in insurance products related to risks arising from systemic events: https://www.eiopa.europa.eu/publications/supervisory-statement-exclusions-insurance-products-related-risks-arising-systemic-events_en

5 Intermediaries and their risks[28]

5.1 INSURANCE INTERMEDIARIES

5.1.1 Unbroken concentration in the intermediary market

Table 5.1
Key data of insurance intermediaries

	Insurance intermediary	
	2021	2022
Number of institutions*	398	378
Broker	*358*	*339*
Multiple agent	*40*	*39*
Number of natural persons (persons)	12 385	11 935
Commission income (HUF billions)	103,7	111,7

Note: The number of insurance intermediaries includes institutions registered as insurance intermediaries and carrying out insurance intermediary activities as their core activity, as well as institutions registered based on other core activity and also carrying out insurance intermediary activities.
Source: MNB

Following the trend started in 2019, the number of institutions licensed as insurance intermediaries continued to decrease in 2022, but at a more significant rate of 5.0 per cent, reversing the slowdown of the previous year (Table 5.1). In addition to compliance with legal requirements, the steady decline is due to the impact on intermediaries of the measures taken in 2022 to address the adverse economic and war situation, which also affected the insurance sector. The concentration also reflects the return of brokers' licences following portfolio transfers. Despite the declining number of intermediary institutions, income from commissions and remuneration for insurance sales went up by 7.7 per cent in 2022 compared to 2021.

[28] Intermediaries are legal entities that are licensed by the MNB in the insurance or financial market and sell competing products in a given product group. If otherwise, it will be specifically indicated.

5.1.2 Increase in non-life offset the decrease in life

Table 5.2
Sales data of insurance intermediaries

	Value of contracts HUF billions		Number of contracts pcs		Commission income HUF billions	
	2021	2022	2021	2022	2021	2022
Non-life insurance segment	183.1	**195.3** ↑	2,208,059	**2,468,111** ↑	76.4	**81.0** ↑
Compulsory motor third-party liability insurance	97.2	98.7	1,492,552	1,540,064	N/A	20.3
Home insurance	5.6	6.1	120,272	114,761	N/A	9.1
Casco motor liability insurance	33.7	38.2	203,833	203,289	N/A	13.9
Corporate and institutional property insurance	29.5	33.9	53,990	48,566	N/A	23.9
Travel insurance	3.1	4.4	166,193	365,460	N/A	1.6
Other non-life insurance	14.0	14.0	171,219	195,971	N/A	12.1
Life insurance segment	53.1	**47.8** ↓	132,640	**115,138** ↓	27.2	**30.3** ↑
Risk (death) life insurance [Traditional life insurance before 2022]	4.3	3.6	69,217	60,350	N/A	6.0
Life insurance with saving aim	47.4	43.1	N/A	53,643	N/A	19.9
of this: Unit-linked life insurance	N/A	38.8	60,813	46,275	N/A	17
of this: Traditional life insurance	N/A	4.3	N/A	7,368	N/A	2.9
Other life insurance		1.0	2,610	1,145	N/A	4.4

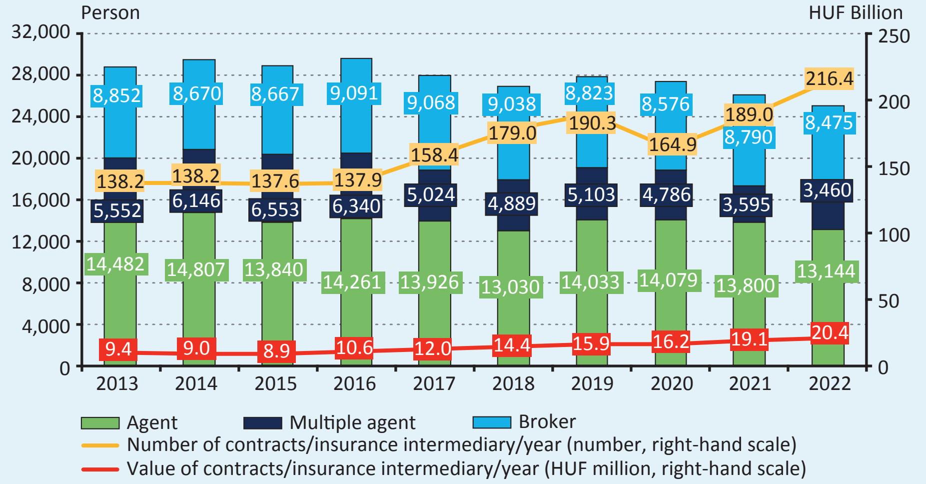
Source: MNB

From 2022, the regular data reporting of insurance intermediaries also track remuneration figures for the premiums and the number of contracts brokered, thus it is possible to analyse remuneration by individual product group and the periodic changes in remuneration by product to promote the deepening of risk-based supervision based on data reporting. Another change in the content of data is that the previous traditional/unit-linked/other structure of life insurance has been extended and clarified, thus facilitating the classification of brokered products. As a result of these amendments, the data ranges in tables at product group level are now more comprehensive; however, figures from previous regular data disclosures relating to 2021 are not available for this new scope of data. The market of brokered insurance products presented a mixed picture in 2022, with non-life insurance showing a rise in premiums and the number of policies, while life insurance was on the decline, with only remuneration and income from commissions for brokered policies increasing in both segments (Table 5.2). In 2022, travel appetite increased spectacularly, with the premiums brokered for travel insurance up 41.8 per cent. The 365,000 policies suggest that the pre-pandemic figure of nearly 450,000 could be within reach in 2023. However, this growth was driven by an increase of over 10 per cent in the contract value of brokered casco and business insurance despite a decline in the number of policies. The increase in average premiums may be partly explained by the impact of inflation and a more accurate and broader coverage of risks in business insurance. 2022 did not favour life insurance sales as both the value and the number of contracts brokered dropped by more than 10 per cent, while remuneration or income from commissions for brokerage was 11.4 per cent higher than in 2021, driven by items carried over from 2021 and an increase in the share of life insurance products with a recurring premium.

It should be noted that the number of home insurance policies decreased even though the MNB warned brokers that consumers' home insurance policies should be reviewed every 2 years to avoid the risk of underinsurance. It should be highlighted that insurance intermediaries and consumers have a shared responsibility to ensure that they conclude contracts that cover the risks of livelihood associated with the consumers' home and that these contracts always reflect current, actual values. The MNB continues to give priority to updating the parameters of existing home insurance contracts and to eliminating underinsurance.

5.1.3 More efficient operation with smaller staff

Chart 5.1
Changes in number of natural person insurance intermediaries

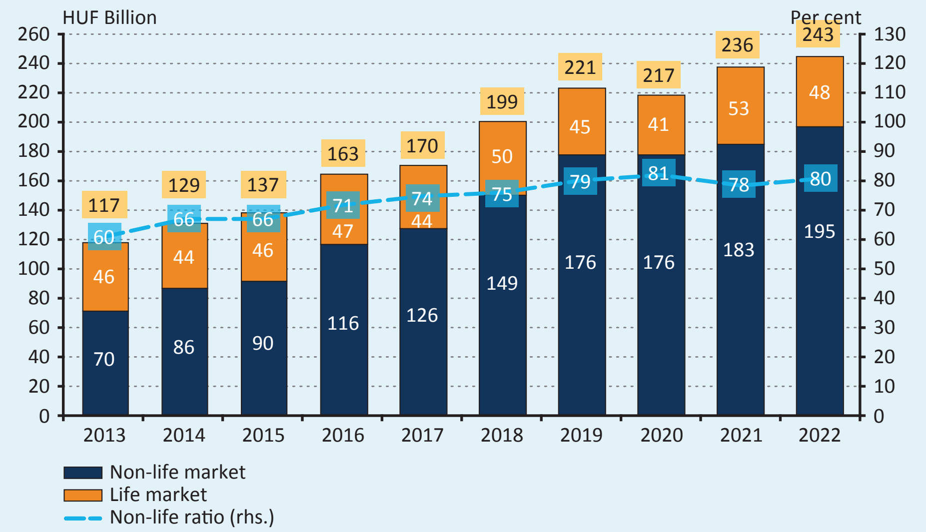


Source: MNB

In 2022, there were even fewer brokers than before. Relative to the previous year, there was a 4.2 per cent decline in staff numbers. The number of brokers fell by 3.6 per cent, the number of independent agents by 3.8 per cent, and the number of agents by 4.8 per cent. In parallel with the decline in the number of employees, concentration of the intermediary market continued, as shown by the 6.8 per cent increase in the value of contracts per capita and the 14.5 per cent rise in the number of policies compared to the previous year. The main driver of the growth in the number of policies per capita was the surge in the number of travel insurance policies, while the increase in the value of non-life policies per capita, partly due to inflation, offset the decline in life policies.

5.1.4 Higher than 80 per cent non-life ratio again

Chart 5.2
Changes in insurance premiums mediated by brokers and multiple agents

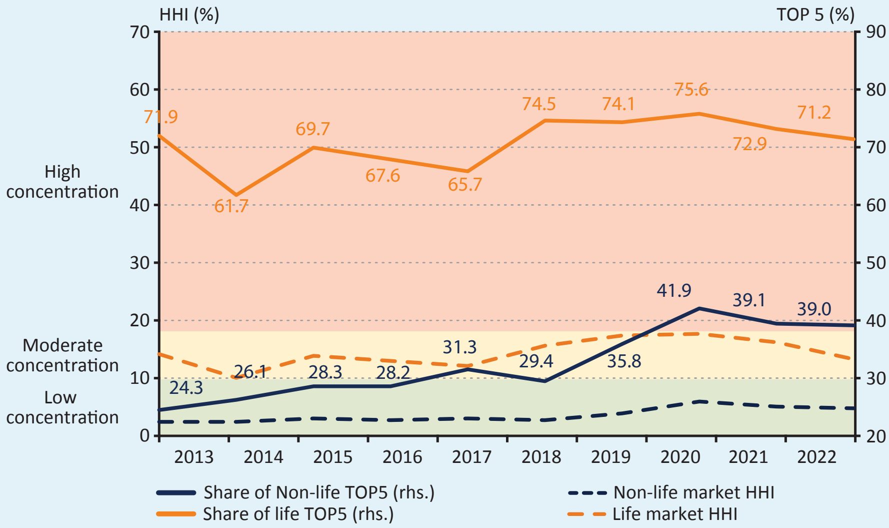


Source: MNB

The total value of brokered contracts equalled HUF 243 billion, 3.0 per cent higher than in 2021. Non-life insurance represented a significant share, reaching 80.4 per cent in 2022. Again, the widening gap is the result of a decline in the life segment. In the life segment, the value of life insurance policies brokered decreased by 10.3 per cent, while the value of non-life insurance contracts brokered were up by 6.7 per cent. The value of casco insurance grew by 13.3 per cent despite a minimal increase in the number of policies. Also noteworthy is the 15.0 per cent increase in the contract value of commercial and institutional property insurance, where the number of policies fell by 10 per cent driven by the impact of inflation. In home insurance, the number of contracts were down by 4.6 per cent, while contract value increased by 8.3 per cent.

5.1.5 TOP5's share continued to fall in both markets

Chart 5.3
Share and Herfindahl-Hirschman index of the TOP5 independent insurance intermediaries based on gross premium income and regular premium, by segments



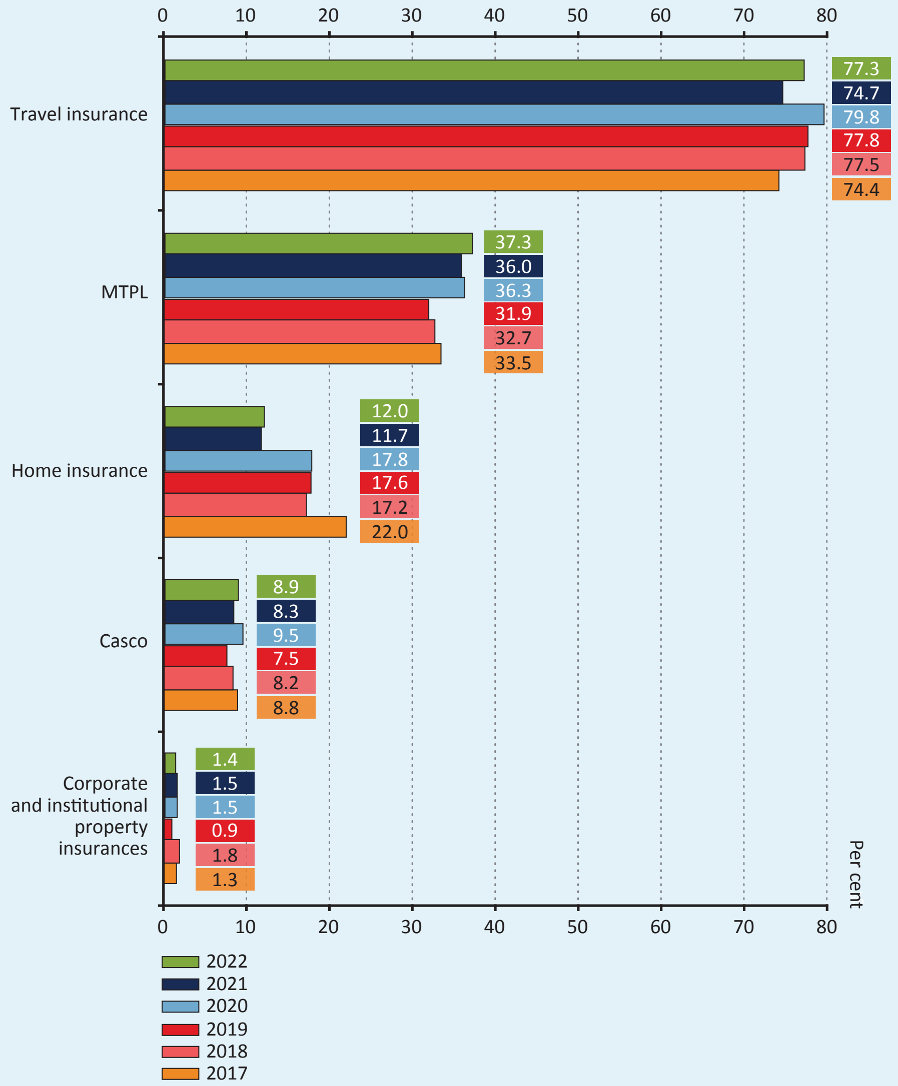
Note: The colour of the background illustrates the strength of concentration under HHI.
Source: MNB

In both the life and non-life segments, the decline in market concentration in terms of the gross premiums brokered and total premiums continued in 2022 (Chart 5.3). In the life segment, the Herfindahl-Hirschman Index (HHI) improved significantly, falling from 16.1 per cent to 13.0 per cent in one year, approaching the level of low concentration (10 per cent). The market share of the TOP5 intermediaries also decreased in the meantime, but is still significant at 71.2 per cent.

The change was not as dynamic in the non-life segment, but both concentration indicators became lower. The HHI index, which traditionally shows a low concentration of non-life market intermediaries, continued to fall to 4.6 per cent, while the share of TOP5 seemed to have stabilised at 39.0 per cent.

5.1.6 Electronic rate stagnating for years

Chart 5.4
Ratio of electronically mediated non-life insurance contracts (by number of policies, ratio within the mediated contracts)



Source: MNB

Digital development projects planned in the pre-pandemic period but postponed due to the pandemic failed to make enough progress in 2022 to shake up pure electronic (no salesperson involved) sales in all business lines, so the stagnation of electronic sales now represents a trend based on data from recent years. The main features of products that can be sold electronically are typically comparability, simple product terms and easy calculation, which the customer can understand without a salesperson. Electronic sales of travel insurance almost reached their peak taking into account the travel habits of customers, but the lower share of MTPL contracts may also indicate that a large number of policies are still taken out offline or in a hybrid way at the dealership when buying a car. Based on the 2022 figures, the market showed a slight improvement after the preceding year's clear downturn, but there is clear untapped growth potential in e-commerce (Chart 5.4).

5.2 MONEY MARKET INTERMEDIARIES

5.2.1 Concentration unbroken also in the money market intermediary sector

Table 5.3
Key data of independent financial market intermediaries

	Financial market intermediary	
	2021	2022
Number of institutions	488	**483** ↓
Broker	*15*	*17*
Multiple agent	*333*	*326*
Multiple special intermediary	*5*	*4*
Hire purchase intermediary	*135*	*136*
Number of natural persons (persons)	12 459	**6 516** ↓
Commission income (HUF billions)	21,9	**21,0** ↓

Note: The number of independent financial market intermediaries includes institutions registered as financial market intermediaries and carrying out financial market intermediation activities as their core activity, as well as institutions registered based on other core activity and also carrying out financial market intermediation activities. Hire purchase financial market intermediaries are not obliged to supply data. An overlap between the financial market and insurance intermediary natural persons is possible.
Source: MNB

Concentration in the money market slowed down slightly, with the number of institutions falling by only 1.0 per cent in 2022. This modest decline may be due to the relatively large number of intermediaries who, being less resilient to economic difficulties, decided to surrender their licence in 2021, making the current players in the intermediary market appear to have proved crisis-proof in 2022. However, there is a risk that if lending continues to decline in the longer term, financial intermediaries will have to adapt with one possible outcome being their entry into other markets (e.g. insurance mediation). In this context, the MNB follows the emerging trends and closely monitors if players entering another market have the necessary personnel and material resources as well as the relevant expertise. The reason for a sharp decline in the number of natural persons acting as an intermediary was that an independent special intermediary with an extensive branch network changed its form of operation and, as a result, its data on natural persons are now included under tied agents. Almost half of the decline in commission income is due to a fall in mortgage borrowing and hence in the number of retail loans (Table 5.3).

5.2.2 17 per cent drop in the number of residential mortgage loans

Table 5.4
Sales data of independent financial market intermediaries

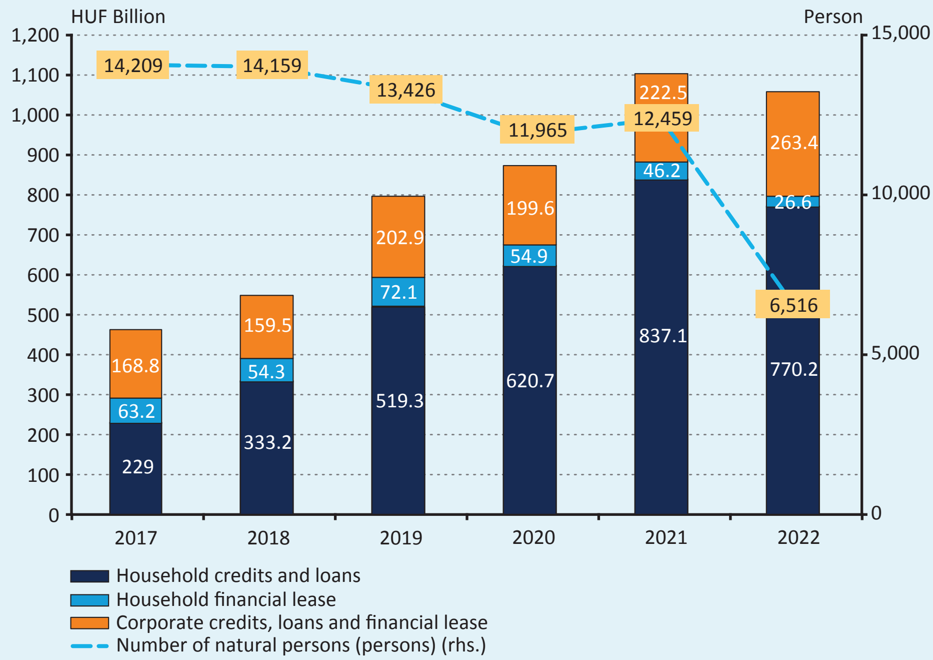
	Value of contracts HUF billions		Number of contracts pcs		Commission income HUF billions	
	2021	2022	2021	2022	2021	2022
Corporate credits, loans and financial lease	222,5	**263,4** ↑	21 073	**19 351** ↓	3,2	**3,5** ↑
Total household credits and loans	837,1	**770,2** ↓	155 054	**158 697** ↑	15,2	**14,7** ↓
of this: Mortgage	*608,6*	*569,3*	*45 001*	*37 159*	*10,8*	*9,5*
Motor vehicle	*0,0*	*0,5*	*58*	*146*	*0,00*	*0,0*
Personal loans	*172,2*	*128,5*	*24 542*	*19 349*	*2,3*	*2,5*
Other	*44,8*	*71,9*	*81 931*	*102 043*	*2,1*	*2,7*
Total household financial lease	46,2	**26,6** ↓	12 172	**6 538** ↓	1,3	**0,6** ↓
of this: Real property	*6,3*	*3,3*	*408*	*246*	*0,1*	*0,1*
Motor vehicle	*39,8*	*23,3*	*11 680*	*6 273*	*1,2*	*0,5*
Other	*0,1*	*0,0*	*84*	*19*	*0,0*	*0,0*

Source: MNB

In contrast to 2021, 2022 saw a decline in the value and the number of mediated contracts in the main product categories of retail credits and loans and retail financial lease. Among retail credits and loans, the most significant decline was observed in mortgage loans. In contrast to the 43.0 per cent increase in 2021, 2022 showed a 17.0 per cent decrease in the number of contracts and a 6.1 per cent fall in contract value. The decline in the number of contracts is due to more expensive credits and loans and weaker borrowing activity on both the retail and SME side. The decline in mortgage lending also pushed the amount of commission income into the negative zone, resulting in a 12.4 per cent decrease (Table 5.4).

5.2.3 Years of stable retail growth halted

Chart 5.5
Number of financial market intermediaries and amount of mediated credits and leases



Source: MNB

The number of natural persons acting as intermediary in 2022 fell by 47.7 per cent relative to the year before. The value of contracts mediated to the corporate segment increased by 18.4 per cent year on year to HUF 263.4 billion in 2022, but stable growth on the retail side, which had been sustained for years, halted. The contract value of retail financial leasing was down 42.4 per cent, mainly due to a fall in new car purchases and high interest costs. The contracted value of retail credits and loans was 8.0 per cent lower, for the most part driven by a 6.5 per cent drop in mortgage loans and a 25.4 per cent decrease in personal loans. Rising interest rates and lower demand for credit thanks to the downturn in housing transactions also played a substantial role in this phenomenon.

5.2.4 The share of subsidised loans remained significant

Table 5.5
Proportion of subsidized loans and leases within mediated loans and leases

	The ratio of subsidised loans					
	Value of contracts HUF billions		Number of contracts pcs		Commission income HUF billions	
	2021	2022	2021	2022	2021	2022
1. Corporate credits, loans and financial lease	36,3%	**33,1%**	25,9%	**29,5%**	42,2%	**39,9%**
2. Total household credits and loans	32,1%	**34,7%**	18,8%	**17,2%**	19,1%	**19,0%**
2.1. Household credits and mortgage	16,7%	22,8%	26,8%	33,3%	16,0%	19,8%
2.2. Lakossági személyi és egyéb kölcsön	75,4%	69,3%	16,1%	13,0%	26,8%	17,8%
3. Total household financial lease	0,3%	**0,0%**	0,2%	**0,0%**	3,5%	**0,0%**
4. Total	31,6%	**33,5%**	18,4%	**17,9%**	22,0%	**22,3%**

Source: MNB

Based on the amount of new loan contracts sold by independent money market intermediaries in 2022, almost a third of them involved some form of state aid, up 1.9 percentage points compared to the previous year. This increase arose from a rise in the share of subsidised credits and loans to households, given the slight decrease in the corporate segment. On the retail side, mortgage loans showed a spectacular increase (6.1 percentage points), while personal and other unsecured loans suffered a decline. The share of subsidised loans remained high for unsecured retail loans, given that this is the category in which data pertaining to prenatal support loans are supplied by institutions. The 2.6 percentage point rise in the subsidy rate for retail credits was driven by a 0.9 per cent increase in the contract value of subsidised loans and a 10.3 per cent drop in loans offered on market terms. In the case of mortgage loans, the increase in the share of subsidised loans offset the decrease in unsecured loans due to higher volumes, with the amount of subsidised mortgage loans increasing by 28.0 per cent in nominal terms compared to the previous year.

