



FINANCIAL CONSUMER PROTECTION AND MARKET SUPERVISION REPORT



2014

*'... we must choose a path which
will most probably take us to prosperity.'*

Ferenc Rákóczi II



FINANCIAL CONSUMER PROTECTION AND MARKET SUPERVISION R E P O R T

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*The objective of the Magyar Nemzeti Bank's (MNB) **2014 Financial Consumer Protection and Market Supervision Report (Report)** is to present the activities in the field of financial consumer protection and market supervision stemming from the MNB's regulatory responsibilities, alongside the risks identified in these areas.*

The Report will be published annually and replaces the semi-annual publication "Financial Consumer Protection Risk Report" and the quarterly "Summary of Consumer Protection Administrative Activities by the Hungarian Financial Supervisory Authority". In addition, a presentation of market supervision activity and risks has been added to this Report. Given the preceding publications, this Report focuses on the first half of 2014. In the future, it will cover the second half year preceding the year of publication and the first half of the year in which it is published.

The new Report has the following structure: an executive summary and presentation of the renewed relevant MNB strategy, followed by a report on consumer protection and market supervision administrative activities. Part two of the Report presents and analyses consumer protection and market supervision risks.

The Report was prepared by staff members of the executive directorate in charge of consumer protection and market supervision under the general governance of Executive Director András Bethlendi. The Report was approved for publication by Deputy Governor Dr. László Windisch.

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1. EXECUTIVE SUMMARY

Central bank and supervisory functions have been integrated since 1 October 2013. The merger was driven by experience showing that the earlier regulatory and organisational frameworks were not sufficiently effective – neither from a prudential, nor a consumer protection perspective – in preventing or managing a financial crisis. This substantially eroded public trust in financial intermediaries. The Act on the Magyar Nemzeti Bank specifically defines the reinforcement of trust in the financial intermediary system as one of its objectives. Restoring public trust and stability is a core value within the MNB's supervisory strategy. The MNB's consumer protection and market supervision efforts aim to reinforce these values.

The MNB's strategy aims to go beyond so-called classical administrative consumer protection, although the latter is now informed by a stronger legal enforcement objective based on the following main pillars: problem-oriented, effective inspection activities, firm reinforced sanctioning and proportionate penalties, and the enhanced protection of vulnerable social groups.

The MNB aims to emphasise preventive, client-friendly consumer protection, capable of effectively preventing and managing the future emergence of institutional and consumer protection risks. One of the tools to achieve this is the regular analysis of market trends and products and the timely identification of risks. The other instrument for prevention is effective communication, the development of informative and educational activities to increase consumer awareness, and support for the nongovernmental sector involved in financial literacy and financial consumer protection. Accessible and plain information sharing on an individual scale is fostered by the development of the MNB's customer service system.

Market surveillance activities are closely linked to consumer protection in several regards. Unlicensed and unauthorised financial intermediaries that mislead consumers acting in good faith undermine confidence in the financial intermediary system, and therefore quick, firm action by the MNB is called for. Eliminating unauthorised players operating alongside the supervised sectors through effective ongoing monitoring is of the essence. Enhanced cooperation with partner authorities, in particular investigating authorities, is pivotal as part of this effort. With an eye to prevention, the central bank follows a guiding and quick legal enforcement practice (prompt barring, quick disclosure and awareness-raising, and enhanced penalty imposition and sanctioning are core elements of this renewed practice).

In addition to the above, in an effort to improve capital market transparency, the MNB has enhanced its oversight of public issuers, of compliance with corporate acquisition rules and corporate operating transparency, and also assumes the role of gatekeeper for capital market product authorisation. The latter means that endorsement of prospectuses is not only a formal verification, but also involves a substantive verification to ensure that the

prospectus fulfils its actual function and provides an accurate picture to investors of the product, the issuer and the risks involved.

Consumer protection administrative activities

Consumer claims and requests

The consumer claims and requests lodged with the MNB are good indicators of the issues affecting consumer protection and the changes therein. An increase was seen in the number of claims filed with the MNB in 2014 H1 in year-on-year terms. This rise resulted from issues affecting financial enterprises acting as car purchase finance intermediaries in the past. Both the number and proportion of insurance sector claims showed substantial improvement. Capital market sector claims have not represented a significant share for a long time, and this tendency continued in the periods under review. The number of claims regarding the fund sector is marginal.

The MNB regards the proportion of claims filed against a service provider compared to its market share as a risk indicator. The top positions of the negative ranking of credit institutions based on this ratio remained unchanged. The ranking is relatively stable in terms of the first five institutions, but a general deterioration characterised each of them. A general rise in ratios was also observed among insurance undertakings in the past quarter. Besides this indicator, the proportion of claims filed with the MNB (in relation to a specific institution) compared to the total number of complaints filed with the service provider also provides insight on the effectiveness of the institution's complaint management. Based on this proportion, the majority of the institutions ranking highest on the negative list showed weaker performance compared to sectoral averages. There was a rise in the number of cases involving notification shortcomings and commissions, expenses and fees, the latter indicative of current account management issues, confirming the need for a thematic MNB inspection in that area.

Consumer protection administrative procedures

In 2014 H1, the MNB found a total of 292 infringements in the context of 158 concluded inspections which identified an infringement, averaging 1.84 infringements per inspection. Infringement was established in 94 per cent of inspections launched ex officio and in 41 per cent of cases launched upon request. The MNB levied a penalty in the majority of these cases. The substantial amount of penalties levied in the first half of 2014 resulted from the penalties imposed in the wake inspections of fee and expense hikes (35 cases, amounting to HUF 1.186 billion), accounting for 86.5 per cent of the total amount (HUF 1.372 billion).

In relation to fee and expense hikes, inspections were carried out at an additional 121 financial organisations by August 2014, identifying infringements in 107 cases. In the wake of the inspections concluded in the matter in 2014, HUF 1.86 billion in consumer protection

penalties was levied, affecting 136 financial organisations, and 139 financial organisations were ordered to reimburse the illegitimately charged fees to consumers.

Among the inspections carried over to the second half of the year, the examination of compliance with the legal provision prohibiting the charging of fees on Casco and payment protection insurance bundled with credit products in a foreign currency is worth noting. A total of HUF 37.15 million was levied in fines, affecting eight undertakings. Institutions must reimburse the exchange rate difference charged to consumers until the resolution of the infringing situation to 24,141 consumers.

Market supervision administrative activities

Capital market product authorisation and market monitoring

In 2014 the MNB endorsed six issuance programmes on the debt securities market and authorised the publication of related base prospectuses in a framework amount of HUF 1.387 billion, and rejected applications pertaining to regulated market launches for HUF 665 million in its gatekeeper capacity. Issuers (currently 74) published a total of 2,254 disclosures, only 154 of which were published with delay, and 27 extraordinary notifications featured inaccurate or deficient content.

An average of 100,000 market offers are scrutinised every week to screen for deviant conduct and suspicious transactions. Thirty-three reports made in the context of the suspicious transactions reporting obligation stipulated for investment service providers were submitted from four different entities, all of which were inspected and one case of insider trading was identified. A total of 366 warnings issued by foreign supervisory authorities on infringing, suspicious non-resident protagonists were processed and published.

Market supervision inspections

In 2014, nine market supervision procedures, one thematic inspection and two targeted inspections were concluded. Of the nine market supervision procedures, the MNB discovered insider trading in one case and sanctioned unauthorised operations in eight cases (unlicensed collection and management of investments; unreported agent activities; unlicensed mortgage lending). The amount of market supervision penalties levied during in this period exceeded HUF 1.5 billion.

The clientele of the sanctioned undertakings was close to 10,000. In addition, the MNB examined the insider list-keeping practice of 11 issuing companies and sanctioned two companies in the amount of HUF 13 million. One of the key market supervision inspections was the Fortress case (unlicensed activities, investment fraud), prompting the MNB to impose a HUF 1.25 billion total fine and file a police report.

Consumer protection risks

The Report classifies various consumer protection risks identified based on the relative impact (potential consumer damage) in an action matrix featuring four categories. According to this matrix, risks affecting a broad group of consumers and would potentially larger impact (category “A”) can be addressed with more substantial measures (comprehensive administrative action), or milder ones in keeping with the principle of necessity and proportionality and the potential consumer damage (in order, categories “B”, “C”, and “D”). The MNB also monitors the risks of category “D”.

The Report presents risks by main product and service group. When planning administrative inspection activity, the MNB also takes into consideration the perceived risks, which also mentioned when they have been incorporated into the inspection plans (“key inspection target area”).

Current accounts and payments

In the field of current accounts and payments, unilateral fee increases and account closure were the priority areas under investigation, along with cost comparison websites (potential misinformation for consumers), the lack of product transparency and the costs of switching banks, identified as sources of risk.

Savings

Households’ cash holdings continue to rise steadily. The MNB perceived uncertainty among consumers regarding the detailed rules of free cash withdrawal and aimed to address the uncertainty by cooperating more closely with financial institutions.

The pension insurance market constitutes a new area within savings. The potentially high and opaque cost levels and structure could represent a serious long-term consumer risk with these products. In order to establish good practices, the MNB issued a recommendation in 2014 to provide guidance for insurance undertakings and insurance intermediaries, which had a positive impact based on back testing.

Households’ holdings of government securities is continuously rising, and the MNB considers it important to inform household investors that regardless of the low risks involved, a capital guarantee is only secured in the case of government securities that are retained until maturity, thus a sale on the secondary market prior to maturity can even result in a loss of principal.

Unit linked products and compulsory motor third-party liability insurance (MTPL) policies are areas of continuous priority inspection by the MNB. The focus on the former is warranted based on the frequent lack of information and transparency of costs and yields, while the focus on the latter is warranted by its compulsory nature and the high volume of consumer claims. Health insurance policies entailing new types of consumer risks (e.g. consumers are

not familiar with the concept of waiting period, which the insurance undertaking may impose for pre-existing conditions known at the time of policy conclusion).

Indebtedness

Regulatory initiatives

Great progress has been made in the past period in the area of legal uncertainty affecting a large portion of consumers, mainly in relation to foreign currency loans. The court decisions and legislative package issued in 2014 are aimed at comprehensively resolving the issues stemming from lending during the 2004-2010 period. Act XXXVIII of 2014 was created on the basis of the Curia's uniformity decision of 16 June 2014, which pronounced the exchange rate spread as null and void and established the statutory presumption of the unfairness of the stipulated unilateral contract amendment right, and Act XL of 2014 (the so-called "Settlement Act") regulates the main rules governing the settlement obligation towards consumers derived from the foregoing (with various MNB decrees governing the technical details). In the past, along with the legislative resolution of service provider abuse to the expense of consumers, the forint conversion of foreign currency loans and the regulation of fair lending conditions were also performed by the legislature in an effort to avoid future risks. Enforcement of the above specified legislative package and the related communication towards consumers will be one of the MNB's consumer protection priorities for 2015, and next year's report will include the experiences in this area.

The regulation of the Payment-to-Income (PTI) ratio and Loan-to-Value ratio has a dual impact in practice: first, it may prevent the population from becoming excessively indebted even once lending picks up in the future ("macroprudential emergency brake"), and second, a correctly calibrated PTI indicator plays a vital role in consumer protection, as it is also capable of averting excessive consumer indebtedness at the micro level. The MNB Decree governing the matter (the so-called "debt brake") comes into force on 1 January 2015. Market lending processes will be continuously monitored based on the data reporting introduced by the regulation, and from 2015, the need for any adjustments can be determined based on the incoming data. In addition, in the context of microprudential oversight, Supervisory Review and Evaluation Processes (SREP) will focus to a greater extent on institutions that lend to a significant degree near the maximum PTI based on the reported data.

The May 2014 amendment of the act on court enforcement was introduced to provide a temporary solution to the social issue of non-performing housing loan debtors by extending the eviction moratorium, without specifying a final date for the extension. The comprehensive resolution of the issue of non-performing household debtors, significant in terms of both number and debt volume, once again raised the possibility of introducing the institution of personal bankruptcy in Hungary.

The possibility of repaying a mortgage loans from cafeteria benefits could facilitate the unwinding of loan portfolios and the soundness of debt servicing, by allowing employers to support their employees' housing loans.

Market trends

With regard to the assessment of market developments, it should be noted that positive real economic developments, in particular the rise in real wages, point in the direction of a pick-up in consumption and credit demand. The impact of this is increasingly translating into data on new lending, but nevertheless the banking system's household loan portfolio is still continuously shrinking, in particular the proportion of foreign currency loans, which still account for the larger part of the portfolio (roughly 55 per cent).

Conditions on consumer loans continued to ease, while credit conditions did not change in the case of housing loans. The annual percentage rate of charge (APR) on housing loans continued to slacken amid a slight increase in the interest rate spread. If supply-driven consumer credit is granted to borrowers already indebted within or outside the financial sector, it may further increase household indebtedness. From 2015, this risk will be mitigated by the MNB's new "debt brake" rules (PTI, LTV), and forint conversion and the shift to fair banking are also expected to substantially impact the characteristics of the household credit market.

In 2014, the household segment's growing volume of non-performing loans (delinquent in excess of 90 days), which had until then shown a rising trend, shrank slightly within the entire portfolio: with the exception of foreign currency mortgage loans (24 per cent), practically every household product type showed a decline. The consumer submissions made to the MNB revealed that some consumers do not ascribe enough importance to delays in their payment obligation, and therefore do not seek assistance from the financial organisation, or do so only with delay, despite the availability of state and market-based payment relief schemes.

State and market payment relief schemes

The stock participating in the exchange rate cap was close to HUF 1.5 trillion by 2014 H1, amounting to participation of over 40 per cent. The number of dwellings up for sale under foreclosure fell short of the maximum quantity allowed under the quota in the various quarters, and the stock of dwellings up for sale under foreclosure based on designations is 1.5 times the quarterly number of housing market transactions.

The National Asset Management Agency (Nemzeti Eszközkezelő Zrt.) has reported the listing of 15,000 homes so far and has purchased somewhat over 5,000 of these; it has announced plans to purchase 25,000 homes by the end of 2014. Nearly one-fifth of the latter were properties pledged as collateral for non-performing mortgage loans.

In addition to the exchange rate cap, banks also strived to convert the largest possible portion of their non-performing portfolio to performing loans by means of their own market

restructuring. Somewhat over 10 per cent of the banking system's household loans have been restructured so far in the context of non-state schemes. At the same time, while the ratio of non-performing loans within restructured loans participating in the state scheme was around 5 per cent, this ratio is close to 60 per cent among those opting for bank schemes.

Other key consumer issues in lending

Unfortunately, a significant portion of debtors have to deal with collection agencies, an area that is still plagued by numerous issues (e.g. continuous harassment-like contacting of consumers, or at inappropriate times). The MNB still considers the statutory regulation of debt collection agencies as a priority; Recommendation no. 2012/14 issued in December 2012 (and effective from May 2013) by the earlier supervisory authority (the Hungarian Financial Supervisory Authority, hereinafter: HFSA) could provide the professional foundation for such regulation.

Unsolicited pre-scoring (quasi credit line setting) presents a risk for consumers in the field of credit cards, especially when a credit card is sent to consumers along with the notification, which can be easily activated. Hasty consumer decisions lacking due or adequate consideration are the source of potential damage, as experience shows that consumers are not fully aware of the rules associated with credit card use.

In the context of the tightening of legislation governing loans extendable to consumers, the MNB identified several legal loopholes (for instance the APR limit not applying to leasing) which enable service providers to circumvent the tightened consumer loan and loan contract rules; these loopholes were addressed by the draft legislation on fair banking.

Combined credit products

The most significant risk in combined credit products (affecting all protagonists of the legal relationship) is that the savings intended for the repayment of principal fall short of the necessary amount at the time repayment falls due. This can be significant for two reasons: first, the return on the investment will be less than expected at the time of contract conclusion, and second, the loan and the underlying savings are denominated in different currencies, which may lead to adverse exchange rate changes for the consumer. The MNB's inspection found that the existing products qualifying as combined will not present a substantial consumer protection risk on a sectoral level in the upcoming five years; however, as the years go by an increasing number of expiring contracts will emerge within the institutions with the largest combined product portfolios, entailing a concentration and consumer risk, which therefore deserves mention.

Consulting/sales channels

The practice of so-called mis-selling, referring to contract conclusion based on misleading information, is a source of heightened risk in the insurance sector, and results in the

consumer concluding a contract ill-suited to his/her actual needs with the financial organisation (a practice particularly targeting older clients).

Non-compliant MiFID ("Markets in Financial Instruments Directive": Directive 2004/39/EC of the European Parliament and of the Council on Markets in Financial Instruments) testing was identified by the MNB as a priority investigation topic, as experience based on claims and requests shows that consumers often give orders for transactions, the risks of which they are not really familiar with. This raises the issue of the adequacy of (the conduct of) mandatory so-called suitability and/or appropriateness tests, which represents a clear investor risk.

Product sales efforts combined with product demos often carry a financial consumer protection risk, as consumers unable to afford the product are offered the opportunity to receive financing in the form of consumer credit on the spot from the financial intermediary. Such borrowing carries particularly significant risk and sales are often geared towards particularly vulnerable groups (such as pensioners), and are not preceded by thorough consideration and overview of the available credit supply and conditions on the financial market.

Various non-governmental consumer protection groups and consumer protection organisations, as well as legal experts specialising in distressed consumers offer assistance, but their professional know-how is highly varied. Based on claims filed with the MNB, we can make the assumption that consumers are often given incorrect or inadequate advice and information. The MNB regards the establishment of a Civil Network fostering financial consumer protection as an important project within its own competence, and the enhancement of the standard of activities and information of the participating non-governmental organisations through the network.

Other non-financial/non-supervised products and services

The first fiduciary asset management firm was reported in Hungary, with far broader activities and a lack of supervision (unsupervised activity), giving rise to a consumer protection risk.

The spread of virtual currencies has recently attracted considerable media attention. The MNB considers it important to highlight the risks inherent to these virtual currencies. Bitcoin and similar virtual currencies do not have a regulated framework of issuer and intermediary institutions, and therefore fall outside the supervisory competence of the MNB. If any problems are encountered in keeping record of Bitcoins or executing transactions, there is no authority that can be contacted by consumers or to protect user interests.

Investment gold remains popular among households. In the past, the HFSA addressed these consumer risks in depth (in its Financial Consumer Protection Risk Report, 2013 H1) and published warnings on its website. Nevertheless, the MNB wishes to stress once again that the investment gold retail market is high-risk terrain from a consumer protection viewpoint,

because a sizeable portion of households' financial assets is flowing into an unregulated and unsupervised, long-term investment where the chances of a profitable exit are moderate.

It should be mentioned, however, that investment gold is not a financial asset or financial/investment service scheme, and the institutions offering investment gold are not classified as financial organisations and as such, are not supervised by the MNB, meaning that they represent a substantial additional consumer protection risk.

Information technology risks

The spread and variety of electronic finance and the rise in the number of users have contributed to making the related information technology risks increasingly tangible and visible, including intentional attacks, destructive codes, the risks of using mobile devices and online risks and attacks. The MNB considers it essential to raise the awareness of consumers and service providers in relation to these risks.

Market surveillance risks

Risks related to authorised activity

As a result of declining deposit rates, many are searching for new investment opportunities with higher yields. These periods bring a heightened risk of consumers encountering misleading or false investment opportunities, often offered by individuals or organisations unlicensed to sell the investment product.

The MNB website offers a wealth of information aimed at raising investor awareness and revealing investor risk, which is developed and updated on an ongoing basis in an effort to enhance investor protection. However, this also requires risk consciousness on the part of investors, and therefore the key things to know and do are also summed up in multiple step verification lists.

Innovative phenomena on the capital market

Investment firms in Hungary have made an increasing number of online trading platforms accessible to clients in recent years. Investors' capital market behaviour has also changed radically with the appearance of these new trading venues, with emphasis shifting towards high-risk, leveraged transactions (typically forex and CFD transactions), as these markets enable trading with far lower margin requirements due to the leveraged involved. In addition to Hungarian offerings, offerings for forex transactions by non-resident institutions have also risen in Hungary. It is important to warn investors that foreign service providers are not supervised by the MNB and the possibilities for legal recourse regarding the contract concluded with them are limited (typically due to foreign jurisdictions), and that leveraged products involve particularly high risk. Contrary to advertising in this domain, the average

consumer will most likely suffer capital losses on these transactions in the long run, as confirmed by both theory and the MNB's own experience.

The major risk that has emerged in the past period is trading using trading robots and the sale and use of software enabling automated trading. The activities of firms developing and selling these robots related to software (e.g. investment advisory, recommendations, potential agent activity and intermediation) could also qualify as investment services subject to licensing, and therefore engaging in such activities could qualify as unauthorised activities. There is a risk of consumers buying trading robots without receiving prior unbiased information and therefore not being fully aware of the risks involved or how the products work, what they are capable of and what supervision they require.

Various sales techniques prevail: Hungarian intermediary companies and individuals send unsolicited spam emails, make cold calls, post banners and other advertising online to promote their services. Many consumers are not and cannot be aware of capital market risks due to inadequate information, or the lack or total absence of clarity of the information that is available, or such information only partly corresponds to the actual investment data, preventing any precise conclusions from being drawn from the actual situation. Due to the high risks involved, the MNB plans to focus particularly on aggressive sales in the near future.

2. STRATEGY OBJECTIVES IN THE AREA OF CONSUMER PROTECTION AND MARKET SUPERVISION

At its 16 September 2013 session, the National Assembly passed Act CXXXIX of 2013 on the Magyar Nemzeti Bank, which decided on the integration of the function of financial supervision into the central bank effective from 1 October 2013. With the merger, the traditional central bank mandate and functions were not impaired, but rather were supplemented and buttressed with the expanded dimensions of responsibility and toolsets. The MNB's fundamental scope of responsibility has been expanded under the new central bank act, and it was also given the necessary effective instruments for fulfilling this new function.

Based on its new powers, the MNB has triple responsibility alongside its traditional mandate. On the one hand, the central bank exercises macroprudential supervision, which is intended to ensure the stability of the entire financial system and a healthy contribution to economic growth. In addition, it exercises microprudential supervision over the institutions constituting the system as well as financial consumer protection, thereby facilitating the enforcement of comprehensive system objectives at the individual level, and – in order to enhance trust in the financial system – protecting household savings and consumer interests.

These central bank functions are not independent of one another. Together, their interaction ensures the stability of the financial system, the efficient operation of the financial intermediary system together and ultimately, economic growth. The following section briefly presents the MNB's integrated consumer protection and market supervision strategy.

CONSUMER PROTECTION

From a consumer protection perspective, the ideal financial system functions ethically and at a high standard, which requires ensuring every necessary condition for all market participants, which the MNB deems feasible, in line with the following directions.

Further bolstering and firmly representing financial consumer protection

Actively taking part in all areas of financial consumer protection

Within the context of financial consumer protection, the MNB systematically protects the rights and interests of consumers using the services offered by financial organisations and steers service providers towards responsible and fair practices. As part of this effort,

phenomena detrimental to consumers¹ must be identified as soon as possible, calling for a focus on pinpointing and resolving their underlying causes over and above addressing their symptoms to prevent their reoccurrence.

Identification and management of product risks; sales of products suited to consumer needs and their financial literacy

Due to the rapid development of the products and sales solutions of certain markets (the capital market, the insurance market), the application of institutional supervisory prudential focus sometimes lacks effectiveness. Comprehensive, strict product supervision is necessary to enable market participants to sell products suited to customer needs and their financial literacy.

Enhanced protection for vulnerable social groups

Protecting vulnerable social groups (the young and the elderly, for instance) constitutes one of the cornerstones of consumer protection efforts, and therefore special emphasis must be placed on the products offered to and the conduct of supervised organisations vis-à-vis these groups.

Professional customer service

The MNB operates its competent Financial Consumer Protection Centre under the direct control of the Deputy Governor in charge of Financial Institutions Supervision and Consumer Protection. By fully redesigning its customer service, the central bank aims to create an effective 21st century consumer protection organisation capable of providing clear, understandable solutions to consumer issues, acting in their best interests. In addition, efforts must be made to resolve issues before they reach the administrative stage, assuming that financial service providers are also interested in smooth resolution.

Developing financial literacy

Establishing and developing financial literacy among consumers and service providers

Improving consumer awareness is essential and encompasses the organisation of transmitting broad financial knowledge and developing financial literacy. Enhancing the transmission of knowledge, the presentation of safe products and raising consumer awareness of the risks inherent to certain products and product groups is a priority task.

¹ Expanding the definition of consumer: going forward, we must grant the opportunity for all financial institution customers with limited capacity to enforce their interests (such as the self-employed and SMEs) to lodge claims* and complaints to the MNB, along with natural persons. This would give the MNB greater insight into the conduct of financial organisations vis-à-vis their customers and into anomalies in financial markets.

Ongoing communication with non-governmental organisations, information websites and training material

With a view to preventing legal infringements, active communication is a must, providing a framework for establishing partnership and dialogue in order to exert an influence on the conduct of supervised entities. Another objective is to produce publications and hold presentations to enhance financial consumer protection and the recognition of the MNB's efforts in this area.

Financial education within public education

It is important for younger generations to become acquainted with the role of money in modern society during their school years in the context of public education, enabling them to prepare for the responsibility and challenges of providing for themselves and to ensure they are adequately aware of the risks inherent to the most common financial instruments.