5.3 CONSUMER PROTECTION RISKS

5.3.1 “Churning”

In 2022, the MNB continued to focus on discouraging the “churning” of insurance contracts as part of its ongoing supervisory and inspection activities. In this context, it also examined whether, in the course of sale, salespersons, by terminating (usually by repurchasing) or waiving the premiums on a previous savings-type life insurance policy, urged customers to take out a new life insurance policy of the same kind, even though their needs remained the same or changed only in part.

The MNB considers this practice to be particularly risky and harmful to consumers, if they are not properly informed of the consequences and no appropriate needs and suitability assessment is carried out. In addition to processing the data collected in the course of continuous supervision, it performed targeted and comprehensive inspections of both insurance intermediaries and insurers to curb this practice (Search decisions and orders (mnb.hu)). In view of the high risk to consumers of the infringements identified in the inspections, the institutions concerned were fined substantial amounts.

In order to ensure that the risks associated with “churning” can be fully identified and eliminated across the whole market, the MNB has fine-tuned its inspection methodology, and strongly reminds supervised institutions that they can expect proportionately severe supervisory sanctions in all cases where market practices that harm consumers' interests and are detrimental to them are detected.

5.3.2 Underinsurance

For households with home insurance, adequate coverage of the risk of damage is a priority. With more than three million home insurance policies currently taken out, a wide range of consumers hold this type of insurance policy, so the MNB pays particular attention to this insurance product.

The renovation, modernisation, possible conversion and expansion of a residential property as well as an increase in the value of movables can raise the value of the residential property and potentially render the existing home insurance policy obsolete. Updating the insurance amounts is of paramount importance because failure to do so may result in the property becoming underinsured in the event of a claim settlement. In addition to renovation and investment, the value of a residential property can also be affected by external factors, such as the increase in the cost of building materials and higher labour costs which can have a significant impact on the cost of rebuilding after any potential damage.

The MNB set out its expectations for the review of existing home insurance policies in 2022 to avoid underinsurance in a management circular to brokers according to which brokers were required to take an active role in ensuring that existing home insurance policies were up-to-date and at all times reflected the current value of movables and real estates they were intended to cover.

Brokers, as an insurance intermediary acting on behalf of the customer, have special responsibility in avoiding underinsurance as in addition to concluding the insurance contract, their activity may also extend to contributing – on behalf of the client – to the enforcement of the client's claims. According to the relevant provisions of the Insurance Act, brokers – as an independent insurance intermediary – are obliged to act in compliance with the insurance industry rules at all times and are liable for any failure to comply with this obligation.

In addition to brokers and insurers (indexation), consumers also have special responsibility for avoiding underinsurance since in addition to providing up-to-date information on real estate and movables, consumers are clearly expected to keep their own insurance policies up-to-date and so review them regularly (every two years at the most) or have them reviewed by an expert.

6 Financial enterprises not belonging to a banking group and their risks

6.1 MARKET PRESENCE

To assess the risks of non-bank financial enterprises, i.e. those not subject to consolidated supervision, the data of the last 5 years were used of which the latest for 2022 were preliminary data[29]. For the assessment of the real risks to the sector, the MNB did not include data from two specific financial enterprises not engaged in the general business of financial enterprises in order to eliminate distorting effects, except for the data in Table 6.1.

Table 6.1
Main data of financial enterprises not belonging to a banking group*

	2018	2019	2020	2021	2022
Balance sheet total of financial entrerprises not belonging to a banking group (HUF billion)	1 163	1 505	1 581	1 735	1993
Number of financial enterprises not belonging to a banking group	223	223	225	226	226

**The table contains the actual data of those financial enterprises who in the given submission period provided data to MNB*
Source: MNB

The number of non-bank financial enterprises had been nearly the same over the past 5 years, but during the year, the factors increasing or decreasing the number of institutions did exert some minor effects on the number of players in this segment. In 2022, 3 financial enterprises obtained a licence to operate from the MNB and 1 institution was reclassified from consolidated supervision to the category of financial enterprises not belonging to a banking group. At the same time, on the initiative of their owners, 4 institutions returned their licence to operate. The MNB revoked the operating licences of 2 financial enterprises; the sanctions were justified by their failure to have the required personnel and material resources and to regularly report data to the MNB, the lack of supervisory cooperation and the concerns and risks identified in relation to prudent operation. The revocation of these two operating licences did not cause a reduction in 2022 in the number of institutions examined as the two institutions failed to report audited data for 2021 and preliminary data for 2022. No sector-wide risks were identified in 2022 in relation to changes in the number of institutions in the sector.

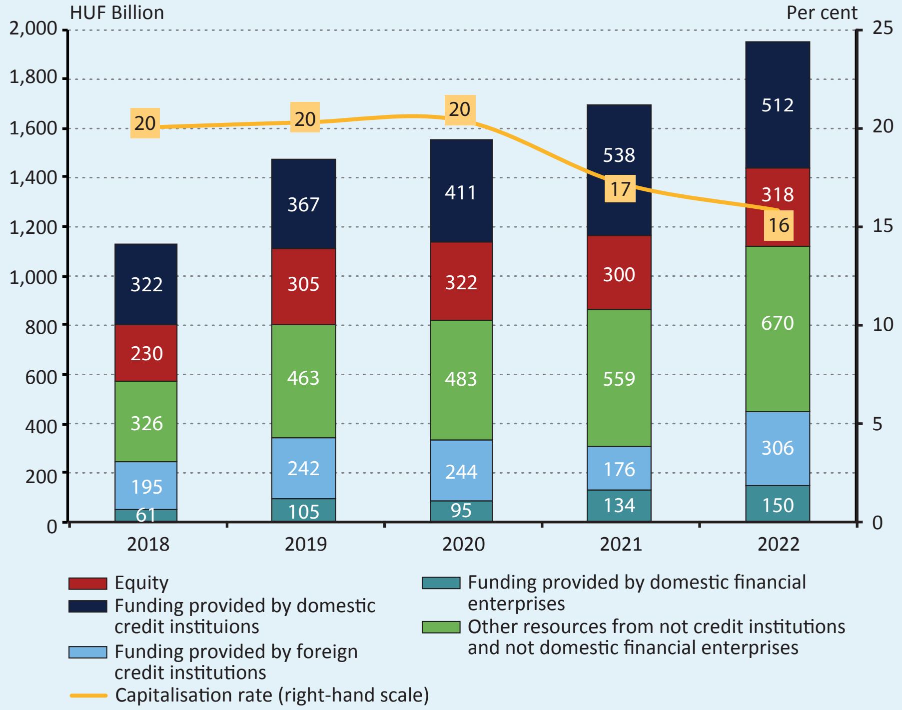
Changes in the regulatory environment of financial enterprises in 2022 had a negative impact on the profit and profitability of the institutions under review; nonetheless, the balance sheet total of non-bank financial enterprises increased by 15 per cent in 2022 relative to the previous year, and its amount reached nearly HUF 2,000 billion. The steady growth of the sector is evidenced by the increase in the balance sheet total of the last 5 years, which continued in 2022.

[29] The difference compared to the 2022 report is that in 2022, the audited data for 31 December 2021 were not available, whereas the present report already includes the audited data for 2021.

6.2 IN ADDITION TO THE INCREASE OF EQUITY, THE SECTOR CONTINUED TO BE CHARACTERISED BY EXTERNAL BORROWING

2022 saw a further increase in external funding covering the sector's operations, as reflected in the growth of liabilities to both credit institutions (115 per cent), in particular foreign credit institutions (174 per cent), and affiliates (123 per cent), the latter mainly in the form of other funding from non-credit institutions and non-domestic financial enterprises. Higher external borrowing shows that investing in financial enterprises remains attractive.

Chart 6.1
The liability structure of financial enterprises not belonging to a banking group



Source: MNB

The share of funding from credit institutions (both domestic and foreign) was high (42 per cent); funding from foreign credit institutions increased considerably, while funding from domestic credit institutions decreased. Besides a small decline in funding by domestic credit institutions, 2 financial institutions, MFB Magyar Fejlesztési Bank Zrt. and Eximbank Zrt. increased their share in the financing of non-bank financial enterprises. In 2022, the growth rate of MFB Magyar Fejlesztési Bank Zrt. equalled 19 per cent, while the growth rate of Eximbank Zrt. was significantly higher at 75 per cent with a similar increase in share.

There was no significant change in the activities of larger institutions with a balance sheet total above HUF 10 billion that received funding from domestic credit institutions, they were still mostly engaged in credit and loan operations. The high concentration remained unchanged: 50 per cent of funding by domestic credit institutions in 2022 was provided only to a total of 8 financial enterprises.

The nearly 20 per cent increase in other sources from non-credit institutions and non-domestic financial enterprises was partly attributable to funding from owners and partly from affiliates. For the most part, growth in cross-financing between domestic financial enterprises continued to be concentrated in just 3 financial enterprises.

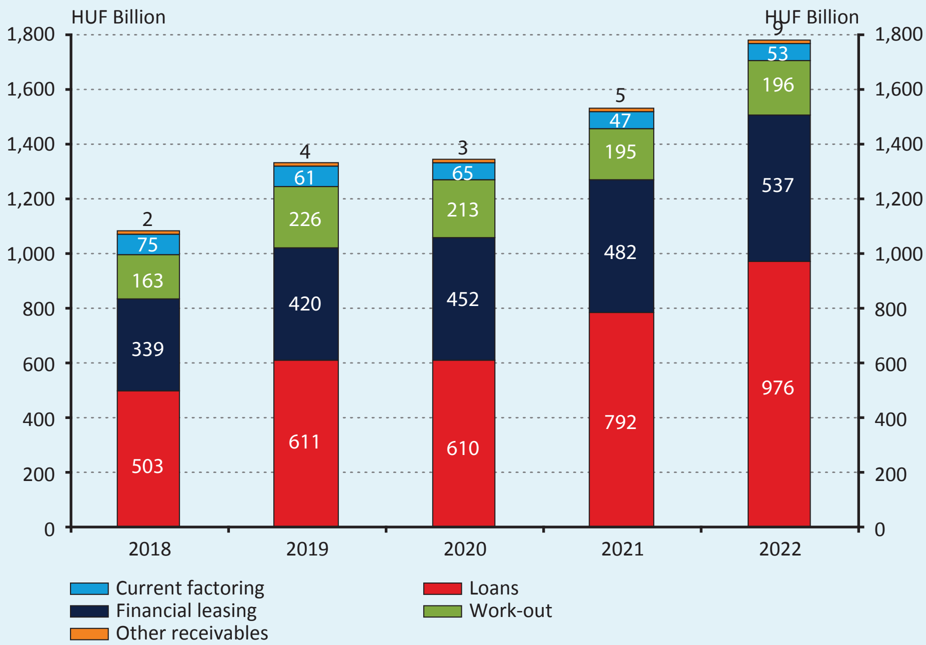
From a different perspective, the stable functioning and growth of the sector was partly the result of sources provided by owners and affiliates, which accounted for almost a quarter of total funding (this type of category is not shown in Chart 6.1). However, the pace of growth saw a shift from direct ownership to intra-group financing, making it the second most dynamically growing source of funding.

The capital adequacy of financial enterprises declined somewhat, but the decline in the volume of equity previously seen in the sector stopped, it even rose in 2022, mainly due to the increase of capital by owners and, to a lesser extent, profitable management. In terms of their number, 29 per cent of non-bank financial enterprises had an equity capital of over HUF 1 billion, while 16 per cent had an equity capital of less than HUF 100 million. The strong growth of the previous year in financing in the form of shareholder loans slowed down slightly in 2022, or rather took the form of capital increase, which was most likely triggered by the upcoming change of the regulatory capital adequacy requirement.

6.3 STEADILY GROWING PORTFOLIO OF RECEIVABLES

In 2022, 66 per cent of financial enterprises, 149 financial institutions, were able to increase their balance sheet total compared to 2021, of which 13 institutions realised an increase of more than HUF 5 billion. These are typically institutions engaged in credit and loan operations.

Chart 6.2
Composition of the receivables of financial enterprises not belonging to a banking group



Source: MNB

The change in the gross receivables of the institutions under review showed a significant increase in 2022 again (116 per cent) after a rise in 2021 (113 per cent). The growth rate was higher than in the previous year, but still remained below that of 2019 (122 per cent). The increase in the volume of all activities contributed to a larger portfolio in 2022, but the growth rate of lending activities declined, while that of leasing and factoring (current and work-out) operations was higher relative to 2021.

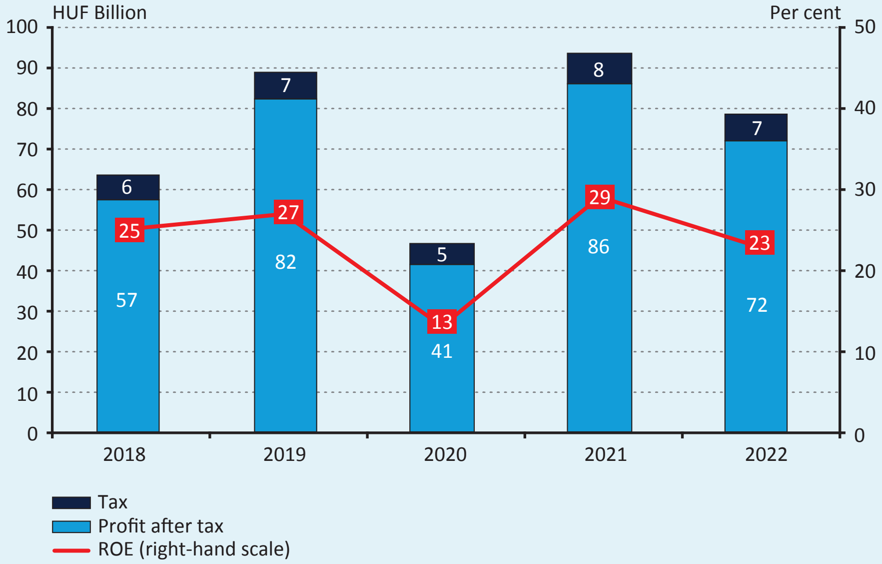
Credit and loan operations continued to be the principal activity of non-bank financial enterprises, which accounted for 55 per cent of gross receivables, followed by financial lease with 30 per cent, work-out with 11 per cent and current factoring with 3 per cent. As in the previous period, the receivables of non-bank financial enterprises remained highly concentrated. 15 per cent of the institutions held 86 per cent of the total receivables.

For the last 5 years, financial leasing showed a steady growth, as did the credit and loan portfolio, except in 2020 when it virtually stagnated. After 2 years of a declining trend following an outstanding increase in 2019 (138.76 per cent), work-out receivables turned into stagnation in 2022 despite the fact that the supervisory review of a financial enterprise engaged in work-out is now carried out in the sector under review.

6.4 DROP IN PROFITABILITY

Around 81 per cent of non-bank financial enterprises were profitable in 2022, but sector-wide profit after tax was significantly below the profit after tax for 2021 as there was a decline compared to the preceding year.

Chart 6.3
Profit of financial enterprises not belonging to a banking group



Source: MNB

In 2022, financial companies with a profit of HUF 1 billion or more carried out lending, leasing and factoring operations. Of the top 5 financial enterprises with the largest decline in profit after tax, 4 continued to generate profit, however, together they recorded more than HUF 28 billion less profit after tax than in 2021.

The negative shift in the distribution of profitability is also evidenced by the fact that while in 2021 a total of 196 financial enterprises managed to realise profit after tax, in 2022 only 181 of them recorded a profit according to preliminary data, while the number of institutions generating a loss after tax increased from 28 to 43.

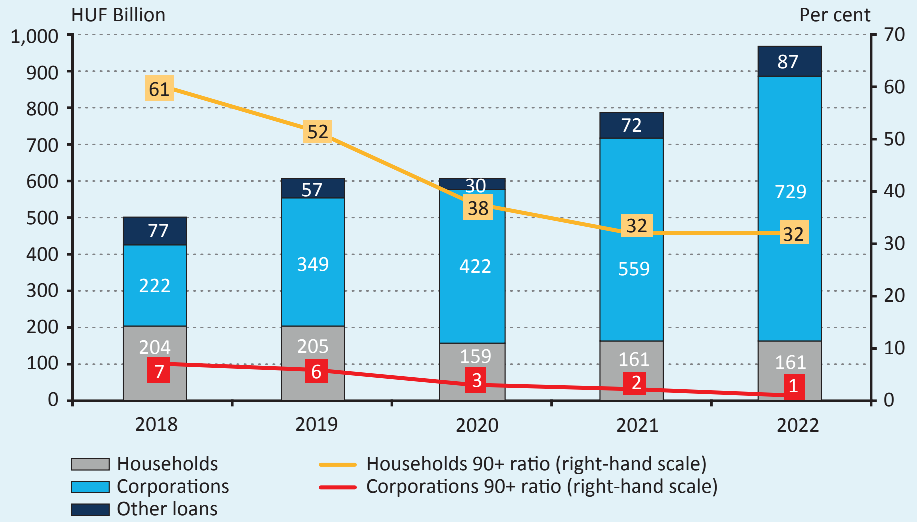
The large drop was partly due to the special tax levied on financial enterprises, which was due in September 2022, and the extra profit tax[30], which was due in October for its first instalment and in December for the second instalment. ROE also fell due to the increase in equity and the fall in profit.

[30] Government Decree No 197/2022 (VI. 4.) on extra profit taxes

6.5 STRONG CORPORATE LENDING GROWTH

In 2022, lending by the institutional sector under review continued to grow, which was driven by corporate lending in line with the trend seen in previous periods. The quality of the portfolio remained basically unchanged in 2022, with a negligible 90+ within the sector's dominant corporate lending portfolio.

Chart 6.4
Composition of the credit portfolio of financial enterprises not belonging to a banking group



Source: MNB

Looking at the evolution of the number of contracts, a trend of steady decline can be identified: while in 2021, the institutions under review had 802,425 contracts, this number fell to 743,879 in 2022. The decline in the number of contracts was reflected in the household portfolio, mostly because a large part of a financial company's portfolio was sold outside the sector, while the number of corporate contracts started to increase reversing the trend of the previous two years, but it still failed to reach the 2020 level.

Compared to 2021, the number of institutions engaged in lending and the number of institutions with a credit and loan portfolio of HUF 10 billion or above increased: while in 2021 there were 17 institutions, in 2022 there were 26 financial enterprises with a loan portfolio of HUF 10 billion. In 2022, institutions with over HUF 10 billion in loans managed 81 per cent of total loans, compared to 69 per cent in 2021.

The increase in corporate lending was reflected both in the total gross corporate receivables and in the number of financial companies engaged in corporate lending operations, with 100 non-bank financial enterprises lending to companies in 2021 and 107 financial enterprises lending to companies by the end of 2022. The number of institutions providing corporate loans of HUF 10 billion or more also increased considerably: while in 2021, 12 financial institutions had a credit and loan portfolio of more than HUF 10 billion (65 per cent of gross corporate receivables), by 2022 this number had increased to 22 (81 per cent of gross corporate receivables). The significant increase is mainly due to the expansion of the refinancing scope of MFB Magyar Fejlesztési Bank Zrt. both in terms of amount and the number of the institutions financed.

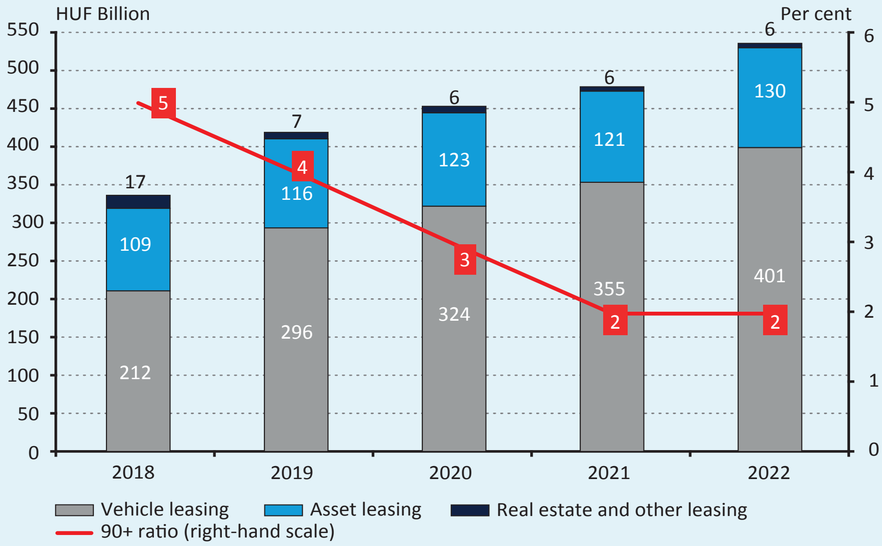
Of the institutions providing household lending, one institution sold its non-defaulting portfolio outside the sector, thus the number of institutions with a loan portfolio of HUF 10 billion fell. However, the decline in the portfolio was offset by an increase in the receivables of other institutions in the sector, leaving the gross receivables from households essentially unchanged in 2022. 65 per cent of the household portfolio was managed by two financial companies which provide payday loans and pledged collateral loans. The quality of the household portfolio remained stable with no deterioration despite the fact that the portfolio sale described above did not affect non-performing holdings.

Looking at the number of contracts in the household portfolio, there was a clear increase in the number of contracts of institutions offering pledged collateral loans. The receivables of financial enterprises providing pledged collateral loans was on a steady upward trend following a slight decline in 2019. In 2021 and 2022, the rate of growth increased, and while in 2021 this significant increase was the result of realignments in the financial market, in 2022 its recovery was witnessed. More than 40 per cent of the financial enterprises that provided pledged collateral loans saw their portfolio of such loans shrink in 2021. By the end of 2022, the receivables of all active financial enterprises providing pledged collateral loans increased with growth at the 2 largest financial enterprises accounting for about three quarters of the total increase, indicating a concentration of the market of pledged collateral loans.

6.6 GROWTH AND A TURN OF TRENDS IN CONTRACTS ON THE LEASE MARKET

Financial lease was, as shown in the breakdown of receivables in Chart 6.2, the second main area of activity of non-bank financial enterprises in terms of volume after lending. It is important to note, however, that while 143 non-bank financial enterprises had a loan portfolio according to 2022 unaudited data, only 29 institutions held a lease portfolio. The specific features of the economic environment in recent years had a positive impact on the lease market, which allowed the overall volume of the lease granted to grow year on year over the last 5 years. In 2022, total leasing increased by 12 per cent compared to the previous year, with the vehicle leasing sector being the main indicator of growth.

Chart 6.5
Composition of the financial leasing portfolio of financial enterprises not belonging to a banking group

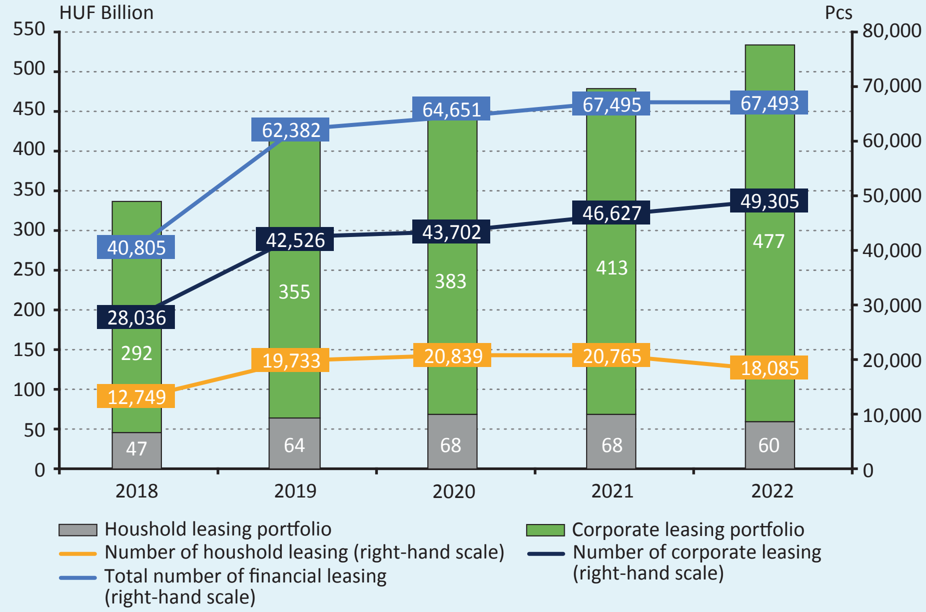


Source: MNB

From a risk perspective, a very positive factor for the leasing market was the steady shrinking of the share of the default portfolio over the past 5 years, which accounted for only 2 per cent of the total portfolio in 2021 and 2022. This share looks all the better as the economic shock of the pandemic in the last 5 years did not affect leasing market players' willingness to pay, and the indicator remained at a low level, partly thanks to the availability of the moratorium on repayments.

The leasing portfolio of non-bank financial enterprises grew in 2022 relative to 2021 reaching HUF 537 billion. However, there was no simultaneous increase in the number of contracts over the same period.

Chart 6.6
Composition of the financial leasing portfolio and the number of financial leasing of financial enterprises not belonging to banking group



Source: MNB

The value of the number of contracts in the leasing portfolio of the institutions under review virtually stagnated in 2022, and remained nearly at the same level as in 2021. The average leasing transaction size on the leasing market thus increased from HUF 7.1 million in 2021 to HUF 7.9 million in 2022. There was a rise in the average leasing transaction size compared to 2021 both in the household and the corporate segments in 2022.

Similarly to loans, there was a shift towards the corporate segment in leasing among non-bank financial enterprises. In 2022, the household portfolio represented only 11 per cent of the total lease portfolio. There was also a more pronounced decline in the number and value of household leasing contracts in 2022 compared to 2021, partly because of the rising interest rates.

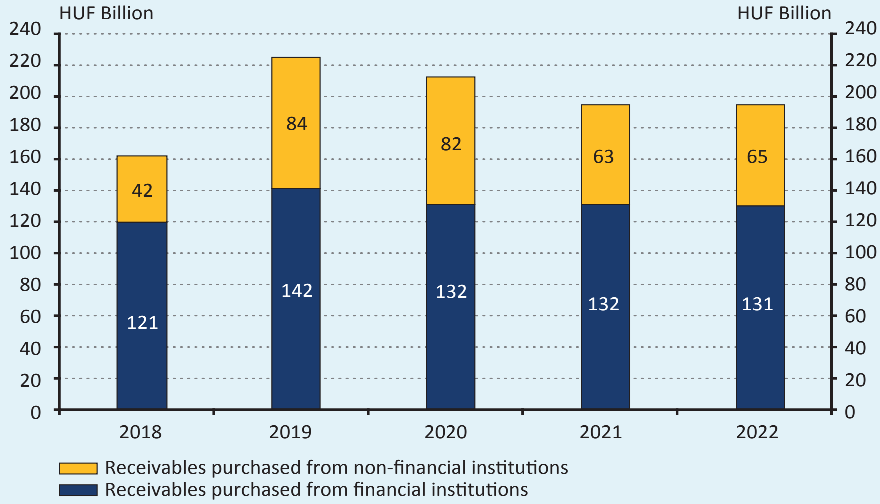
6.7 FURTHER DECREASE IN PORTFOLIO PURCHASED FOR DEBT MANAGEMENT WITHOUT RECLASSIFIED INSTITUTION

The work-out portfolio managed by non-bank financial enterprises in 2021 decreased by 2 per cent in 2022. Purchases from financial institutions also fell by 4 per cent, but purchases from non-financial institutions increased by 2 per cent.

At the end of the third quarter of 2022, the sector of non-bank financial enterprises expanded due to the reclassification of an institution of significant size, which affected changes in the 2022 figures above. Taking into account the data of the financial enterprise in question, increase in the portfolio remained below 1 per cent.

As a consequence, as shown in Chart 6.7, the total amount of receivables managed by non-bank financial enterprises increased by less than 1 per cent in 2022, compared to a decrease of 8 per cent in 2021. Within this, the portfolio purchased from financial institutions decreased by less than 1 per cent, while the portfolio purchased from non-financial institutions, which was almost half the size of the portfolio purchased from financial institutions, rose by 2 per cent following a 23 per cent decline in 2021.

Chart 6.7
Composition of the work-out portfolio of financial enterprises not belonging to a banking group



Source: MNB

In 2022, 6 non-bank financial enterprises realised an increase in their portfolio of close to or above HUF 1 billion. Receivables purchased from financial institutions were typically of higher amounts, and their share stagnated compared to 2021, accounting for 45 per cent of the total receivables in terms of the number of contracts and 67 per cent of the book value of the portfolio.

The volume of receivables from residential mortgages purchased from financial institutions fell by 21 per cent and the number of contracts by 3 per cent compared to 2021. The portfolio swaps between non-bank financial enterprises were at the same level as in 2021.

The receivables purchased in 2022 by financial enterprises engaged in work-out could not compensate for the fall in transactions resulting from management, which also fell. The 20 per cent drop in repayment volumes was likely to be the result of high worldwide inflation in 2022 and a reallocation of debtors' incomes.

Financial enterprises, whose main profile is debt purchase, tended to use less financing from credit institutions and relied more heavily on own sources or funding from owners. The after-tax profit of financial enterprises engaged in debt purchase fell by 24 per cent in 2022 compared to 2021 according to the relevant data. As this was the result of changes in the profit of 3 financial enterprises, it cannot be considered a general, sector-wide phenomenon.

6.8 CONSUMER PROTECTION, FOCUS ON CONTINUOUS SUPERVISION

As part of its supervisory activity, in addition to checking the documents provided during the authorisation procedures and inspections, the MNB also examined the advertisements, websites and other press releases of the supervised institutions. The shift towards digital solutions is not yet a feature of this sector, but several financial enterprises, including lending institutions, started to develop these options to increase competition.

The MNB also paid particular attention to the consumer-friendly conduct of non-bank financial enterprises during its continuous supervision, with calls for declarations, data provision and analyses. In 2022, financial enterprises providing small personal loans, debt managers and institutions offering pledged collateral loans represented the bulk of consumer protection exercises.

The MNB also monitored the implementation of recommendations and regularly gave consumer protection warnings when it identified practices that could potentially harm consumers' interests or violate the MNB's recommendations.

In response to requests, the MNB launched an investigation into the complaint handling and customer information practices of financial institutions, and received several customer notifications acting upon which it is calling on financial institutions to comply with Recommendation No 9/2020 (VII. 14.) on the application of consumer protection principles and Recommendation No 2/2019 (II. 13.) on consumer debt management.

In the debt management sector, as in previous years, the MNB continued to focus on consumer requests concerning the conduct of financial enterprises involved in the purchase and management of overdue debts, in particular on complaint handling, and on the licensing procedures of companies planning to start operation in this sector.

In 2022, several institutions in the pledged collateral loans sector were subject to proceedings, in addition to on account of prudential issues, compliance with the maximum APR and the appropriateness of the methodology for calculating the APR, and fines were also imposed. In this case, in addition to compliance with the relevant legislation, the main focus was on the monitoring of compliance with MNB Recommendation No 24/2018 (VII. 5.) on pledged collateral loans.

In 2022, the MNB also launched an inspection of financial institutions not providing pledged collateral loans to verify compliance with the provisions of the PTI[31] and APR[32] decrees, which was extended to include the verification of information provided prior to the conclusion of a loan agreement and compliance with the legal provisions of the Act on the Central Credit Information System[33].

Based on an indication from the Financial Arbitration Board, the MNB launched a consumer protection investigation against several financial institutions in 2022 on account of failing to cooperate in the Financial Arbitration Board's proceedings or to appear before the Board.

[31] MNB Decree No 32/2014 (IX. 10.) on the regulation of the debt-service-to-income ratio and the loan-to-value ratio
[32] Government Decree No 83/2010 (III. 25.) on the determination, calculation and publication of the annual percentage rate
[33] Act CXXII of 2011 on the Central Credit Information System

7 The capital market and its risks

The number of investment service providers active in the domestic capital market fell by three to 31 in 2022. The HUF 48,340 billion in client securities managed by investment service providers in 2022 – HUF 40,593 billion for credit institutions and HUF 7,747 billion for investment firms – was 0.5 per cent higher than the previous year's figure of HUF 48,106 billion. The number of client securities accounts held by investment service providers increased by 4.8 per cent. In 2022, investment service providers – credit institutions and investment firms providing investment services – realised a total capital market turnover of HUF 710.2 thousand billion, 59.5 per cent up from the total turnover realised in 2021.

Table 7.1
Key data of investment service providers

Investment service sector	2021			2022		
	Credit institutions	Investment firms	Total	Credit institutions	Investment firms	Total
Number of institutions (pcs)	20	14	34	18	13	31
Customer securities portfolio (HUF billions)	41 335	6 771	48 106	40 593	7 747	48 340
Number of securities accounts managed (thousand pcs)	1 492	351	1 843	1 519	413	1 932
Capital market turnover (HUF billions)	366 979	78 230	445 209	620 692	89 509	710 202
Profit after tax (HUF millions)		20 180			51 541	
Solvency capital/Capital adequacy ratio (percent)		763,1%			1417,2%	

Note: the number of institutions includes branches as well
Source: MNB

Assets of HUF 13,154 billion managed by 41 supervised investment fund managers were up 10.8 per cent year on year and reached a new all-time high. The growth in managed assets is explained by the increase in assets managed by investment funds, while the other portfolios managed typically showed a decrease. The net asset value of investment funds in December 2022 of HUF 9,872 billion was HUF 1,578 billion (19%) higher than the net asset value in 2021.

Table 7.2
Key data of investment fund managers

Investment fund management sector	2021	2022
Number of institutions (pcs)	42	41
Number of funds managed (pcs)	675	698
Volume of assets managed (HUF billions)	11 875	13 154
Profit after tax (HUF millions)	45 955	41 506

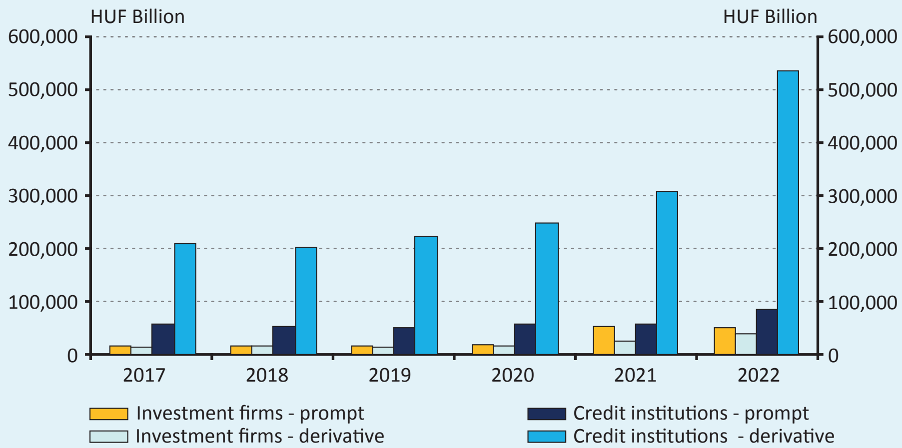
Source: MNB

7.1 INVESTMENT SERVICES MARKET: TURNOVER AND PORTFOLIOS

7.1.1 Capital market turnover grew strongly in 2022

In 2022, investment service providers – credit institutions and investment firms providing investment services – realised a total capital market turnover of HUF 710.2 thousand billion, 59.5 per cent higher than the HUF 445.2 thousand billion realised in 2021. Capital market turnover increased in 2022 significantly for both credit institutions providing investment services and investment firms: the HUF 620.7 thousand billion capital market turnover of credit institutions in 2022 was more than one and a half times higher than the HUF 367 thousand billion in 2021, while the HUF 89.5 thousand billion capital market turnover of investment firms was up 14.5 per cent compared to the HUF 78.2 thousand billion in 2021 (Chart 7.1).

Chart 7.1
Developments in the capital market turnover



Source: MNB

The significant increase in the capital market turnover of credit institutions in 2022 was achieved in the OTC segment: the OTC derivatives turnover of credit institutions jumped by 74.6 per cent to HUF 529.5 thousand billion, while the spot turnover of credit institutions rose by 47.2 per cent to HUF 81.4 thousand billion. The stock exchange turnover of credit institutions also increased: spot turnover on the stock exchange rose by 8.3 per cent to HUF 2.9 thousand billion, while stock exchange derivatives turnover expanded by 19.2 per cent to HUF 6.8 thousand billion.

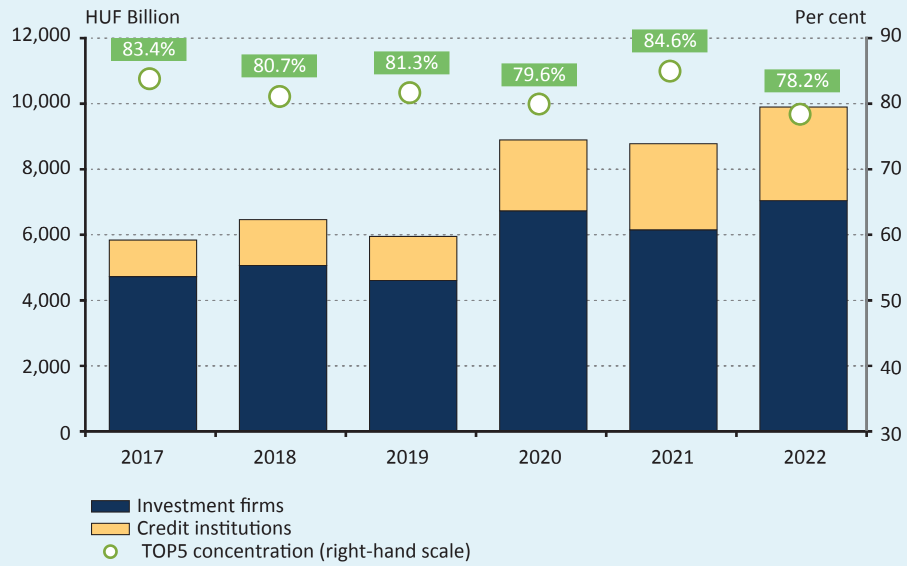
Investment firms' turnover in the capital markets increased in 2022 in all segments except the OTC spot segment. Investment firms' derivatives turnover grew strongly: in 2022, the stock exchange derivatives turnover of investment firms increased by 80.9 per cent to reach HUF 14.5 thousand billion, while OTC derivatives turnover rose by 39.7 per cent to HUF 24 thousand billion. The growth of investment firms' turnover of exchange-traded derivatives was significantly boosted by the dynamic growth of forwarded turnover[34], which increased from HUF 4.2 thousand billion in 2021 by nearly one and a half times to HUF 9.9 thousand billion. The stock exchange spot turnover of investment firms grew by 31.5 per cent to HUF 27.7 thousand billion: the growth dynamics were significantly enhanced by the 38.5 per cent increase in stock exchange spot forward turnover, which reached HUF 20.7 thousand billion by 2022. A decrease was observed in the OTC spot turnover of investment firms: the turnover of HUF 23.4 thousand billion in 2022 was 26.9 per cent lower than the turnover of HUF 32.1 thousand billion in 2021, explained by a 41.3 per cent drop in OTC spot turnover from HUF 25.5 thousand billion in 2021 to HUF 14.9 thousand billion in 2022 on account of a foreign-backed institution.

[34] "Forwarded orders" are transactions where the order received from a client is not executed by the investment service provider whom the order is given to, but is passed on to another investment service provider who actually executes the order

7.1.2 Further increase in spot stock exchange turnover

Last year, spot exchange turnover[35] grew solidly: the 2022 spot exchange turnover of HUF 9,886 billion was 12.5 per cent higher than the 2021 turnover of HUF 8,787 billion and about 50 per cent more than the turnover in the years before 2020. The increase in spot stock exchange turnover is mainly due to the surge in investor activity generated by the Russia-Ukraine war that broke out in February 2022: the turnover of HUF 3,763 billion in Q1 2022 was 80.4 per cent up from the turnover of the same period in the previous year. The trend of the previous years seemed to halt in 2022: while the share of investment firms in the spot market turnover on the stock exchange was in constant decline until 2021 (2021: 69.9%, 2020: 75.6%, 2019: 76.9%, 2018: 78.1%, 2017: 81.1%), in 2022 it increased to 71.1 per cent. In 2022, the composition of the top 5 investment service providers with the highest spot exchange turnover remained unchanged, with 3 investment firms and 2 credit institutions in the TOP5 in 2022. The concentration of spot exchange turnover in 2022 returned to around 80 per cent of its pre-2021 level: the share of the five largest investment service providers of spot exchange turnover decreased by 6.4 percentage points from 84.6 per cent in 2021 to 78.2 per cent on account of a one-off effect (79.6 per cent in 2020, 81.3 per cent in 2019 and 80.7 per cent in 2018) (Chart 7.2).

Chart 7.2
Stock exchange prompt capital market: turnover and concentration

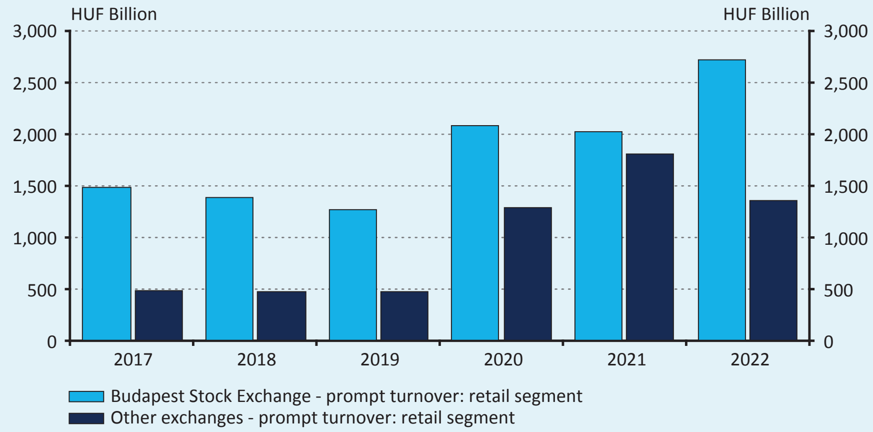


Source: MNB

The 12.5 per cent growth in spot exchange turnover was mainly due to the increase in turnover generated by corporate clients (+17.1%), while turnover generated by retail clients – resident and non-resident clients combined – was also in surplus: the HUF 4,107 billion turnover in 2022 was 6.6 per cent higher than in the previous year. Retail turnover on domestic and foreign stock exchanges showed a contrasting trend in 2022 – while retail spot turnover on domestic stock exchanges increased by 34.2 per cent to HUF 2,729 billion in 2022 compared to the previous year, retail spot turnover on foreign stock exchanges fell by 24.8 per cent to HUF 1,362 billion in 2022, but still exceeded the levels seen in previous years (2020: HUF 1,294 billion; 2019: HUF 476 billion; 2018: HUF 479 billion). Compared to the previous year, there was a significant decline in activity in 2022 on the domestic stock exchange for retail non-residents: the turnover of HUF 171 billion in 2022 was 41.9 per cent lower than the HUF 294 billion in 2021, but several times higher than the HUF 20-30 billion in previous years (Chart 7.3).

[35] The non-forwarded part of spot exchange turnover.

Chart 7.3
Stock exchange prompt capital market: Retail segment



Source: MNB

Non-forwarded derivatives exchange turnover[36] increased by 18.6 per cent in 2022, or by around HUF 1,687 billion, to HUF 10,768 billion: this was down from the 33.2 per cent growth rate in 2021, but matched the growth rate of previous years. Concentration of derivatives exchange turnover increased slightly in 2022, with the top 5 largest exchange derivatives-trading investment service providers increasing their share from 72 per cent in 2021 to 73 per cent in 2022 (73% in 2020 and 75% in 2019). In 2022, the derivatives exchange turnover of credit institutions providing investment services increased by 16.6 per cent year on year to HUF 6,192 billion – the bulk of the increase was attributable to two institutions, while the derivatives exchange turnover of investment firms increased by 21.3 per cent year on year to HUF 4,577 billion. As a result, the share of investment firms in derivatives turnover on the stock exchange increased by 1 percentage point to 42.5 per cent in 2022. The growth rate of derivatives exchange turnover in 2022 for both credit institutions providing investment services and investment firms was below the 2021 level. As in previous years, the composition of the top 5 largest providers of investment services for derivatives exchange trading changed in 2022: while one credit institution dropped out of the top 5 largest investment services providers, one of the 3 investment firms was newly included in the TOP5 in 2022. Forwarded derivatives exchange turnover virtually doubled from HUF 4.677 billion in 2021 to HUF 10.575 billion in 2022: forwarded derivatives exchange turnover was essentially attributable to a large foreign-backed investment firm.