Effective, problem-focused inspection activity

After reviewing, compiling and categorising all submitted consumer requests, claims and enquiries, the objective is to conduct targeted, thematic inspections in lieu of addressing individual claims, the latter being an inefficient approach, to reveal and address issues affecting all consumers, and to effectively sanction them at the systemic level. In addition, trial transactions enable the MNB to directly experience the contract conclusion and notification practice of financial organisations, their conduct vis-à-vis customers and any unfair market practices or infringing procedures.

Firmly-enforced sanctions, proportionate penalties – expectation of consumer-friendly, fair service provider conduct

Adequate, consistent sanctioning can spur institutions to abide by the law and communicate a consumer-friendly approach and the MNB's expectations, and provide a quick remedy to consumer grievances. The objective of consumer protection penalties is to levy fines that are proportionate, but still impact financial organisations sufficiently to act as a dissuasive burden.

MARKET SUPERVISION

Eliminating unauthorised players

Eliminating unauthorised players operating alongside the supervised sectors through effective, ongoing monitoring

By identifying and shutting down unlicensed or unreported financial market participants, the MNB aims to foster an intermediary system which offers transparent investment opportunities and a level playing field for economic agents, thus creating an effective, trusted capital market environment in Hungary. The objective is to ensure that investors

only have access to products, the market of which the MNB is familiar with, supervises and regulates, while the “grey” area, the sale of high-risk cross-border “quasi” investment vehicles needs to be reduced to a minimum.

By excluding unsupervised sellers and unfamiliar products from the money and capital markets and cleaning up these markets, the MNB aims to reinforce consumer protection aspects. At the same time, globalised financial markets carry the risk of giving domestic consumers around-the-clock access to complex products that assume a thorough knowledge of financial markets. The MNB must therefore react quickly and firmly to phenomena and abuse which threaten the financial markets.

The early identification and elimination of unlicensed operations shields market participants from subsequent losses and bolsters confidence in the financial intermediary system; timely intervention is therefore essential in the MNB’s market supervision efforts. Accordingly, the MNB operates a monitoring system and has developed and applies an inspection methodology enabling quick recognition, and the more effective identification of money and capital market abuse committed using online publications, websites, blogs and social media.

Applying guiding legal enforcement that addresses financial market innovation

The response to financial innovation must be powerful legal enforcement in tune with market trends. If the legislative background shielding against harmful innovation is incomplete in terms of sectoral legislation, logical legal interpretation, examination and enforcement of the legislator’s objectives must provide guidance. This relies on a consistent, strong MNB policy of market supervision action and sanctions, also acting as a continuous communication channel with the public, over and above efficiently applying the range of available fines.

One key objective is the consistent, market-shaping application of the new sanctioning policy created by the MNB for its market supervision procedures, periodic review of this policy and its fine-tuning based on practical experience and in light of any new legislation enacted in the meantime. The MNB wishes to actively make use of the entire range of potential measures available to benefit from their preventive and dissuasive impact, and strives to establish guiding legal practice on new forms of trading and products. The effective examination of unauthorised and unreported capital market intermediary activities in an effort to cleanse the market is essential, and heightened cooperation with the investigating authority in this context.

Active supervision of financial markets

Effectively identifying deviant conduct by continuously developing data-mining methods

The MNB uses the most advanced IT solutions and data-mining methods to enhance the effectiveness of identifying deviant conduct, prohibited market influence, insider trading or acquisition activity by market participants, irrespective of the location of such transactions.

Deviant market actors decrease capital market process transparency by issuing false or misleading signals to the market or manipulating capital market prices, or achieve extra profit by using information in unauthorised ways. In an effort to improve capital market transparency, the MNB not only publishes major short positions on shares affecting Hungarian issuers, but also reveals market-disturbing activities over and above regulated market transactions, hand-in-hand with foreign partner authorities.

Active verification of public issuers and corporate acquisition rules, increasing operating transparency

The MNB enhances capital market transparency by continuously assessing and interpreting issuer publications and conducting targeted inspections of issuer publications, including the application of international financial reporting standards (IFRS). By conducting stricter audits of the consolidated accounts drawn up based on international financial reporting standards (IFRS) by the issuers of securities introduced to the regulated market, the MNB is improving international comparability.

The MNB will expand its toolset and methodology by introducing the soon to be amended European Union rules against capital market abuse, enabling it to act more firmly against perpetrators of capital market abuse than in the past.

Capital market authorisation

Publicly traded capital market products can only be marketed or launched on the stock market accompanied by a prospectus approved by the MNB. The MNB must act as the “gatekeeper” in the context of authorising such products in an effort to bolster and maintain trust in these markets. The endorsement of prospectuses is not only a formal verification, but also involves a substantive verification to ensure that the prospectus fulfils its actual function and provides an accurate picture to investors of the product, the issuer and the risks involved.

3. CONSUMER PROTECTION AND MARKET SUPERVISION ADMINISTRATIVE ACTIVITIES

3.1. Consumer protection

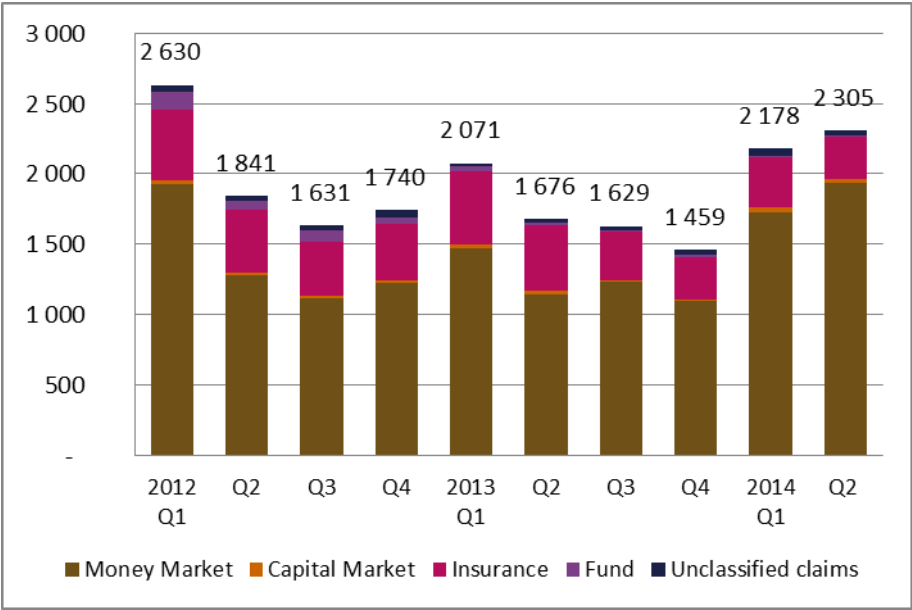
3.1.1. Consumer claims and requests²

3.1.1.1. Consumer claims – summary

Sectoral breakdown of claims filed

A total of 4,483 consumer claims were filed with the MNB in 2014 H1, exceeding the previous year’s figure by 19.6 per cent. This increase clearly occurred within the money market sector, **due to the influx of enquiries related to car purchase financing (1,576 or 35 per cent of all requests), which offset the decrease in insurance product related enquiries.**

Chart 1 Number of claims filed with the Magyar Nemzeti Bank – quarterly breakdown³



As a result of the above, **money market related claims** now amount to over 80 per cent of all claims filed.

² **Consumer claims** are claims meeting the substantive and formal requirements defined in legislation and examined by the MNB in the context of administrative consumer protection proceedings, to assess whether the operations of the financial organisation under review comply with the consumer protection provisions set out in the relevant legislation. **Requests** are submissions, e-mails and enquiries – whether in person or via telephone – received by the Customer Service that cannot be examined in the context of an administrative procedure and are intended to obtain general information from the supervisory authority/the MNB.

³ If the source of the data is the Magyar Nemzeti Bank, it is not indicated separately under the charts/tables.

Requests related to car purchase financing through intermediaries

On 18 February 2014 the Metropolitan Tribunal of Budapest pronounced a foreign currency car loan agreement as null and void, as the agent who signed the agreement was operating as a type “B” agent within the meaning of Act CXII of 1996 on Credit Institutions and Financial Enterprises (the former Credit Institutions Act).⁴

According to the court's position, the agent would only have been allowed to sign the contract as a type “A” agent. The ruling attracted significant media attention and a record number of ensuing requests were submitted to the Financial Consumer Protection Centre, as many as 300 on certain days. Consumers typically made enquiries linked to car purchase financing, their number spiking, on whether the MNB’s records listed the company (intermediary/agent) was classified as type “A” or “B” at the time of contract conclusion. The Magyar Nemzeti Bank replied to client enquiries regarding the legal status of intermediary agents (agent “A”, agent “B” or “unreported”).

Both the number and proportion of insurance sector claims showed substantial improvement in 2014 H1 (approximately 13 per cent in Q2). **Capital market sector claims have not represented a significant share for a long time, and this trend continued in the periods under review.**

The number and proportion of **fund sector** claims have also remained **at marginal levels**, similarly to recent quarters, **due to the decreasing weight of the sector (and the quasi drying up of claims related to returning to the state pension scheme).**

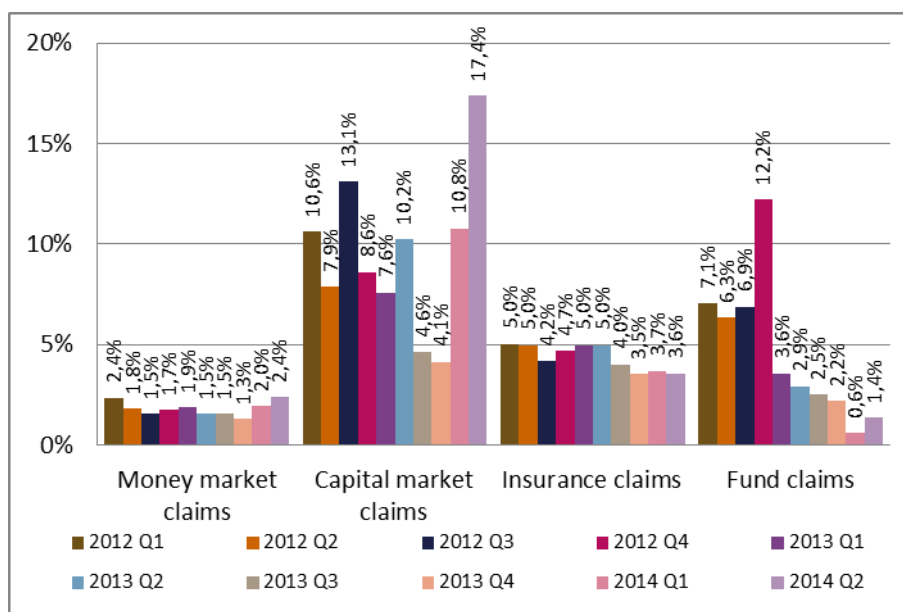
Claims filed in proportion to institutional complaints⁵

Chart 2 illustrates the proportion of claims filed in the MNB’s supervisory area as a percentage of total complaints filed with institutions. **The “MNB claims as a proportion of institutional complaints” indicator** expresses the effectiveness of the institution’s complaint management procedure (the lower the indicator, the more effective the procedure): if the indicator is low, the majority of consumer complaints of presumably resolved in the context of the institution's complaint management process.

⁴ These were intermediary classifications effective until 30 September 2010. Type “A” agents were authorised to conclude contracts with borrowers for the benefit, on behalf of and under the liability and risk of the financial institution under an agency contract, and therefore the borrower did not come into direct contact with the creditor. Type “B” agents only fostered the conclusion of the loan transaction but were not authorised to receive or handle the money, or to undertake any obligations at the financial institution’s risk.

⁵ The concept of complaint refers to reports of reporting agent conduct, activity or omission registered in the complaint registration system submitted or made to the institutions (through the branch office, customer service, via post, etc.) in written (in hard copy or electronic form) or spoken form (by telephone or in person). Spoken complaints that are immediately investigated and, when warranted, remedied by the service provider, and the consumer has not contested the management of its complaint are not included among the reported data. Classification is based on the primary topic of the complaint.

Chart 2 Claims filed with the MNB in proportion to institutional complaints, in a sectoral breakdown (%)



In the money market sector, a clear deterioration characterised the first half of the year, albeit the proportion remains quite low compared to the other sectors.

The number of capital markets claims stagnated over the past period, but the number of complaints filed with institutions fell to half or a third, a tendency that explains the spike in the ratio in 2014 Q2.

The indicator exhibited a decline (that is, an improvement) in the insurance sector. A significant downward trend characterises funds, largely due to the drying up of claims linked to disbursements to returning private pension fund members.

Institutions with the highest number of claims compared to their market share

The following tables illustrate the five credit institutions and five insurance undertakings featuring the highest number of claims filed with the MNB compared to their market share in the first two quarters of 2014. The “negative list” includes the data of service providers with regard to which at least five claims were filed with the MNB in Q2.

The table’s “Claims/market share ratio” indicator illustrates the ratio of claims affecting the institution in proportion to its market share. If the ratio of claims is lower than market share, it signifies that fewer claims were filed with regard to the institution than the number that would result based on an equal distribution of claims among institutions.

Table 1 Top five ranking of the money market negative list for 2014 Q2

Credit institution	2014 Q1						2014 Q2					
	Market share ⁶ %	Claims regarding the credit institution filed with the MNB		Claims/ market share ratio (%)	Negative ranking	Claims filed with the MNB in proportion to institutional complaints	Market share %	Claims regarding the credit institution filed with the MNB		Claims/ market share ratio (%)	Negative ranking	Claims filed with the MNB in proportion to institutional complaints
		number	proportion (%)					number	proportion (%)			
1. KDB	0.1%	2	0.3%	233.2%	4.	2.7%	0.1%	8	1.1%	1013.0%	1.	12.1%
2. Banif Plus	0.2%	13	1.6%	684.0%	1.	4.8%	0.2%	14	1.9%	805.8%	2.	7.7%
3. Merkantil	1.6%	55	6.9%	445.2%	2.	5.5%	1.6%	68	9.0%	568.3%	3.	5.6%
4. CIB	3.3%	64	8.0%	231.5%	5.	1.6%	3.4%	69	9.2%	267.7%	4.	2.3%
5. AXA	1.1%	24	3.0%	260.0%	3.	3.6%	1.1%	22	2.9%	265.4%	5.	3.4%

The negative ranking of credit institutions remained relatively stable in respect of the first five institutions in the first two quarters of 2014 (the five institutions remained the same), however a general deterioration was seen for every protagonist. A general rise in ratios was observed among insurance undertakings in the past quarter. In terms of the claims to complaints ratio, the ratio of claims mostly deteriorated for the negative ranking leader institutions compared to the sectoral averages (money market: 2.4 per cent; insurance: 3.6 per cent).

Table 2 Top five ranking of the negative list of insurance undertakings for 2014 Q2

Insurer	2014 Q1						2014 Q2					
	Market share ⁷ %	Claims regarding the insurance undertaking filed with the MNB		Claims/ market share ratio (%)	Negative ranking	Claims filed with the MNB in proportion to institutional complaints	Market share %	Claims regarding the insurance undertaking filed with the MNB		Claims/ market share ratio (%)	Negative ranking	Claims filed with the MNB in proportion to institutional complaints
		number	proportion (%)					number	proportion (%)			
1. MKB	1.2%	5	2.0%	172.5%	3.	7.9%	1.2%	6	2.9%	503.3%	1.	9.0%
2. KÖBE	1.4%	12	4.8%	338.8%	1.	8.5%	1.4%	6	2.9%	428.8%	2.	9.7%
3. UNION VIG	3.1%	8	3.2%	92.4%	8.	14.3%	3.2%	9	4.3%	284.2%	3.	23.7%
4. Groupama Garancia	15.7%	53	21.4%	139.0%	4.	15.2%	15.6%	44	21.3%	281.9%	4.	12.4%
5. Allianz	15.9%	46	18.5%	124.0%	5.	2.5%	16.1%	41	19.8%	254.9%	5.	3.0%

⁶ The money market sector based on the household loan contract portfolio.

⁷ The insurance sector based on the household contract portfolio.

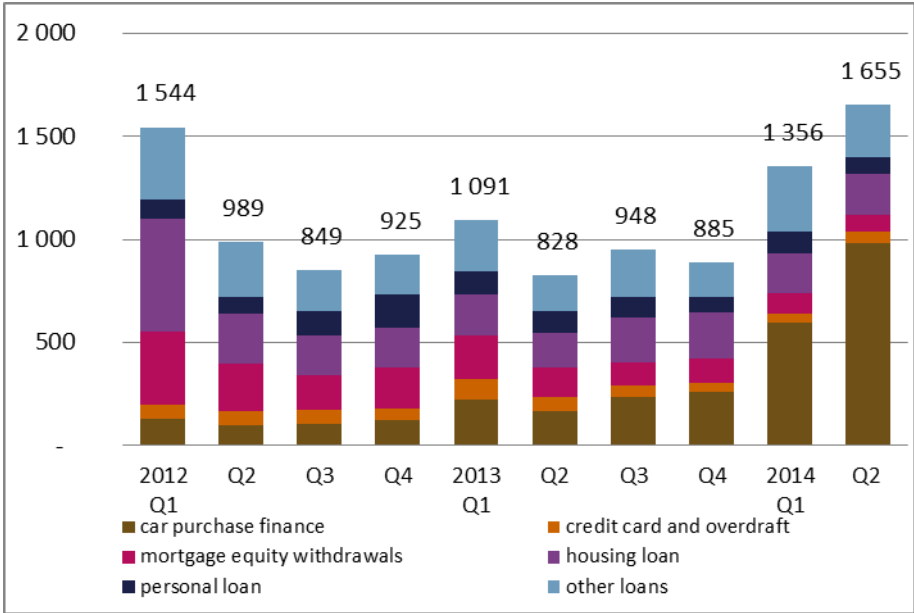
3.1.1.2. Consumer claims – certain sectors⁸ in a more detailed breakdown

3.1.1.2.1. Money and capital markets

By type of credit

In 2014 H1, over three quarters of **money and capital market claims were linked to lending**; Chart 6 clearly illustrates the **proliferation of claims related to car purchase financing and intermediation**.

Chart 3 Number of claims by main type of credit



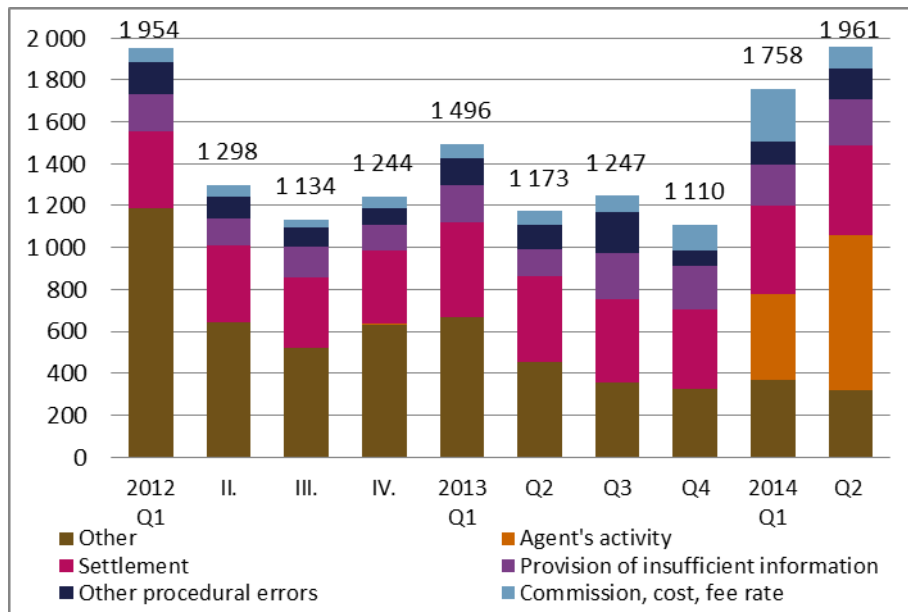
The aggregate number of claims linked to mortgage loans and personal loans has stagnated in recent periods. Another interesting point is the number of claims pertaining to home equity loans, which fell by half in year-on-year terms.

By type of claim

Among the most common types of claims, the number of claims related to settlement, agent activities, commission, cost and fee amounts and other administrative errors increased in 2014. The issues plaguing car purchase finance intermediation are the source of the massive rise in agent activities, but the number of cases involving notification shortcomings and commissions, expenses and fees increased, the latter indicative of current account management issues, which confirms the need for the MNB’s thematic inspection in that area.

⁸ As presented above, capital market sector claims have not represented a significant number or share for a long time, and this trend continued in the periods under review. In this chapter, it is addressed together with the money market sector. The number and proportion of fund sector claims have also remained at marginal levels, similarly to recent quarters, due to the decreasing weight of the sector (and the quasi drying up of claims related to returning to the state pension scheme) (a total of 73 claims in 2013 and 17 claims in 2014 H1), therefore they are not addressed in detail.

Chart 4 Number of claims by main type

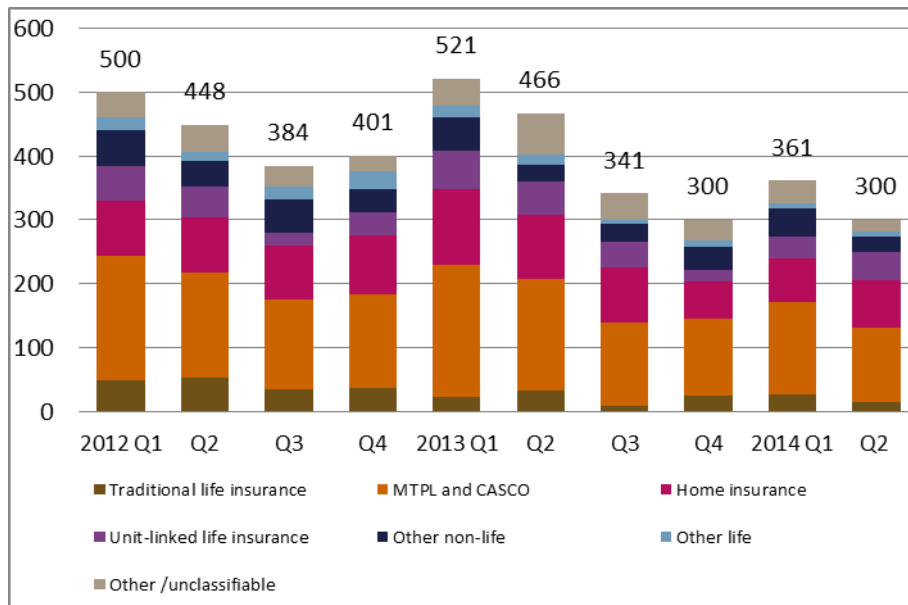


3.1.1.2.2. Claims related to insurance undertakings

Distribution of insurance related claims in a breakdown by service type

A marked improvement was registered in 2014 H1 in year-on-year terms, with a 33 per cent decline in the number of claims (from 987 to 661). Among the most common service types, the number of claims linked to **motor vehicle third-party liability insurance and home insurance** changed in similar proportions.

Chart 5 Distribution of claims linked to the insurance sector by service type (number)

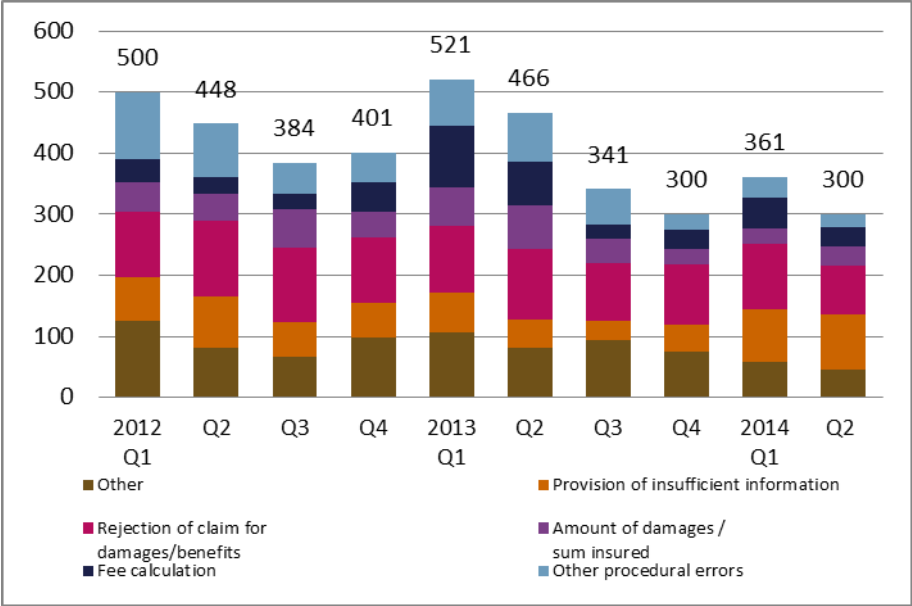


By type of claim

In 2014 H1, the number of claims linked to insurance products **fell markedly in both quarters** in year-on-year terms. **Information deficiencies** are the only exception from the

annual trend, exhibiting a more than 30 per cent rise in year-on-year terms and **advancing to become most common claim type.**

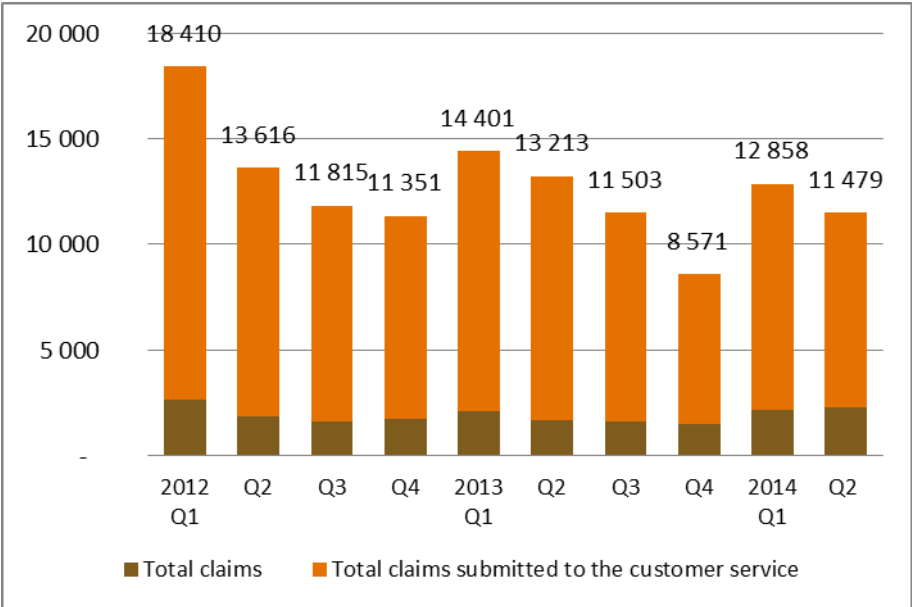
Chart 6 Distribution of claims filed with the MNB linked to the insurance sector by claim type (number)



3.1.1.3. Customer service requests

A total of 19,854 customer service requests were submitted to the MNB in 2014 H1, 16.8 per cent less in a year-on-year comparison.