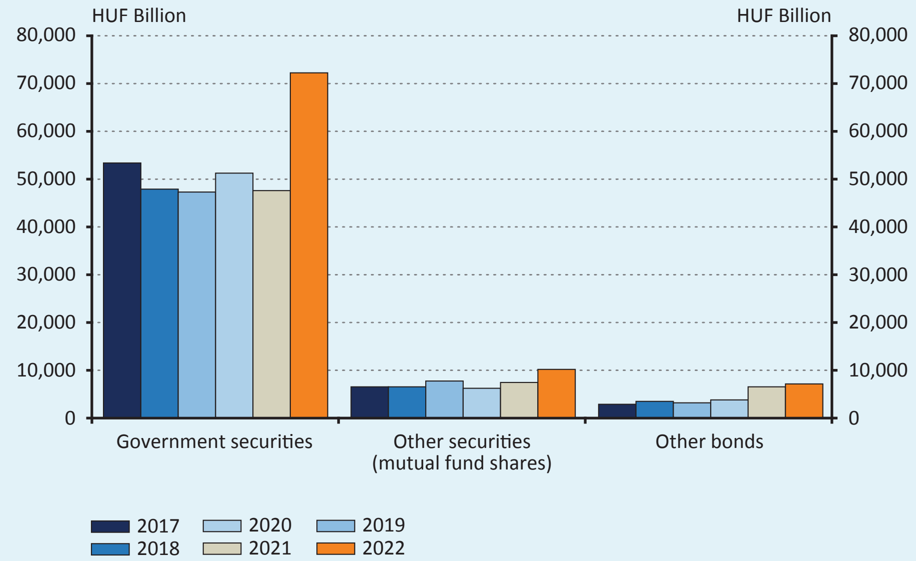
7.1.3 Strong growth in credit institutions' OTC spot capital market turnover

In contrast to previous years, non-forwarded OTC spot capital market turnover realised by investment service providers increased by 45.2 per cent from HUF 61,603 billion in 2021 to HUF 89,469 billion. In previous years, OTC spot turnover typically fluctuated around HUF 60,000 billion (2020: HUF 64,547 billion; 2019: HUF 57,114 billion, 2018: HUF 56,750 billion). The dynamics of turnover was mainly explained by the strong growth of the OTC spot capital market turnover of credit institutions: the OTC spot capital market turnover of credit institutions increased by 47.2 per cent in 2022, reaching HUF 80,976 billion, while the OTC spot capital market turnover of investment firms, HUF 8,493 billion, was 28.6 per cent higher than in the previous year. Accordingly, the dominance of credit institutions in OTC spot trading, again, exceeded 90 per cent and reached 90.5 per cent, up by 1.2 percentage points relative to 2021. The significant surge witnessed by credit institutions was mainly the contribution of two credit institutions providing investment services. In 2022, the number of credit institutions active on the OTC spot capital market decreased by two, from 18 in 2021 to 16 in 2022, while the number of investment firms remained unchanged. In the spot OTC capital market, the turnover of government bonds in 2022 rose by one and a half times from HUF 47,533 billion in 2021 to HUF 72,207 billion in 2022. The increase was mainly attributable to three credit institutions providing investment services. There was also a surge in the non-forwarded OTC spot turnover of investment fund shares: the value of HUF 10,118 billion in 2022 was up 40.3 per cent from the HUF 7,210

[36] Hereafter, non-forwarded transactions will not be marked as such when considering derivatives turnover on the stock exchange.

billion in 2021, representing a sector-wide growth. The OTC spot capital market turnover of other bonds increased: the 2022 turnover of HUF 7,155 billion was 9.3 per cent higher than the 2021 turnover of HUF 6,549 billion. The concentration of OTC spot capital market turnover increased significantly in 2022, with the top 5 market participants accounting for 72.9 per cent of OTC spot turnover, up by around 9.6 percentage points from 63.3 per cent in 2021 (70% in 2017, 68.7% in 2018, 64.7% in 2019, 66% in 2020). The composition of the top 5 largest OTC investment service providers changed: one credit institution was replaced by an investment firm in 2021 (Chart 7.4).

Chart 7.4
OTC prompt turnover by types of securities



Note: due to the negligible volume of the OTC turnover of shares, they are not included in the chart
Source: MNB

7.1.4 Overall, the stock of client securities remained stable despite the turbulence in the capital markets

In 2022, due to the turbulence in the capital markets caused by the Russia-Ukraine war on the one hand, and interest rate hikes by major central banks on the other, the market value of client securities managed by investment service providers remained broadly unchanged: HUF 48,340 billion in 2022, 0.5 per cent higher than the HUF 48,106 billion in 2021. The growth rate in 2022 was significantly below the historic high of 23.1 per cent in 2021, but also below the growth dynamics of previous years (2020: 2.1%; 2019: 11.3%; 2018: 5.9%). The HUF 40,593 billion in customer securities under management by credit institutions at the end of 2022 was 1.8% lower than the HUF 41,335 billion at the end of 2021 – a mixed picture at sector level. The stock of client securities managed by investment firms increased by 14.4% in 2022: the stock of HUF 7,747 billion managed at the end of 2022 was HUF 975 billion higher than the HUF 6,771 billion in 2021 – the dynamic growth is explained by the change in the stock of the first and second largest market players. In line with the above trends, the share of client securities managed by investment firms in total client securities under management reached a new historic high in 2022: the share of 19.1% in 2022 is 2.7% points higher than in 2021 and 8-10% points higher than in previous years.

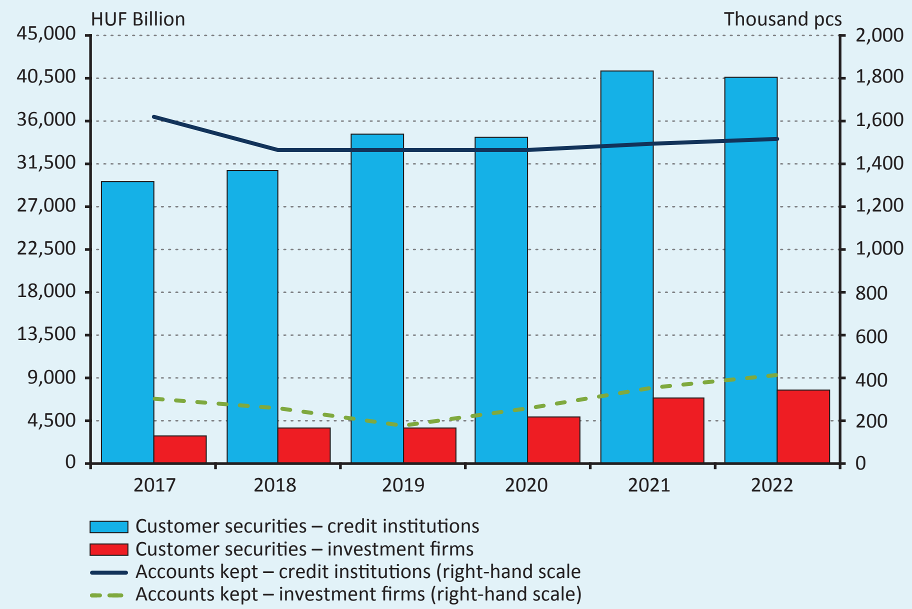
By asset class, the holdings of client securities of credit institutions providing investment services were mixed in 2022. In line with capital market developments, the stock of registered shares of credit institutions providing investment services decreased by 14.1% from HUF 15,627 billion at end-2021 to HUF 13,430 billion, while the stock of registered government securities decreased by 7.4% from HUF 13,638 billion at end-2021 to HUF 12,626 billion. This was partly offset by the dynamism of the stock of investment fund shares held by credit institutions: the stock of HUF 11,557 billion at the end of

2022 is 18.6% higher than the HUF 9,745 billion at the end of the previous year. The stock of corporate bonds registered with credit institutions also showed a strong increase, with the value of HUF 2,625 billion at the end of 2022 up 27% from 2021.

Investment firms' holdings of client securities increased in all asset classes except government securities in 2022. The stock of equities increased by 15.9% from HUF 3,143 billion at the end of 2021 to HUF 3,643 billion at the end of 2022, while the stock of mutual fund shares rose by 21.9% from HUF 2,398 billion at the end of 2021 to HUF 2,922 billion at the end of 2022 – the increase was present at sector level. The stock of government securities registered with investment firms fell by 22.4% to HUF 669 billion at the end of 2022 from HUF 862 billion in 2021 – the decline is mainly attributable to one institution. The stock of bonds jumped by 53% from HUF 271 billion in 2021 to HUF 414 billion at the end of 2022 – the increase is mainly attributable to one institution and also occurs in the stock of bonds issued by non-domestic issuers.

The number of client securities accounts held by investment service providers increased by 4.8% in 2022. Customer securities accounts held at credit institutions increased by 1.8% to 1,519 thousand, while investment firms saw an increase of 62 thousand, bringing the closing stock of 413 thousand in 2022 to 1,519 thousand, up 17.6% year-on-year (Chart 7.5).

Chart 7.5
Customer securities portfolio

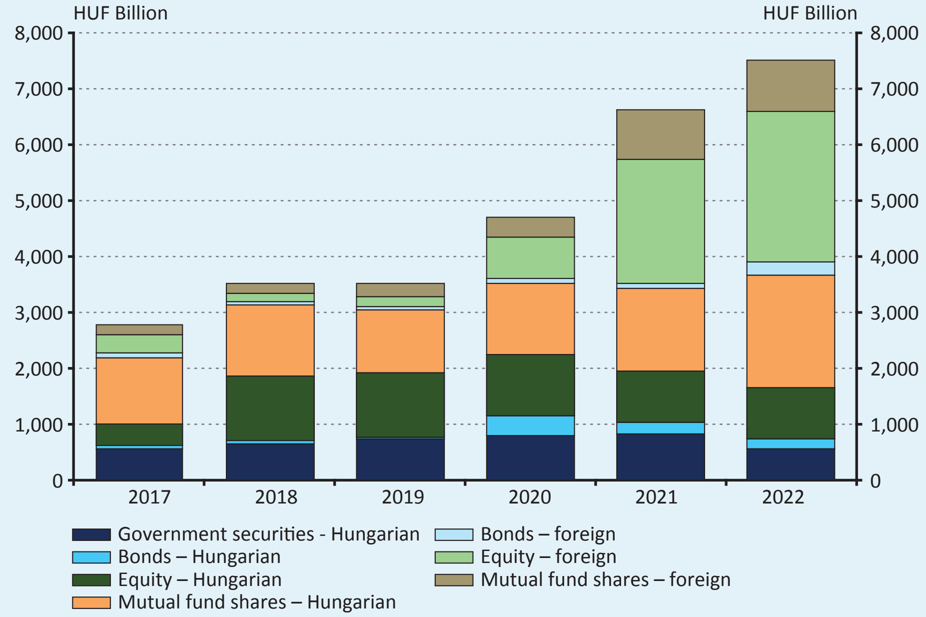


Source: MNB

7.1.5 Foreign issuers' share of investment firms' holdings of client securities continued to increase

The shares of the different asset categories in investment firms' holdings of client securities remained unchanged at sector level. Equity came first again, with a share of 47 per cent in 2022 (2021: 46.4%), followed by investment funds in second place with a share of 37.7 per cent (2021: 35.4%). The share of government securities, which ranked third, decreased from 12.7 per cent in 2021 to 8.6 per cent in 2022, while corporate bonds rose by 1.3 percentage points to 5.3 per cent in 2022. Looking at the domestic-foreign breakdown of asset categories, the weight of foreign-denominated securities increased further by 3.3 percentage points to 52.4 per cent in 2022. It should be noted that in 2021, the entry of a new foreign-backed large investment firm significantly increased the weight of foreign-issued securities, and accordingly, this share jumped from 25 per cent in 2020 to 48 per cent. Looking at the domestic-foreign split of government securities, the share of domestic government securities fell from the former 97-98 per cent to 81 per cent, owing to an increase in the government securities issued by non-EEA countries on account of the emergence of a new large foreign-backed investment firm in 2021 (Chart 7.6).

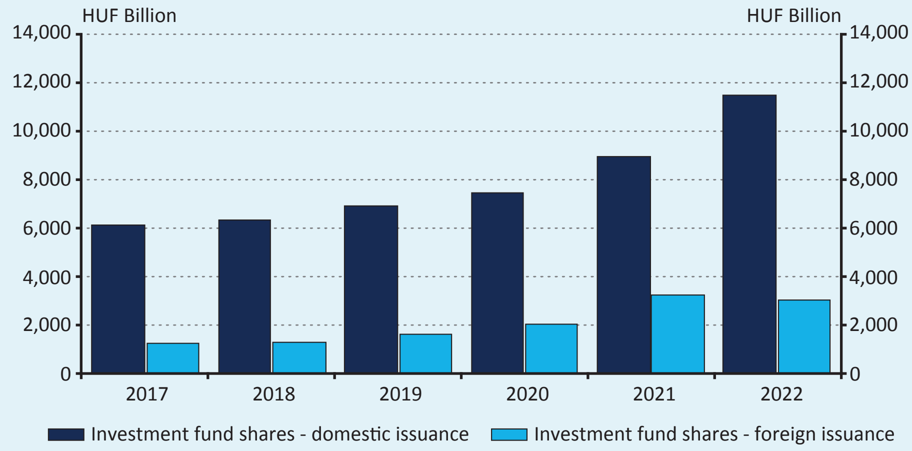
Chart 7.6
Customer securities portfolio by asset classes



Source: MNB

Considering the foreign-domestic distribution of investment fund shares registered by investment service providers among their client securities, an opposite trend was observed last year: while domestic investment fund shares were up by 28.5 per cent from HUF 8,932 billion in 2021 and reached HUF 11,480 billion by the end of 2022, foreign investment fund shares shrank from HUF 3,210 billion at the end of 2021 to HUF 3,005 billion at the end of 2022 (a decrease of 6.4 per cent year on year). The decline in foreign investment fund shares was due to credit institutions and practically characterised the whole sector. Domestic investment fund shares increased by 27.2 per cent to HUF 9,458 billion in 2022. For investment firms, domestic shares increased by 35 per cent, while foreign shares remained virtually unchanged in 2022. The share of foreign and domestic shares/units decreased from 36 per cent in 2021 to 26 per cent in 2022, a figure basically the same as in previous years. The hike of 36 per cent by the end of 2021 is attributable to the entry of a large foreign-backed investment firm (Chart 7.7).

Chart 7.7
Distribution of investment funds in terms of domestic-foreign issuance



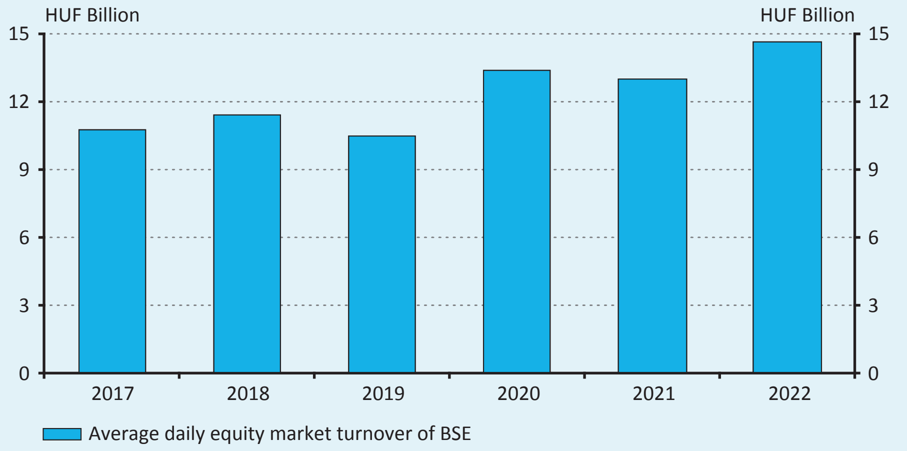
Source: MNB

7.2 REGULATED MARKET

7.2.1 Budapest Stock Exchange turnover increased in both key markets

The total turnover of the Budapest Stock Exchange in 2022 grew by 19.5 per cent year on year, significantly exceeding the 9.7 per cent growth in 2021 (2020: +19.2%; 2019: -6.1%; 2018: +2.8%). As in 2021, the growth in 2022 was driven by the performance of the derivatives market – derivatives turnover jumped by 27.1 per cent in 2022 (2021: +30%) to HUF 3,968 billion. The spot market also contributed to the growth: the HUF 3,802 billion turnover in 2022 was 12.5 per cent higher than in 2021 and 7.8 per cent higher than the HUF 3,526 billion spot turnover in 2020, which was generated by a surge in investor activity due to capital market turbulence. The increase in derivatives turnover in 2022 – similarly to 2021 – was the result of a 35.7 per cent jump in foreign exchange futures turnover which reached HUF 3,634 billion (2021: HUF 2,679 billion), while the turnover of other derivatives relevant to turnover dropped – index-based futures turnover fell by 26.6 per cent to HUF 155 billion and equity futures turnover by 27.1 per cent to HUF 160 billion. The concentration of the derivatives market increased in 2022: the turnover generated by the top 5 members covered 87 per cent of the total derivatives market turnover, which was about 3.1 percentage points higher than the 83.9 per cent in 2021 and practically the same as the 86.6 per cent in 2020. In terms of derivatives turnover in 2022, the composition of the top five exchange members changed from 2021 to 2022, and this change concerned one investment service provider. In 2022, the HUF 421 billion increase in spot market turnover was affected by a HUF 406 billion (12.4 per cent) increase in domestic equity turnover (Chart 7.8), a HUF 22 billion (22.5 per cent) increase in certificates turnover, and a HUF 7 billion decrease in mortgage bonds and corporate bonds turnover, which corresponds to an 87 per cent plunge. The turnover of mortgage bonds and corporate bonds was highly volatile in recent years: while in 2019 the turnover was low (HUF 2 billion), it jumped to HUF 32 billion in 2020, then fell to HUF 8 billion in 2021 and further dropped to HUF 1 billion in 2022. The concentration of trading turnover in the spot market decreased in 2022: the turnover generated by the first five members covered 84.9 per cent of the total spot market turnover, which was around 2.1 percentage points lower than in 2021. There were no changes in the composition of the top five members.

Chart 7.8
Average daily equity market turnover of the Budapest Stock Exchange

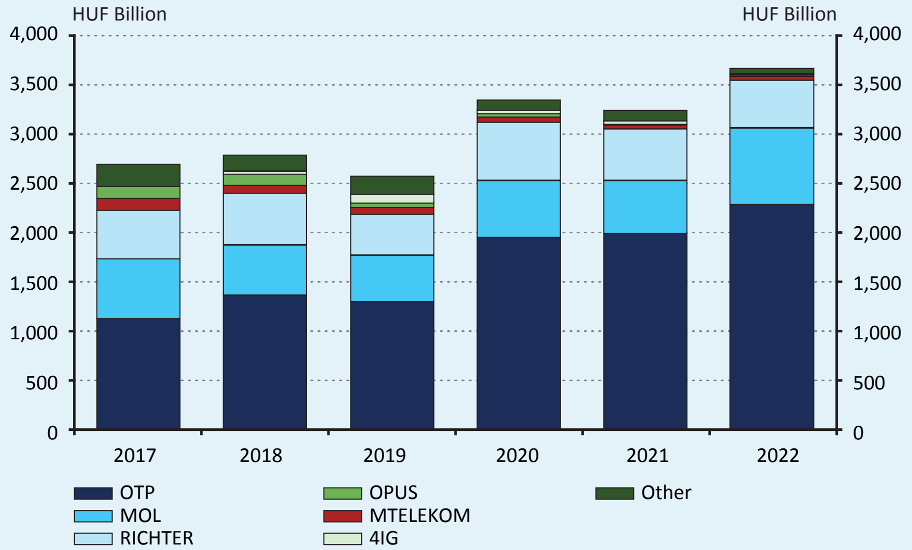


Source: MNB

7.2.2 Turnover concentration continued to rise on the Budapest Stock Exchange

In terms of issuers' stock market turnover, the composition and order of the top three most traded stocks – OTP, MOL, Richter – remained unchanged in 2022: OTP continued to be number one, followed by MOL and finally Richter in third place. The very high concentration of the stock market continued to increase in 2022: the top three largest issuers accounted for 96.8 per cent of the total stock market turnover in 2022, up by around 3.3 percentage points from 93.5 per cent in 2021 (2020: 92.8 per cent). The increase in concentration was mainly driven by a 45.7 per cent increase in MOL's share turnover (2021: HUF 538 billion; 2022: HUF 784 billion) and a 14.5 per cent hike in OTP's share turnover (2021: HUF 1,994 billion; 2022: HUF 2,284 billion), while Richter's turnover decreased by 6.8 per cent to HUF 486 billion. Of the other major issuers, all but Opus shares saw their turnover fall in 2022: Mtelekom's share turnover decreased by 2.7 per cent (2021: HUF 41 billion; 2022: HUF 40 billion), while 4IG's share turnover dropped by 67.9 per cent (2021: HUF 37 billion; 2022: HUF 12 billion) and Masterplast's share turnover plummeted by 72.1 per cent (2021: HUF 37 billion; 2022: HUF 10 billion). Opus share turnover increased by 18.5 per cent to HUF 14 billion in 2022 (Chart 7.9).

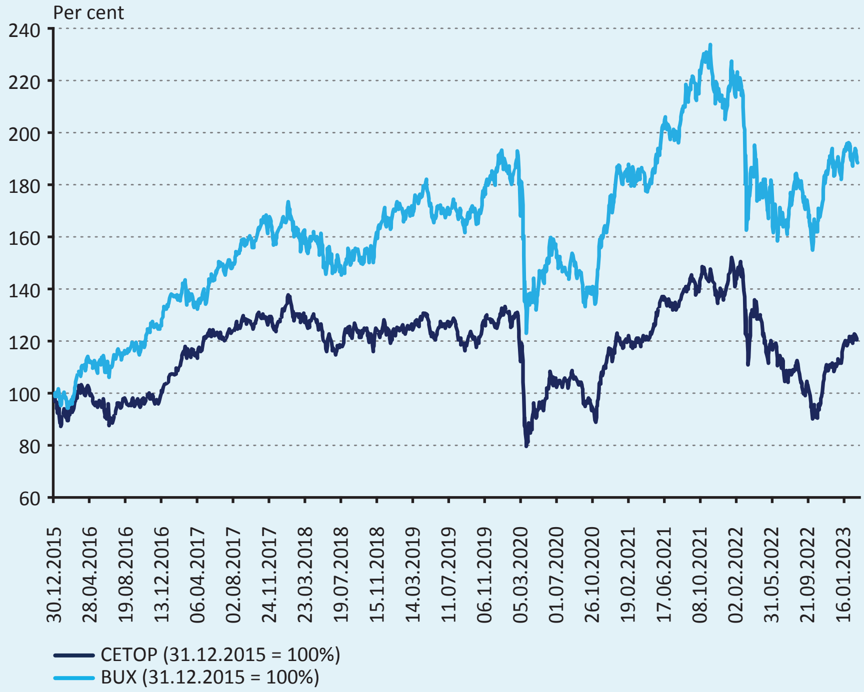
Chart 7.9
Annual stock exchange turnover of issuers



Source: MNB

After an increase of 20.6 per cent in 2021, the BUX index fell by 13.7% in 2022, from 50,721 at the end of December 2021 to 43,794 at the end of December 2022, due to the turbulence on the capital markets caused by the war between Russia and Ukraine. The BUX index reached its annual low on 29 September 2022, closing at 37,036 (Chart 7.10).

Chart 7.10
Changes in the BUX and CETOP indices



Note: CETOP is the Blue Chip Index of Central Europe and includes the 25 Central European equities of the highest capital value and stock exchange turnover. The composition of the index is revised twice a year, in March and September

Source: MNB

7.2.3 In 2022, shares of 12 new issuers were listed on BSE trading venues

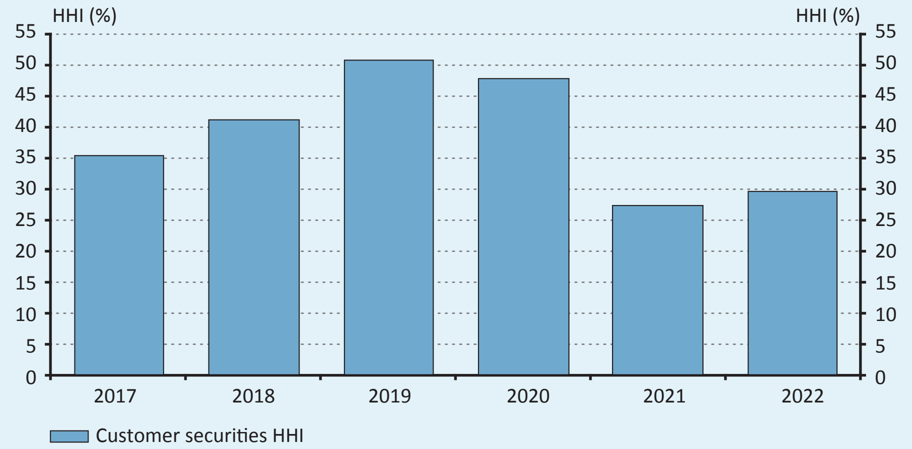
In 2022, the shares of eSense Nyrt. were admitted to the main market of the Budapest Stock Exchange (i.e. Xbud), the shares of Kartonpack Dobozipari Nyrt. were delisted and the shares of DM-Ker Nyrt. were transferred from the Xtend market to Xbud. In 2022, 11 issuers – EU-Solar Nyrt., Vivetech Nyrt., Biggeorge Property Nyrt., Naturland Holding Nyrt., Navigator Investments Nyrt., Multihome Nyrt., ASTRASUN Solar Nyrt., Valberg Nyrt., Energy Investment Nyrt., CDSyS Nyrt., Goodwill Pharma Nyrt. were listed, and one issuer on the Xtend market (Épduferr Nyrt.) was listed in 2021 on Xtend, the multilateral trading system created for SMEs, but trading started only in 2022.

7.3 RISKS OF INVESTMENT FIRMS

7.3.1 Market concentration in the investment firm sector remained low

The concentration of investment firms' holdings of client securities, as calculated by the Herfindahl-Hirschman Index (HHI), was 29.7 per cent at the end of 2022, up 2.3 percentage points from 27.3 per cent in 2021. The increase is mainly explained by the more dynamic growth of large investment firms, while the concentration of clients in the sector remained low compared to previous years. It is worth noting that the market share of small investment firms continued to decline in 2022: the market share of the 4 investment firms with the smallest holdings of client securities halved from 2 per cent in 2021 to 0.8 per cent in 2022 (2.2% in 2020 and 2.6% in 2019) due to the merger of a small investment firm (Chart 7.11).

Chart 7.11
Market concentration of customer securities portfolio

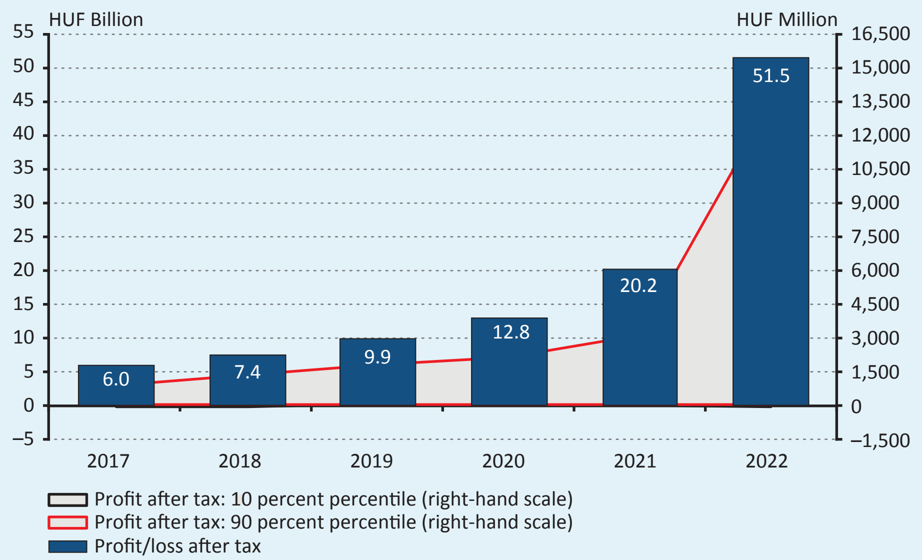


Source: MNB

7.3.2 Profitability of the sector remained high

The profitability of the investment firm sector, including branches, continued to grow by leaps and bounds in 2022, with a profit after tax of HUF 51.5 billion in 2022, up 155.4 per cent from HUF 20.2 billion in 2021 (year-on-year profit after tax grew by 57.8% in 2021 and 29.5% in 2020), reaching a new all-time high for the sector. Around half of the growth dynamics was attributable to the increase in the after-tax profit of a foreign-backed investment firm that entered the market in 2021, mainly serving foreign clients. At the same time, the profitability of the other large investment firms, which are typically active on the domestic market, also increased significantly, explained by the dynamics of their capital market turnover. Of the 13 investment firms active at the end of 2022, i.e., providing investment services, including branches, 9 recorded an increase in profit after tax, while 4 recorded a decrease in profit after tax: all of the latter were small investment firms. The sector's earnings concentration increased in 2022: the top 3 operators with the highest after tax earnings increased their combined after tax profit to HUF 41.4 billion, up from 75 per cent of the total sector's earnings in 2021 to 80.3 per cent, and the top 5 players with the highest after tax profit increased their combined after tax earnings to HUF 47.99 billion, up from 90 per cent of the total sector's earnings in 2021 to 93 per cent (Chart 7.12).

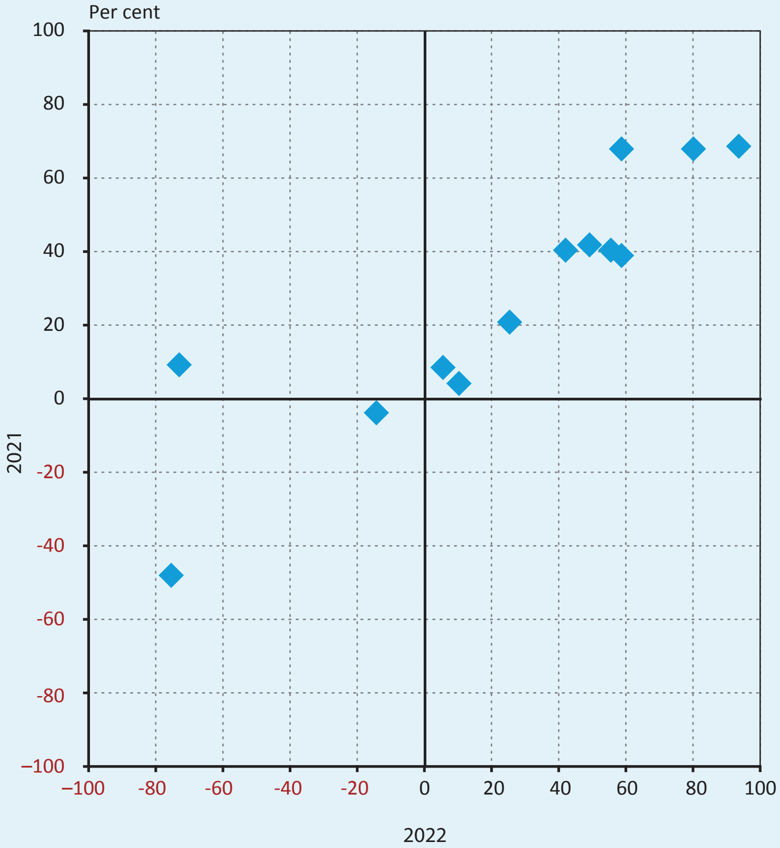
Chart 7.12
Profitability of investment firms



Source: MNB

While in 2021 two investment firms were loss-makers, this number increased to three in 2022. Of the three investment firms that were loss-makers in 2022, two were already loss-makers in 2020 and 2021: one was licensed in 2017 and had no client base and no client accounts, while the other loss-making investment firm had profitability problems due to the business model it used. The improvement in profitability at sector level was also boosted by the after-tax return on equity (ROE): as shown in Chart 7.13, investment firms were clustered to the right of the vertical zero axis.

Chart 7.13
ROE value of investment firms (percent)



Source: MNB

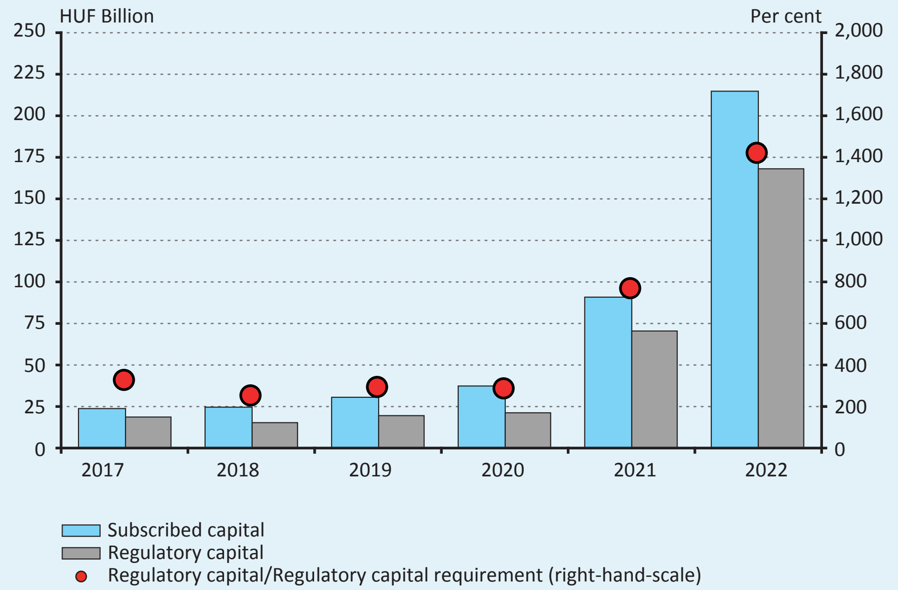
7.3.3 Good capital adequacy at sector level

The equity capital of investment firms increased from HUF 90.5 billion in 2021 to HUF 215.3 billion in 2022, due to an increase in the equity capital of a large foreign-backed investment firm. As a consequence, the capital adequacy of the investment firm sector also improved significantly, with the ratio of own funds to capital requirement jumping from 763 per cent in 2021 to 1,417 per cent in 2021. Even if the large foreign-backed investment firm was excluded, sectoral capital adequacy was still outstanding: the ratio of own funds to capital requirement reached 322 per cent in 2022, about 20 percentage points lower than the ratio of 342 per cent in 2021. Of the 11 investment firms domiciled in Hungary, all had own funds in excess of capital requirements at the end of 2022 (Chart 7.14). It should be noted that 2022 was the first full year in which the new IFR[37] applied to investment firms. The key change in the new IFR capital framework is that the capital requirement based on credit, market and operational risk exposures (Pillar 1 under the CRR), as defined by the former CRR[38], has been replaced by a so-called K-factor-based capital requirement covering the risks related to investment services, including risks to clients, markets and investment firms.

[37] IFR: Regulation (EU) No 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014

[38] CRR: Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012

Chart 7.14
Capital and capital adequacy ratio of investment firms



Source: MNB

Table 7.3
Sector level risk map of investment firms

Risk category	Risk groups	Risk rating	Risk prospects	Evaluation in words
Market risk	Global geopolitical and financial market events	significant	stagnant	The geopolitical tension at the global level, as well as the basically isolated institutional bankruptcies of the recent past, increase the volatility of capital market trading and investments, which require strict and effective risk management practices from the institutions, both from a prudential and consumer protection point of view.
Profitability	Interest rate environment, inflation	moderate	stagnant	The profitability of investment companies is stable at the sector level and ensures long-term capital adequacy. At the same time, the high inflation and interest rate environment can increase the operating costs of companies, and based on the nature of the business model, unique risks can affect profitability
Capital adequacy	Risks related to proprietary trading book positions Partner risk	moderate	stagnant	The capital adequacy ratio of the investment firm sector is favorable and stable. Investment firms' trading book exposure and counterparty risk are affected by changes in the yield environment and exchange rate volatility, for which the investment firms apply the risk management controls defined in the IFR/IFD proportionately. Specific liquidity and capital adequacy risks related to the business model may arise, which necessitate the imposition of additional requirements.
Regulatory risk	Transition to IFR/IFD regime	significant	increasing	The additional requirements related to sustainability related to investment advisory and portfolio management activities stemming from the amendments to the MiFIDII directive should be highlighted. The compliance tasks were also supplemented by the verification of securities sanctions provisions related to the Russian-Ukrainian conflict. In addition, several new regimes (CSDR, SFDR, SFTR) have been added to the regulatory framework of investment companies in recent years.

Legend:

Degree of risks	*high*	*significant*	*moderate*	*low*
Direction of risks	*increasing*	*stagnant*	*decreasing*	

Source: MNB

Summing up the risks, the profitability of investment firms at sector level was excellent, except for individual effects, but from a financial planning perspective, high interest rates and inflation could pose downside risks. The capital adequacy of the sector was stable. Recent events in international financial markets highlighted that, in addition to macroeconomic developments, the specific risks inherent in the business model of service providers could be a key determinant of long-term profitability and capital adequacy. In addition, ongoing compliance with ever-expanding international regulatory requirements demands significant organisational resources by investment firms, most notably the implementation of sustainability standards in investment advising.

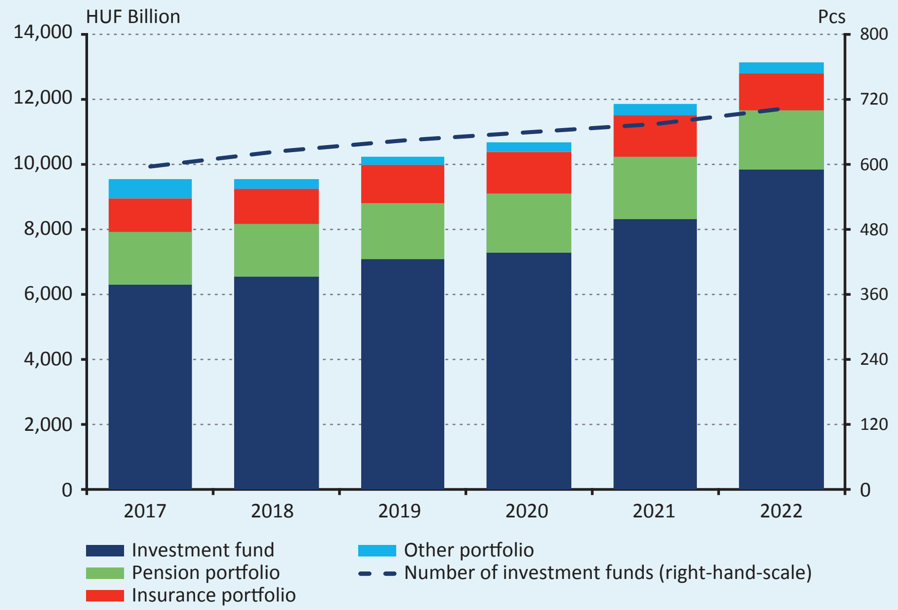
7.4 FUND MANAGEMENT MARKET AND RISKS OF INVESTMENT FUND MANAGERS

7.4.1 Further growth in assets managed by investment fund managers

The number of investment funds increased from 675 at the end of 2021 to 698 at the end of 2022. The previous trend of increasing real estate funds continued in 2022 and the number of real estate funds increased from 171 in 2021 to 189 at the end of 2022. In 2022, the number of securities funds also increased from 504 in 2021 to 509. The number of real estate funds also available to small investors increased from nine in 2021 to ten in 2022.

In 2022, even in the midst of the economic instability caused by the Russia-Ukraine war, assets managed by domestic investment fund managers continued to grow and reached a new historic high: managed assets of HUF 13,154 billion at the end of 2022 were 10.8 per cent higher than the HUF 11,875 billion at the end of 2021 (managed assets grew by 11.3% in 2021, 4% in 2020 and 7.5% in 2019). The increase in total assets managed by fund managers, including investment funds, pension funds, insurance and other portfolios, was triggered by a rise in the net asset value of investment funds, while the other portfolios typically showed a decrease. The December 2022 net asset value of investment funds of HUF 9,872 billion is HUF 1,578 billion (19%) higher than the 2021 net asset value of HUF 8,294 billion. For pension funds, assets under portfolio management for private pension funds decreased by HUF 26 billion (9.3%) from HUF 279 billion in 2021 to HUF 253 billion in 2022. In absolute terms, a larger decline was observed in the portfolio assets of voluntary pension funds, which decreased by HUF 123 billion from HUF 1,649 billion in 2021 to HUF 1,526 billion in 2022. In 2022, assets managed in other portfolios were virtually unchanged (HUF 336 billion), while assets managed by investment fund managers in insurance portfolios decreased by 12% to HUF 1,125 billion due to the exit of one fund manager (Chart 7.15).

Chart 7.15
Assets managed by investment fund managers and the number of investment funds

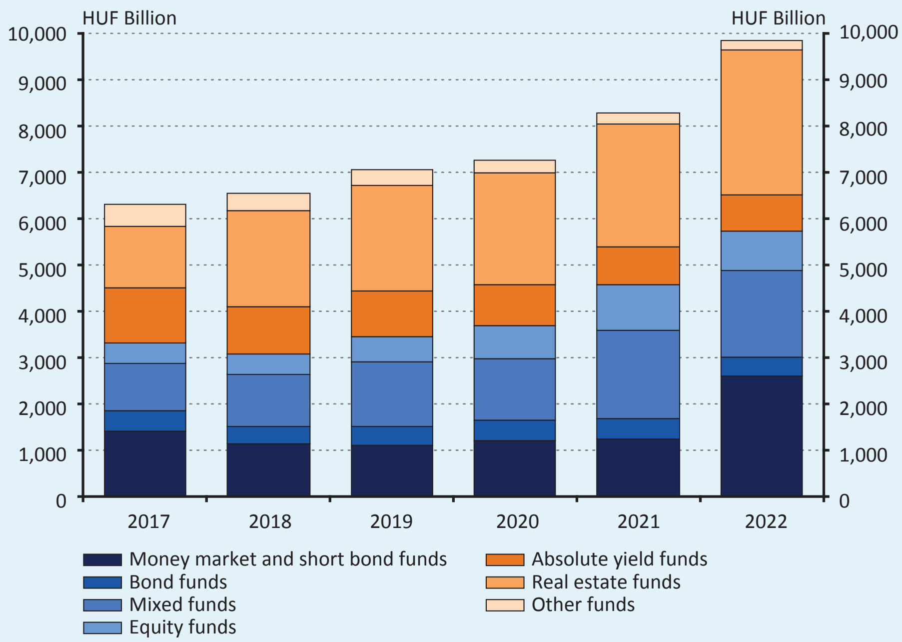


Source: MNB

7.4.2 Net asset value of investment funds reached new historic high thanks to capital inflows

Despite the economic instability caused by the Russia-Ukraine war, the net asset value of investment funds increased by 19% to HUF 9,872 billion in 2022. As in the previous year, the growth in the assets of investment funds in 2022 was driven by net inflows: of the HUF 1,578 billion increase in net asset value, HUF 1,470 billion was attributable to net inflows, while the remaining HUF 108 billion to returns. Assets managed by money market and short bond funds more than doubled from HUF 1,241 billion in 2021 to HUF 2,610 billion at the end of 2022. In contrast, the net asset value of bond funds fell by 11.6% to HUF 386 billion in 2022. Overall, the assets managed by mixed funds were virtually unchanged in 2022 (2021: HUF 1,898 billion, 2022: HUF 1,890 billion). A significant decline was observed for bond-heavy mixed funds, whose net asset value fell by 47.2% from HUF 584 billion in 2021 to HUF 308 billion. In contrast, the assets under management of balanced mixed funds increased by 40.1% from HUF 787 billion in 2021 to HUF 1,103 billion. After a dynamic increase in the previous year, assets managed in dynamic mixed funds decreased by 9.2% to HUF 478 billion in 2022. Following increases of 32.9% in 2020 and 37.1% in 2021, the net asset value of equity funds fell by 14.9% to HUF 862 billion in 2022: of the HUF 151 billion decline, HUF 33 billion was brought about by capital withdrawal, while the remaining HUF 118 billion was due to the impact of returns. The decline in the assets of capital protected funds in recent years continued in 2022: the net asset value of capital protected funds in 2022, at HUF 58 billion, was 32.7% lower than in 2021 – since 2016, the net asset value of capital protected funds fell to around the ninth of the around HUF 500 billion in previous years. In line with the market trends of previous years, the growth of real estate funds – funds investing directly and indirectly in real estate – continued in 2022: at the end of 2022, assets held in real estate funds amounted to HUF 3,131 billion, 18.1% higher than the closing value of HUF 2,650 billion in 2021 (Chart 7.16).

Chart 7.16
Breakdown of the investment funds by investment policy

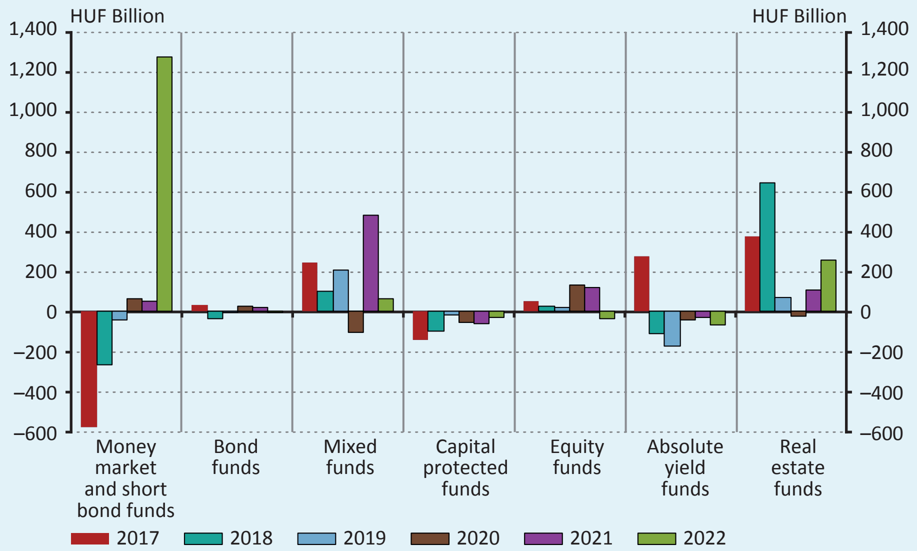


Source: MNB

7.4.3 Net inflows of investment funds reached new historic high

In 2022, investment funds recorded extraordinary positive capital inflows, far exceeding the levels seen in previous years: in 2022, investment funds had a total net capital inflow of HUF 1,470 billion, more than double the HUF +699 billion net capital inflow in 2021 and several times higher than the HUF +12 billion in 2020, the HUF +67 billion in 2019, the HUF +260 billion in 2018 and the HUF +270 billion in 2017. This surge in net capital inflows was the result of increased retail demand for money market and short bond funds, prompted by soaring inflation and the attractive yields on money market and short bond funds. Retail demand was so strong that by the end of the year, bond funds held the largest assets, dethroning mixed funds. The largest net capital inflows in 2022 were observed in money market and short bond funds: the net capital inflows of HUF +1,278 billion in 2022 fully reversed the net capital outflows of HUF -1,267 billion in the previous 9 years, i.e. in the period 2013-2021. Demand for mixed funds moderated over the past year, with net inflows of HUF +63 billion in 2022 being significantly below the HUF +484 billion in 2021. For absolute return funds, capital outflows accelerated: net capital outflows of HUF 68 billion in 2022 were more than double the HUF 31 billion in 2021 and one and a half times the HUF 41 billion in 2020; it should be noted that retail demand for absolute return funds had been declining since 2018, with five consecutive years of net capital outflows. As with absolute return funds, capital outflows were also recorded for capital protected funds in 2022 (HUF -26 billion) (Chart 7.17).