Chart 7 Developments in the number of claims and customer service requests submitted to the MNB



At the same time, a 50.2 per cent increase was registered in 2014 Q1 (compared to 2013 Q4), stemming from the aforementioned rise in requests related to car purchase finance.

3.1.1.4. Requests handled by the Financial Consulting Office Network and Government Windows

Providing information and redress related to financial consumer protection is a broad social interest. To this end, **the MNB concluded a framework agreement in 2014 Q2 with the Ministry of Justice and Public Administration in the context of which consumers are able to submit their financial consumer protection claims to Government Windows located at county seats across Hungary, Pest county and the city of Vác as of 15 April 2014.** The first leg of the cooperation was completed on 15 October 2014.

In 2014 H1, the Financial Consulting Office Network directed consumers to the MNB, competent in the matter of financial consumer protection legislation breaches, in 160 cases, and to the Financial Arbitration Board, competent in contract-related legal disputes, in 179 cases. In addition, consumers were advised to contact the service provider directly in 1,961 cases and to go to court in 147 cases.

In addition, **1,278 cases** were categorised as “miscellaneous” because the client contacted the consultant with a simple issue answered on the spot or deemed as unfounded, with no need to refer the case to either the Financial Arbitration Board, the MNB or a court.

3.1.2. Consumer protection administrative procedures

One of the instruments for ensuring the enforcement of consumer protection provisions is the MNB’s targeted inspection of compliance with such provisions. Accordingly, during the first half of the year the **MNB placed special emphasis on checking compliance with consumer protection rules** in the context of inspections. The MNB also conducted on-site inspections and the majority of inspections ex officio and also concluded trial transactions in many cases in an effort to curb infringements and ensure their future prevention.

In the course of the inspections, **MNB staff members** helped the supervised institutions’ staff members in charge of consumer protection in **clarifying legal interpretation issues** and in answering any other questions to provide a set of unified principles for these institutions to discharge consumer protection related tasks. The significance of this effort by the central bank is attested to by the fact that in H1, the Consumer Protection Directorate issued 13 position statements and other forms of reply to the supervised organisations, for instance in response to questions regarding the institution of obligations imposed in resolutions.

The more recent inspections of institutions inspected in the past show the **positive impact of these earlier consultations, feedback and inspections.** The MNB is confident that the outcomes of repeated inspections on specific topics will **yield a perceptible improvement for consumers as well in complaint management, information provision and other activities** of supervised organisations directly affecting consumers.

3.1.2.1. Money market sector

In terms of credit institutions, in total 69 **ex officio inspections** were concluded in H1. A penalty was levied in 54 cases, while in ten cases the MNB opted for other consumer

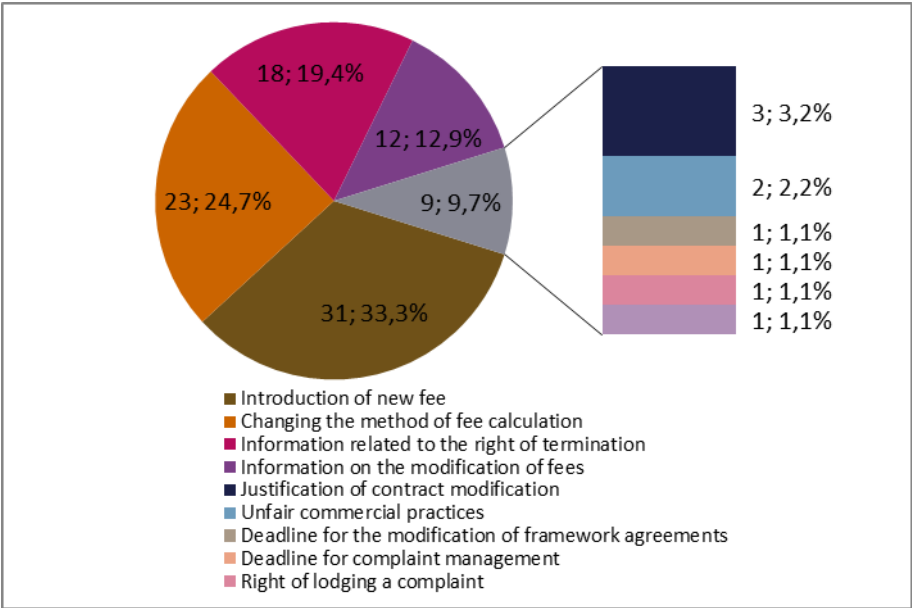
protection measures. No infringement was found in five cases. In 2014 H1, 104 consumer protection **procedures launched based on claims** were concluded, resulting in the imposition of a penalty in 33 cases and other consumer protection measures in four cases. No infringement was established in 67 cases.

In the credit institution sector, the pending ex officio inspections and targeted inspections affecting a broad range of consumers were primarily concluded. In 2014 H1, the MNB **scrutinised rate hikes on payment services across the entire credit institution sector, and also focused particularly on checking compliance with the main consumer protection provisions** affecting consumers.

With regard to payment services, the MNB concluded 35 ex officio inspections focusing on the **legal obligations on unilateral contract amendments detrimental to consumers** in the period ending 30 June 2014, and found infringements in every one of these cases.

In many cases, the inspections established that financial organisations amended their fees set out in service agreements despite the fact that neither the agreement nor the General Terms and Conditions or the Business Terms forming part of the agreement, contained the so-called **list of reasons** warranting the amendment of fees required by legislation.

Chart 8 Distribution of the findings of inspections linked to the unilateral amendment of agreements concluded in 2014 H1 (number)



In many cases, the MNB found a **failure to provide information on the deadline for initiating the amendment of the framework agreement and on the grounds for fee amendments**, and a **failure to provide information on agreement termination rights**. The inspections also identified many cases where financial organisations amended agreements **by introducing new fees or changing the pricing calculation method** set out in the agreement, both of which are explicitly prohibited by legislation.

On the topic of fee and expense hikes, inspections were carried out at an additional 121 financial organisations by August 2014, identifying infringements in 107 cases. In the wake of the inspections concluded in this matter in 2014, HUF 1.86 billion in consumer protection penalties was levied, affecting 136 financial organisations, and 139 financial organisations were ordered to reimburse the illegitimately charged fees to consumers.

As a result of ex-officio consumer protection inspections launched in relation to the high number of consumer submissions made to the MNB, the **MNB established, in relation to complaint management**, at over ten supervised institutions that the financial organisations under review often failed to respond to consumer complaints within the 30-day deadline stipulated by law, along with a range of other complaint management related issues.

The MNB carried out **consumer protection inspections of institutions specialising in retail consumer credit** and levied penalties amounting to HUF 65 million on Cetelem Bank Zrt. (Cetelem), Cofidis Magyarországi Fióktelepe (Cofidis) and Provident Pénzügyi Zrt. (Provident).

The inspection established that all three market participants proceeded in a non-compliant manner in the context of the commercial communication of the financial products, **failing to correctly indicate the annual percentage rate of charge** for the loans, the true measure of their cost and the basis of comparison with other service provider offers.

The central bank also perceived that the **credit intermediary agents** of these institutions often provided **deficient or no information** to consumers on the conditions of the loan and their related rights, including the option of withdrawal, prior to contract conclusion. Experience shows that credit intermediaries **failed to always notify** consumers that the product offered by them **will be paid with a loan (hire purchase)**, and also failed to present the contents of the notices and contract documents linked to the loan and signed by the consumers. Not every agent **gave detailed information as stipulated by the law** on the exact conditions and terms of use of the schemes requested by the consumers (for instance hire purchase or credit card).

The notification section of the order form used by one of Cofidis Magyarországi Fióktelepe's tied agents, Mellék6ás Kft., did not state the name of the credit institution of which Mellék6ás Kft. was a tied agent. Based on this, consumers could not make a decision based on truthful information.

The MNB also established that the market participants under review did not always comply with the rules pertaining to the Central Credit Information System and the provisions governing complaint management and other notification obligations (repayment table, periodic information of clients, sending a statement to client at the time the contract expires).

2014 H1 saw the conclusion of numerous **ex-officio** consumer protection procedures focusing on financial enterprises. Among these, **the 22 inspections of financial enterprises engaging in car purchase finance are worth noting; these focused on the examination of compliance with the legal provision prohibiting the charging of fees on Casco and payment protection insurance bundled with credit products in a foreign currency.** During this period, the targeted inspection focusing on complaint management by the five financial enterprises was also completed.

In the first half of 2014, in addition to its ex-officio inspections, the MNB also identified infringements in the context of numerous consumer protection procedures launched based on **individual claims**, which typically consisted of the failure by financial enterprises to meet their notification obligations, their violation of complaint management rules and misleading of consumers.

One inspection worth noting was the targeted inspection of Lombard Pénzügyi és Lízing Zrt., which identified the following instances of infringing conduct:

- **The legal requirements on client notification** were violated by the fact that Lombard Pénzügyi és Lízing Zrt. failed to publish its interest rates, service fees, other costs charged to clients and default interest calculation method in its notices.
- The financial lease agreements and car purchase finance agreements concluded by Lombard Pénzügyi és Lízing Zrt. that did not specify the actual key transactional interest rate or the percentage value of the transactional interest rate did not comply with the **substantive requirements for loan agreements.**
- The inspection of **notification practice regarding the APR** also identified infringing conduct in terms of APR calculation, as Lombard Pénzügyi és Lízing Zrt. took the discounted contract management fee into account despite the relevant government decree stipulating that APR must be defined based on the valid, rather than the discounted fees. By announcing lower APR than that required by law, Lombard Pénzügyi és Lízing Zrt. misled clients regarding the content of the credit and lease agreements to be concluded.
- Regarding the practice of **increasing the interest rate, fees and costs set out in the contract**, the MNB also identified infringements, as the financial enterprise's notices announcing fee and cost hikes were not published within the deadline stipulated under legislation, and it also failed to provide direct notification of these fee and cost hikes.

Based on the above specified infringements, the MNB levied a consumer protection penalty of HUF 5 million and HUF 12 million.

The MNB conducted inspections of 22 financial enterprises engaged in car purchase finance with regard to the violation of the legal provisions governing the **charging of fees on foreign currency loans in a foreign currency** and concluded 15 of these inspections in 2014 H1, with the last one completed in September. Before the end of 2014 H1, the MNB established that

three institutions had illegitimately charged Casco insurance premia in a foreign currency from the end of September 2011, as the Casco insurance premium bundled into the transactional interest was incorrectly qualified fees and costs incurred by the acquisition of foreign currency funds in the interest of performing and maintaining the contract, contrary to the relevant legal provisions. The central bank imposed consumer protection fines amounting to HUF 30 million on the abovementioned financial enterprises.

Another eight inspections were wrapped up in 2014 H1, in the wake of which the MNB imposed fines in the amount of HUF 7.15 million on five financial enterprises on the same grounds as in the previous case.

The central bank thus **imposed penalties on eight of the 22 financial enterprises examined in a total amount of HUF 37.15 million** and also required them to reimburse the exchange rate difference stemming from the charging of Casco insurance premia in a foreign currency until the time of resolution of the infringing situation to all affected consumers, (24,141). The MNB terminated the procedure with regard to 14 companies without taking any measures, as it failed to establish any infringement or because the companies did not have any consumer clients, or because financing was not provided in the context of a credit agreement.

A large number of consumer submissions were received with identical content and form – such as objections regarding the comprehensiveness of replies to complaints – affecting certain financial enterprises. In light of this, the MNB reviewed complaint management practice at the seven financial enterprises affected by a high number of claims (Santander Consumer Finance Pénzügyi Vállalkozás Zrt., Raiffeisen Lízing Zrt., UniCredit Leasing Hungary Zrt., Budapest Autófinanszírozás Zrt., CIB Lízing Zrt., Merkantil Car Gépjármű Lízing Zrt., Lombard Pénzügyi és Lízing Zrt.).

Numerous other inspections focusing on complaint management were also carried out based on individual claims, over and above these ex-officio inspections. In the context of examining the violation of legal provisions on **complaint management**, the MNB found infringing conduct at numerous financial enterprises.

The MNB completed a targeted inspection during the half year and issued a notice stating that it had identified multiple legal breaches in the area of complaint management by Dunacorp Faktorház Zrt. Dunacorp Faktorház Zrt. failed to record a substantial portion of client complaints made by telephone or failed to archive the recorded audio material for the one-year period stipulated by law. In many cases, the company failed to draw up a protocol of complaints made by telephone and often failed to issue written notification to the affected clients on the investigation of the complaint.

When it did respond to complaints, Dunacorp Faktorház Zrt. often failed to provide comprehensive information to consumers, did not list the available redress forums and also violated the legal provision on the deadline for replying.

In addition, Dunacorp Faktorház Zrt. also amended and published its complaint management regulations with delay and its complaint management records were not kept with the data content required by law. The MNB imposed a consumer protection penalty of HUF 30 million on account of these violations.

In the context of ex-officio targeted inspections, the MNB established that Bankárnet Befektetési és Tanácsadó Kft. was engaging in **misleading commercial practice** via its website content and “credit calculator” application featured on its website. The designation of “credit calculator” for the application featured on Bankárnet Befektetési és Tanácsadó Kft.’s website qualifies as an untrue claim, as the “calculator” consisted merely of a client contact data form through which clients could request a callback and, contrary to its name, did not calculate any results or yield possible solutions.

Consumers were only notified that they had made their data available to a financial intermediary, i.e. Bankárnet Befektetési és Tanácsadó Kft. once they had completed the “credit calculator” and initiated a callback. Bankárnet Befektetési és Tanácsadó Kft. By its website content, the concealment of its name and use of the “credit calculator” designation, may have unfairly manipulated the business decisions of consumers who wished to access loan data, but were only given the sole choice of Bankárnet Befektetési és Tanácsadó Kft.’s service instead.

3.1.2.2. Capital market sector

A total of six claims were filed with the MNB in 2014 H1 in which the affected consumer contested the conduct, a procedure or omission by a capital market sector participant. Among the consumer protection procedures **launched based on these claims**, a consumer protection penalty was levied in two cases based on the infringement identified or the circumstances of the case. The MNB found no infringement in another four procedure is launched based on claims, and therefore dismissed these claims. **Among the individual capital market sector claims**, consumers contested the information provided by and the client risk classification practice of investment service providers.

Among the procedures launched based on individual claims, the case where the MNB established that Buda-Cash Brókerház Zrt. failed to comply with its preliminary information and information requesting obligation, and its obligation to ensure subsequent verification defined in legislation is worth noting. In the context of its investment services activities, Buda-Cash Brókerház Zrt. failed to identify the client and failed to comply with its client identification requirements set out in its business terms prior to taking orders through a recorded telephone line. It thereby failed to comply with the requirement for enabling the subsequent verification of whether orders were in fact made by the client.

3.1.2.3. Insurance sector

A total of 92 procedures launched based on claims were concluded by the MNB in 2014 H1 in which the affected consumer contested the conduct, a procedure or omission by an

insurance market sector participant. Among the consumer protection procedures **launched based on these claims**, a consumer protection penalty was levied in 38 cases based on the infringement identified or the circumstances of the case. The MNB established infringements in six procedures launched based on specific claims, but only opted to apply consumer protection measures in light of the severity of the infringements. A total of 48 procedures launched based on claims were wrapped up without establishing any infringement.

In 2014 H1, the MNB's main findings in the consumer protection procedures launched in the insurance sector **on the basis of individual claims** were (typically) **the violation of complaint management rules and the misleading of consumers through false information**. The inspection of submissions pertaining to MTPL insurance policies focused on the circumstances under which the insurance offer was forwarded, compliance with the policy's provisions on bonus-malus rating and with the provisions on the dispatch of premium payment and instalment payment reminder letters.

In 2014 H1, the Consumer Protection Directorate **launched five ex-officio procedures** against insurance sector institutions, levied a consumer protection penalty in two cases and opted for simple consumer protection measures in three of the cases.

Besides the abovementioned ex-officio procedures, the MNB's consumer protection staff **also took part in every comprehensive inspection conducted at insurance companies by the prudential area**. Comprehensive consumer protection supervisory inspection covered several years of operation, focusing on client information practices prior to contract conclusion, client information practices in the case of life insurance policies, client notification practices related to MTPL products and complaint management.

In order to ensure continuous market presence, the MNB regularly conducted **trial transactions in the insurance sector in 2014 H1, covering all phases of the insurance legal relationship**. Worth noting is the fact that trial transactions were concluded in almost all comprehensive inspections. In 2014 H1, a total of ten mystery shopping transactions were carried out by the MNB, and it continues to perform such transactions in the context of select inspections.

The MNB established violation of the legal provision concerning the **prohibition of unfair business-to consumer commercial practice** in respect of almost every type of insurance contract:

- K&H Biztosító Zrt. engaged in **unfair commercial practice** by providing misleading information to consumers on the redemption value of its **life insurance policy** and regarding the taxation rules linked to redemption, as did Allianz Hungária Biztosító Zrt., which gave misleading information on the duration of the contract prior to the conclusion of the **life insurance policy**, as a result of which the policy concluded was not suited to the consumer's needs.

- Generali Biztosító Zrt. also engaged in **unfair commercial practice** by providing misleading information to consumers on the exercising of the right of withdrawal on **home insurance policies**.
- Astra S.A. Biztosító Magyarországi Fióktelepe also engaged in unfair commercial practice by providing misleading information on **home insurance policies** through its telephone customer service.
- Wáberer Hungária Biztosító Zrt. also gave out **misleading information** by providing inadequate information on the aggregate amount of the client's payment obligation stemming from its **MTPL insurance policy** comprising the quarterly insurance premium, no coverage charge and accident tax.
- K&H Biztosító Zrt. engaged in **misleading commercial practice** by providing contradicting information to clients regarding its **MTPL insurance policy**, misleading clients and influencing their business decisions on whether action, and the extent thereof, was necessary to ensure that they had a valid MTPL insurance policy. The client did not take the necessary steps to have a valid MTPL insurance policy based on the contradicting and misleading information and thus incurred a substantial financial loss on account of the resulting no cover charge.
- Uniqa Biztosító Zrt. also violated the prohibition of **unfair commercial practice** by failing to notify its client of its overdue premium payment on its **MTPL insurance policy**, and also of its termination of the policy in the wake of the non-payment. Despite terminating the agreement, Uniqa Biztosító Zrt. issued a premium payment request to the client for the subsequent quarter, thereby misleading the client into thinking they had a valid policy.

The consumer protection procedures conducted by the MNB established that brokers often failed to act in accordance with the requirement of **professional prudence** vis-à-vis their clients.

Conduct in violation of professional prudence was established in the cases where brokers failed to provide adequate information on insurance policies to clients or failed to provide information on the policies. In addition, in some cases the date indicated on the insurance policy as the policy inception date was almost one month later than on the insurance offer.

In the context of its ex-officio inspection of Astra S.A. Biztosító Magyarországi Fióktelepe, the MNB **found infringement with respect to the branch's complaint management practice** and issued a press release. The MNB's consumer protection procedure investigated what type of commercial communication was used by Astra S.A. Biztosító Magyarországi Fióktelepe regarding the submission of complaints by fax and the discontinuation of this option.

The MNB found that the insurance undertaking had disclosed untrue and deficient information on its website on the option for complaint management by fax and restricted consumers in their right to file complaints, as regulated by the Act on Insurance Institutions and the Insurance Business.

The case's significance was exacerbated by the fact that the insurance undertaking had discontinued the option for filing complaints by fax at a time when the termination of MTPL insurance policies by clients with anniversary contracts was falling due. Therefore, not only did Astra S.A. Biztosító Magyarországi Fióktelepe fail to provide the option of filing complaints by fax, it also prevented the submission of MTPL insurance contract termination declarations by fax, which severely impinged upon the interests of clients wishing to submit their termination declaration by fax.

In its order imposing an interim injunction, the MNB required Astra S.A. Biztosító Magyarországi Fióktelepe to remedy the infringing status of preventing consumers from submitting their complaints by fax, in the wake of which approximately 2,000 contract termination declarations were submitted to the insurance undertaking. In addition, the MNB also levied a HUF 3 million consumer protection penalty on the grounds of unfair commercial practice and ordered the insurance undertaking to comply with the relevant legal provisions.

The MNB deemed the absence of the grounds for offering a specific insurance policy featuring a certain service, content and sum insured in the product information document linked to the life insurance policy based on the assessment and specification of client needs as a violation of the **obligation to provide information to clients defined in legislation**.

The legal requirements stipulates that the product information document must include a brief summary of the client's objectives defined based on a preliminary assessment of needs, helping clients to gain a clearer picture of their requirements to be met with the insurance and enabling them to better assess whether the insurance policy offered by the intermediary truly meets their needs.

Insurance undertakings with MTPL products in their offering announced premium rates on 36 occasions during the first half of the year. **The continuous ex-officio inspection of MTPL notices did not identify any severe issues; measures were applied in minor cases on grounds of infringement.**

3.1.2.4. Funds sector

The MNB did not conduct any **consumer protection procedures based on individual claims** in the domain of voluntary pension, health and mutual aid funds. Several **comprehensive inspections** were initiated in 2014 H1, covering Erste Nyugdíjpénztár, Generali Önkéntes- és Magánnyugdíjpénztár, Budapest Magánnyugdíjpénztár, and MKB Önkéntes és Magánnyugdíjpénztár.

The **MNB is also inspecting the funds' activities from a consumer protection perspective** in the context of these inspections (primarily focusing on funds' complaint management practice, specifically the replies given to written complaints, the management of telephone complaints, record-keeping of complaints in compliance with the rules governing complaint management regulations). These inspections should be completed in 2014 H2.

3.1.2.5. Measures

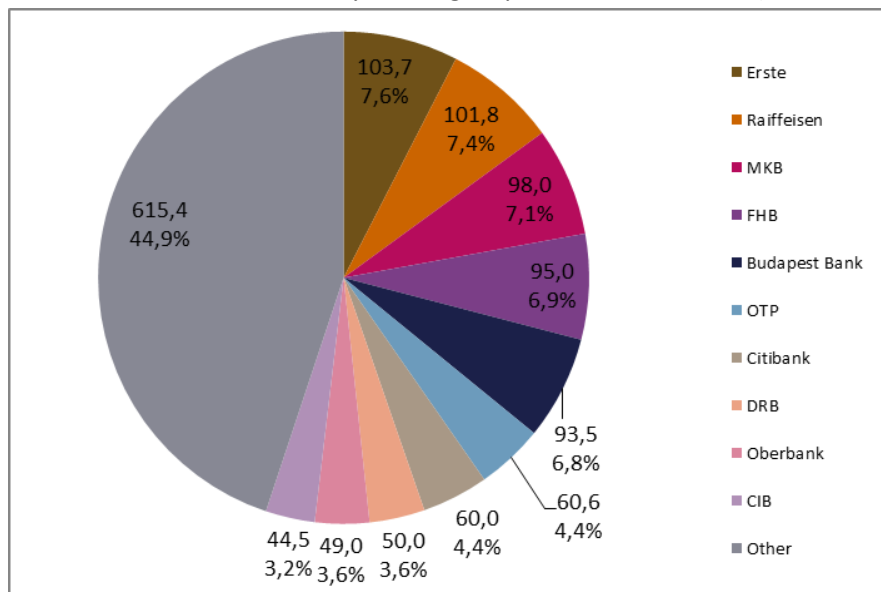
Among the inspections opened ex officio in 2014 H1, 94 per cent were concluded with the establishment of infringement. By contrast, **infringement was established in 41 per cent of cases launched upon request.** This is due to the fact that ex-officio inspections focused on compliance with numerous consumer protection provisions, resulting in higher chances of violations, and the topics of the inspections, prone to infringement.

In 2014 H1, the MNB found a total of 292 infringements in the context of 158 concluded inspections having revealed an infringement, **averaging 1.84 infringements per inspection.** The MNB **also levied a penalty in the majority of cases** where infringement was established. The MNB only waived the imposition of a penalty in the least severe cases from the perspective of consumers in the event of infringement, with all circumstances of the case considered. **The highest available penalty was levied in ex-officio inspections** in light of the fact that the identified infringements generally affected a broader group of consumers.

The MNB also strives to apply sanctions in individual cases that act as an incentive for the supervised institutions to handle the identified issues on the overall organisational level to prevent their reoccurrence. The MNB saw the imposition of a penalty for omission as being justified in the majority of inspections concluded with the establishment of infringement, along with other sanctions. Worth noting among other measures is the prohibition of continued infringing conduct, compliance with legislation, orders to resolve the identified shortcomings and to resolve the identified flaws and shortcomings within the set deadline.

The substantial amount of penalties levied in 2014 H1 resulted from penalties imposed in the wake inspections of fee and expense increases (HUF 1.186 billion), accounting for 86.5 per cent of the total amount (HUF 1.372 billion). Another HUF 674 million was levied on grounds of fee and cost hikes by August 2014 (the date of conclusion of the inspections), and a total of HUF 1.86 billion in consumer protection penalties.

Chart 9 Institutions affected by the largest penalties in 2014 H1 (HUF million)



Warnings issued by the MNB in 2014 H1

In parallel with its legal enforcement activities, the MNB also issued a warning to consumers on the importance of **obtaining preliminary information prior to concluding contracts**.

Thoroughly reading contracts, considering the financial burden being accepted and comparing the offer conditions to those of other service providers are essential to making informed consumer decisions. The “Loan and lease product selection tool” available on the MNB website enables an objective comparison of the products offered by various service providers, and the central bank’s consumer protection publications help them make informed decisions.

The MNB has warned consumers **of the risks of using virtual currencies**. These virtual currencies involve far greater risk than customary payment solutions: they have no issuer, are not under any national jurisdiction or central bank supervision and are not governed by any rules of liability, guarantee or damage. The MNB warned consumers to be particularly prudent and careful before using such virtual currencies, such as Bitcoin.

The MNB published the ESMA warning on **the risks of investing in complex products**.⁹ The use of misleading nomenclature among these products is common practice (using terms such as “high”, “guaranteed”, “hedged” or “absolute” returns), which do not always accurately reflect the true features of the product.

If the consumer is not entirely familiar with the features of complex products, they are advised to seek independent professional advice. The fees and cost of an investment will impact the return consumers are likely to achieve, and therefore it is essential that they obtain an overview of these costs before embarking on a decision. Consumers should also be aware of the terms of terminating the contract before maturity, as consumers are often short-changed when they wish to access their money before the product is due to pay out (potentially even losing capital).

In an effort to help take advantage of the opportunity of free cash withdrawals, the MNB called consumers' attention to the fact that in order to take advantage of the opportunity to withdraw a monthly HUF 150,000 free of charge, consumers must not only submit a relevant declaration, but also raise their ATM cash withdrawal limit to HUF 150,000 per day, and HUF 75,000 per transaction. At the same time, prior to setting the limit, it is important to assess personal needs and the safety risks involved.

⁹ http://felugyelet.mnb.hu/bal_menu/figyelemfelhivo

3.2. Market supervision

Ensuring the transparent operation of public issuers and safeguarding the fairness of the capital market feature among the main objectives of the MNB's market supervision efforts. To achieve these goals, the MNB also plays the **role of gatekeeper** as part of its market monitoring operations (authorising issuance), and also **checks whether public issuers' regular and extraordinary disclosures comply with the effective statutory requirements**. In addition, it also **screens for prohibited market manipulation, insider trading, unlicensed activities and suspicious transactions and protagonists**.

Identification of deviant market movements is followed by a **market supervision procedure** and further analysis of the facts and data obtained during the inspection. Market supervision procedures are conducted based on a unified, predictable and consistent market supervision measure and sanctioning policy. **Accordingly, the MNB's market supervision policy of measures was created to guarantee an adequate dissuasive impact for deviant market conduct applicable to all money and capital market players, and the effective identification of market abuse.**

3.2.1. Market monitoring

3.2.1.1. Issuance authorisation – the role of gatekeeper

The MNB places special emphasis on applying consistent legal practice in all of its procedures to ensure that capital market introduction by market participants takes place in a transparent manner, providing all necessary information to investors to allow them to make informed decisions (acting as a gatekeeper), in order to protect investors, reinforce confidence in securities markets and ensure the smooth operation and development of securities markets to the greatest degree possible, as objectives laid down in legislation.

Along with its gatekeeper role, as a key parallel market interest, it is essential that issuance and capital market product authorisation be seen as a smoothly functioning and smoothly operated service by all market participants. These objectives require the strictest possible adherence to the deadlines defined in legislation, as well as the legal enforcement practice whereby the MNB endeavours to keep up with the rational needs of market participants' business activity channelled into authorisation in a flexible manner within these deadlines, in addition to the explanatory nature of the authority's rectification of deficiencies aimed at helping market participants and the implementation of development needs in the field of electronic administration.

In 2014, six issuance programmes were approved on the debt securities market, and the MNB authorised the publication of related base prospectuses (and related notices) in a framework amount of HUF 1.387 billion.

The MNB authorised the publication of a prospectus and a notice by OPIMUS GROUP Nyrt. prior to issuing shares in excess of HUF 5 billion on the regulated market during the period under review in the wake of its prudent procedure covering all aspects, including company

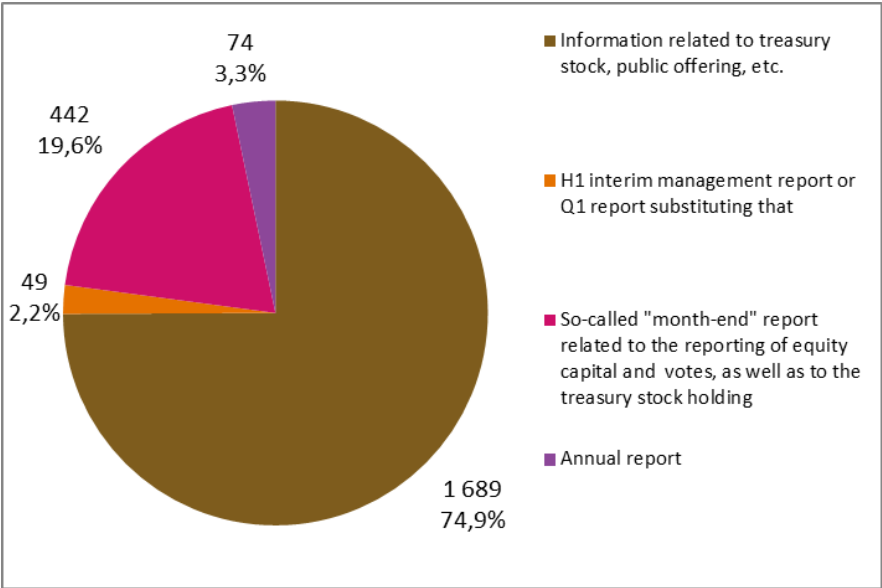
law matters with the opening of supervisory proceedings on court of registration legality. At the same time, due to the reinforcement of its substantive inspection of authorisation applications, in September, following a procedure conducted during the first half of the year, the **MNB rejected Blue Seven Group Nyrt.’s prospectus and notice authorisation application for the introduction of shares in the amount of HUF 665 million to the regulated market.**

The MNB has consistently stressed that the authorisation of regulated market launches is based on the examination of data and information indicative of the prospective entity’s current and future financial, economic, market and the legal situation from an “investor perspective”, in particular from the perspective of whether the presentation is reflective of the truth, accurate and suitable for making well-founded investor decisions.

3.2.1.2. Monitoring the activity of public issuers

In accordance with the requirements of Act CXX of 2011 on the Capital Market (hereinafter: Capital Market Act), **issuing companies** (currently 74) **published 2,254 disclosures** through the official dedicated information storage system¹⁰ during the first six months of 2014. Chart 14 presents the distribution of these disclosures.

Chart 10 Distribution of disclosures by type in 2014 H1 (number)



The main takeaway from the inspection of announcements is that the **majority of issuers fully comply with the relevant obligation, while others only do so with significant shortcomings.** With regard to the disclosure of regulated information, we registered a delay in 154 cases compared to the disclosure deadline stipulated by the Capital Market Act, and the content of extraordinary notification was inaccurate or incomplete in an additional 27

¹⁰ www.kozzetetelek.hu

cases. The MNB has warned the issuers committing these breaches to fully comply with the obligations in the context of its currently ongoing and future targeted inspections.

3.2.1.3. Analysis of capital market transactions

3.2.1.3.1. Screening for insider trading and prohibited market manipulation

The main pillar of the MNB's capital market monitoring activity **is the continuous verification of its proprietary statistical models and algorithms**. The MNB's data warehouse and various statistical software are available for this, boosting the efficiency of capital market supervision and introducing automatic processes. In 2014 H1, a weekly average of 35,000 deals intermediated by Hungarian entities and 12,000 deals intermediated by non-resident entities were inspected, and 100,000 offers were inspected weekly on average to screen for deviant conduct and suspicious transactions. A total of 42 Hungarian and 503 non-resident investment service providers submitted transaction data pertaining to the financial asset market.

Client and transaction inspections are performed with the help of proprietary **regression, VaR and factor models**, enabling the quantification of factual and circumstantial evidence suggesting market manipulation and insider trading, based on mathematically collaborated data. The continuous monitoring of clients executing suspicious transactions which have already come under scrutiny by the MNB will be enhanced going forward. The MNB inspected a weekly average of 30 clients' transactions in the first half of 2014, identified suspicious conduct among 73 clients and subsequently requested data from the investment service providers reporting the client's transactions.

Checking the data quality of incoming data is vital in the interest of the successful mass processing of the **robust volume of disclosed data**. Unfortunately, the 2014 calendar year started off with a substantial deterioration in data quality stemming from the introduction of the new trading system in early December 2013, as many data elements to be included in the MiFID transaction report can be accessed differently on the new platform, as a result of which the IT-side development of reporting mechanisms took time for reporting agents, in addition to the occurrence of other interpretation issues. In an effort to improve data quality, **continuous contact and communication with investment service providers to restore data quality as soon as possible was strongly emphasised in H1**.

In the context of the project, the MNB contacted 19 investment service providers with recommendations and requirements to improve data quality. Continuous supervision and back testing **was able to increase the ratio of adequate quality data submitted from 60 per cent to 88 per cent**. Experience shows that investment service providers most often made errors in completing the accurate trading time, the transaction identification and the venue identification fields.

The MNB continuously reviews **reports made in the context of the reporting obligation for suspicious transactions stipulated by the Capital Market Act for investment service providers**. In the past half year, 33 such reports were submitted from four different entities. The main takeaway from the inspections based on these sources is that **few players subject to a reporting obligation fully meet their obligations stipulated under the Capital Market Act in accordance with the MNB's expectations**; nevertheless in terms of content the submitted reports comply with the requirements and contribute to more effective screening.

3.2.1.3.2. Supervision of net short positions

In response to the financial crisis, the European Union passed **Regulation (EU) No. 236/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps (hereinafter: SSR)**, which establishes obligations on net short positions. **The MNB is also in charge of overseeing compliance with these obligations on a national level**. In the context of the data reporting stipulated by the regulation, 112 submissions were made in 2014 H1 (compared to 61 in 2013 H1). In relation to the reporting of net short positions, it should be noted that data quality issues were encountered due to interpretation difficulties of the regulation. In 2014 **the largest number of data quality issues occurred in the calculation of government paper positions**.

In addition, there was a general downward trend in the aggregate net short positions in both shares and government securities during the half year. During the six months under review, 17 players reported net short positions on securities linked to Hungary (compared to 21 in 2013). The number of submissions to be processed increased in a year-on-year comparison with 2013, but the number of submitting entities decreased. Therefore, there were **fewer market participants taking out short positions on securities with Hungarian relevance, but changes their net short positions with greater frequency**.

3.2.1.4. Other investor protection activities

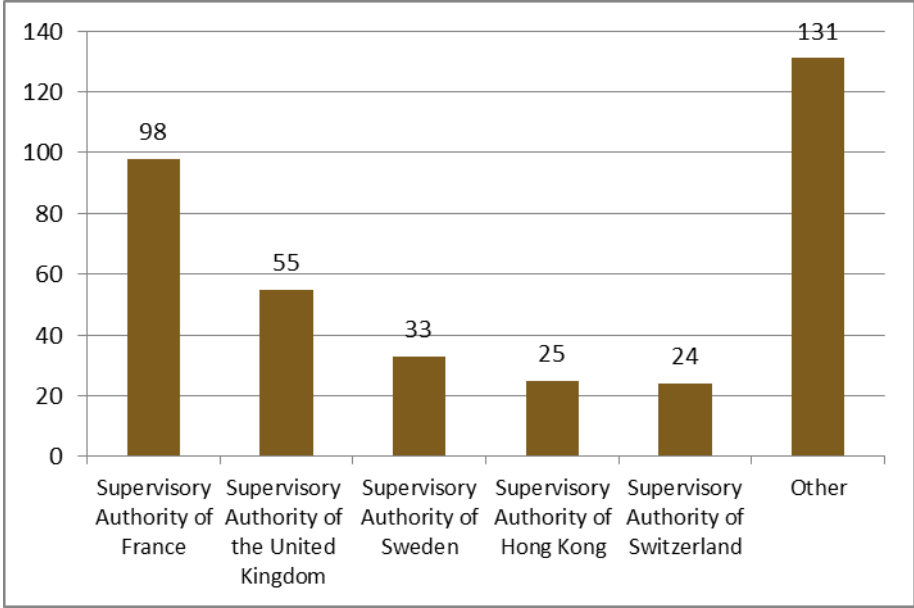
Beyond the activities presented above, the MNB also **publishes warnings**¹¹ on both unlicensed resident protagonists (not listed in the MNB's records) and suspicious non-resident protagonists which have violated legislation and been disclosed by foreign supervisory authorities to help protect investors. The primary objective of these warnings is to provide effective, up-to-date information to Hungarian – primarily retail investors – on organisations offering investment opportunities without the mandatory central bank licences in an effort to prevent the market operations of unauthorised service providers and to channel retail investor savings into the supervised sector.

¹¹ http://felugyelet.mnb.hu/bal_menu/figyelemfelhivo

Service providers operating in Hungary without a licence, in often misleading ways and offering the sale and intermediation of investment and financial services and products significantly exceeding the population’s average risk sensitivity, represent a substantial risk to the safety of investments and erode small investors' trust in the Hungarian money and capital market.

In 2014 H1, the MNB processed and published 366 warnings, illustrated by Chart 11 in a breakdown by submitting supervisory authority.

Chart 11 Developments in warnings by reporting entity in 2014 H1



3.2.2. Market surveillance administrative procedures

In its market supervision procedures in the past six months, the MNB shed light on the background of several investment and financial schemes geared towards household consumers which were not only offered by entities disregarding the requirements of governing sectoral laws, but based their operation and activities primarily on consumers’ poor financial literacy and lack of financial investment knowledge, and substantial impingement of consumer interests.

The statistical balance of the MNB's market supervision procedures for 2014 shows that nine market supervision procedures, one thematic inspection and two targeted inspections were concluded. Of the nine market supervision procedures, the MNB discovered insider trading in one case and sanctioned unauthorised operations in eight cases (unlicensed collection and management of investments; unreported agent activities; unlicensed mortgage lending). The following chapter presents two key cases in greater detail. The amount of market supervision penalties levied during in this period exceeded HUF 1.5 billion. The clientele of the sanctioned undertakings was close to 10,000. The chapter entitled ‘Inspection of stock exchange issuers’ contains more information on thematic and targeted inspections.

With regard to market supervision developments in the past half year, it should be noted that the European Union has adopted the new Market Abuse Regulation (MAR) and the Market Abuse Directive (MAD II) to ensure criminal sanctions for market abuse.

These new regulations represent a great step forward in the area of financial and capital market products and services from a consumer perspective, opening the door for firmer and more unified supervisory action across Europe. The two pieces of legislation were published on 12 June 2014, as the new legislative framework established by MAR and MAD II replaced Directive 2003/6/EC that came into effect in 2003. Member states, including Hungary, have two years following the enactment of European Union legislation to transpose the new rules into national law and put them into practice.

The topics regulated by MAR include insider lists, an inside information publication obligation, rules governing the prohibition period, and the use of various websites, blogs and social media. Based on these rules, executives of the issuer will be prohibited from trading prior to the publication of the interim financial report or the end of the year report. In addition, MAR supplements the general prohibition on market manipulation with the prohibition of benchmark manipulation in the forwarding of false or misleading information, the disclosure of false or misleading data and of any other actions aimed at manipulating the calculation of benchmarks.

3.2.2.1. Key market supervision inspections¹²

Meritum Hungary Zrt.

In the context of a market supervision procedure, the MNB established that **Meritum Hungary Zrt. provided monetary loans without a licence in the context of its financial security provision service.** In the agreement it concluded, Meritum undertook to provide financial security in the form of cash to the financial institution extending consumer credit in lieu of the debtor in exchange for a monthly security fee. The MNB established that the two fundamental elements of monetary lending (provision of funds and the related repayment obligation) were clearly met in the legal relationship for the provision of security between the two parties. The MNB established that by intermediating natural persons seeking credit to a specific financial institution, it was engaging in agent activities for the intermediation of financial services – subject to mandatory notification – without being listed in the MNB's records.

The MNB imposed immediately barred Meritum Hungary Zrt. from continuing its credit and monetary loan provision financial service activities and unreported financial service intermediation activities, **and imposed a HUF 55 million fine on grounds of unlicensed monetary loan provision and a HUF 1 million market supervision fine on grounds of**

¹² The MNB issued resolutions concluding the two key market supervision procedures in 2014 Q2.

unreported agent activities. In view of the fact that evidence suggesting suspected criminal offences was also collected during the market supervision procedure, the MNB has initiated criminal proceedings with the police.

The Fortress case

As reported by the MNB on several occasions, market supervision procedures were conducted since November 2013 in relation to the activities of the natural person and Budapest resident Zsolt Sándor Sz.-F., Fortress Holdings LLC, Flow MoneyConsulting Korlátolt Felelősségű Társaság and FLOW MONEY INT. LTD.

Based on the evidence obtained in the context of the market supervision procedure, the MNB issued a prohibition, published in late February 2014, with immediate effect for any of the above listed entities to engage in activities requiring the MNB's authorisation or its notification. The procedure also established that Zsolt Sándor Sz.-F. engaged in the public collection of funds "in representation of" the non-existent Fortress Insurance & Investment Company until November 2013, misleading investors and giving the false impression that he was a representative or agent (most often claiming he was the director) of a globally renowned US company.

In the context of these activities, proceeding "in representation of" the fictitious Fortress Insurance & Investment Company, Zsolt Sándor Sz.-F. came into contact with over one thousand investors in all likelihood. The inspected documentary evidence has revealed that Zsolt Sándor Sz.-F. **collected, directly or indirectly, nearly HUF 8 million in repayable funds** in the context of his operations. From November 2013, he continued his activities "in representation of" the fictitious Fortress Insurance & Investment Company on behalf of Fortress Holdings LLC. **The MNB identified more than 1,500 investors** who in all probability came into contact with Fortress Holdings LLC. Fortress Holdings LLC **collected, directly or indirectly, nearly HUF 3 million in repayable funds** in the context of his operations.

With regard to the substantial amount of funds involved, the **MNB imposed a HUF 500 million market supervision penalty** on both Zsolt Sándor Sz.-F. and Fortress Holdings LLC on the grounds of unauthorised financial service activities (specifically "other collection of repayable funds from the public"). Prior to the imposing the maximum market supervision penalty, the MNB thoroughly assessed whether the imposition of the fine on the parties involved in the unauthorised activities could jeopardise the repayment of the investors' money. Based on the available evidence, the MNB concluded that Zsolt Sándor Sz.-F. and Fortress Holdings LLC were not in possession of comprehensive and accurate records on the investors involved with them and their investments. In addition, in light of the conduct exhibited by Zsolt Sándor Sz.-F. and Fortress Holdings LLC during the market supervision procedure, the MNB had doubts that Zsolt Sándor Sz.-F. and Fortress Holdings LLC would actually use their assets to repay the money due to investors in the event that lower fines were imposed.

In addition, the market supervision procedure also found that Zsolt Sándor Sz.-F. and Fortress Holdings LLC had involved Flow Money Kft. and FLOW MONEY INT. LTD in seeking out investors, presenting the investment opportunities and communicating with investors. As the evidence revealed that both Flow Money Kft. and FLOW MONEY INT. LTD had engaged in so-called priority intermediary activities, **the MNB imposed a HUF 1.1 million market supervision fine on Flow Money Kft. and a HUF 250 million fine on FLOW MONEY INT. LTD.**

Although the MNB filed a police report in November 2013, evidence suggesting additional suspected criminal offences was collected during the market supervision procedure, and the MNB has initiated further criminal proceedings with the police.

3.2.2.2. Examination of stock exchange issuance

The importance of on-time publication is mainly linked to the establishment and support of investor decisions. Transactions concluded based on undisclosed information shaping the value or yield of securities issued by companies, or directly or indirectly affecting the issuer's assessment qualify as insider trading. In order to enhance regulatory inspections of insider trading, publicly traded companies must keep up-to-date records on all persons with access to inside information. **The MNB examined the insider list-keeping practice of 11 issuing companies in the context of thematic inspections.** The MNB's main message to companies based on the inspections concluded in 2014 H1 was that records must be kept on all events potentially qualifying as inside information (e.g. key negotiations, contract conclusion processes) and the group of persons with access to such information continuously expanded until public disclosure of the information. **The MNB has added the topic to the agenda of the upcoming capital market professional day in order to provide the most thorough information to stakeholders.** Going forward, the MNB will continue to focus on **checking the veracity of disclosed information**, as the announcement, dissemination, disclosure or public announcement of unfounded, misleading or false information qualify as prohibited market manipulation.

Safeguarding and enhancing trust in the capital market relies particularly on the users of financial information (investors, analysts, the press) obtaining a full, transparent picture from financial reports and statements on the wealth, financial and income position of issuers, the risks incurred by their operation and the uncertainties encountered during their activities.

The **MNB** scrutinises compliance with the relevant rules on extraordinary notification directly or indirectly affecting the value or yield of publicly issued securities or the issuing company, **as well as the compliance of statements forming part of annual and semi-annual reports – including consolidated reports drawn up in accordance with International Financial Reporting Standards (IFRS)**, among other things.

In this context, the **MNB did not examine the accounting and documentary substantiation of the amounts stated in the reports; therefore, its activities in this area do not constitute secondary auditing by any means.** The MNB's inspections of annual reports according to IFRS are aimed at checking whether the issuer has disclosed sufficient and adequately in-depth information and whether such information is consistent with the intention of the standards and European Union practice.

Taking into account the above specified criteria, in the first half of 2014 the MNB sanctioned EST Média Vagyonkezelő Nyilvánosan Működő Részvénytársaság and OPTISOFT Számítástechnikai, Pénztárszolgáltató, Könyvelő és Oktató Nyilvánosan Működő Részvénytársaság and imposed a HUF 8 million and a HUF 5 million supervisory fine, respectively.

4. CONSUMER PROTECTION AND MARKET SURVEILLANCE RISKS

In this chapter the consumer trends, risks and regulatory changes observed during the consumer protection and market surveillance activity of the MNB are outlined. In each section, these aspects are introduced in units, except for aspects that required separate sections due to volume or relevance (e.g. the section on ‘Indebtedness’).

4.1. Consumer protection risks

The MNB intends to actively take action in the area of financial consumer protection in order to protect the rights of consumers using financial services, and steer service providers towards a responsible, fair behaviour. In this context, it identifies phenomena that have a detrimental effect on consumers as quickly as possible, and instead of confining itself solely to their "symptomatic" management, the MNB pays special attention to discovering and eliminating their root causes, thus preventing the repeated occurrence of behaviours detrimental to consumers.

This chapter presents a summary of the risks identified by the MNB which have an effect on consumers. These risks were identified on the basis of incoming official requests and customer service inquiries as well as analysis of market processes. The risks are introduced in a breakdown of types of customer needs. The MNB takes into consideration risks already detected when planning official inspections, and hence, where this has been integrated into the inspection plans, this is also mentioned ("priority inspection target area").

Each identified risk was assigned to an action matrix based on 4 categories according to the relative effect and the size of affected consumer groups. Analogously, stronger action is considered in the case of risks affecting a wider group of consumers and having relatively more severe potential effect, while on the basis of the principles of necessity and proportionality, relatively less severe action is also possible, depending on the size of the affected group and potential damage to consumers (in order: category B, C and D).