Chart 7.17
Net capital flows of investment funds



Source: MNB

Box 7.1
Amended regulation of securities funds

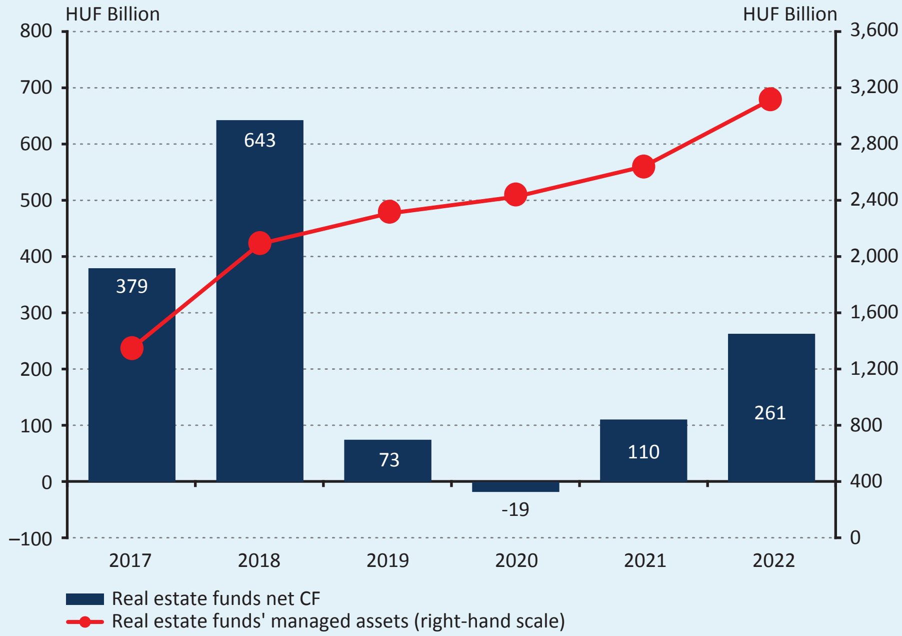
In its Decree No 156/2023 of 27 April 2023, the Government set the minimum amount of securities to be held by securities funds. According to the Government Decree, bond funds, equity funds and mixed funds are defined as securities funds whose assets held in the portfolio are composed of securities in a ratio of at least 60 per cent. In other words, the legislator requires securities funds to have a securities-weighted portfolio. According to a related statement from the Ministry of Economic Development, in order to ensure that the funds are designed to protect investors to the fullest extent, securities funds must have a security-weighted profile, as their name clearly implies.

The Government Decree enters into force on 1 July 2023, meaning that investment fund managers will have until that date to restructure their relevant funds to meet the 60% minimum requirement. The new provision does not affect investment funds alike, only part of the sector needs to restructure its portfolio to comply with the legislation. As part of their adaptation, fund managers must invest their assets previously held in bank deposits or in other investment forms at least to the extent expected.

7.4.4 Stronger capital inflows for real estate funds in 2022

In 2022, capital inflows into real estate funds – funds investing directly and indirectly in real estate – accelerated: net capital inflows of HUF 261 billion in 2022 were nearly 140% higher than net capital inflows of HUF 110 billion in 2021 (Chart 7.18). Interest in real estate funds continued to focus on closed-end real estate funds. For funds investing directly in real estate, the net asset value increased from HUF 2,304 billion in 2021 to HUF 2,640 billion in 2022: of the HUF 336 billion increase, the investment return on assets equalled HUF 157 billion, while net inflows amounted to HUF 179 billion. The HUF 491 billion net asset value of funds investing in indirect real estate in 2022 is 41.7% higher than the HUF 347 billion in 2021. Of the HUF 145 billion increase in the net asset value, HUF 83 billion was affected by net capital inflows and HUF 62 billion by returns on investments.

Chart 7.18
Portfolio and net capital inflows of real estate funds



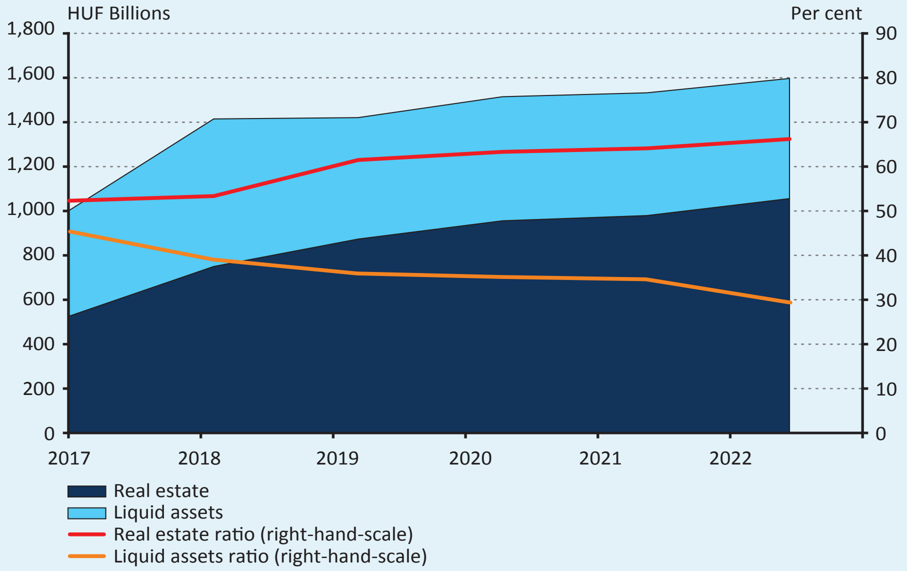
Source: MNB

7.4.5 Increase in assets of public real estate funds in 2022

In 2022, the portfolio of public real estate funds of nearly HUF 1,600 billion was 4.3% higher than their closing assets in 2021 (the increase was 0.6% in 2021, 6.9% in 2020 and 0.4% in 2019). The HUF 66 billion increase in the net asset value of public real estate funds in 2022 was the result of two opposite effects: while investors withdrew a total of net HUF 69 billion from public real estate funds in 2022, this was offset by a HUF 135 billion return on investment. Public real estate funds recorded net capital outflows mainly in the second half of 2022, as net capital outflows in the first half of 2022 were negligible. This can be explained by an accelerating inflation in the second half of 2022, and attractive alternative investment opportunities – a surge in short government bond yields – in the second half of 2022. Despite the withdrawal of capital, the share of real estate investments in public real estate funds ranged between 65% and 68% in 2022, up by

3 percentage points from 63-66% in 2021 (Chart 7.19). The high concentration in the public real estate funds market increased in 2022: the 3 public real estate funds with the highest net asset values accounted for 77.2% of the total net asset value of public real estate funds, 2.3 percentage points higher than the 75.9% in 2021. In 2022, a new public real estate fund appeared on the market.

Chart 7.19
Real estate investment portfolio of public real estate funds and the ratio thereof compared to net asset value

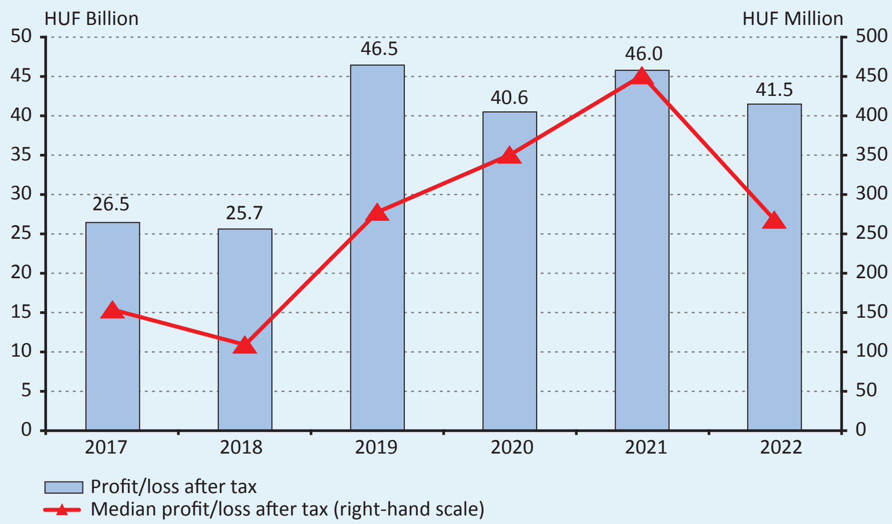


Source: MNB

7.4.6 Profitability in the fund management sector remained high

Investment fund managers' net profit after tax fell by 9.7% from HUF 46 billion in 2021 to HUF 41.5 billion in 2022. The decline was due to the fact that a large institution transformed into a branch and is thus no longer supervised by the MNB. If this effect is neglected, the after-tax profit of investment fund managers in 2022 was 4.4% higher than in 2021. In 2022, the number of loss-making fund managers fell to three from four in 2021. In 2022, loss-making fund managers' after-tax profit equalled HUF -108 million, 36% lower than in 2021. Of the three loss-making fund managers, two have been loss-making since their inception – three years ago (Chart 7.20).

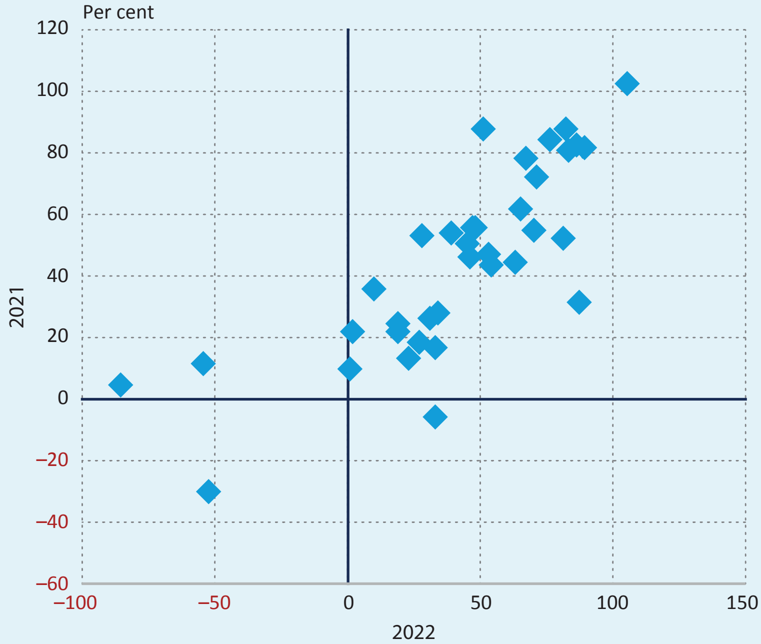
Chart 7.20
Profitability of investment fund managers



Source: MNB

In 2022, the concentration of income in the investment funds management sector decreased significantly, as the above-mentioned large institution changed into a branch and because of the merger of two large investment fund managers: the 5 largest market players in terms of after-tax profit accounted for 47.9% of the total sector's after-tax profit in 2022, 9.2 percentage points lower than in 2021. Overall, the business model of investment fund managers continued to be characterised by high profitability in 2022, as evidenced by the high level of ROE – profit after tax to equity: only those investment fund managers that were still active in 2021 and 2022 and did not surrender their licence in 2022 were included in Chart 21 (Chart 7.21).

Chart 7.21
ROE value of investment fund managers (percent)



Source: MNB

Table 7.4
Sector level risks of investment fund managers

Risk category	Risk groups	Risk rating	Risk prospects	Evaluation in words
Market risk	Liquidity, operation of real estate funds in a stress environment"		⬆	The lingering effects of the Russian-Ukrainian conflict, the energy crisis that unfolded in 2022, the accelerating inflation in the second half of 2022, and the risks of bank lending all increase the vulnerability of financial markets. In the strong uncertainty, rapidly spreading, turbulent movements can be expected in various market segments. Investment funds were challenged by the rising short-term government bond yields in the second half of 2022, which offer a good alternative investment opportunity.
"Corporate governance"	Aspects related to sustainability, stricter international expectations		➡	The corporate governance of fund managers continues to be challenged by the expansion of domestic and EU legislation. Primarily, meeting the expectations related to sustainability and ESG topics and avoiding the phenomenon of "greenwashing" is a challenge.
Profitability	Market yield environment"		➡	The profitability of the fund management sector remained high in 2022, however, due to the difficult macroeconomic situation and uncertain market prospects, the fund management sector may face a more difficult period. Income from fund management and success fees may fall as a result. The sector is challenged by the high interest rate environment and the competitive situation generated by the yields of residential government securities. Income from success fees may be affected by the fact that the fund management sector has modified its success fee models for the period of 2022 and 2023 in accordance with the expectations of ESMA and the MNB.
Operational risk	Risk management systems"		➡	For the time being, there is little domestic capacity to prepare ESG analyzes and ratings, which is why institutions typically need to use external service providers. For some fund managers, it is necessary to develop the risk management, liquidity management and back-office processes due to the above.
Capital adequacy	Profitability		➡	The profitability of the fund management sector is stable, and the capital situation of smaller fund managers is also improving. From capital situation point of view, the consolidation observed in the sector has a positive effect.

Legend:

Degree of risks	*high*	*significant*	*moderate*	*low*
Direction of risks	*increasing* ⬆	*stagnant* ➡	*decreasing* ⬇	

Source: MNB

In 2022, the outbreak of the Russia-Ukraine conflict affected the fund management sector through several channels. In the aftermath of the war, an energy crisis, accelerating inflation and high interest rates, capital market participants had to adapt quickly. However, the direct impact of the freezing of Russian markets on the domestic fund management sector was limited. Two market leader fund managers had dedicated Russian-focused equity funds the trading of which had to be suspended as many securities ceased to be traded and quoted. Within their Russian equity funds, the two fund managers concerned segregated their assets – typically Russian securities – which had become permanently illiquid due to the war. Generally speaking, the stock of domestic investment funds with Russian exposure was minimal within the investment fund market. Despite the challenges, the profitability of the fund management sector remained stable in 2022, with no intervention needed in terms of capital position. In terms of capital, the consolidation observed in the sector had a positive effect. For the future, fulfilling expectations concerning sustainability and ESG issues, and avoiding greenwashing remain the main challenges.

Box 7.2
Developments in sustainable finance

In the area of sustainable finance, it is worth highlighting that by the end of 2022, both the SFDR[39] and the Taxonomy[40] regulations had become fully applicable and the relevant detailed rules were, for the most part, also in force. These include the SFDR RTS[41], the MNB Q&A[42], which complement the previous regulations, and Regulation (EU) 2017/565[43], NGM Regulation No 16/2017 (VI. 30.)[44], and the updates of the ESMA Suitability Assessment Guidelines[45], which set out the expectations for sustainability.

With regard to the obligations of market actors, in summary, the main expectation is to ensure transparency as to how they manage sustainability risks and how they deal with impacts that are detrimental to sustainability. Providers of financial products are also subject to specific product-level disclosure obligations, while providers with an investment advising and portfolio management profile are required to assess and meet any sustainability preferences of the client – these obligations also entail extensive information gathering and verification obligations.

The main difficulty with sustainable financial products in Hungary is still the lack of mass uptake of these instruments, and the biggest challenge for the MNB is to encourage this process without significantly increasing the risk of greenwashing. To this end, the MNB has taken a number of initiatives, including the organisation of workshops, consultations for market participants, the launch of the Green Financial Product Finder and, more generally, advocacy in both legislative and enforcement processes.

Box 7.3
Capital market developments in the first quarter of 2023

The domestic capital market grew in the first quarter of 2023. The Budapest Stock Exchange's first quarter 2023 spot turnover was almost 2% higher than in the last quarter of 2022, while stock prices declined. Holdings of client securities managed by investment service providers – credit institutions and investment firms providing investment services – increased by 2.7% in the first quarter of 2023 compared with the end of 2022. For credit institutions, growth in client securities exceeded 2.8% in the first quarter of 2023, while for investment firms it stood at 2.1%.

[39] Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector
[40] Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088
[41] Regulation (EU) No 2022/1288 EU supplementing Regulation (EU) No 2019/2088 of the European Parliament and of the Council with regard to regulatory technical standards specifying the details of the content and presentation of the information in relation to the principle of 'do no significant harm', specifying the content, methodologies and presentation of information in relation to sustainability indicators and adverse sustainability impacts, and the content and presentation of the information in relation to the promotion of environmental or social characteristics and sustainable investment objectives in pre-contractual documents, on websites and in periodic reports
[42] Questions and Answers on the application of Regulation 2019/2088 on sustainability-related disclosures in the financial services sector and Regulation 2020/852 on the establishment of a framework to facilitate sustainable investment https://www.mnb.hu/letoltes/20220629-sfdr-tr-qa-final.pdf
[43] Regulation (EU) 2017/565 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive
[44] NGM Decree No 16/2017 (VI. 30.) on the product approval process to be applied by investment firms
[45] Guidelines on certain aspects of the MiFID II suitability requirements https://www.esma.europa.eu/sites/default/files/2023-04/ESMA35-43-3172_Guidelines_on_certain_aspects_of_the_MiFID_II_suitability_requirements.pdf

Assets managed by investment fund managers grew more dynamically, rising by 8.1% in the first quarter of 2023 to HUF 14,219 billion. The growth was mainly triggered by the increase in assets managed by investment funds, in particular money market and short bond funds. Investment funds continued to show strong positive net inflows in the first quarter of 2023. Demand for money market and short bond funds remained massive and net inflows into these funds reached HUF 523 billion in the first quarter of 2023. At the same time, mixed funds, equity funds and absolute return funds experienced net capital outflows during this period, bringing the total net inflows of investment funds to close to HUF 480 billion in the first quarter of 2023. Public real estate funds were stable at sector level, with sector-wide liquidity ratios trending upwards from December 2022, while the vulnerability of the euro area real estate fund sector increased over the past period.

In the first quarter of 2023, the SREP of investment undertakings conducted by the MNB concluded that the capital adequacy of the investment business sector was adequate.

7.5 CONSUMER PROTECTION IN THE CAPITAL MARKET

In line with the objectives set out in the MNB's 2020-2025 supervisory strategy (consumer focus, strong consumer protection), consumer protection supervision in the capital market first and foremost seeks to ensure that product sales practices result in the recommendation of suitable capital market investment opportunities to customers coupled with a transparent, understandable and fair presentation of the costs of the service and the risks related to the investment vehicles offered. Guided by this approach to consumer protection, the MNB carried out consumer protection inspections examining various aspects in recent years.

7.5.1 Annual ex-post cost information

Investment service providers are required by law to provide their clients with information at least annually, including ex-post, on the costs of all the services they have used and the financial instruments sold to them. Cost disclosures, already a focus of the MNB's consumer protection-focused supervision of the capital market in 2020, were included in the prioritised topics of the ESMA risk heat map in 2022, which led to European supervisors acting according to a common methodology – the common supervisory action coordinated by ESMA (CSA). The MNB, cooperating under the CSA, has reassessed the ex-post cost disclosure practices of investment service providers after 2020 and 2021 adhering to the expectations set out in the MNB's 2020 Management Circular and the criteria set by ESMA. Based on the good practices identified among domestic market players and the foreign good practices learned through participation in various international working groups, the MNB has issued a management circular to draw the attention of service providers to the practices they are expected to follow, primarily in order to ensure that customers receive more consistent ex-post cost information and that customers have access to this information in a timely manner. On the basis of the 2022 backtesting, it can be concluded that MNB's expectations have been properly incorporated into ex-post cost reporting practices of service providers: similarly to the information for 2020, the majority of service providers (13 out of 15) sent their cost statements for 2021 to customers already by the end of April or the beginning of May 2022. The statements provide an appropriate breakdown of the costs related to the products and services, the impact of costs on returns is presented in an appropriate manner, and the standard explanations attached to the statements by the service providers, which have been developed as per the MNB's guidelines, make the content of the individual types of costs and the interpretation of the statements clearer and easier to understand for customers. The backtesting shows that service providers include payments accepted from third parties and spreads in their cost statements, and that service providers also provide customers with statements by asset either as part of their standard cost information or on the request of the customer, which is highlighted in the information provided. Based on the MNB's guidelines, more than half of the service providers covered by the inspection have a practice of informing their customers separately about the costs incurred in a given period of the year after they conclude a contract for a service. The MNB reported on the progress identified in the backtesting exercise and the good market practices in a separate report submitted to ESMA under the CSA.

Based on the results of the backtesting carried out in the context of ongoing supervision, the MNB also launched a thematic inquiry into the drafting of annual cost statements by investment service providers that had not put adequate internal policies in place. This was the fourth in a row of the MNB's consumer-focused thematic inspections of the capital markets following the compliance assessment, suitability assessment and review of the product governance practices building on the common supervisory action initiated by ESMA. The inspection concluded with management letters in which the MNB called on the service providers concerned to lay down internal rules for the ex-ante verification of the cost data included in the cost statement, to establish internal rules that make the method of compiling the statements easy to follow, to include more information on the use of payments accepted from third parties, and to adopt the practice of sending the cost statement to customers together with the last balance statement where the contract has been terminated.

7.5.2 Ex-ante cost information

In addition to monitoring compliance with the requirements of annual ex-post cost reporting, ESMA has scheduled a common supervisory action for ex-ante cost reporting in 2022. In the context of up-front cost information, service providers should inform clients in good time before the execution of investment transactions about the expected costs and expected impact on the return of the transaction and the product. Mystery shopping was used as a tool to assess market practice. The MNB carried out mystery shopping at several investment service providers that had a large branch network and market share in order to assess their product and cost disclosure practices through the use of investment advice on investment funds. The mystery shopping exercise revealed a positive picture of the information practice and the preparedness of the advisers. During the advisory process, the service providers (advisors) provided detailed information on the related transaction, account management and fund management fees in a clear and understandable way before they gave advice, and in several cases, this was done in the form of a written statement in addition to verbal information. The information provided on the recommended product was objective and limited to that contained in the official product information documents. No action was warranted in relation to information practices, but the MNB required a review of two service providers for deficiencies in gathering information before giving advice (experience, knowledge, assessment of the investment objective). In addition to on-the-spot mystery shopping, the MNB also checked the ex-ante cost information practices related to electronic transactions, which showed that when executing a transaction for a given product, service providers give a statement of the expected costs in two steps, one general and one detailed, tailored to the parameters of the transaction: in the former case, the supply an estimated cost calculation that can be partly tailored to the customer and the product, and in the latter case, a breakdown by the different types of expected actual costs, such as transaction costs. The MNB provided ESMA with a separate detailed report on the findings of the inspection.