Table 3 Action matrix according to the relative effect of risks and the size of the affected consumer group

Relative effect Severe Slight	Needs assessment, action to be taken, if necessary <i>Field C</i>	Comprehensive official action <i>Field A</i>
	To be assessed and monitored <i>Field D</i>	Calling attention to it, action to be taken, if necessary <i>Field B</i>
	Slight	Severe Size of the affected group

Description of current risks belonging to each category and related actions:

Risk	Category	Measure
Inadequate management of financial difficulties by the consumers	A	Issue of guides, enhancement of financial awareness MNB Decree on the prevention of future debt overhang (cap on PTI and LTV)
Litigations related to foreign currency-denominated loans, mass consumer protection problems	A	Maximum implementation of the tasks delegated to the MNB by the Act on Settlement and Conversion to Forint
Risk of inadequate principal instalment in the case of combined loans	A	Analysis of the data supply related to this problem; monitoring of certain particularly exposed institutions
Unilateral increase of fees and account termination	A	The Supervisory Authority pays special attention to the compliance with the regulation Publication of a notice on the MNB home page
Misselling	A	Inspection within the framework of consumer protection audits, trial purchase, enhanced audit of the compliance with the obligation to provide information, notice on the MNB home page
The contract renewal date must be known for the termination of the MTPPL contract	B	Ensuring compliance with the rules pertaining to the obligation to provide information is priority audit area of the Supervisory Authority Publication of notice on the MNB home page, issue of informative brochures
Risks involved in the increasing use of cash	B	Calling the consumers' attention to the risks
Unsolicited credit facility setting/increase, unsolicited dispatch of credit cards	B	Providing the consumers with comprehensive information on the risks
Non-compliant MiFid-testing	B	Inspection within the framework of consumer protection audits Publishing information on the MNB home page on the risks inherent in the various investments
Additional risks inherent in the usage of credit cards	B	Providing the consumers with comprehensive information on the risks
High level of expense related to pension insurances	C	Issuing an MNB recommendation on the total expense ratio (TER).
Online platforms, high leverage transactions, trading robots	C	Conducting capital market prudential and market surveillance proceedings Notice on the MNB home page on the risks of the online investment opportunities
Risks related to the CCIS (KHR) list	C	Inspection within the framework of consumer protection audits Notice on the MNB home page related to CCIS, issue of informative brochures
Financial risks inherent in event marketing	C	Providing the consumers with comprehensive information on the risks; ordering consumer protection inspections
Fiduciary asset management	C	Monitoring this new type of service; making regulatory proposal as necessary
Investment ratio	C	Informing the consumers on the risks of unregulated investment vehicles
Unauthorised services activity	C	Market supervision proceedings, registration of the market participants in a retrievable form; possibility to report unauthorised activity ("Warnings" on the home page)
Car purchase financing activity of financial enterprises before 2010	C	Providing the customers with regular update on the types of the agents' contracts
Waiting period in case of a health insurance	D	Providing the consumers with comprehensive information on the risks
Providing the customers with information with regard to portfolio management	D	Inspection within the framework of capital market prudential or consumer protection audit
Advisory services provided by civil consumer protection organisations	D	Developing a civil network with a national reach, providing services of controlled quality
Bitcoin	D	Informing the consumers on the extreme risks inherent in the virtual unregulated means of payment

4.1.1. Current account and payment services

Regulatory changes

Act LXXXV of 2009 on the Pursuit of the Business of Payment Services was also supplemented with some important regulations **which are significant from the aspect of consumer protection**. In fact, in order to enable consumers to fully take advantage of the free-of-charge cash withdrawal option, the relevant law prohibited the setting of contractual conditions by payment service providers that specify an upper limit of cash withdrawal transactions carried out through non-cash means of payment from any automatic banknote dispenser installed in Hungary by the contracting consumer, that is lower than a daily HUF 150,000. At the same time, financial organisations had to ensure, both in terms of contractual and technical conditions, that the client can withdraw at least HUF 75,000 from an ATM per each transaction.

The rate of interbank commissions of payment service providers in Hungary applied inland, was formerly higher than the interbank commissions applied for cross-border transactions completed with a payment card. **Considering the provisions coming into effect on 1 January 2014**, payment service providers may no longer apply charges that are higher than the international charges, that is, the average of interbank commissions weighted with the circulation, may not exceed the average of cross-border transactions calculated in a similar manner. This is, in the case of a transaction initiated using a non-cash means of payment debited on the payment account, 0.2%, and, in case of using a non-cash means of payment debited on the credit line, 0.3% of the value of the payment transaction.

Priority auditing target areas – raising charges unilaterally and account cancellation

Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises (new Hpt.) allows for the unilateral raising of charges, if **disadvantageous for the client**, outside the scope of consumer credit and lease agreements, that is for instance in account contracts for payment services, only if certain conditions are met. The Act sets forth two specific prohibitions related to the unilateral raising of charges: on the one hand, contracts may not be amended unilaterally by introducing new charges or costs, and, on the other hand, the method of calculation specified in the contract for certain interests, charges or costs may not be modified unilaterally, if that proves to be disadvantageous for the client.

In the opinion of the MNB, making the free-of-charge, "0 Forint" service a pay service by either a fixed amount, a percentage or the accumulation of these, and the introduction of the charge with a payment obligation, would be considered the introduction of a new charge both from the aspect of consumers and service providers. Changing the method of calculation means the changing of the way the given charge is determined or calculated and a shift from one method to another method of calculation, that is, when the rate of charge has to be defined using a calculation method different from the previous one. **The MNB has observed violations at several supervised institutions with regard to the above, and thus,**

in the future, it will continue to treat this issue as a priority area. Prevention has particular significance, since financial institutions have a considerable economic and social function in providing payment services, as payment services affect a significant portion of consumers and due to the fact that the regular use of payment services is relatively unavoidable.

Risks related to the lack of transparency, changing banks

The structure of brochures and lists of conditions can differ to a great extent by market operators, which lowers the degree of transparency, and typically the manner of publication does not promote fast, accurate gaining of information. A variety of **price comparison websites** partially manage this issue. In the near future, the MNB wishes to place greater emphasis on these comparison websites and on the bank account selector application run on its own website.¹³ The **account selector application of MNB** is, uniquely in Europe, based on mandatory data provision, and hence consumers can obtain information on services currently offered at various financial institutions based on genuine, up-to-date information by using the application.

The **significance of changing bank** will increase in the future, since consumers are more conscious in choosing service providers as a result of increasing costs in the typically price-sensitive Hungarian market. The process of changing bank must be simplified. This can be accomplished by regulation and ensuring and developing technical conditions. The European Parliament adopted the "payment account" policy on 15 April 2014 which deals with the comparability of payment account charges and the issue of changing account as well. The policy aims to provide a fast and simple procedure for clients who wish to open a new account at another bank or payment service provider to replace their existing payment account. The policy must be implemented into national law within 2 years, but its implementation into Hungarian law in the shortest time possible would be important.

The **account number forwarding service**, appears to be a good way of ensuring technical conditions, since this service would allow the client to have his incoming transfers and direct debit instructions automatically forwarded from his old account to the new one for a predefined period of time. Another important aspect is to make the data of direct debit payments available to the new financial service provider, which can be achieved by a direct transfer of data between the old and the new service provider or by storing the data in a central database, where authorised providers may gain access to these data.

4.1.2. Savings

4.1.2.1. Short-term savings

The cash balance of households is constantly improving, which is attributable to the adoption of a transaction tax and the decreasing interest rate of the Hungarian forint. Low

¹³ <https://felugyelet.mnb.hu/fogyasztoknak/alkalmazasok/szvp>

deposit rates, the introduction of a free cash withdrawal option and maintaining the transaction tax will push residential cash holding habits in this direction in the rest of 2014.

In parallel with the decrease in deposit rates, the restructuring of households' portfolio continued. In 2014 H1, households' **bank deposits** continued to drop. However, the rate of on demand and current accounts increased within the deposits of households. At the same, the **volume of public securities and investment coupons** was also on the rise. Instruments promising a higher rate of return in the low interest rate environment became more attractive, and hence a larger portion of households' short-term savings is being invested in treasury bills instead.

Chart 12 Base rate of the central bank and the interest/yield of short-term investments

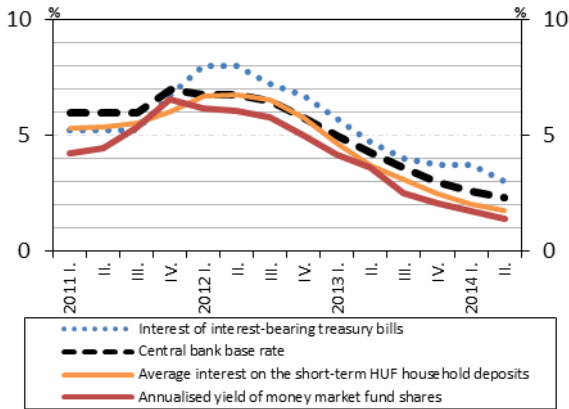
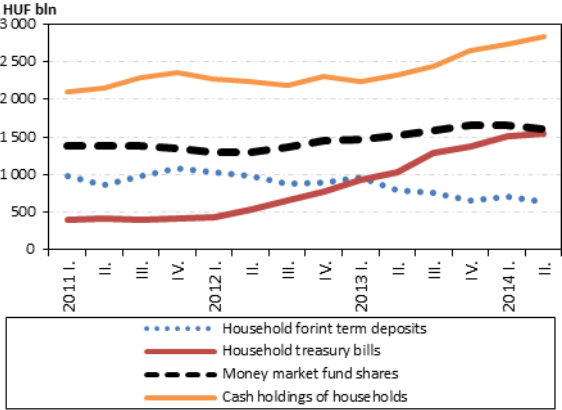


Chart 13 Volume of short-term savings of households



Risks involved in the wider use of cash

There has been a change in ATM use trends as well: due to the positive regulations ensuring the option of free cash withdrawal to consumers, as legislators intended, consumers are withdrawing larger amounts 1-2 times after their monthly income has been transferred to their accounts.

As regards free cash withdrawal, as a consequence of **the lack of information**, there is some uncertainty on the side of consumers as to which accounts offer this option, and how the declaration obligation or the upper limit can be interpreted in the case of primary and secondary cards.

Accordingly, it should be noted that this option applies only to HUF-based payment accounts (not to deposit accounts), and cannot be used for cash withdrawal with a credit card linked to credit card accounts either. It should also be noted that only one declaration can be made to one account, so the option pertains to accounts and not to account holders. If an account has more holders or more bank cards are linked to it (primary and secondary cards), then the option is applied collectively, since it pertains to the account itself.

4.1.2.2. Long-term savings

Long-term savings include, but are not limited to, various pension products, public securities, investment funds, long-term investment accounts, direct investments on the capital market and life insurance savings.

The **number of private pension fund members is falling continuously** mainly due to funds ceasing their activities, and as a result the number of citizens returning to the pension system under public social security has risen.¹⁴ **The number of members also dropped at voluntary pension funds**, primarily because of the decreasing number of new entrants, the exclusion of members failing to pay their membership fees and employers changing their approach in terms of controlling costs. **It should be noted, however, that the volume of assets deposited in the funds is slowly, but continuously growing.**

The **pension insurance market** is a new area of savings. The sales channels of some dominant service providers in the voluntary funds market will become weaker, since the owners of certain fund providers, i.e. insurers, are expected to prioritise the sales of their own insurance products. **Pension insurance has an important role in ensuring the financial security for the elderly in the future, and accordingly, the interests of the client must be taken into account with particular attention in product development.** Service providers must make efforts to ensure that the product maintains its value and value is added to it over the long term. Therefore, the products must be structured in a way that the projected yields of investments adjusted to the objective of the product at least cover the costs and the rate of inflation, and, in addition, the tax incentive presents actual benefits for the client.

The lack of these is a serious consumer risk, more so in the case of a cost level and structure that is high, but not transparent for consumers. For the purposes contemplated above and to achieve the social objective of pension savings, **the MNB, as a body responsible for a prudential surveillance and financial consumer protection, provided assistance to insurers and insurance agents by issuing a recommendation¹⁵ in 2014 in order to establish good practices.**

The recommendation includes suggestions regarding the **principles of fair product development**, and **TCIs^{Ny} (total cost indicator %) offered for full terms.**

According to responses received on the follow-up of the pension recommendation, 13 pension insurance products were removed from the market in the sector since July 2014. Based on the follow-up responses, the parameters of 28 products were changed by taking into consideration the specifications in the recommendation; these modified products (due

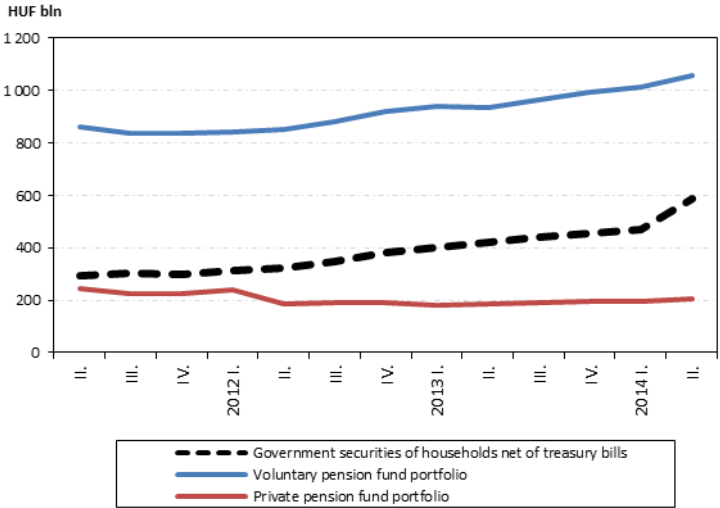
¹⁴ In the case of private pension funds involved in liquidation proceedings, the members that have not made any declaration automatically returned to the pension system under public social security.

¹⁵ Recommendation no. 2/2014 (V. 26.) of the The Central Bank of Hungary on pension insurance.

to the nature of the offer) are unit-linked (UL) type pension insurance policies. Of 45 products sellable on the market, 43 comply with MNB's recommendation. Therefore, two sellable UL products do not comply with the MNB's recommendation, because the TCI^{Ny} value achievable with asset funds containing public securities aligning to the term but not having a complex structure, based on the responses of insurers given in the questionnaire, exceeds the value specified in the recommendation.

One instrument of long-term investments is **public securities, which is a form of investment that has been gaining more and more popularity**, mainly due to the objectives of the government. One of the reasons for this is the range of public securities schemes offered that are attractive to residential clients as well (premium Hungarian treasury bond, bonus Hungarian treasury bond), while the other reason is the reduction of bank deposit interest rates in parallel with cuts in the base rate of the central bank, as mentioned above.

Chart 14 Public securities holdings of households (excluding treasury bonds) and pension fund savings



From the aspect of applying the requirements of Bszt., the MNB considers it important that residential investors know that even with clearly lower risks, a capital guarantee is only provided to public securities that are held until expiry, and hence they may sustain capital losses in the case of secondary market sales.

The decrease in bank deposit interest rates directed consumers' attention towards **investment funds and long-term investment accounts as well**, but turnover in shares has been declining for some years, both on the regulated markets and outside regulated markets.

Chart 15 Investment unit holdings of households

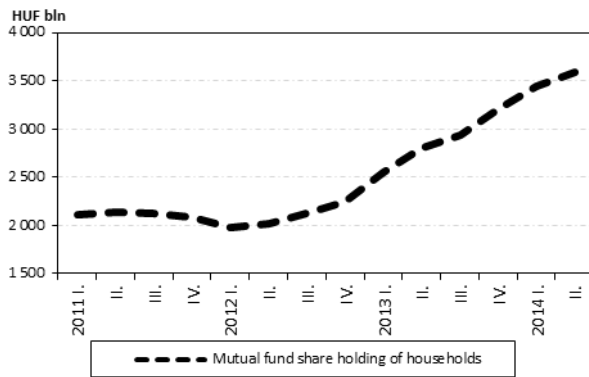
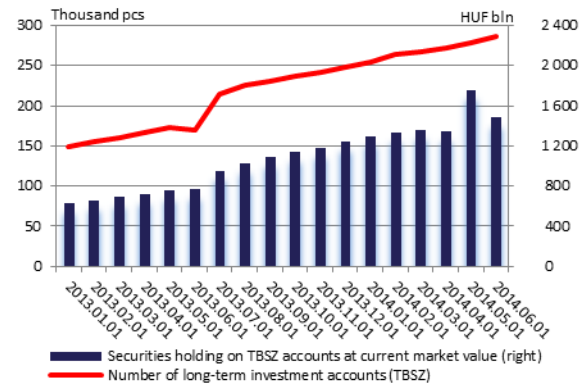
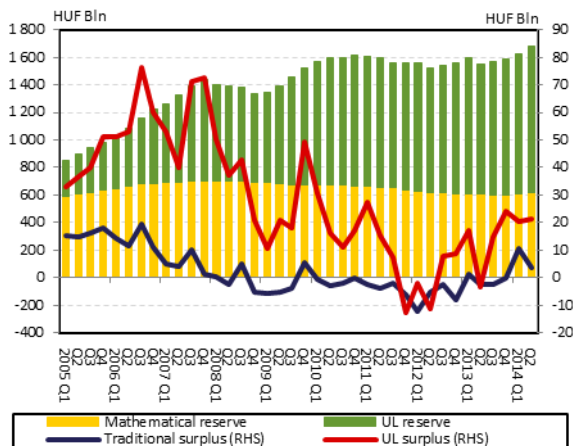


Chart 16 Number of long-term investment accounts and the value of securities holding



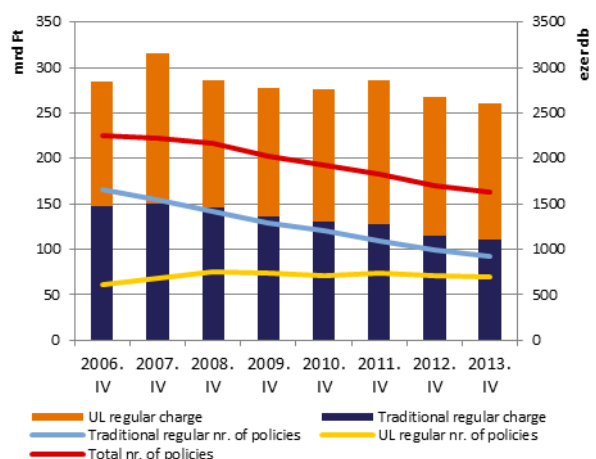
The number of **long-term investment accounts** increased by nearly 80% in one year, advancing to almost 260,000 by the end of the year. The stock held on long-term investment accounts is also continuously increasing, and exceeded HUF 1,236 billion by the end of the year.

Chart 17 Life insurance savings and the development of the CF balance*



* Net, i.e. payments less services used

Chart 18 Development of the income of regular fee life insurance policies and number of contracts



The decline in **life insurance savings** could be stopped by a tax allowance for a special type of life insurances, i.e. pension insurance policies. Partly due to the gradual cancellation of tax allowances, net payments (value reduced by the services used up) into regular fee life insurance policies moved on a downward trend in the last 8 years. The financial crisis in Hungary in 2008 did not interrupt this trend. In the case of traditional life insurance policies, this process (which started in 2005) escalated into actual money withdrawal since 2008.

Unit-linked life insurance policies were supported by higher yield expectations, a higher level of allowances and the interest tax exemption up to 2007, but the economic crisis had its effect in the area as well. As a result of falling deposit interest rates, the market of unit-linked life insurance is reviving, but a real breakthrough could come with a tax allowance for **pension insurance policies similar to that of pension funds and pension advance-savings**

effective from 1 January 2014. The revenues from one-off and casual fee life insurance policies has inherently shown great fluctuation in recent years, since these products react more sensitively to external effects (crisis, early repayment, low-interest environment).

4.1.3. Risk-mitigating products

Regulatory changes

In the **insurance sector**, from the aspect of consumer protection, the following important changes were adopted in Act LX of 2003 on Insurance Institutions and the Insurance Business (Bit.) and Act LXII of 2009 on Insurance Against Civil Liability in Respect of the Use of Motor Vehicles (Kgyb tv.) as of 1 January 2014. The provisions on insurance agents were amended in several places to ensure wider support of consumers and their secure contracting, and, as a result, insurance agents are required to inform clients in advance in the form of a written notice, whenever an insurance policy contract is concluded or modified, about the party that accepting responsibility for damages and injuries caused in the course of his activity. Later, in order to prevent any disputes of eligibility, the insurance agent must make a statement on whether he has authorisation for selling the given product or for accepting the fee or advance payment as well as to indicate the power of agency he has.

Another legislative modification facilitates the information of consumers, under which insurance policy contract must include detailed regulations on the suspension and division of the asset fund, **in the case of unit-linked life insurance**, meaning that the insurer must send the information to clients affected by these contracts by the first annual notice sent out after 1 January 2014 the latest.

To terminate a contract for MTPL insurance, the record date of the contract should be known

With regard to MTPL **insurance**, consumers must be informed that **not all contracts have a calendar-based record date**, and therefore, the accurate record date of the insurance policy must be known, if the contracting party intends to terminate the contract.

However, consumers should also know that if the contracting party decides to change insurer, the MTPL insurance termination must be submitted to the insurer by mail, fax or high-security electronically signed email, if possible, in a verifiable manner, so that it arrives at the insurer within **30 days before the record date**. Any improper notices of termination (e.g. oral, by email without electronic signature) will not be accepted by the insurer.

Due to the above issues, enforcing the rules on information related to MTPL insurance contracts is a priority inspection area of the MNB.

Waiting time in the case of health insurance

Consumers are faced with new types of risks by the spread of health insurance policies. In the case of insurance for care services or when a permanent illness of the person to be

insured was known to both parties, i.e. the insurer also had knowledge of this, the parties may agree in a maximum of **three-year waiting time** in a life insurance coverage for the above-mentioned illness. That is, the insurer may limit reimbursements for care services in the period specified in the contract in cases where the service is provided with regard to a permanent illness that was present at the time of offer and the insurer was fully aware of it.

Consumers shall be informed that health insurance may not be cancelled by regular termination. An exception from the above rule is when the insurance risk significantly increases, but the deterioration of health due to ageing cannot be taken into consideration as such.

4.1.4. Indebtedness

4.1.4.1. Regulatory changes

4.1.4.1.1. Comprehensive settlement of unfair lending activities

The following improvements were made in the recent period in the area of legal uncertainty relating to the credits, and primarily foreign currency credits, which affected a large number of consumers.

On 16 December 2013 the Curia adopted a resolution on the uniformity of the law no. **6/2013**. on certain issues of principle arising in suits related to foreign currency credit agreements and drew the following conclusions:

A foreign currency credit agreement as a type of contract in itself is not in conflict with the law and cannot be regarded as unethical or an act of usury; it is not aimed at providing impossible services and is not a sham contract, only because for an advantageous interest rate **the foreign exchange risk is borne by the debtor.**

The unilateral, unpredictable shift in contract burdens after the conclusion of the contract cannot be assessed in the sphere of nullity, as the reason for invalidity must exist upon conclusion of the contract. By law, the information requirements imposed on financial institutions had to cover the **possibility of exchange rate changes**, and the impact of such on instalments. The obligation to provide information could not cover the extent of changes in the exchange rate.¹⁶

¹⁶ In case no. C-26/13, having considered the application for a preliminary ruling submitted by the Curia, the Court of Justice of the European Union found that, in relation to the unfairness of the spread, it should be examined whether the "the primary subject matter of the contract" falls within its definition. According to the Directive, the general terms and conditions should be clear and understandable; this not only means that the condition in question must be understandable to the consumer in terms of grammar, but the contract shall indicate how the exchange mechanism of the foreign currency specified in the conditions works, in a transparent manner. This way, the consumer may be able to evaluate the economic consequences resulting from this on the basis of clear and understandable information. When the agreement between the provider and the consumer cannot be fulfilled because the unfair provision was left out, the invalidity of this condition shall be remedied by replacing it with a dispositive provision available under national law.

On 3 June 2014, the Curia gave its opinion on the merits of the following three issues with regard to the so-called "spread rate" case, including: the contractual provisions laying down the use of the litigated disparate exchange rates do not fall within the scope of contractual clauses defining the main services and the contractual clauses defining the proportion of service and consideration, and thus the court may assess the unfairness of contract terms.

The challenged contract terms are unfair, since in the case of foreign currency loan contracts, no exchange, only currency conversion was performed for which the fees used normally may not be applied. In this specific case, the dispositive provisions of national law become part of the contract, that is, in line with subsection (2) of section 231 of the Civil Code, the **official exchange rate** of MNB shall apply.

At its meeting of 16 June 2014, the Curia also issued a uniformity decision on the following issues:

- Currency risk is part of the main services, consequently its unfairness can only be assessed, if its content was not clear for the average customer when it was concluded.
- The unilateral modification of the contract is unfair, if it was not clearly and unambiguously explained for the consumer how changes in certain circumstances affect the payment obligations of the consumer.
- According to the previous individual decision, the uniformity decision also found the application of the spread unfair.

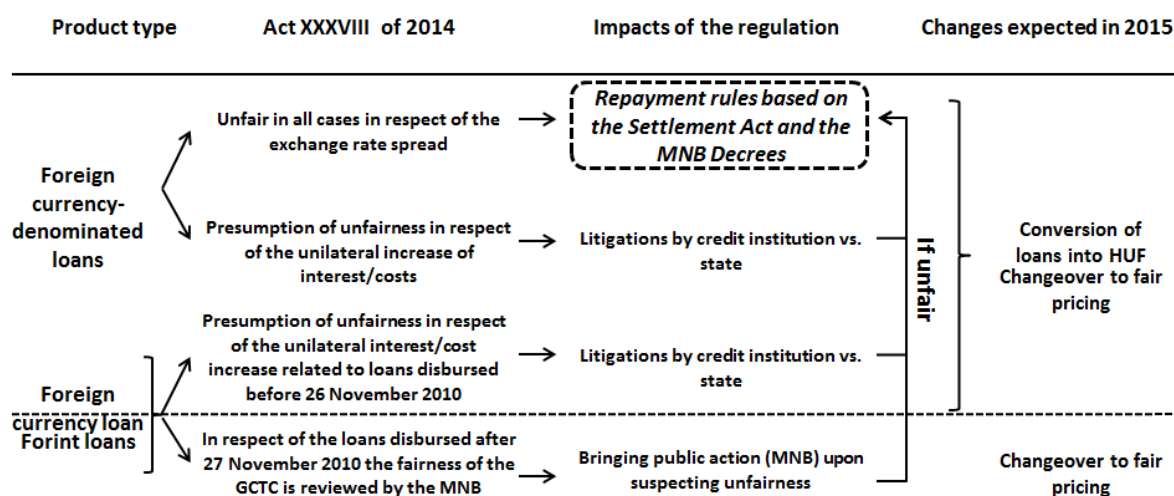
In its Decision 8/2014 (III. 20.) AB, the Constitutional Court established, based on the motion on the interpretation of the Fundamental Law put forward by the Minister of Justice on behalf of the Government, that the content of contracts concluded before the entry into force of the law may be exceptionally modified.

The legislature intends to settle the legacy of unfair lending, which primarily typical of the period 2004-10, in several steps, and, at the same time, created a precise regulatory environment for fair lending.

Chart 19 Comprehensive settlement of unfair lending activities

Comprehensive settlement of unfair lending activities

- application of exchange rate spread
- unfair unilateral increase of interest/cost



Settlement Act

As the **first step** of the legal settlement of issues related to unfair lending, in its session on 4 July 2014, the Parliament adopted *Act XXXVIII of 2014 on the settlement of certain issues relating to uniformity decisions of the Curia on the settlement of consumer loan contracts of financial institutions* (hereinafter referred to as "Act XXXVIII of 2014"). This put the civil law provisions included in Decision 2/2014 PJE of the Curia into a legal framework, and declared the **nullity of the spread rate** and set up the **statutory presumption of unfairness for setting the right of unilateral contract modification**. As a result of applying invalid contractual clauses, overpayment occurred on the side of consumers, and such overpayments shall be settled by financial institutions with consumers in accordance with the law.

In the second step, on 24 November 2014, "*Act XL of 2014 on the rules of settlement and other provisions laid down in Act XXXVIII of 2014 on the settlement of certain issues relating to uniformity decisions of the Curia on the settlement of consumer loan contracts of financial institutions*" (hereinafter referred to as "ETv.") was adopted. **ETv.** regulates separately the issues arising from the invalidity of terms in HUF-based consumer credit, loan and financial leasing contracts, which required the establishment of rules differing from the procedural order related to foreign currency consumer contracts. Besides, foreign currency and HUF-denominated loans, other types of consumer credits also required legal settlement, such as loan contracts granted in foreign currency by the bank and paid back in foreign currency, but not considered as currency loans. There are contract schemes where the consumer is provided the option to pay back the loan either in HUF or in foreign currency. These types of consumer credit make up only a small part of total residential loan portfolio, but with a view to accounting these also required a legislative-level settlement.

In line with the Decision of the Curia and Act XXXVIII of 2014, ETV. contains provisions exclusively applying to consumer loans. The **consumer** is a natural person acting outside his own profession and economic activity, and hence the act only covers the non-business loans of private individuals. ETV. provides for the general civil law rules of settlement, while defining detailed rules was submitted to the competence of the The Central Bank of Hungary by lower-level legislation. ETV. sets out the rules of settlement with consumers in accordance with the Civil Code.

ETV. treats settlements becoming necessary due to the nullity of the spread rate and owing to the invalidity of terms relating to the right of unilateral contract modification **uniformly**, and settlement rules govern overpayments arising from either the nullity of spread or the invalidity of contract terms. Settlements of overpayments, where the consumer loan contract **was affected by both cases of invalidity, must be fulfilled simultaneously and together**. Considering the large number of consumer loan contract existing in practice, it was impractical to set out all detailed rules, however, **the MNB**, acting in its macroprudential competence, **provided for the detailed rules and methodology of all types of settlements in a resolution, as a third step**.

Pursuant to ETV., overpayment occurring on the side of the consumer **shall be accounted against the debt capital as an advance repayment** meaning that the benefits from an advantageous exchange rate manifest themselves for the consumer. The **costs and expenses related to the fulfilment of the settlement obligation** are borne by the financial institution and, in its own scope, by the winding-up institution, **and no such costs and fees may be charged to the consumer. Financial institutions have an obligation to settle accounts** in all cases when the consumer loan contract falling under the effect of the act **has not been terminated, or has been terminated**, but its termination occurred within 5 years prior to the effective date of Act XXXVIII of 2014, that is, **after 26 July 2009**.

The settlement obligation even applies to the case when the contract **was terminated before 26 July 2009**, but **no time-barred financial claims** were or are upheld following this date and it is known to the financial institution, or if the **consumer has undisputed claims** towards the financial institution, or if **a final court ruling verified that the consumer claims** were not time-barred.

Finally, the financial institution is obligated to settle accounts even if the contract forming the basis of the settlement was terminated prior to **26 July 2009**, and he has no claims arising from that, because he assigned it to a financial institution (winding-up institution) otherwise not obligated to settle accounts, but the consumer requests the fulfilment of a settlement obligation with the verification that **the assigned claims were enforced by the winding-up institution against him**. Settlements will take place in various groups between **15 January 2015 and 30 November 2015**.

The **principle of the settlement methodology** is that the consumer must be put into a situation as if settlement was done at an exchange rate specified in Act XXXVIII of 2014 with an interest rate laid down originally at the time of entering into the contract. If the debt was denominated in foreign currency, then the overpayment must be converted into the given currency as well. In the course of this, the overpayment has to be calculated at the exchange rate the financial institute used for converting the payment, that is, the interest and capital repayment related to the overpayment. If the consumer has overdue payments towards the financial institution, then the overpayment must be settled in accordance with the provisions of the Civil Code.

In the case of civil proceedings pursuant to ETV. and Act XXXVIII of 2014 initiated by the MNB, the financial institution sets the deadline for fulfilling settlement obligations by **taking into consideration the deadlines specified for submitting the statement of claim**. The deadline is set for each consumer group depending on whether **an action was brought by the financial institution** to refute protection under the law **or the MNB submitted an action in the public interest** in the given case.

The financial institutions must send the settlement of accounts to the consumers by **registered letter**. In addition, financial institutions are required to **publish this on their website** and, at the same time, post this in all of their **branch banks** within 15 days, if the settlements of accounts were sent to all affected consumers. If financial institutions are required to publish **at different points in time**, then they must fulfil this obligation **in a breakdown according to consumer groups**.

In the event that the consumer disputes the contents of the settlement he was given by the financial institution, or the financial institution has not settled accounts and in his view a settlement obligation exists, then he may file a complaint. **The complaint must be submitted to the financial institution. The time window open for submitting the complaint** is 30 days from the receipt of the settlement of accounts, while, in case of being inhibited to do so, it is 30 days from the elimination of such inhibition with an upper limit of **120 days, after which no complaints will be accepted**. The financial institutions **must send their position and justification with regard to the complaint within 60 days of being notified of the complaint**, if the complaint could not be promptly assessed and its remedy was not possible. If the consumer's complaint relates to the amounts in the settlement, the calculation of the interest rate or the setting of a new repayment rate, then, in case of partial or complete rejection, the financial institution must attach a full, detailed account at the prior request of the consumer.

After rejection of the complaint, the consumer may request legal remedy in accordance with a **separate remedial procedure: he may apply for the initiation of a procedure by the Financial Arbitration Board (FAB) within 30 days of receiving the position** of the financial institution. As compared to the general rules on the FAB, the law contains special provisions on the **mandatory content of the application** and on the conduct of the procedure, in line

with the specificities of the settlement procedure. Since in consideration of settlement procedures the FAB is the remedial forum "of second instance", its decision is binding upon the **financial institution even if it did not make a general or individual declaration of submission.**

The consumer or the financial institution may bring the case to court after the FAB has made its decision. **The application shall be submitted to the FAB.** The application of the consumer and the financial institution is assessed by the FAB and the courts in the scope defined in the law, in accordance with special procedural rules enabling a fast and mass procedure.

The right to seek court ruling is bilateral; the consumer or the financial institution may request the **repeal of the MNB's decision** made in the course of the contested procedure and containing the claims, by submitting an application to the Metropolitan Court of Budapest, and the consumer or the financial institution may request the court, by initiating a non-action procedure, to review the merits of the decision of the FAB.

The MNB acting in its control and consumer protection competence continues to assess, in the framework of a control procedure to be initiated, on an ex-officio basis, whether financial institutions are in compliance with Act XXXVIII of 2014, Etv. and the MNB resolution. The MNB may conduct a control procedure with regard to terms and conditions specified in ETV. but not assessed before, and between **14 and 28 of February 2015**, if it sees fit **the MNB may initiate an action in the interest of the public.**

Conversion of loans into HUF

The issue of converting loans into HUF is regulated in the act on the modification of the currency of certain consumer loan agreements and issues relating to interest rate rules. The most important elements of the act:

- The consumer loan agreement is modified with the power of law. The financial institution shall prepare the text of the amended provisions of the consumer loan agreement, and the effect of the amendment shall be the record date, 1 February 2015.
- The financial institution shall inform the consumer on the conversion and the amount of the loan in HUF by registered mail together with the notification of settlement in accordance with the settlement act.
- When the foreign currency consumer mortgage loan agreement is modified and converted to HUF, the financial institution may only apply an interest rate linked to the reference interest rate. The applicable reference interest rate is a three-month BUBOR.
- The financial institution shall, until the deadline set for the fulfilment of its settlement obligation, convert the remaining debt based on either the
 - average of exchange rates officially registered by the MNB in the period between 16 June 2014 and 7 November 2014, or

- the exchange rate officially registered by the MNB on 7 November 2014, whichever rate is more advantageous for the consumer, to HUF-denominated outstanding debt (hereinafter referred to as "conversion to HUF").
- The consumer may request the omission of applying the conversion to HUF and the omission of applying interest rate rules. Such initiative is only possible with the joint and concordant declaration of co-debtors, if co-debtors exist. The consumer may rely on the above-mentioned omission, if he has regular income in that currency or meets the PTI requirements or his term expires by 31 December 2020 the latest or the initial interest to be calculated for conversion to HUF would exceed the interest and interest surcharge calculated originally, and makes a written declaration of acknowledging that the financial institution will not provide the options enabled by the exchange rate cap scheme as of the record date.
- The consumer may request a review at the financial institution, then from the Financial Arbitration Board, if he has not received the documents on the amendment of contract or disputes the calculation of conversion to HUF of the outstanding debt, the calculation of interest or the correctness and accuracy of data and calculations indicated in the repayment chart containing the new instalments.
- The general reduction of the repayment rate is promoted by the rule that for consumer loan agreements affected by an exchange rate cap scheme and conversion to HUF the instalment due in February 2015 may not exceed the instalment that was due in January 2015.

Establishing the conditions of fair lending ("fair banking")

The legislator provided for the establishment of the conditions of fair lending in the Act CLXII of 2009 on Consumer Credit and on the modification of other relevant laws. The most important elements of the act are the following:

- The interest rate, interest surcharge, cost and fee specified in the loan agreement can only be modified unilaterally to the disadvantage of the consumer, if the law allows this and the parties explicitly agreed on this in the agreement. Other conditions, including the condition on unilateral modification, cannot be modified unilaterally to the disadvantage of the customer.
- Loans with a term of maximum 3 years can be provided with a fixed interest rate or a floating rate linked to the reference interest rate published on the website of the The Central Bank of Hungary and with a fixed interest surcharge laid down in the loan agreement for the entire term, and the interest conditions of the loan may not be modified unilaterally to the disadvantage of the consumer. Loans with a term exceeding 3 years can be provided with a floating rate linked to the reference interest rate published on the website of the The Central Bank of Hungary for the entire term or with an interest surcharge fixed for at least 3-year interest periods and with a loan interest fixed for at least 3-year interest periods, or with fixed interest.

- If the interest or the interest surcharge changes in the upcoming interest period to the disadvantage of the consumer after the expiry of the interest period specified in the loan agreement, the consumer may terminate the loan agreement without any costs or charges.
- The act provides for the definition of the interest change index, interest surcharge and interest surcharge change index with the aim of putting the options of changing interest and interest surcharge into narrow confines, and all of this is done in a transparent manner. The application of indexes will be approved by the MNB.
- The interest or interest surcharge applied in the new interest period shall be set by taking into account the interest rate change index and interest surcharge change index calculated for the 120th day preceding the expiry of the interest period.
- The rules aimed at improving the information of consumers were broadened to a large extent. The information preceding the conclusion of a loan agreement shall be provided to the consumer in a concise and informative manner to make it clear and understandable for the consumer, in due time, but before the consumer would be bound by any offer or loan agreement, about the details of the relevant credit product. It is an important step from the aspect of informing the consumer, that the draft loan agreement is made available free of any cost, charge and other payment obligation at the request of the consumer. In the case of financial leasing for mortgage loan or real estate, the draft agreement shall always be made available to the consumer at least seven days prior to the date of concluding the agreement without the explicit request of the consumer. In principle, agreements may not be concluded electronically.
- It was an important legislative intention to limit the application of charges and costs related to loans. The charges allowed in the act may be increased by no more than the annual change of the consumer price index of the KSH (Hungarian Central Statistical Office). The charge rates were also limited, e.g. the disbursement charge may not exceed 1% of the disbursed amount and may not go above HUF 200,000.
- The creditor may not specify additional costs or charges over the ones integrated into and fixed in the loan agreement.
- It should be stressed that the APR limit was also introduced for leases provided to consumers (mainly for vehicles) in the future.

Additional priority responsibilities of the MNB regarding the settlement, conversion to HUF and conditions of fair lending

After adoption of the regulation (laws, MNB resolutions), the supervisory part of the MNB will launch an intensive communication campaign for both consumers and financial institutions. On the one hand, by organising Consumer Protection Forums in December and January, and by displaying Frequently Asked Questions, sample forms and other reference materials in the section of the website of the MNB dedicated for institutions, on the other.

Members of the Civil Network (Civil Háló) will be prepared to give proper information to consumers asking assistance from them.

The accounting and procedural rules of settlement, contract modification and conversion to HUF are extremely complicated. Modelling and calculating accounting formulas or the effects on accounting of past events influencing accounting pose serious challenges even to experts in the field. The mandatory and recommended information contents specified in the MNB's resolution have a wording that is understandable to consumers. In the course of this, the fact that the consumer has to give an accurate indication of the calculation error to the Financial Arbitration Board in accordance with relevant legal regulations, shall be taken into consideration. **The settlement work issues are given particular attention in the control activity in consumer protection of the MNB.** The observance of various regulations are controlled through this process, and **the detection of any kind of violation shall be immediately followed by a public action, hence sending a message to the market and consumers that the MNB pays special attention to the legality of this operation.**

"Debt brake" regulation of the MNB

The issue of repayment rate proportionate to the income and loan-to-value ratios was previously regulated by a government decree, but the new central bank act effective from 1 October 2013 assigns the regulatory authorisation, as a macroprudential tool, to the MNB. **In addition, the regulation has two effects in practice: on the one hand, it can prevent the overindebtedness of the population even in the case of a future recovery in lending ("macroprudential emergency brake"), and, on the other hand, a well-calibrated payment to income index can play a key role in consumer protection, since it can prevent the overindebtedness of the consumer at a micro level.**

Prior to the introduction of this regulation, discussions were held with market participants, which basically supported the adoption of a payment-to-income ratio. **The new MNB resolution becomes effective from 1 January 2015; its main elements are summarised below.**

The resolution's planned regulation defines the concept of the **payment-to-income indicator (PTI)** in the following way:

$$PTI = \frac{\textit{Monthly Installment}}{\textit{Verified monthly net income}}$$

One important new aspect from the aspect of the client and the creditor that **only verified, legal net income (salary, pension, family allowance, etc.) can be considered as available income.** This could bring some "whitening" effect into prudential processes, since the majority of residential creditors accepted grey incomes as well.

The "loan-to-value ratio" shows the proportion of the gross loan to the market value of the asset serving as security for the credit. The limits of indexes (i.e. "debt brakes") were defined as follows:

Table 4 Limits of "debt brake" indexes

		<i>HUF</i>	<i>EUR</i>	<i>Other currency</i>
<i>PTI</i>	<i>Below a net income of HUF 400,000</i>	<i>50%</i>	<i>25%</i>	<i>10%</i>
	<i>Above a net income of HUF 400,000</i>	<i>60%</i>	<i>30%</i>	<i>15%</i>
<i>LTV</i>	<i>For mortgage loan</i>	<i>80%</i>	<i>50%</i>	<i>35%</i>
	<i>For vehicle loan</i>	<i>75%</i>	<i>45%</i>	<i>30%</i>

In line with the earlier regulation, the MNB resolution covers mortgage loans and loans backed by vehicles as well. **Slightly more moderate rules were needed for financial leasing, and hence the resolution provides for loan coverage limits that are 5 percent higher. The resolution does not apply to loan transactions involving small amounts (below HUF 200,000).**

This may ensure that segments of the credit market, where obtaining documents for clients would be too complicated relative to the value of the loan transaction, will not become unviable, but the risk that using this exception consumers become overindebted is reduced in this way.

After introduction of the regulation, market processes will become traceable based on data service, and then from 2015 the necessity of modifications can be assessed based on the data received.

Furthermore, institutions that are lending excessively near the maximum P-to-I based on the data service, will be given more attention in microprudential control and SREP inspections.

4.1.4.1.2. Other changes in legislation

The new Civil Code which came into effect on 15 March 2014 has modifications that make vehicle loans more risky to financial service providers. The law does not enable the setting of call option rights, thus in the case of non-performing loans the financial service provider will not have the right to take into possession the vehicle serving as collateral to close the transaction. Consequently, financial service providers currently only **offer leasing schemes for the purposes of financing auto vehicles**. The main difference between the two schemes is that with the loan the client taking advantage of the leasing service will immediately become the owner of the vehicle, while in case of a leasing scheme, the owner is the leasing

entity up to the end of the term, and meanwhile the client is only registered as the operator of the vehicle.

In order to provide temporary solution for the social issue of non-performing residential real estate loans, the amendment of May 2014 of the law on judicial enforcement **extended the term of the moratorium on eviction** without setting its terminal date. Therefore, no natural person may be evicted from residential property to enforce repayment of obligations arising from any kind of loan, who is not eligible for other homes, was not sentenced for any loan-related misuse, does not qualify as an unlawful squatter and was not sentenced for any loan-related misuse. According to the text of the law and the justification of the amendment, this is a temporary measure lasting until the dissolution and comprehensive settlement of currency lending.

The option of repaying mortgage loans from **cafeteria income** could facilitate the reduction of stocks of loans and the safety of debt servicing, where employers could help the repayment of the housing loans of their employees. This form is completely exempt of tax, and its condition is that the employee has an ownership or usufruct rights in the affected real estate and has a legitimate demand for housing. The amount of support, examining the last 5 years, may not exceed HUF 5 million, or 30% of the construction cost or purchase price.

The introduction of **private bankruptcy** was considered by the legislator as a comprehensive solution to the issue of a large number and high volume of non-performing residential housing debtors. In order to reduce ethical risks, persons wishing to take advantage of this option will have to meet strict requirements and assume obligations for the future. The expenses of households applying for bankruptcy protection would be controlled by a financial expert and part of the debt would be deductible after a given time has lapsed. The expert would assist consumers in keeping contact with financial institutions and keeping to the family budget, which might also strengthen the financial awareness of households in the future.

4.1.4.2. Market processes

Projections for growth in the Hungarian economy are improving, and household consumption is increasing. Household consumption is expected to keep growing, due to rising household real income as a result of a low rate of inflation. **The positive developments in the real economy and, in particular, the increase in real incomes indicate the recovery of consumption and higher demand for credit, and these effects are become more and more visible in new lending figures.**

Chart 20 Development of new lending to households

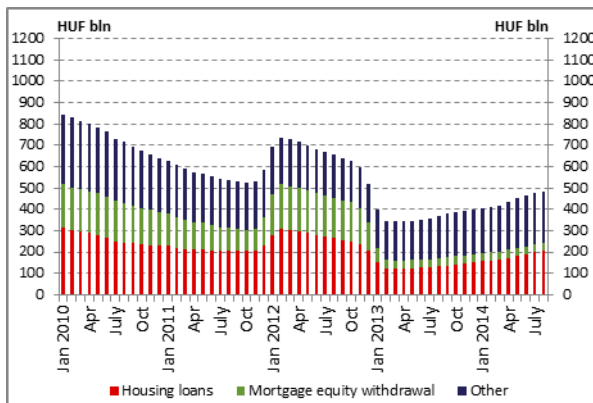
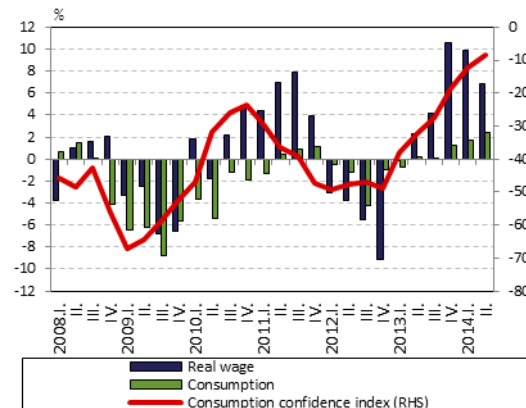


Chart 21 Residential consumption, real income and consumer confidence indicator



Source: KSH, GKI, MNB

The stock of household loans of the banking system, and the ratio of currency loans (which are the riskiest from the aspect of consumer protection) is continuously decreasing, but these loans continue to account for large share of the entire credit stock (more than 55 percent). Moreover, it is worth mentioning that the legislator intends to resolve the issue of foreign currency loans, to protect residential mortgage lending from exchange rate risks and strengthen the right to housing

Chart 22 Debts related to real estate (households)

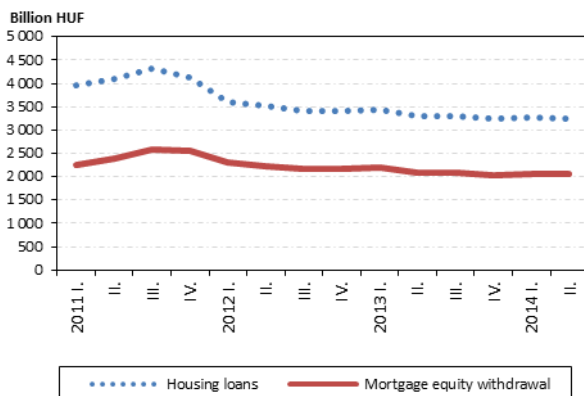
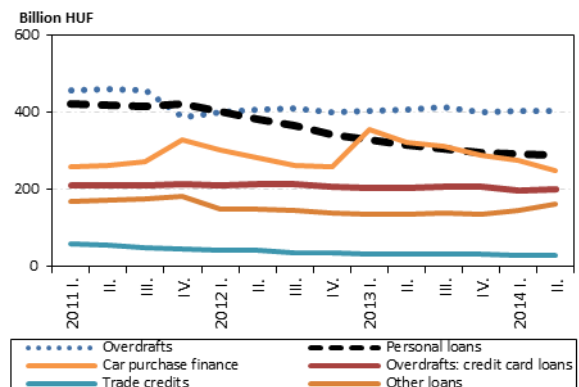


Chart 23 Debts without underlying real estate (households)



Conditions for consumer loans have further eased, while conditions for housing loans have not changed. Within consumer loans, the easing covered unprotected loans, while banks have not changed conditions for mortgage loans with unrestricted use.

Based on responses from banks, the easing affected price conditions, and more specifically, primarily charges and the spread between the interest rate and the input cost were eased. The banks' responses show that the easing tendency observed since the second quarter of 2012 may continue in the next half year in the case of consumer loans, while no changes are expected with regard to housing loans.

An easing in lending conditions is also signalled by new products on the market. Several banks now offer purpose loans. This type of lending is somewhere between mortgage loans with an unrestricted use and housing loans (its pricing is in accordance with this position), and can be used for a specific purpose, modernisation of real estate or energy developments. Developments in energy use will reduce the overhead costs of households and free up resources for the repayment burden.

Therefore, there is a risk that if demand-driven consumer loans are granted inside or outside the financial sector to already indebted clients, then that could increase the rate of indebtedness of the population (e.g. personal loans for the payment of public utilities arrears).

In order to ensure careful consumer lending, the MNB plans to launch an information campaign at the end of the year.

The MNB's "debt brake" rules will alleviate the risk of overindebtedness from 2015, and the expected conversion to HUF and shift towards a fair banking will have considerable influence on the features of residential credit market.