7.5.3 Follow-up to the suitability assessment thematic inspection

The MNB's 2020-2021 thematic inquiry, the second consumer-focused inspection of the capital market under the CSA, examined in detail the suitability assessment practices of 13 investment service providers for the investment products they sell. The main focal points of the inspection were the content and the evaluation logic of the suitability assessment questionnaires, the risk rating of the recommended assets and its methodology, the suitability reports that support the investment advice, and the cost-benefit analysis to be performed when switching between investment products. For the 13 inspected institutions, there were a total of 62 findings that required action, 23 of which took the form of an MNB decision specifying an obligation, and 39 that of a management letter setting out expectations. In addition to the feedback from each institution, the MNB also issued a management circular at the end of the inspection, in which, in addition to describing positive practices, it further elaborated on the MNB's recommendation concerning the relevant legislation or the subject, sometimes also giving examples to illustrate its expectations. In 2022, the MNB closely monitored the implementation of the required measures and the actions taken by service providers as part of its continuous supervision, which showed that service providers, for the most part, complied with the requirements specified in the MNB's decision and management letter. Due to the complexity and time needed for the necessary IT upgrades, some providers still have actions underway to ensure that the suitability assessments are comprehensive both in terms of content and their logic, and they regularly report such actions to the MNB.

7.5.4 Product governance thematic inspection

Product governance obligations have been introduced in the investment services market with MiFID II, with the focus of the regime being on identifying the target market for products and developing a distribution strategy. When identifying target markets, service providers essentially examine products and product groups from the point of view of the level of knowledge and experience expected for investment, the time horizon for which the product is recommended to be invested, the investment objective to be achieved and the risk tolerance and loss-bearing capacity needed to achieve these objectives. This obligation applies to both product manufacturers and distributors. For the latter, it is essentially a matter of adapting to the target market characteristics and distribution strategy defined by the product manufacturers. At the same time, using information from product manufacturers and their knowledge of their own customer base, they also need to define the target market for the products they sell. The definition of the distributor's target market is particularly important in cases where the distributor is not related to the product manufacturer (e.g. in the case of products traded on the stock exchange). Based on an ESMA initiative, the MNB launched a thematic inquiry in 2021 to monitor the product governance practices of investment service providers, which was the third in a row of the MNB's thematic inquiries with a focus on consumer protection in the capital markets in the context of ESMA's CSA to strengthen supervisory convergence. The inspection covered 16 institutions. The main objective of the study was to verify whether the institutions, both as manufacturers and distributors of products, have adequate regulation, processes and approvals for product governance, in terms of the methodology for setting target market characteristics and reviewing characteristics, and whether the target (and negative target) market characteristics defined for specific products and product groups are indeed appropriate, taking into account all the relevant product characteristics. The thematic inspection was closed by the MNB in 2022. The MNB did not detect any serious irregularities, but identified practices of concern in terms of consumer protection at several institutions. A recurring problem was that the target market criteria for certain products and product groups were not always well defined. For some service providers, some elements of the criteria required by the MNB were not assessed, while for others, although all aspects were included in the assessment, there was insufficient differentiation between products or, in particular for higher risk products, the target market was not adequately characterised. According to the legal requirement, products can in principle be sold within the defined (positive) target market, but it is also allowed to sell products outside it in justified cases. In this respect, many operators define cases outside the target market where a customer does not meet a criterion, but this does not necessarily exclude them from the scope of the legislation. Service providers must also define a negative target market, customers within this market are not normally matched by product characteristics, but products can also be sold with due justification in this case. In the MNB's experience, most service providers allow such transactions for services that do not involve investment advice, but some institutions will forego this requirement even when advice is given (e.g. for diversification or hedging purposes). For several institutions, it was noted that a negative target market was not defined for complex, high-risk products: the MNB called on the institutions concerned to remedy this. During the inspection, the MNB also paid particular attention to the exchange of information between distributors and product manufacturers. This was adequate for most institutions, however, there were institutions where this did not meet the MNB's expectations, for example due to the lack of adequate records of sales outside the target market and negative sales on the target market. The MNB, together with other supervisors, reported the main findings of the inspection to ESMA, which will revise and supplement its recommendations on the basis of the reports, where appropriate.

7.5.5 Expanding suitability and product governance requirements

In 2022, a new element was added to the suitability assessment and product governance obligations of investment service providers: following the revision of the MiFID II Directive, the suitability assessment will require information to be collected and assessed on clients' sustainability preferences and its results to be incorporated into the providers' target market analysis and distribution practices in relation to the provision of advice and portfolio management services. In order to review the target market analysis, providers should also collect detailed information on which products sold with advising and portfolio management are considered sustainable financial instruments. In addition to the new legislation, ESMA has also issued guidelines on the subject. The MNB conducted two rounds of market consultations with investment service providers in the context of ongoing supervision to monitor and support the practical implementation of the new requirements, clarifying supervisory expectations and gathering information on the challenges faced by market participants, in particular regarding the collection of data on products. The MNB monitors market participants' compliance in the context of ongoing supervision, for example by completing the suitability questionnaires on sustainability preferences, which the MNB has already set out as a supervisory expectation in the management letters to market participants that conclude the suitability assessment.

7.5.6 Cross-border CFD providers

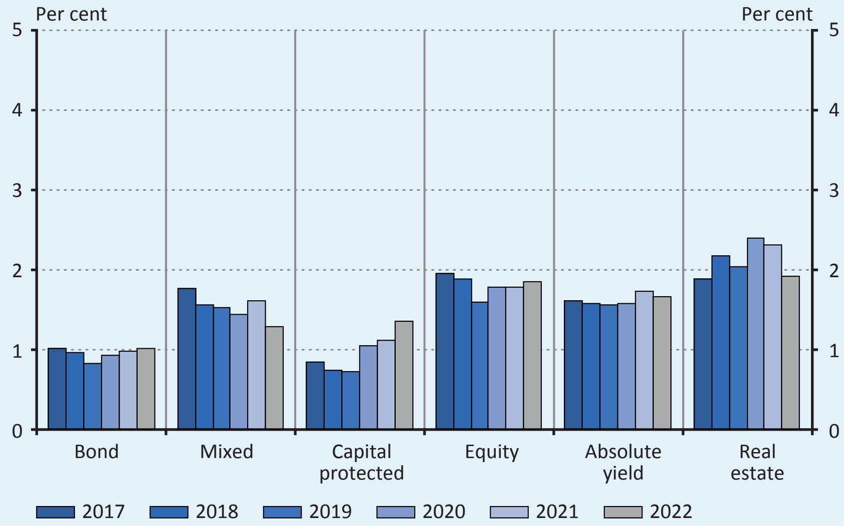
A significant number of institutions providing cross-border services in Hungary from other EU Member States offer high-risk CFDs to Hungarian clients. MiFID II has given both national supervisors and ESMA the opportunity to impose restrictions or prohibitions on the manufacturing and distribution practices of certain products in order to mitigate consumer protection risks. Because of the high risk and speculative nature of CFDs, ESMA and then the supervisors of some Member States, including the MNB, have taken advantage of this possibility and imposed strict restrictions on the sale of CFDs. In 2020, the MNB, in line with other Member States, extended its measure on domestic CFD providers to cross-border providers and banned the sale of binary options to retail customers. As part of its regular consumer protection monitoring activities in the capital markets, the MNB continuously follows the advertisements and websites of the more popular cross-border service providers that advertise in Hungarian on social media or on other internet platforms, primarily with regard to the information elements it requires, such as mandatory risk warnings and the balanced nature and accuracy of messages conveyed in connection with CFD trading. The MNB did not identify any serious breaches of the law, but identified a number of cases of consumer protection risks in the information provided for which it referred several cases to the foreign supervisory authority supervising the institution. In view of the high risk of CFDs, the MNB will continue to monitor advertising by providers closely. It is important to underline that the MNB's product intervention decision on CFDs (or binary options) applies to CFDs traded by investment firms domiciled in Hungary, as well as to CFDs traded by branches or cross-border services to retail clients in Hungary: i.e., the restrictions set out in the decisions apply not only to domestic service providers involved in the sale of the product, but also to all market participants potentially authorised to trade it, both domestically and cross-border. Extending the scope of product intervention as described above will ensure a consistent level of investor protection across the EU. In addition to consumer protection monitoring, by analysing available transaction data, the MNB also monitors the compliance of domestic service providers with product intervention requirements in terms of the leverage used, and monitors the profit/loss ratios of clients' CFD transactions.

7.5.7 Costs of public investment funds in 2022

Looking at the total expense ratio (TER)[46] – using the preliminary unaudited data – it can be seen that the funds with low average cost ratios included bond funds that preferred interest-bearing instruments (such as liquidity, money market, short, long and free bond funds), with the expense ratio of these funds increasing slightly in 2022. For capital protected funds, the low TER was justified by the funds' investment strategy and business model, as they incur higher costs in the year of launch. The TER also increased moderately for capital protected funds. In the case of funds with a higher risk profile (such as equity funds, absolute return funds), the higher average TER was justified by the need for additional investment expertise. Equity funds saw a slight increase in costs, while absolute return and mixed funds recorded a decrease in costs in 2022. For mixed funds, average TER ratios typically declined over the past five years. Looking at the same period, real estate funds showed an increase a few years ago, but a decrease again in 2022. Overall, investors faced a TER ratio of around 1.5% on average in 2022 when buying investment units, which hardly changed at sector level compared to 2021. Following the receipt of the audited data, the MNB will publish the TER indicators broken down by fund, in line with previous practice (Chart 7.22).

[46] The TER (Total Expense Ratio) indicator shows the total expenses of an investment fund as a percentage, making it possible to compare different investment funds in terms of expenses.

Chart 7.22
Development of the TER index of domestic public investment funds



Source: MNB

Box 7.4
Evolution of the success fee payments of domestic investment funds

Success fees are a type of potential cost for investment funds. An investment fund manager may only charge a success fee to a fund if the managed investment fund is able to outperform a predetermined rate or benchmark over a given period. More than a quarter of the 400 or so public investment funds in the domestic investment fund management market use some form of success fee model. Based on past practice, the success fee was most often determined on the basis of a short-term government bond (ZMAX, RMAX) or other money market index. In the year 2022, this practice could only be maintained for funds where the benchmarks mentioned above were indeed well matched to the fund profile. In the majority of funds using the success fee model, which are typically absolute return or derivative funds, the use of money market or short-term government bond indices had been phased out. Most of the work of developing success fee models that better fit the profile of the funds was done in 2021 and 2022.

Based on ESMA guidelines, the MNB issued recommendations to ensure that the success fee models used by investment fund managers comply with the principles of honest and fair conduct in the conduct of their business and of acting with due skill, care and diligence in the best interests of the fund they manage. A recommendation based on the ESMA guidelines published in 2020 was issued in summer 2021 and must be applied by all investment funds using success fees from 1 January 2022. Subsequently, ESMA issued further guidance, while the MNB provided clarifications in a management circular.

The main objective of the recommendation is to ensure that the success fee model used by investment fund managers is appropriately aligned with the fund's investment objectives, strategy and policies and does not allow for manipulation. The recommendation contains a separate chapter on the consistency of the success fee model with the specific characteristics of the fund. It defines the process for verifying and reviewing the target, the criteria to be taken into account in this process and the so-called consistency indicators. The recommendation also sets out the mandatory elements of the method for calculating the success fee and establishes as a principle that it should be in line with the interests of investors and ensure that success fees are always proportionate to the fund's actual investment performance. As regards the frequency with which the success fee is calculated, the MNB recommendation states as a basic principle that it should ensure the alignment of the interests of the fund manager and the investors and fair treatment between investors. The success fee may, as a general rule, be calculated and determined no more than once a year, on the same date for each series of units in the fund. The recommendation states that a success fee can only be paid if the fund achieves positive performance over the performance reference period. In the spirit of reasonable incentives, an important requirement of the recommendation is that success fees should not encourage excessive risk-taking by the fund manager.

The peak year for domestic public mutual funds using success fees was 2019, when the funds charged HUF 20.33 billion in success fees. In the following years, however, the success fee burden decreased year by year. The first year in which the MNB and ESMA's success fee recommendation had to be fully implemented by fund managers was 2022. In the same year, the volume of success fees accounted for was only HUF 8.8 billion, a 57% decrease from the peak in 2019, while the portfolio managed by fund managers increased by nearly 39% from 2019 to 2022.

Box 7.5
Changes to the Key Information Document

As regards the fund management sector, the exemption from the obligations under Regulation (EU) No 1286/2014 (PRIIPs Regulation) which concerns the key information documents to be prepared by investment product manufacturers of packaged retail and insurance-based investment products (PRIIPs) was abolished with effect from 1 January 2023. With the expiry of the exemption granted to fund managers until 31 December 2022 for the application of the PRIIPs Regulation, investment fund managers will be required to prepare a more detailed KID under the PRIIPs Regulation, if they have not already done so. The PRIIPs Regulation is accompanied by a number of complementary pieces of legislation and guidance, which need to be taken into account together when designing a KID.

According to the PRIIPs Regulation, the KID can be up to three A4 pages and contains information of importance to residential customers. Accordingly, it should be easy to read, and its language and style should be clear and understandable. The regulations contain detailed formal restrictions. One of the important requirements of the PRIIPs Regulation is that the document containing the key information must be drawn up in the order (title) specified in the Regulation. This order is also followed by the model document in Annex I to Decree 2017/653. The section "What is the product?" should, for example, describe the nature and main characteristics of the product and a description of the target investor, in particular the ability to bear losses and the maturity expectation. There is also a separate section on risks, potential performance and costs.

The complementary legislation to the PRIIPs Regulation has brought significant changes to the assessment of market risk by establishing uniform and detailed rules. The formulas for calculating risk indicators have been defined and guidance has been given on the use of appropriate benchmarks or approximations when the fund manager determines the category of investment funds. The detailed rules include the methodology for assessing market, liquidity and credit risk. One of the key elements of the regulation is the standardised presentation of these risks. For the presentation of the aggregated risk indicator, the legislation provides guidance on how to fill it in.

Legislation introduced in recent years and now further refined will help retail investors to compare different products and understand their characteristics. The MNB, as the supervisory authority for the fund management sector, therefore, pays particular attention to compliance with the PRIIPs Regulation and works with the sector to continuously improve the quality of information available to retail investors.

7.6 ISSUER SUPERVISION AND MARKET SURVEILLANCE

7.6.1 Market abuse investigation

In 2022, there were 38 market surveillance proceedings for breaches of the MAR – the Market Abuse Regulation – and the SSR – the Short Selling Regulation – of which 23 were for market abuse, 11 for insider dealing, 3 for breaches of reporting requirements and 1 for suspected breaches of the prohibition of uncovered short selling and failure to comply with reporting and disclosure obligations in relation to short selling. In 2022, the MNB initiated 20 market surveillance procedures on market abuse and closed 20 of them, out of which cases the MNB also initiated 16 criminal proceedings at the criminal authority. The MNB imposed measures and sanctions on 17 individuals and 1 legal entity, as well as a total of HUF 327.1 million in market surveillance fines.

Box 7.6
One form of market manipulation is collusion

One of the best-known violations in both Hungarian and global capital markets is market manipulation, one possible form of which is “collusion”. The MNB has recently detected and sanctioned several cases of market abuse.

The Market Abuse Directive (MAD II) aims to ensure that the most serious market abuses, including market manipulation, are subject to criminal sanctions across the EU. This, together with the EU Market Abuse Regulation (MAR), provides the regulatory framework for market abuse and sets out measures to prevent it. The definition of collusion also requires an understanding of market manipulation. The relevant definitions are contained in the MAR, which also states its (and its attempted) prohibited nature.

Market manipulation is the entering into a transaction, the placing of an order to buy or sell, or any other conduct that gives, or is likely to give, false or misleading signals as to the supply, demand or price of a financial instrument, a related spot commodity exchange transaction or an auctioned product based on emission allowances. This includes conduct that fixes, or may fix, the price of one or more financial instruments, related spot commodity transactions or auctioned products based on emission allowances at an abnormal or artificial level.

One form of market manipulation is collusion. In this context, simultaneous or near-simultaneous execution of buy and sell orders for very similar quantities and prices by the same market participant or by different but colluding parties constitutes a trading practice that is indicative of market manipulation. These are called “improper matched orders”.

Conduct that constitutes collusion may give investors false and misleading signals about the supply and demand conditions, liquidity and price movements of a financial instrument. This infringes the subject matter of the law, specifically the fairness and transparency of trading in financial instruments, and therefore the integrity of the capital market.

Market manipulation, and thus collusion, is not linked to a result, i.e. it is not necessary for it to have an actual result in order to be established. It is also not a prerequisite that market participants are actually deceived or that the supply and demand conditions for the financial instrument in question change or that the exchange rate changes as a result. It is therefore sufficient for administrative sanctions to apply if, for example, such a specific trading practice threatens the integrity of the capital market (and is indeed capable of producing such a result).

The MNB will report any such cases and the investigating authority will examine whether the trading technique in question has in fact given false or misleading signals about the supply or demand conditions, exchange rate or price of the financial instrument.

If so, it is a criminal offence punishable by up to 5 years' imprisonment under the Criminal Code.

Overall, these deal-making techniques are also prohibited because they can give a false and misleading picture to other market participants, who make investment decisions based on "distorted" information. The primary objective of market surveillance is to protect investors' decisions, strengthen public confidence in the financial system, prevent market abuse and sanction ex post market participants who engage in such behaviour. The MNB aims to ensure that everyone in the capital market can make investment decisions on the basis of the same, real information, on an equal information basis and free from influence.

Among the market surveillance cases investigating market abuse in 2022, the MNB imposed a market surveillance fine of HUF 30-30 million on two individuals for violating the legal provisions prohibiting market manipulation. The parties concerned agreed in advance on the main parameters of their trading in the share of Kulcs-Soft Nyrt. One of the individuals also manipulated the capital markets in several other ways, giving misleading and false signals to investors about the true market perception and supply and demand for the shares of Kulcs-Soft Nyrt. Based on the evidence obtained during the procedure, the MNB also conducted market surveillance proceedings against other individuals in the case, which resulted in a total of HUF 24 million in market surveillance fines being imposed on three individuals for violating the legal provisions prohibiting market manipulation. The parties concerned - active participants in an online forum of business topics – had confidentially discussed their trading in the shares of Kulcs-Soft Plc. and concluded a transaction on that basis. This could have given investors a misleading, false signal about the supply and demand for a particular stock.

Among the proceedings on prohibited insider trading, two were outstanding, where the MNB investigated the infringement separately against individuals on the sell and buy sides of an OTC transaction. As a result of these proceedings, the MNB imposed market surveillance fines of HUF 58 million and HUF 64 million on two individuals for having entered into a transaction with shares of EST MEDIA Nyrt. one day before the announcement of the Delta transaction, knowing that the acquisition of Delta Systems Kft. by EST MEDIA Nyrt. was insider information, and thus having obtained an unfair advantage over other investors.

Also noteworthy is the MNB's market surveillance procedure, in which the MNB investigated the trading behaviour of a private individual, mostly in premium shares, amounting to billions of euros – in illegal market manipulation. On the basis of the evidence, the MNB found that the individual had, on several occasions during the period under investigation, entered into significant transactions with himself, i.e. placed self-binding stock exchange orders for the shares concerned, for tax optimisation purposes. On any given day, the vast majority of the total trading in the shares concerned on the exchange on the day under review was in the shares in the sanctioned individual's transactions. On the basis of the decision on the merits of the proceedings, the MNB imposed a market surveillance fine of HUF 45 million on the individual.

Box 7.7
The inclusion of long-term investment accounts (LTIAs) in capital market trading may also carry market manipulation risks

The supervisory experience of recent years shows that several Suspicious Transaction and Order Reports (STORs) received by the MNB could have been avoided if investors had correctly assessed the risk of transactions. For this reason, when trading in the capital markets, it is advisable to place orders and execute transactions carefully and to be aware of the risks of transaction(s), even if they may seem innocent at first sight, before investing.

The MNB receives reports of suspicious market manipulation behaviour through several channels. Of these, STOR reports are required by law to be made and sent to the MNB primarily by market participants and investment firms operating trading venues if market abuse is suspected. Investors' account managers and the Budapest Stock Exchange

(BSE) constantly monitor the behaviour of market participants in the capital markets, including what orders they place, what transactions they execute and how they do so. STORs, as well as indications and notifications from other sources, may also give rise to market surveillance procedures.

The most recognisable form of market manipulation is perhaps the “price gouging” that can be identified through an attempt or transaction to influence the exchange rate. However, it is not so clear to many that what is commonly known as a “transfer” or “self-dealing” (where the buyer and seller are the same person) can be just as much a concern under MAR rules as a “currency misalignment”.

Several examples show that the inclusion of long-term investment accounts (TIIAs) used to take advantage of tax benefits in capital market trading can carry such risks. If the investor sells the shares held in the TAB account to himself or buys other financial assets from himself using the funds available in the TAB account, these series of transactions may also distort the supply and demand for the assets concerned. This type of behaviour may also lead to a STOR warning and the opening of market surveillance proceedings.

For these reasons, anyone who is considering trading in the capital markets and does not have a comprehensive knowledge of trading behaviour of concern should exercise caution and seek help and information about the potential risks.

7.6.2 Investigation of unauthorised activities

Timely detection and effective action against unauthorised and unreported activities with the available tools remains a priority within market surveillance. Reducing the activities of operators providing services without authorisation or notification is of particular importance for both supervised institutions and the customers using the services in question, in terms of increasing the protection and shock resistance of the financial sector.

The MNB, often in cooperation with investigative or other authorities, identifies, bans and reports on unauthorised market operators to ensure the safety of consumers and legitimate market operators. Although unauthorised financial activity is a criminal offence in itself (and therefore prosecuted by the investigating authority in addition to the MNB), in many cases the unauthorised activity may cause significant harm to consumers, which may even lead to suspicion of a more serious crime (fraud, embezzlement).

Box 7.8
The MNB has a wide range of tools to crack down on illegal financial service providers

The MNB may investigate suspicions of certain activities carried out without MNB authorisation or without notification in a market surveillance procedure. Practice shows that the clients of market surveillance procedures (natural persons or companies against whom the procedure has been initiated) are often taken by surprise by the MNB’s actions and the wide range of tools it has at its disposal, which are authorised by the rules of the market surveillance procedure laid down in the MNB Act.

The MNB’s market surveillance procedure is initiated ex officio, but it is less well known that the MNB is not obliged to notify customers in advance of the initiation of the procedure, as it is mandated to do by the MNB Act, and customers typically learn about the initiation of the procedure during MNB on-site inspections. The aim is to find the evidence necessary to clarify the facts. The MNB’s staff (within the scope of their powers) may enter any premises necessary for the conduct of the inspection, examine documents, data carriers and objects related to the subject of the inspection, and may seize and confiscate them in a manner similar to criminal proceedings. This does not apply to documents or devices containing trade secrets or personal data.

During the market surveillance procedure, it is also possible to conclude a test transaction, which the MNB may decide at its own discretion. An employee of the MNB is an official in the course of his or her duties, and the legislator therefore affords the same protection – in particular under the statutory offence of violence against an official – as, for example, an investigator conducting a search. However, a fundamental difference compared to a criminal procedure is that MNB staff cannot use coercive means (e.g. physical force, handcuffs), despite similar action. However, the MNB may request the assistance of the police during on-the-spot checks.

Those who, by their actions or conduct during the market surveillance procedure, seek to delay or obstruct the procedure or to prevent the discovery of the true facts may be subject to a heavy procedural fine. This can range from HUF 50,000 to HUF 10 million.

In the course of market surveillance procedures, the MNB places great emphasis on the protection of victims, and the MNB Act allows for the application of a number of measures known from criminal proceedings. For example, the MNB may, in order to protect the interests of its customers, order the freezing of funds or financial assets, a prohibition on the alienation or encumbrance of movable or immovable property or the temporary unavailability of electronic data (website blocking), in the context of an insurance or temporary insurance measure, in order to protect the interests of its customers.