Chart 24 Changes to credit conditions in the household sector

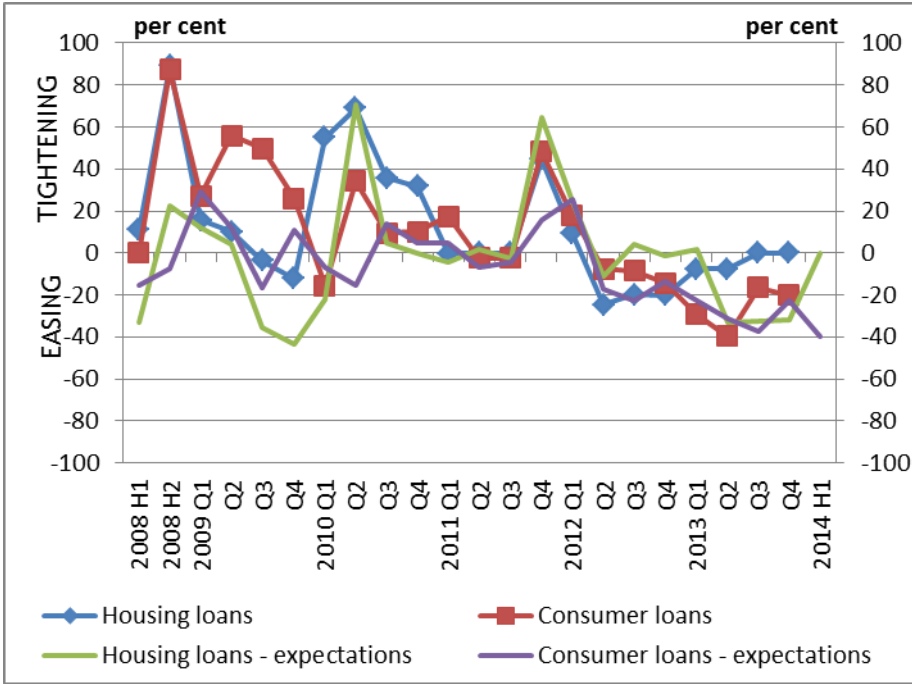


Chart 25 Development of the interest rate of new household credits

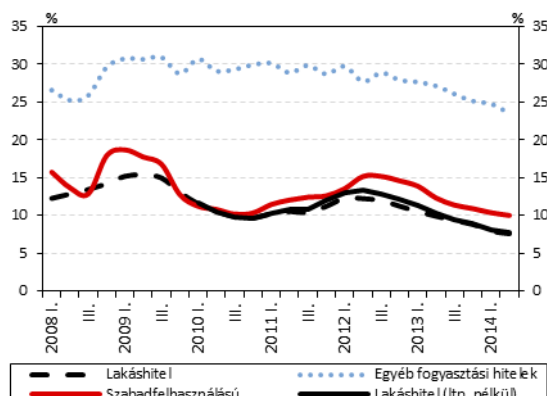
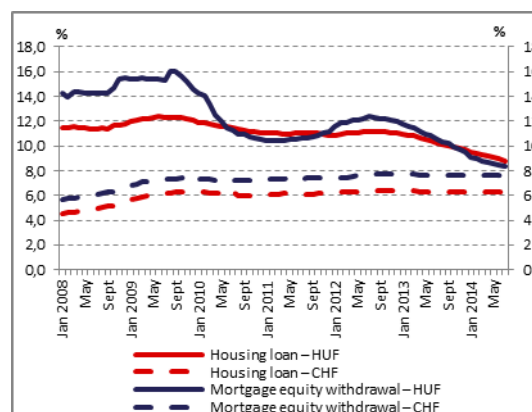


Chart 26: Typical interest rates in existing stock of credit in various partial segments



In addition to the slight increase in the interest surcharge, the decrease in the annual percentage rate related to housing loans has continued. **The APR of housing loans dropped from 9.3 per cent in the third quarter to 7.6 per cent by 2014 Q2, representing a surcharge of 5.3 per cent above the reference interest rate.**

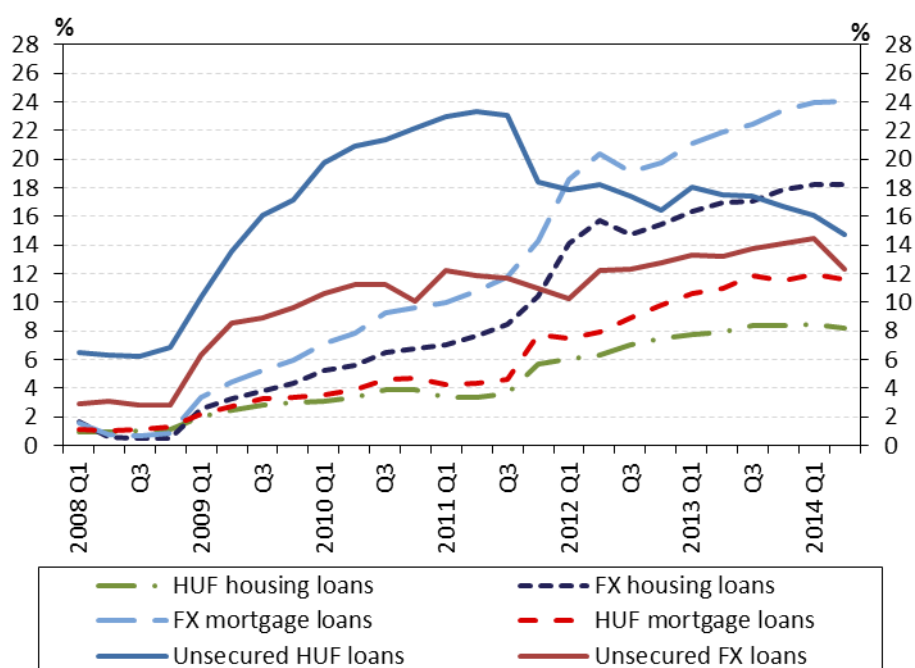
The surcharge is still considered quite high, but lower instalments due to decreasing APRs are making housing loans accessible to more and more households. As a result of a state interest support, the interest to be paid by the client can even be as low as 6 per cent. It should be added, however, that the interest on a supported loan may not go below 6 per cent, and hence the benefit provided by the interest support is smaller owing to the fall in market interest rates.

The APR has also dropped in the case of newly disbursed mortgage loans with unrestricted use, reaching 10 percent by 2014 Q2. The average annual percentage rate of charge on unsecured consumer loans decreased by 1.5 per cent in the first half, reaching 23.5 per cent. **Average interest rates were cut in case of HUF-denominated credits, but have not changed substantially for loans denominated in CHF.**

The average typical interest rate for the entire credit stock dropped to around 8 per cent as a result of interest rate cuts by the central bank with regard to HUF housing loans and loans with unrestricted use. There has been no substantial change in the interest rates on CHF-denominated loans: the interest rate of housing loans is a stable 6 per cent and 8 per cent in case of loan with an unrestricted use.

In the household segment, the rate of non-performing credit stock (default above 90 days), which has been growing up to now, decreased slightly in 2014: with the exception of currency mortgage loans (24%), this trend can be seen in all residential product types.

Chart 27 Rate of household loans in default within the banking system by product types



Based on reports received by the MNB from consumers, it can be established that **some consumers do not ascribe adequate significance to being in default on payment obligations**, and hence they only ask for help late or do not ask help at all from the financial organisation, whereas they might be eligible for several state and market-organised schemes to ease payment terms. **The obligations and burdens of debtors could be partially decreased by the legislative package adopted to settle unfair lending conditions. The effect of this will become visible in the course of 2015.**

4.1.4.3. State and market-organised programmes to ease payment terms

The options provided by the state include the **exchange rate cap scheme, the introduction of a forced sale quota** and the programme of **NET Zrt.**

The credit stock involved in the exchange rate cap scheme only grew moderately in 2013 after dynamic growth in 2012, and by 2014 H1 the stock approached HUF 1,500 billion, representing involvement above 40%. The legislator extended the scope of eligibility for participating in the programme to consumers with non-performing loans, and thanks to these measures, the stock participating in the scheme showed some growth in the first half of 2014, but based on the feedback from market operators, the lack of a dynamic growth after the extension of eligibility can be explained by the following aspects:

- The realistically viable 20-25 percent cut in instalments is not enough for consumers struggling with payment difficulties to remedy their income situation.
- Applications for joining the programme rejected upon launch were not reviewed under the new and change regulations. Since ensuring that non-performing credits become performing credits is in the common interest of consumers and market

participants, an automatic review of rejected applications taking into consideration the change in the legislation and the notification of previously interested consumers, would be a solution.

- Some consumers struggling with payment difficulties are trying to pay the instalments and wait for the step of the legislator at the end of the year hoping for a more favourable scheme.
- Some of the consumers cannot accurately estimate or understand how the scheme will change after the grace period of the exchange rate cap scheme.
- House value limit: the consumers' attention should be drawn to the option of applying for equity, if the price established in the course of valuation exceeds the maximum value specified by law.

The number of residential properties designated for **forced sale** has not reached the amount allowed by the quota, but a small portion of designated properties (slightly more than 1,300 by the end of 2013) was sold by credit institutions and debtors. Hence, the stock of residential properties designated for forced sale still exceeds the quarterly number of transactions of the housing market two and a half times. The basis of the quota is provided by mortgaged properties where a payment default of over 90 days exists.

Chart 28 Stock participating in the exchange rate cap scheme and utilisation of the exchange rate cap

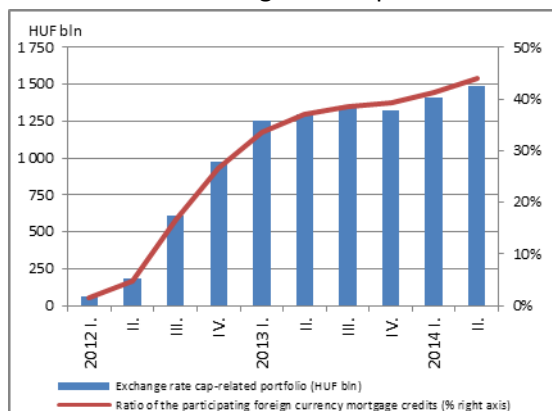
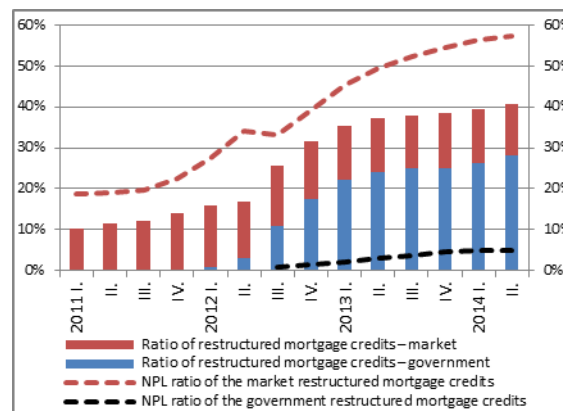


Chart 29 Credits restructured in state and market schemes



The sale of residential properties was essentially supported by **NET**. NET announced the inclusion of 15,000 residential properties, out of which it purchased more than 5,000 and the sale of 25,000 properties in total was projected until the end of 2014. The latter represents nearly one-fifth of the credit collateral underlying non-performing mortgage loans. Strict conditions must be met to join the NET programme. For debtors in trouble, there is an option to remain in the property for an advantageous rent and then be able to repurchase it when their financial condition have improved.

Besides the exchange rate cap, banks are also trying to make the non-performing portfolio a performing one as much as possible **by restructuring the market**. Slightly more than 10 per

cent of household credits in the banking system were restructured in the framework of private schemes. It is clear, however, that while the rate of non-performing credits among restructured credits is around 5 per cent in the state programme, among borrowers opting for the bank scheme this rate is near 60%. This tendency can be explained by the fact that non-performing consumers who are in the most difficult situation could not join the state programme in the beginning, and hence they only had the option of using payment easing schemes offered by the banks (it should be noted however that market programmes were launched earlier). Another possible explanation however is that the exchange rate cap is used by people in a somewhat better financial situation, and can possibly save a part of the difference between the old and the new repayment rate for the period coming after the exchange rate cap.

In addition to the above, it is important that the consumer obtains information about **social programmes** initiated by the state or the local government even in case of losing a job, permanent health problem or difficulties in payment. Such information can be obtained at local governments and Labour Centres of County Government Offices

4.1.4.4. Other significant consumer problems concerning credits

Debt management

Unfortunately, a significant group of credit debtors have come into direct contact with **debt management or claim recovery companies, and numerous problems related to the latter's activities continue to occur**. One of the goals of the MNB (The Central Bank of Hungary) is to continuously monitor the activities of such companies. Still, it must be highlighted that the market segment of debt managers should, in no way, be generally regarded as illegal. Of course, there are mistakes, violations of the law, and some of these problems may even be activity-specific. Nevertheless, such deviations are apparently rooted in the sensitive nature of debt management: clients will definitely comprise a much more sensitive consumer group once they have accumulated arrears. The MNB is committed to ensuring that debt managers act lawfully and recover their claims while observing the relevant regulations. It should also be noted that the fact that an authority or client has perceived unlawful behaviour in a debt manager's activities does not give ground to debtors' exemption from debt payment requirements.

Nevertheless, MNB still finds it important to regulate debt management activities by law, whereby regulations could be based on HFSA Recommendation 14 of 2012 (effective as of May 2013) for debt managers.

Credit limit-setting and extension without request, credit card delivery without request

Communication **without request**, from previous service providers or other organisations, about credit facilities up to a certain limit by a company may create risk on the consumers' side. The delivery of a credit card along with the above notification poses further risk if the

card can be easily activated. The above all entail risks because they enable consumers to make quick decisions without the appropriate consideration of conditions or without any consideration whatsoever.

In the case of credit card or current account credit line products, consumer reports also testify that **credit institutions sometimes automatically increase credit limits without the clients' request**. In several cases, the increase in the credit limit has not been preceded by a revaluation of creditworthiness. It is therefore vital, in particular due to automatic credit limit increases, that clients make sure that credit limits do not go beyond their debt payment capacities.

Further risks in the use of credit cards

In several reports submitted to MNB, clients made complaints concerning the credit card products of various financial institutions. In the majority of these cases the problem was subject to the **prolonged repayment period for the requested credit amount, extending for several years**, or related to the quantified sum the financial institution claimed. Some consumers complained of having requested a small credit amount, free of interest, or with low APR, yet the continuous repayment that had been going on for years still had not led to the elimination of the financial institutions' claim.

The various consumer protection assessments by the MNB revealed that within the group of financial institutions specialised in this field the common problems derived from the **consumers' lack of knowledge about the responsible use of credit cards, which in the long run constitutes entails consumer risks, due to the product-specific aggressive sales strategies**. A remedy to this may be found in the preliminary information provision by financial institutions, prior to the signing of any contract, drawing the consumers' attention to the risks in the use of credit cards, and thus helping them avoid liabilities whose settlement would threaten their livelihood.

Delayed notification of the Central Credit Information System (KHR) of data to constitute a risk of borrowing

Consumers face the consequences of **delayed data provision related to positive KHR qualification** when they turn to a financial institution with credit application or with an application for a simplified payment scheme, or launch a so-called "customer enquiry". The correction of KHR data is often time-consuming and involves extensive administration, harmfully affecting consumers.

Updating the KHR system data is essential on the consumers' side because for credit applications it is mainly the data stored in the KHR system that underlie the financial institutions' assessment of consumers' **creditworthiness** and the **establishment of their borrowing capacity**. The delayed recording of any data may result in the rejection of credit applications or cause their prolonged evaluation, which thus may prevent consumers from

using a product or service of a special offer. In addition, it may manifest in higher interest payment requirements due to an increase of interest rates during the credit-scoring period, again causing considerable damage.

4.1.5. Combined products

Combined products are created by **financial institutions** in different sectors, as separate products are closely linked to form a new type of **product to be sold**. In the first decade of the 21st century, one of the most popular products of this type was the so-called "combined credit", whereby loans were linked with some type of savings product. **There were no definite regulatory provisions applicable to combined products** with various elements (insurance, building society products, investment services), and the lending activities by financial institutions universally had to meet the requirements of loan regulations. Data submissions for the HFSA required separate data on combined products for participants in the various sectors.

Previously, the HFSA had made a recommendation **(13/2012. (XII. 4.))** on the application of prudential and consumer protection principles related to unit-linked life insurance. In its recommendation, it set requirements for credit products combined with unit-linked life insurance. In the case of combined public credit products, with the exception of building society products combined with HUF-based loans, the supervisory authority established capital adds-on for portfolios dated after 1 March 2013. The range of this constituted 50–100% of the portfolio's capital requirement under Pillar 1. The remarkable increase in the capital requirement, however, resulted in a drop of the number of combined credits.

Table 5 Number of contracts for combined public credit products by banks

Number of contracts for combined public credit products by banks									
Aggregated data, filtered for banks	2012				2013				2014
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Number of contracts	166,154	158,458	151,005	143,798	138,889	133,607	129,903	127,074	121,659

Risk of unsatisfactory capital repayment by combined credits

In terms of any of the combined products, **different risks are faced** by clients requesting a credit product, by credit institutes and by the institutions managing products that offer a saving option for the loan's principal (e.g. insurance companies). One of the highest risks of all, faced by all of the three legal participants in the case of combined credit products, is when – as opposed to expectations and calculations at the time of contracting – **the savings for capital repayment do not reach the level needed for capital repayment at the time of capital repayment.**

This risk may be significant for two reasons. On the one hand, the investment yield will fall below the values expected at the time of contracting. On the other hand, the loan and the underlying savings have different currencies, potentially exposing consumers to unfavourable exchange rates. Since contracts offering a cooling-off period of ten years related to capital repayment only started to appear on the market from 2004 on, capital repayment of the first credits combined with savings typically became payable in 2014.

A common feature of loans combined with insurance or building society savings is that capital repayment is not entered into the principal of the debt. Instead, it accumulates on the insurance-related account or it is credited on the building society account. **Instalments paid by the client do not reduce the principal of the debt.** However, interest and management costs are continuously charged on the debt. At the time specified in the contract, the sums accumulated on the insurance-related account and on the building society account will be transferred to the principal of the loan. Nevertheless, instalments do not necessarily decrease as a result.

Another risk may be faced in connection with building society loans when it comes to their premature termination. In such cases, the debtor is not entitled to state aid, which would otherwise cover a remarkable ratio of the principal outstanding at the end of the savings period. With regard to loan agreements combined with insurance, risks may be rooted in a lack of knowledge of potential exchange losses, the costs of the insurance product, or an inappropriate investment portfolio on the insurer's side. All of this may result in a considerable principal outstanding on the client's side at the end of the term.

Based on the MNB's survey, combined credits (building society savings and life insurance together) are **relatively long-term loans**, and around 75% of loans at the end of 2013 will expire in 2018.

From the point of view of **unsatisfactory capital repayment, it should be understood as a positive feature** that 67% of combined life insurances are mixed life insurance, whereas 33% consist of unit-linked products. This ratio does not match the 2/3 : 1/3 revenue proportion of unit-linked and traditional branches in the life insurance sector. Some insurance companies have exclusively sold mixed life insurance products, which through the capital and technical interest rates also ensure yield protection.

In the coming five years, existing combined products **will not constitute considerable consumer protection risk at a sectoral level.** Nevertheless, companies with a concentrated portfolio of combined products will have a larger number of expiring agreements, posing ever-increasing concentration and consumer risks. In parallel with this, **a rise in the number of complaints can also be anticipated due to possible risks at the level of individual consumers.**

At the international level, as regards the regulation of combined products, the PRIIPS-related (packaged retail investment products) EU regulation is worth mentioning. A related political

agreement was previously reached at the European level; the regulation is expected to enter into force in the fourth quarter of this year.

4.1.6. Consultation, distribution channels

Intensified examination by MNB of insurance mis-selling

Insurance companies and insurance intermediaries are bound by law to perform **detailed needs analysis**.¹⁷ Service providers must offer adequate constructions on the basis of consumer information and the identification of concrete goals for contract conclusion, as well as needs and life situations. At the same time, they must provide detailed information on the most important conditions, risks and costs. The aim of needs analysis on the consumers' side is to clarify their needs so that they may make a more precise information-based decision about what insurance agreement to conclude under what conditions.

Mis-selling in the insurance sector, however, constitutes greater risk where contract conclusion based on misleading information may result for the financial institution in the signing of a contract that does not meet the consumer's real needs. A case of mis-selling can be when the consumer would like to sign a single-premium life insurance agreement, yet the partners ultimately conclude a contract with a continuous payment scheme.

The following irregular practices by the service provider may lead to mis-selling:

- the needs analysis form used is not suitable for the identification of goals and needs in support of the signing of a contract;
- the recorded content of the needs analysis form does not reflect the consumer's needs;
- part of the needs analysis form has not been completed;
- data in the completed needs analysis form do not match data in the contract offer;
- although in the documentation of the offer the consumer formally confirms that prior to the offer he or she has taken part in a needs analysis process and has received sufficient information about the terms and conditions of the contract, neither the needs analysis nor the relevant information provision process has been performed.

Besides the above risks, during the needs analysis process, service providers must devote extra attention to special situations concerning clients (e.g. their age). **Elderly people are a much more vulnerable group than average consumers when it comes to the conclusion of a life insurance contract, and service providers are therefore expected to give more**

¹⁷ Before the conclusion of a contract, they must assess the potential client's financial knowledge, information, burden-sharing capabilities and risk-taking willingness. Needs analysis covers data concerning the client's marital status and number and age of dependants, since these details are essential to be able to draw the appropriate conclusion about the contracting party's actual insurance requirements.

attention and show deeper cooperation during the information provision and needs analysis phase. In the case of elderly clients, the conclusion of a contract with long-term commitments and high annual fees (unit-linked life insurance) is regarded as inappropriate.

In our experience, the primary problem with making deals is the neglecting of consumer needs,¹⁸ the failure to perform needs analysis or the preparation of an inappropriate contract offer. Intermediaries seek a higher commission, and to this end they may make offers that disregard consumer needs and even entail higher risk.

In addition, trial transactions and consumer protection proceedings have revealed further anomalies:

- unprepared agents;
- lack of knowledge in connection with mediated products and relevant legislation;
- unauthorised activity (for example, a multi-agent performs brokerage activities); and
- in the case of electronic contract, the ex-post submission of contract conditions is offered in the form of an electronic message.

Due to the above problems, the practice of information provision by independent insurance intermediaries has also become a selected target of monitoring by the MNB.

Another form of mis-selling is **insurance distribution** through banks. In these cases, the sold product is an insurance product, not a bank product. The two products are not identical, and they entail different consumer rights and commitments, yet consumers are not always appropriately informed of these differences at the time of product distribution. Consumers should be told that any natural person signing a life insurance contract may terminate the life insurance contract in a written statement, without any justification, within 30 days of receipt of the compulsory insurance information guide about the conclusion of the contract, if only after the signing of the contract they become aware of the fact that, contrary to their intentions, they opted for a life insurance agreement instead of a bank product. The contracting party may not officially waive its right of withdrawal.

Unit-linked life insurance is not an investment fund. It is often incorrectly stated that such unit-linked insurances combine the benefits and advantages of mixed life insurances (payment in the case of death or at the end of the contract) and investment funds. Admittedly, at first glance there are many similarities. However, unit-linked insurances are typically for a long term. They are rather hard to realise as cash due to their special

¹⁸ A typical case is when the client requests a single-premium contract for a fixed period, yet the agent persuades him or her to sign a contract with a life-time payment schedule, stating that the sum paid by the client in one amount (equivalent of the sum of the continuous fee for the insurance) will be accounted as a case-by-case payment above the first sum. Meanwhile, the following sum to be paid will be written off of the sum on a case-by-case basis until the paid amount equals zero. Client decisions may also be distorted by intermediaries putting more emphasis on benefits when concluding a contract and disregarding or giving very little information about related risks. They may highlight the investment nature of a life insurance while neglecting qualities that are inherent in any insurance product.

redemption conditions, and the related procedure will most likely generate losses. Unit-linked insurances also contain investment elements, and related client costs significantly differ from those of investment funds.

Non-compliant MiFid-testing

Although market participants make more and more high-quality information guides available on their websites, client knowledge and risk-taking capacity are, in principal, subject to assessment through the stages of preliminary information. According to the MNB, consumers often place orders for transactions whose risks are unclear to them.

Based on the above, it is of utmost importance that investment firms provide **unambiguous and clear** information to consumers about suitability and appropriateness tests. It should be explained that evaluation through such tests is aimed at ensuring that the service provider is acting in the best interests of the consumer to the largest extent possible.

For investment firms, it is essential to obtain comprehensive information about their potential clients, since they can only assure the proper selection of the best service for them based on such information. Therefore, it is mostly in the interest of consumers that they provide the service provider with complete and up-to-date information. In addition, consumers should inform the service provider of any changes in their status without delay. Investment firms are required to keep such information confidential.

In the form of so-called **suitability and appropriateness tests**, consumers are asked various questions before contracting. These questions generally cover the consumers' investment objectives and their financial status, as well as knowledge and experience, and the investment firm builds its service offer based on the answers given.

Investment firms, however, are required to offer potential clients or consumers financial instruments whose qualities the clients are fully aware of. It must be made clear that an assessment of client-risk relations (risk profile) underlies the purpose of this test, so that appropriate financial instruments, groups of instruments (products) and their related risks can be precisely identified.

Non-compliant MiFid-testing has been defined as a priority topic of investigation by the MNB.