In the context of the taking of evidence, the MNB is entitled to obtain, by means of a hearing, the statements or testimony of a client, witness or person obliged to cooperate in clarifying the facts, either orally or in writing, with no exception for personal and proprietary data. It is also possible to appoint an expert in the framework of a market surveillance procedure.

It is also worth mentioning the sanctions that can be imposed during the market surveillance procedure. It can apply the same sanctions for both unauthorised and non-notified activities: it can prohibit the activity, take measures, apply exceptional measures or impose market surveillance fines. The amount of the latter can range from HUF 100,000 to HUF 2 billion.

The MNB Act therefore provides the MNB with a wide range of instruments. The infringements related to the unauthorised activities investigated and sanctioned by the MNB in the course of market surveillance procedures are also covered by the Criminal Code, so that the perpetrators of such acts may typically become not only the subject of market surveillance procedures, but also suspects of criminal proceedings, following the MNB’s reports.

In 2022, the MNB initiated 21 market surveillance procedures due to suspected unauthorised activities, i.e. activities carried out without authorisation or notification, and closed 14 market surveillance procedures, in connection with which it imposed market surveillance fines totalling HUF 144.5 million. As in previous years, the MNB continued to conduct a wide range of investigations in 2022, with market surveillance procedures covering a variety of suspicious financial, investment and insurance activities. At the same time, a significant number of investigations were aimed at investigating unauthorised money exchange activities and unauthorised lending.

In the framework of this action, the MNB imposed a market surveillance fine of HUF 70 million on Bankmentor Kft. and immediately prohibited it from carrying out unlicensed financial intermediation activities. For a long period of time, the company carried out financial brokerage and mortgage brokerage activities without a central bank licence, contracting with thousands of retail customers, by concluding commission contracts with Bankmentor Kft.’s customers in order to “settle” the debtors’ previous loan and credit contracts with financial institutions, which had been terminated in the meantime.

Another noteworthy market surveillance procedure in 2022 involved the MNB’s investigation into the activities of CreditLure Kft., during which the MNB found that the company had been providing so-called “debt settlement” or “mediation” services to several individuals for a fee for several years. In addition, the client had for years regularly accepted funds from unspecified persons, with an obligation to repay, in order to secure the necessary resources for its operations and activities, by disposing of the funds as owner. Based on the facts revealed during the market surveillance procedure, the MNB found that the activities of CreditLure Ltd. exhausted the elements of commercial brokerage and "deposit taking", therefore it immediately prohibited the unlicensed financial services activities and imposed a total market surveillance fine of HUF 43 million for the violations revealed.

The year-on-year increase in the number of consumer reports of unauthorised activities indicates an increase in financial awareness in Hungary, which could lead to reduced financial vulnerability. For this reason, the MNB places great emphasis on raising financial awareness: in the investor alerts section of its website, consumers can review and check the warnings of foreign supervisory authorities, and in the search engine of the website, which lists legal market operators, they can check whether the person or company offering a financial service or investment product is licensed or registered by the MNB before they use it. The MNB also publishes on its website the main characteristics of unauthorised financial activities and extracts of decisions on market surveillance procedures that have been closed with a finding of non-compliance. The MNB's website, its customer service and its financial advisory offices in rural areas provide all the necessary information on financial operators operating within the legal framework.

7.6.3 Issuer supervision

At the end of 2022, 42 companies were trading on the regulated market operated by BSE (Xbud), 18 companies were trading on the Xtend multilateral trading facility and a further 92 companies were trading on the Xbond multilateral trading facility. In the framework of continuous supervision, the MNB issued 24 decisions in 2022, including 13 decisions imposing fines and a total of HUF 38.1 million in supervisory fines. In addition, in 105 cases, it has sent requests for information or statements to issuers, shareholders or auditors. In 2022, the central bank launched 5 direct inquiries of public issuers in the context of IFRS and 1 direct inquiry in the context of regular and extraordinary disclosure of information (SET Group Nyrt.).

7.6.3.1 Targeted inspections of issuers

Among the issuer direct inquiries carried out by the MNB, the procedure initiated against SET Group Nyrt. in February 2022, which closed on 30 March 2023, is noteworthy. The MNB imposed fines totalling HUF 105 million: a HUF 20 million supervisory fine for breaching the provisions on the extraordinary disclosure obligation and a HUF 85 million market surveillance fine for breaching the legal provisions on the prohibition of market manipulation.

The investigation by the central bank revealed a significant number of disclosure failures by the issuer. On the one hand, SET Group Nyrt. has regularly published disclosures that may have raised positive expectations among investors regarding the issuer's future, business opportunities, performance and financial position. However, in a number of cases, the issuer was unable to substantiate these disclosures during the investigation, and as a result, the overall effect of the disclosures may have been to create an unfounded positive image of the issuer in the minds of investors. SET Group Nyrt., on the other hand, failed in several cases to disclose information directly or indirectly affecting the value of its securities or the perception of the issuer. For example, it did not provide information on the failure of a group member to acquire assets, the fact that its granddaughter company was excluded from the scope of consolidation, the sale of shares in its subsidiary, the existence or termination of significant contracts of its consolidated companies, or the existence of a third-party claim against its subsidiary that is large in relation to its consolidated turnover. Until the end of the investigation, SET Group Nyrt. did not provide information to the MNB on the identification and handling of the insider information related to the disclosures under investigation, even after repeated requests from the MNB.

In 2022, the MNB issued 6 decisions and orders concerning direct inquiries and imposed a total of HUF 118 million in fines. Of these, a significant share is held by OTT-ONE Nyrt. HUF 111 million fine decision for breach of information obligations. In the procedure, the MNB found that the issuer had failed to disclose, in several cases, extraordinary information directly or indirectly affecting its perception or the value of its shares (e.g. significant money lending or termination of a contract that the issuer had previously disclosed as material, significant asset purchases).

The investigation also revealed that the issuer regularly made disclosures about transactions of significant value. With these transactions, it gave the impression – contrary to reality – that it had received substantial income or profit from these transactions. In addition, the disclosures made by the issuer about the various cooperation agreements contained, in some cases, unsubstantiated, incomplete or outright untrue information. All this may have led to an unjustifiably positive investor perception of OTT-ONE. The issuer, on the other hand, did not disclose any news contrary to its previous extraordinary disclosures, e.g. that it did not actually perform any material economic activity under certain disclosed contracts, that it did not receive any revenue from them, and that some of the disclosed contracts were terminated without performance. By failing to provide corrective information, the issuer may have given false or misleading signals to the market about the perception of OTT-ONE, indirectly about the demand or price of its shares, which constitutes market manipulation. OTT-ONE also failed to promptly disclose the information identified as inside information in a number of cases, in which it did not choose to delay disclosure, thereby unlawfully preventing investors from learning the inside information as soon as possible.

Due to the above, the MNB imposed a supervisory fine of HUF 4.5 million for the violation of the provisions on the extraordinary disclosure obligation, a supervisory fine of HUF 22.5 million for the violation of the legal provisions on the prompt public disclosure of inside information and a market surveillance fine of HUF 84 million for the violation of the provisions prohibiting market manipulation on OTT-ONE in its decision of 21 January 2022.

Box 7.9
In the case of a takeover, the amount of own shares in the company is also relevant

Own shares without the right to exercise voting rights[47] can change the internal structure of a public limited company due to changes in voting proportions, and an influence-gatherer[48] can also gain control of the company (even passively, if necessary) by holding sufficiently large holdings of own shares. In order to protect the minority shareholders of a public limited company, the rules of the Capital Market Act on the acquisition of influence should therefore also apply to acquisitions by and/or in addition to own shares. If the acquirer acquires control of the company without a public tender offer, the MNB will take action against the offending acquirer using the supervisory measures at its disposal.

According to the interpretative provision of the Capital Markets Act (CMA), the acquisition of influence (takeover) is understood to mean the acquisition of shares with voting rights or the related voting rights of a publicly traded company (target company) having its registered office in Hungary or listed on a regulated market in Hungary.

According to the interpretative provision of the Tpt., influence is also acquired if the influence is not created by the direct conduct of the acquirer, but, for example, as a result of a decision of the target company to change the voting rights of shareholders by changing the voting proportions. Since no voting rights can be exercised by a treasury share acquired by a resolution of the company and must be disregarded when determining the quorum of the general meeting, the resolution of the company to acquire a treasury share is therefore a resolution to change the voting proportions. As a result of this amending resolution, the shareholders will acquire additional influence under the Tpt., which may also result in the acquisition of control of the target company. Thus, the acquisition of influence conceptually goes beyond the acquisition of a share with voting rights, as not only the extent of the voting rights but also the proportion of voting rights actually attached to them, which may have an impact on the control of the target company, must be taken into account.

[47] As a general rule, voting rights are calculated on the basis of all shares to which voting rights are attached under the terms of the issuer's articles of association (irrespective of any provisions limiting the exercise of voting rights). This is therefore independent of the treasury shares acquired by the issuer, so the issuer's own shares do not change the voting rights of other shareholders.

[48] In determining the degree of influence, the provisions limiting the exercise of voting rights must be taken into account, as this degree of influence represents, inter alia, the proportion of control of the target company actually acquired by the acquirer. The voting right must, in fact, be capable of conferring influence on the company's decisions if the degree of influence conferred by its exercise is examined. In determining the degree of influence, it is therefore no longer only the number of shares held by the shareholder that must be taken into account, but also, for example, any voting limit in the company, the number of shares held by the target company itself or even the limitation of voting rights attached to individual shares. In determining the degree of influence, and hence effective control, shares which are subject to a restriction on the exercise of voting rights for whatever reason should therefore be disregarded. The degree of influence is thus determined on the basis of the shares with which voting rights can actually be exercised.

According to the Civil Code (Civil Code), a joint-stock company cannot exercise shareholder rights with its own shares, and the own share must be disregarded when determining the quorum of the general meeting. Therefore, there may be a material difference between the voting rights and the degree of influence that can be exercised if the target company holds its own shares. Although according to the Act the voting right is calculated on the basis of all shares to which voting rights are attached under the articles of association of the target company, irrespective of the provisions on the limitation of the exercise of voting rights, the same is not applicable to the determination of the degree of influence. In the acquisition of influence, not only the voting rights but also the influence actually conferred must be assessed. Accordingly, treasury shares are to be taken into account when calculating voting rights, while they are to be disregarded when determining the degree of influence.

Thus, if the share capital of a target company consists of 100,000 ordinary shares, of which 25,000 are treasury shares, the voting rights of the influence holder, who also holds only 25,000 ordinary shares, can be calculated to be exactly 25%, while the influence he can actually exercise – because of the exclusion of treasury shares – can be calculated to be 33.33%. If the target company later transfers its own shares to a third party, the acquirer will have both voting rights and influence equal to 25%.

Under the Act, a public bid must be made in the target company, subject to the prior approval of the MNB, for the acquisition of more than 25% of the voting rights if no one other than the shareholder acquiring the influence has more than 10% of the voting rights, or for the acquisition of more than 33% of the voting rights. As the decision of the public limited company to acquire its own shares and the actual acquisition of the shares by the target company will change the voting proportions, the voting rights corresponding to 25% will in fact result in an acquisition of influence exceeding 33%, as in the example above.

If the target company already owns 25,000 of its own shares at the time of the acquisition, the acquirer must make a public tender offer in advance in accordance with the Act, which must be approved by the MNB. If the acquisition of influence exceeding the aforementioned proportions takes place in such a way that the public limited liability company acquires the 25,000 treasury shares after the acquisition of influence, the acquirer of influence must make its subsequent mandatory bid within fifteen days of the publication of the extraordinary information on treasury shares of the target company at the latest.

The above interpretation of the MNB's law was also confirmed by the judgment of the Curia in Case Kf.V.35.067/2022/12. According to this, "when calculating the extent of the acquisition of influence in a public limited company, the issuer's own shares must be disregarded, because the exercise of voting rights on the basis of these shares is excluded by law".

As the MNB has already pointed out in several management circulars, regular and extraordinary information on voting rights, treasury shares and share capital is essential information for calculating the extent of shareholder influence and determining the mandatory takeover bid, and its accurate disclosure is in the common interest of all shareholders. Pursuant to the Act, the special purpose vehicle shall publish the number of voting rights attached to its shares by series, indicating the holdings of treasury shares, and the amount of share capital in the information storage system operated by the MNB for the last day of each calendar month, without delay and no later than the next business day.

This disclosure allows the influence multiplier to ascertain the actual extent of its influence in relation to its own shares. On the other hand, pursuant to the provisions of the Act on Extraordinary Information, the offeree company shall also publish its information concerning its own shares without delay. The influence buyer can thus also draw conclusions about the extent of its influence from extraordinary disclosures about the target company's own shares.

The MNB pays particular attention to monitoring the full and timely compliance with the provisions of the Tpt. on regular and extraordinary information and applies supervisory sanctions in the event of violations. If the acquirer of influence does not make a mandatory public takeover bid, either beforehand or subsequently, in breach of its obligation under the Tpt., it may not exercise its shareholder rights, including its voting rights, in the target company and must terminate the influence acquired by the infringement within sixty days of the acquisition or of receipt of the MNB's decision.

If the MNB initiates a market surveillance procedure under the Act on the Magyar Nemzeti Bank (MNB Act) for the purpose of monitoring the rules on takeovers, and if the same procedure reveals a violation of the provisions of the Act on mandatory public takeover bids, the MNB may impose a market surveillance fine of HUF 100,000 to HUF 2 billion on the violating acquirer for violation of the takeover rules.

7.6.3.2 Continuous supervision of issuers

The backbone of the ongoing monitoring of issuers is the monitoring of issuers' compliance with regular and extraordinary disclosure requirements. As part of the regular disclosure, the issuer of the securities admitted to trading on a regulated market shall regularly inform the public of the main data on its assets, income and operations, and shall also inform the Supervisory Authority at the same time as the disclosure. Based on the provisions of Act CXX of 2001 on the Capital Market (Capital Market Act) and PM Decree No 24/2008 (VIII. 15.) of the Minister of Finance on the detailed rules of the disclosure obligation concerning publicly traded securities (PM Decree), the main regular information obligations are the publication of annual and semi-annual reports. In addition, issuers are required to disclose the number of voting rights attached to their shares by series, indicating the holdings of treasury shares, and the amount of share capital for the last day of each calendar month without delay, but no later than the next business day.

As part of the extraordinary disclosure obligation, the issuer of a security admitted to trading on a regulated market is required to disclose to the public without delay, and at the latest within one working day, any information which directly or indirectly affects the value or yield of the security or the perception of the issuer. The detailed rules for extraordinary disclosures are also set out in the PM Regulation (e.g. significant changes in the issuer's plans and strategy compared to the issuer's last disclosure, large orders, significant increase or decrease in the issuer's new investments or assets, change of auditor and the reasons for such change, etc.).

In addition, any of the information subject to regular and extraordinary disclosure obligations may contain inside information that is already covered by MAR. The MAR regulatory framework is designed to deter and prevent market abuse. The most important of these are the proper handling and public disclosure of inside information as soon as possible, the prohibition of market manipulation and insider trading, and the obligation to report transactions and the periods of prohibition of transactions for persons discharging managerial responsibilities (including persons closely associated with persons discharging managerial responsibilities).

The MNB's objectives are to encourage voluntary compliance by public issuers of securities, rather than imposing sanctions ex post, and to inform the market as widely as possible about the MNB's expectations and the practices required by law. To this end, in 2022, the central bank provided even more resources for the education of market participants and held a total of 23 tailored issuer workshops and technical consultations in 2022, which provided, among other things, an opportunity to clarify issues related to capital market obligations.

In addition to the personalised consultations and presentations, the MNB also issued an executive circular in 2022, which aims to set out the MNB's expectations regarding compliance with MAR, thereby increasing the predictability of the application of the law and promoting the uniform application of the relevant legislation. In addition, it is the MNB's practice that all new registrants on the Xbond market receive a general information letter explaining their obligations under the MAR Regulation.

Box 7.10
Systemic availability of audit opinions on the annual reports of listed issuers

In the context of its supervision of listed issuers, the MNB considers it a priority to safeguard confidence in the capital market and therefore continuously monitors and controls the disclosures of listed issuers. Issuers are increasingly expected to disclose reliable and truthful information about their assets, liabilities, financial position and income within the time limits set by law, as required by accounting rules.

According to Act CXX of 2001 on the Capital Market, the issuer must publish an annual report within four months after the end of each financial year at the latest as part of its regular disclosure obligations. The annual report must also contain the report of the independent auditor authorised to audit the issuer's annual report pursuant to PM Decree No 24/2008 (VIII. 15.) of the Minister of Finance on the detailed rules of the disclosure obligation concerning publicly traded securities (PM Decree).

According to Act C of 2000 on Accounting, there are the following types of audit opinions and audit certificates:

1. audit certificate: unqualified audit opinion contained in the independent audit report issued on the basis of the Hungarian auditing standards pursuant to Section 4(5)(b) of Act on the Hungarian Chamber of Auditors, Auditing Activities and the Public Supervision of Auditors;

2. qualified audit opinion: a qualified audit opinion included in the independent auditor's report issued as per point 1;

3. disclaimer of opinion: an adverse opinion contained in the independent auditor's report issued as per point 1;

4. refusal to express an audit opinion: a refusal to express an audit opinion in an independent auditor's report issued as per point 1.

The PM Decree does not make any distinctions with regard to the content of the independent auditor's report, so the publication of the annual report with any of these opinions or a refusal to express an audit opinion is in compliance with the legal requirements. Accordingly, the legislator has left it to the prudent investor to assess the riskiness of the investment and to decide on the investment opportunity on the basis of the information available about the issuer, whether positive or negative.

On the basis of the above, the MNB has no possibility to take action against an issuer whose published annual report contain a qualified opinion or a disclaimer of opinion or, in an extreme case, no opinion at all. Since in the former cases the issuer's accounts may contain material misstatements or may not reflect the true financial situation of the issuer in the absence of sufficient and appropriate evidence, the MNB has found it necessary to draw the attention of investors to the audit opinions in question by means of the appropriate communication channels.

To this end, the MNB makes audit opinions on the annual accounts of listed issuers available on its website (https://www.mnb.hu/felugyelet/piacfelugyelet/a-tozsdei-kibocsatok-beszamoloihoz-kapcsolodo-konyvvizsgaloi-velemenyek).

The information available on the website shows which issuers do not have audited annual accounts, which issuers have been issued a qualified audit opinion and a list of issuers with an unqualified audit report. With the creation of the website, the MNB intends to use its own tools to enhance transparency about issuers and thus investor protection, in order to provide investors with transparent information before they make investment decisions.

It is important to note that the MNB does not intend to make value judgements with the information available on the website, as this is not its role. It should be stressed, however, that in all cases where an issuer fails to publish its disclosure in a timely manner, or fails to do so in accordance with the legal requirements or at all, the MNB will take immediate and appropriate action (if necessary, with the imposition of a fine or, as a last resort, suspension of trading) to remedy the situation.

7.6.3.3 Annual reports in the European Single Electronic Format (ESEF)

In accordance with Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (TD) and Commission Regulation (EU) 2019/815 of 17 December 2018 supplementing Directive 2004/109/EC of the European Parliament and of the Council with regard to regulatory technical standards on the specification of a single electronic reporting format (ESEF Regulation), the publication of annual reports in the ESEF format was originally to have been mandatory for financial years starting on or after 1 January 2020.

At the same time, EU legislation was amended to allow Member States to postpone for one year the introduction of ESEFs, which represent an extra financial and workload for issuers, in order to facilitate recovery from the Covid-19 pandemic. Hungary took advantage of this opportunity, and based on the Government Decision 1078/2021 (II. 27.), domestic issuers were finally obliged to publish their annual report in ESEF format for the first time for financial years starting on or after 1 January 2021, during the year 2022.

In recent years, the MNB has repeatedly reminded issuers that the English text of the ESEF Regulation and its official Hungarian translation, based on the Hungarian translation of the TD and the terminology used in Act CXX of 2000 on Capital Markets (Act on Capital Markets), should be interpreted as meaning that the full annual report is subject to the requirements set out in the ESEF Regulation, so the consolidated annual report data should be marked up with xbrl tags. This must be done in the manner, format and file structure directly laid down in the ESEF Regulation and as required by the specifications to which it refers.

Based on its examination of the published annual reports for 2021, the MNB found that in 2022 most of the published documents did not fully comply with the ESEF requirements. On the one hand, often the full annual report with all its components (individual and consolidated annual financial statements, issuer's statements, management report) was not in a single xhtml file, and if the annual report included consolidated financial statements, the report was not published in a zip file with the required folder and file structure. In several cases, issuers have included script-based viewers in the xhtml file to display the xbrl tags in a human-readable way, ostensibly to help inform investors, but these scripts may technically contain malicious executable code and are strictly prohibited under the ESEF Regulation. Furthermore, the use of an inappropriately structured zip file or script can be a major flaw because it can even prevent the ESEF from fulfilling one of its main objectives, namely to provide a standardised, structured format for the rapid, uniform, automated processing of consolidated financial data in annual reports, thereby facilitating and speeding up investor decision-making.

Of course, this can only be realistically achieved if reliable data are available: the financial data on which the automatic processing is based are marked up with the appropriate xbrl tags and all the information required by the ESEF Regulation is marked up. In the EU legislation, the auditor was seen as one of the safeguards for this, whose report must also declare compliance with the ESEF Regulation. In order to provide a concrete legal basis for the auditors' opinion on compliance with the ESEF Regulation for Hungarian issuers, Act C of 2000 on Accounting was amended in 2021, so that for the first time the auditors have to express an opinion on the compliance of the annual reports with the ESEF Regulation in the audit report(s) on the annual reports for the year 2022. Based on practical experience, Hungarian auditors use a hash code to identify the digital file on which they deliver an opinion. In this case, for a file containing consolidated financial statements with xbrl tags, the hash code must be generated for the zip file, because the folders in the zip file, with the content defined in the ESEF Regulation and its specifications, contain files essential for the machine interpretation of the xbrl tag.

Achievement of the above-mentioned legislative objective related to the introduction of the ESEF may also be hampered by the error of an issuer not correctly using the “legal entity identifier”, i.e. the LEI code, which is also required by the ESEF Regulation. In this case, automatic machine processing can take place, but the information cannot be clearly linked to the issuer using the incorrect LEI code.

For the 2022 consolidated annual financial statements with xbrl tags, another challenge is tagging of the notes. Issuers face the following difficulties when applying the block tagging in the notes:

– if disclosures correspond to more than one element of different granularity, issuers should use multiple tags for the same block, with the information marked multiple times;

– with regard to the principle of block tagging, it is recommended that individual paragraphs and tables be tagged without the need to tag smaller units within the tables (e.g. rows, columns, cells);

– where multiple pieces of text corresponding to one block tag are disclosed in different sections of the notes, the block tag shall be applied in each case.

The MNB drew the attention of issuers to all these risks at a conference organised by the BSE in 2022, and of auditors at an event organised by the Financial and Capital Markets Section of the Hungarian Chamber of Auditors. In addition, the MNB presented its findings in a management circular to issuers and held several stakeholder consultations throughout 2022.

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H-1013 BUDAPEST, KRISZTINA KÖRÚT 55.