Information provision to clients in connection with portfolio management

Information provision to clients in connection with portfolio management often violates regulations. More frequent information provision "in accordance with the client's requirements" or "upon the client's request" is allowed by law. Nonetheless, some clients are unaware of their rights. Therefore, it is vital that service providers alert them to the possibility of requesting or requiring more frequent information provision in accordance with their wishes. In the case of portfolio management, if the portfolio contains an open

position and the "realised loss exceeds the limit set in the agreement between the investment undertaking and the client", clients should be informed of this on the following day at the latest. Due to the lack of legal definition for the scale of this "limit", however, its value may differ from company to company.

Financial risks behind product showcases

It has become rather common for businesses to contact consumers on the phone or through postal services to invite them to local product showcases or one-day showcases, on domestic trips within the country, with participation either at a low cost or free of charge. Offers may become even more attractive if the low cost, which is a defining element of the programme, includes lunch or the guarantee of some gifts.

Sales specialists subsequently commit themselves to encouraging potential consumers to buy something or other – kitchen utensils or electronic or health-related devices – through a combination of showcases and related product sales activities.

Certain combinations of product showcases and sales activities, however, have **inherent financial consumer protection** risks. There will always be participants who lack the financial assets to afford the products. Therefore, at the end of these showcases, financial intermediaries who are regularly present at such venues provide them with options to take out immediate consumer loans in order to be able to purchase the desired goods. Such loans have particularly high risk, since sales activities are mostly targeted at vulnerable groups (e.g. pensioners). Besides the lack of considerate thought, risk options on the financial market and their conditions are also not thoroughly studied. Consumers apparently tend to make sudden decisions based on their emotions, which may lead in the long term to heavy burdens due to regular payment requirements of monthly instalments.

For a segment of such consumers, it is unfortunately only after their purchase of goods that they realise that they have accumulated debt for a product that they do not really need, or they simply cannot meet the credit exposure requirements. In such cases, it may prove critical for consumers to know that they can waive their rights to purchase within eight working days after the purchase, without any justification, in accordance with the government decree on agreements concluded with customers off-premises. Based on the relevant provisions of Act LXXXV of 2009 on the Provision of Payment Services (hereinafter Pft.), this also terminates the loan agreement for the acquisition of that particular product.

MNB Civil Network – for a higher standard of consultations by the civil sphere

In connection with its task completion, the MNB has noted that consumers enjoy the support of various civil **consumer protection agents, consumer protection** organisations and lawyers specialised for distressed clients. Support often covers (or sometimes it exclusively covers) the consumer's submission to the financial institution or to the MNB of a completed sample form as a statement of complaint. The high number of written statements received

by financial institutions, all identical in respect of layout and content, hinders efficient operations. In many cases, such written statements contain many references to non-relevant regulations and court decisions, which are either not applicable to the specific case or do not shed light on the consumer's actual complaint.

These written statements may possibly lead to a possible conclusion that clients often receive incorrect or inappropriate advice or information. Following their submission of complaints, clients often express dissatisfaction with the failed solution to their problem. On the one hand, a reason for this is that clients do not perceive that their complaint has not focused on the actual and specific problem. In addition, according to our information, certain consumer protection groups charge a some fee for their services.

It should be stressed here that the above phenomena are not widespread. The MNB **considers it an important objective** to support distressed customers through civil organisations. Therefore, it has developed a **civil network with countrywide coverage**, whose network participants must pass a civil qualification test in order to ensure high-quality work.

Based on the above, however, attention must be drawn to the fact that consumers may directly approach both financial institutions and the MNB with their applications or complaints, free of charge. In addition, as of April 2014 government offices are also available for such purposes. The MNB website makes available all of the information and documents that can facilitate and make administrative procedures for consumers more efficient. Given the availability of customer service departments, clients can turn to them with their questions.

The MNB regards the establishment of Civil Network (a network to promote financial consumer protection) and Civil Forum (a board regularly convening meetings under Civil Network) as a significant project. In addition, the monitoring of the quality of information provision and other activities performed by civil organisations participating in the establishment of the above are also given priority. Information provision by civil organisations may also be supported by the MNB initiative affecting a large group of consumers, which suggests the publication of 40 topics in 'Navigator' information booklets.

4.1.7. Other financial or non-regulated products and services

In addition to products considered as financial services by legal regulations, **spreading among the population are several similar products with economic content and for which the legal framework does not apply or only partially applies, or are only partially regulated; therefore, these have added risk for consumers.** However, in the treatment of these risks the competence of the MNB is limited, and more attention will be drawn to such.

Fiduciary asset management is a non-regulated activity which involves risks

The MNB does not have surveillance authority experience with regard to fiduciary asset management, because it is a completely new legal institution and data on the operation of institutions is not available.

The first fiduciary asset management undertaking has been registered in Hungary. However, the activity exists in a much wider area.

In general, the surveillance rights of the MNB are narrow. They do not extend to an in-depth assessment of fiduciary asset managers, and hence fiduciary asset management pertains to non-regulated activities, posing risks on this new market and for its clients.

Risks of Bitcoin

The spread of so-called "**virtual instruments for payment**" has recently received wide press coverage. The MNB considers it important to draw attention to the risks involved in using these instruments.

The special feature of virtual instruments for payment, such as **Bitcoin**, is that its issuer is **not an institution** that has obligations and responsibility with regard to the issuance, but simply the totality of users. These instruments typically only exist electronically, and they can be found in special so-called "virtual wallets". These instruments can be earned by so-called "mining" (possible using open-source software requiring a high computing capacity), purchasing with legal means of payment or accepting it as consideration for goods or services as dealers or service providers.

The virtual instruments for payment can be purchased from a user who has similar instruments or on a specialised exchange market. However, considering that there is no effective regulation of these exchange markets, **nothing guarantees that the adequate amount of virtual instruments for payment will be provided in exchange for the legal means of payment transferred by users.** The virtual wallets that can be used for payment can be stored on any device. Hence, like other data stored digitally, the virtual instruments for payment can become accessible and stealable by the relevant codes being broken. As opposed to systems operated by payment providers, however, **the client is not protected by any regulations.**

In the case of Bitcoin and other virtual instruments for payments that function in a similar way, **there are no issuing and intermediary institutions operating in a regulated manner**, and thus these are outside of the surveillance competence of the MNB. If any problems arise in the administration of Bitcoin or the conclusion of transactions, there is no authority to which the consumers may turn and that can act in the interest of consumers.

Bitcoin and similar devices operate in a decentralised system where transactions are completed using the resources made available by the members of the system, and the final

approval of transactions is based on the confirmation of the members of this system. If any problem arises in such a system, either with regard to the completion of transactions, the operation of the system or the wilful abuse of a member of this system, there is no institution that can guarantee the completion of transactions of virtual instruments for payment to the users, no institution will indemnify the losses of clients and no institution can be held responsible for the money deposited as a virtual means of payment.

As experienced in the last months of this year, the prices of virtual instruments for payment are quite volatile, and they can show remarkable movements in a positive or negative direction. This makes their acceptance by dealers and service providers very difficult and significantly increases the risk of paying or making purchases with them.

Investments in physical gold

The HFSA provided a detailed introduction of the risks related to investments in physical gold,¹⁹ and it published an awareness-raising bulletin on its website.²⁰

It can be concluded that retail investment in the gold market is especially risky from the aspect of financial consumer protection, **as a large part of the financial assets of the population flows in the direction of long-term – not regulated or supervised – investment from which the chances of a profitable exit are moderate.** The MNB receives applications for resolution and requests for information with regard to such activities.

It is important to mention that the introduced schemes (physical gold) are not considered financial instruments or financial/investment service schemes. The institutions providing them are not qualified as financial organisations, and hence they do not fall under the supervision of the MNB.

Each scheme has to be assessed and qualified individually. Other authorities have competence to take measures against any unlawful behaviour of unregulated businesses (for instance, when a penalty was imposed by the Office of Economic Competition in 2014 for a business selling precious metal coins and investment gold under the pretence of being official).

4.1.8. IT risks

With the spread and increase in the number of electronic financial services and the number of their users, the related IT risks are becoming more palpable and obvious as well. The MNB considers it important to draw the attention of consumers and providers to these. In the following, these risks are briefly described.

¹⁹ See the relevant risk assessment in the consumer protection risk report of May 2013.

²⁰ http://www.pszaf.hu/bal_menu/figyelemfelhivo/befektetesi_arany.html

Risk of a wilful attack

Breaches can happen directly (e.g. through physical access with username and password) or through unprotected netbank connections. It is also possible that by reopening or returning to a session that was previously closed by exiting, the user with his related privileges can be completely or partially impersonated; this can pose a real threat (for instance, in the case of public computers shared with others). Data exposure by direct or video surveillance, network tapping or keystroke recording can also pose realistic threats. Even when sophisticated tools and methods are employed on computers used exclusively in an environment that is under complete physical protection, successful attacks can be carried out: data-phishing emails and warnings, as well as notices to change a password or enter personal and log in data, are all aimed at deceiving the user. Electronic interfaces with a seemingly identical appearance can deceive even the most experienced computer user.

Risk of harmful codes

The recognition and defence against harmful codes using targeted or generic tools often exceed the capabilities of the user: if malicious software masked as a game, wallpaper or ringtone exposes data on the activities of the user or intervenes in financial transactions (e.g. by reading and modifying), without multiple checks and verification it can only be detected when the next statement is received and reviewed. An attack by a harmful code can occur when surfing the Internet or as a result of failure to update the system or anti-virus software being out of date.

Risk arising from the use of mobile devices

Besides the comfort and speed provided by mobile devices and smartphones, it should also be taken into consideration that their integrated and complex environment, as well as the rapid development of technology, can lead to numerous security compromises and rapid arising threats. The solutions that we are used to in the world of personal computers are no longer applicable: the application of firewall technology is limited, the application of multiple anti-virus programmes is questionable, users may not separate communication and storage of confidential data, and the management of operations carried out with privileges results in an assumption of obligations.

Risks and threats from the Internet

The identification of and defence against **risks and threats from the Internet** is only possible through consistently managed and maintained system elements. However, special attention must be given to phishing and other attacks based on deception. The user must have comprehensive knowledge of electronic services and their environment in order to identify if

- unauthorised persons are requesting information, or
- someone is trying to deceive him by imitating the original interface.

The method of maintaining and managing certificates related to the service (operation events, logging in, creation, emailing, instant messaging, proofs, balances, etc.) must be considered with regard to using electronic financial services. The solution that is compliant with the legislation offered by the provider does not always meet the demand of the user: it is the user's responsibility to understand that a certificate sent by email to a storage generated automatically must be preserved for seven years with unchanged content.

4.2. Risks related to market surveillance

4.2.1. Risks of activity pursued without a permit

As a result of diminishing deposit interest rates, many have started **looking for new investment opportunities with a higher yield**. In periods like this, the risk of a user encountering fake investment opportunities is higher. These are often offered by a person or organisation without a licence to sell the investment product. A common feature of fake investment promises is that they offer an outstanding yield with very low risk or even with a capital or yield guarantee. Outstanding yield cannot be achieved without risk, and often there is no actual investment behind such promises.

In the course of investigating unauthorised activities, the MNB relies on data collection and the reports of market participants (investors and competitors with a permit). **The following features can be mentioned as signs of risk** based on the monitoring of market behaviour related to such activities:

- promises of outstanding yields during a short term, typically with a capital guarantee;
- the involvement of many intermediaries with commissions exceeding normal market prices;
- using and cloning emblems of successful companies;
- aggressive PR campaigns; and
- lack of local permits being explained by the service provider as cross-border activity.

At the MNB's website, material drawing attention to and revealing investor risks is continuously developed and updated. While this promotes the protection of investors, it is not possible without the risk-aware behaviour of investors. Therefore, things to know and do are summarised on a checklist.

The MNB intensifies its actions against unauthorised providers of services

In the case of unauthorised service provision, clients are convinced to make investments by attractive marketing elements. The illusion of the reliability of the product is established using foreign players in the supply chain, which makes traceability of the scheme difficult.

The MNB takes measures against activities pursued without a permit and against insider trade and market influencing. It also checks the observance of rules on acquisition and limitation of unprotected credits by means of **market surveillance procedures**.

In the case of pursuing unauthorised activities (without permit/registration), the following sales channels were identified by the MNB:

- the agents' sector falling under the effect of certain sectoral legislation (Hpt., Tpt., Bit.);
- players falling outside the "visible" agents' sector (private individuals, legal persons); and
- online contact without any form of identification (only the consumer gives his data in the system, while the other party actually pursuing the activity is invisible even in the data of the domain register).

In the case falling under the scope of Section 1, it is a particular difficulty of applying legislation that certain operators in the agents' sector are pursuing many different sectoral activities at the same time with regard to the client and the client base. The problem occurs in the course of separation and deception, such that consumers are convinced to make investments, using a citation in a registry of the MNB for investments outside of the ones offered by the regulated sector. Agents with an insurance agent license in the registry of the MNB often sell such high-risk products to their previous client base.

Both professional agents and consumers are recommended to obtain information on the product offered and the issuing/selling company at the MNB's website in publicly available registries and other online resources. Agents are recommended to always confirm the validity of products offered by themselves and that any agents contacting them have all necessary permits. Agents involved in selling the products, notwithstanding the imposition of high commissions, need to be fully aware of their obligations under the legislation and must also duly fulfil such obligations. It is not true that the issuer (or asset manager) bears all risks.

In the case specified in Section 2, a particularly high latency is calculated. The fact that this group of agents often has links with registered/licensed agents causes further problems, since this creates a false pretence that the activity is supervised by the authority.

Case 3 can be said to be typical with regard to unauthorised **currency trading** activities or "client acquisition" to support such activities, and the "voluntary" entering of the personal information of the consumer enables the use and sale of such information (personal information and contact information of potential investors) for other purposes and in other domains, such as convincing the consumer to make investments with other content (e.g. through cold calls).

These cases can only theoretically be seen as separate; in reality, they mutually coexist and overlap, making law enforcement by the authority and the enforcement of consumer rights extremely difficult (if not impossible).

It is important that the consumers do not have unconditional trust in agents whom they have known for some time (since even if agents mean well, they could still deceive them) and they should gain firsthand information about investments, products and issuers. Consumers who only rely on the good experience of their friends and enter into contracts without thinking through the entire scheme are irresponsible. There is competition on the financial and exchange markets, both of which consider the national and international markets. Promises of outstanding yields should always be treated with reservations.

Consumers are recommended to ask questions of the agents in contact with them and to seek answers for their doubts. Investments that are "only now, only for you" are quite risky to jump into without hesitation. If unknown companies registered in exotic countries are mentioned in a scheme, consumers should be suspicious and ask themselves the question: "In the event of any problem, how will I get answers or compensation from this country?"

Meanwhile, agents are recommended to always confirm the validity of products offered by themselves and that any agents getting into contact with them have all necessary permits. On the websites of most supervisory authorities (also on the website of the MNB), a list of providers and intermediary companies with proper permits is publicly available. An important parameter of the register is whether the given company is currently active, that is, if it is currently authorised to pursue activities.

Agents should not be blinded by opportunities to earn high commissions; it is a misconception that all of the responsibility is borne by the issuer (or asset manager). The activity of the agent can also include an unauthorised investment or financial service activity, which results in the initiation of a market surveillance procedure or criminal procedure.

Accordingly, filtering out unauthorised activities is a priority supervisory area of the MNB.

4.2.2. Innovative phenomena on the capital market

High-risk leverage transactions

Hungarian investment companies have made an increasing number of **alternative trading venues and online trading platforms** available to their clients. The appearance of new types of trading venues has changed the capital market behaviour of investors to a great extent, and **high-risk leverage transactions** (typically forex and CFD transactions) arose, since on these markets transactions can be concluded with much lower margin requirements due to the leverage.

Besides Hungarian supply, **the range and volume of foreign currency transactions (forex) of institutions registered in foreign countries in a cross-border activity have increased; however, this issue is linked to the problem of services provided without a license.**

It should be mentioned that in the MNB's view, the fact that investment firms with Hungarian headquarters have lagged behind in this market segment has contributed to

these transactions gaining ground, and, as a result, there must have been a considerable market niche before these foreign currency traders spread.

A **highly complex and multi-actor industry built on** the investment demand of retail investors which, in addition to **forex brokers** and **financial service providers** contributing to transmit the orders to the interbank market, includes the following:

- agents of forex brokers ("introducing brokers");
- producers of trading platforms specialised in forex trading;
- the developers of software tools (robots) capable of supporting or substituting for the investor in investment decisions; and
- professionals and self-appointed persons specialised in the education of investors and the **collective investment management of their assets**.

Experience shows that with a promise of outstanding yields, retail investors transfer their resources into forex instruments due to:

- past negative investment experiences with traditional investments (high costs, excessive administrative burden, unfulfilled yield expectations and even losing capital);
- "one-click" online administration offered by forex brokers (opening of account, follow-up, money withdrawal);
- low demand for initial capital as a result of the leverage of forex instruments; and
- **primarily, the opportunity (or illusion) of investing comfortably in widespread collective investment management, such as so-called account management products (MAM, PAMM, LAMM), which relieve the client from the need to manage the investment and understand foreign currency tools.**

The essential "advantage" of account management products compared to traditional, collective or individual forms of investment management is that, in line with established market practices, the **money manager** often **ensures the shared management of clients' investments in a master account at a forex broker** (in fact, a special trading account controlled by software following a MAM, PAMM or LAMM accounting principle, on the basis of which users can link their private client accounts managed by the money manager under their authorisation) **without requiring or obtaining any activity license for this** (as opposed to investment fund managers or investment firms with portfolio management licences).

Although either of the abovementioned account management products can be found in the product range of the most popular forex brokers and have very strong capital-attracting capability, **clients that link their private trading accounts to the account of so-called managed master accounts cannot be assured that their invested money will be managed with adequate expertise and in their interest.**

PAMM (Percentage Allocation Module Management). This enables the money manager to manage client accounts linked to the master account by accounting for the profits/losses of transactions completed in the master account by proportionately (percentage) calculating the positions in the client accounts after positions were closed.

LAMM (Lot Allocation Management Module). As opposed to PAMM, the lot of transactions completed by the manager of the master account appears on the client accounts linked to the master account, proportionate to the capital.

MAM (Multi Account Manager). In essence, this includes PAMM and LAMM and any account management method based on any other accounting principle. The software is the account manager.

However, consumers are not aware of the legal framework in which companies located in foreign countries operate in Hungary. The reasons for this can be found partly in the regulation itself. This confusion is also made worse by the information provided by agents of the service to consumers, creating a false pretence that due to the foreign service provider this activity falls outside of the competence of the MNB, emphasising the existence of a perceived or real foreign supervisory license, which ultimately leads to a false sense of security.

It is important to stress for investors that **the foreign service provider is not under the jurisdiction of the MNB**, that the enforcement of their rights related to such contract is limited (typically foreign jurisdiction), and that the product carries particularly high risk. It is also very important to make clear that the activity of the operators in the sector is more "infected" than on average and persons pursuing activities and offering services without a license are more present in this market segment. Therefore, investors are recommended to **gain information about the existence of registered licenses on the website of the MNB** before making investment decisions.

The leveraged positions of international markets can produce unusually high losses or profits in a day. Comprehensive knowledge of the market and acquisition of various trading strategies are required to select the appropriate instrument.

In order to minimise risks, investors are expected continuously follow up their transactions to avoid losing the whole capital involved or prevent losses exceeding the invested amount in the course of leveraged trading. The majority of Hungarian investment firms published a brief and revisable notice **on the risks of high-leverage transactions** on their websites, in accordance with the managerial letter no. 6/2013 of HFSA.

Another serious consumer risk is that, as opposed to advertisements, both in theory and on the basis of the MNB's experience, the average consumer is likely to lose capital over the long term with these transactions.

Table 6 Consolidated result of closed and open high-leverage positions of retail clients

Period	Household clients' aggregate open position			Number of clients
	profit (mln HUF)	loss (mln HUF)	result (mln HUF)	
2012Q1	5 969	5 975	-6	2 584
2012Q2	5 223	4 607	615	2 593
2012Q3	5 415	3 832	1 583	2 367
2012Q4	3 910	3 141	769	2 366
2013Q1	4 199	4 424	-224	2 654
2013Q2	6 541	4 110	2 431	2 331
2013Q3	4 174	2 898	1 276	2 612
2013Q4	4 555	4 839	-284	3 028
2014Q1	4 347	5 316	-969	3 126
2014Q2	5 316	3 853	1 464	3 305
2014Q3	6 278	6 383	-105	3 408

Period	Household clients' aggregate open position		
	profit (mln HUF)	loss (mln HUF)	result (mln HUF)
2012Q1	1 397	3 164	-1 767
2012Q2	1 431	2 944	-1 513
2012Q3	936	2 282	-1,346
2012Q4	952	3 304	-2 352
2013Q1	1 108	3 909	-2 801
2013Q2	1 348	2 641	-1 293
2013Q3	2 075	3 512	-1 437
2013Q4	3 038	4 681	-1 643
2014Q1	2 652	7 272	-4 619
2014Q2	2 028	6 839	-4 811
2014Q3	5 101	9 613	-4 512

Trading robots

Consumers have the option to purchase software that facilitates automated foreign currency trading on the international currency market. So-called **trading robots** are algorithms supporting foreign currency, commodity, index and share-trading decisions that substitute for the trading activity of consumers unable to monitor the market around the clock. By using predefined parameters, they perform online automated trading without human intervention.

There have recently been some cases where applications for opinions were submitted to the MNB with regard to the controlling and legal classification of the sale and use of such programs. The activities of the companies developing and selling robots related to the software (e.g. investment advisory services, investment recommendation, any agent services, mediation) may be investment services requiring a license; hence, engaging in them could be unauthorised activity.

It is problematic that consumers can purchase trading robots **without receiving balanced information**. Thus, they are not aware of the risks and have no idea of how the products work, what they are capable of and what kinds of controls they need.

Aggressive sales techniques

Sales techniques vary widely. Hungarian intermediary companies/individuals seek to draw attention to their services by means of unsolicited electronic mails (spam), cold calls on the phone, and banners appearing on various websites and other advertising space. Other sales techniques are based on contacting clients on the financial, insurance or capital market or trying to involve clients in MLM networks created with a different profile.

The profile of agents offering the service is often very different from that of capital market intermediaries. The agents and sales techniques of companies offering online currency

trading without a license are characterised by emphasising the benefits of products and exclusively showing positive examples. Similarly, rough descriptions of the financial side of the product (often only a reference or nothing at all) and illustrating the activity only as a trading technique are also characteristic of these agents.

Due to inadequate information, a significant number of consumers are not and cannot be aware of **the risks involved in the capital markets**, the regulatory background, the practical difficulties or the frequent impossibility of rights enforcement. The information available to the consumer (or filtered by the agent) is either incomprehensible or only partially covers the actual data related to the investment, such that an exact conclusion of the actual situation can rarely be made from it.

In the near future, the MNB intends to pay more attention to aggressive selling due to the high risks involved.

Ferenc Rákóczi II

(27 March 1676 – 8 April 1735)

Hungarian aristocrat, Prince of Transylvania. His name is closely associated with the war of independence he launched in 1703, the purpose of which was to regain complete national independence from the Habsburg Empire. This is why he was elected Prince of both Transylvania and Hungary. His father, Ferenc Rákóczi I died when his son was only an infant. His grandfather, great grandfather and great-great grandfather were all Princes of Transylvania. His mother was Ilona Zrínyi, daughter of Governor of Croatia Péter Zrínyi and Katalin Frangepán, and niece of the poet Miklós Zrínyi. After he completed his university studies, Rákóczi married Princess Charlotte Amalie von Hessen-Rheinfels-Wanfried in 1694 without permission from the royal court. His wife's aunt was the Princess of Orleans, which made Rákóczi a relative of King Louis XIV of France.

Once he reached legal age, Rákóczi moved to Vienna, then in 1693 he toured Italy, and upon his return he was appointed count for life of Sáros County. In 1700 he gave in to Miklós Bercsényi's agitation and began to organise an anti-Habsburg rebellion. After his letter requesting assistance from King Louis XIV of France was intercepted, Rákóczi was imprisoned, but he was eventually able to escape from captivity and flee to Poland with his wife's help. There he was contacted by the leaders of the 1703 peasant revolt of the Tiszahát region who asked him to head the uprising. Rákóczi was the leader of the war of independence against the Habsburgs in 1703–1711, which was eventually named after him. Even though the uprising failed, the eight years of struggle secured a favourable position for Hungary that guaranteed a special status within the Habsburg Empire for two centuries to come.

Considering the circumstances, the Peace Treaty of Szatmár offered favourable terms to Rákóczi himself. In exchange for an oath of loyalty to the Emperor, he would have received full pardon and even if he did not want to stay in the country, he was free to leave for Poland. Rákóczi, however, did not accept the peace terms. He chose to go into exile instead, first for a short period of time in Poland and then in France, but he eventually settled down in Rodosto, Turkey, where he lived out his life.

Hungarians still cherish him as an ingenious and honourable leader because he rejected the general pardon offered after the Peace Treaty of Szatmár was signed and because he remained faithful to the cause of Hungarian independence until his death.

His body of correspondence in Hungarian, Latin and French was of international significance. His most powerful works were written in the long years of his exile. His Memoirs detailed the events of the war for independence in chronological order. Confessions was the product of many years spanning from the early years of his exile in France until late years in Turkey. The works by Rákóczi were mostly preserved in the form of manuscripts: Supplications (cca. 1720), Contemplations reflecting on the five books of Moses (1721–1731) and Treatise on Power (1722), Rákóczi's political and ethical testament written to his sons.

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