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

2020

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

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

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2020

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Pursuant to Act CXXXIX of 2013 on the Magyar Nemzeti Bank, the MNB supervises the financial intermediary system in order to ensure, amongst other things, the smooth, transparent and efficient functioning of the financial intermediary system, to foster prudent operations, to identify undesirable business and economic risks, to protect the interests of users of financial services and to strengthen public confidence in the financial intermediary system. Consistent with those tasks and in accordance with Article 135 (2) of the Act, the MNB has prepared this risk and consumer protection report, which presents key characteristics and risks of insurance companies, funds, intermediaries, non-banking group entities and markets of capital market participants. The purpose of the "Report on insurance, funds, capital market risks and consumer protection" is to inform the public and the institutions of the financial system in respect of current prudential and financial consumer protection issues, thereby enhancing the risk awareness of stakeholders and maintaining and strengthening confidence in the financial system. According to the intention of the Magyar Nemzeti Bank, its official activities to identify and reduce risks, its information and educational activities, and its efforts to enhance financial literacy all contribute to making the information necessary for decisions concerning financial institutions and products available to stakeholders, and thus strengthen the stability of the financial system as a whole.

The Report incorporates input from the MNB's Financial Institutions Supervision Executive Directorate, Executive Directorate for Prudential, Consumer Protection Supervision of Capital Markets and Insurers, Directorate of Supervisory Coordination, the Economic Analysis Department and the Central Bank Statistics Department.

The data used in the Report and the analyses based on those have been prepared for the reference date of 31 December 2019 – and for certain parts – for 31 March 2020, based on information received until mid-May 2020.

The Report was approved by the Financial Stability Council; the publication was approved by Dr Csaba Kandrács, Deputy Governor, respectively.

Contents

Executive Summary

The Magyar Nemzeti Bank publishes its Insurance, Funds and Capital Markets Risk Report and Financial Consumer Protection Report annually. Starting from this year, in order to provide a full picture of the individual supervised sectors and the most important changes that took place in the insurance, funds and capital market sectors, the two reports have been combined, and accordingly the consumer protection risks also appear in parallel with the prudential risks.

2019 was an important year in respect of the MNB's supervisory area; from 2 October 2019 Dr Csaba Kandrács took over the Deputy Governor position from Dr László Windisch, following the expiry of his mandate. The new Deputy Governor regarded the formulation of the supervisory strategy for the next 6 years as his first and most important duty; accordingly, at the end of 2019, the MNB's Financial Stability Council adopted the new supervisory strategy entitled 'Stability and Trust 2.0' applicable to the period of 2020-2025. The vision of the supervisory area is a developing, competitive and sound financial sector with the MNB supporting, shaping and efficiently overseeing it. The mission in the coming years is to support and deepen the stability of the financial system, with special focus on consumer protection, digitalisation and sustainability.

In 2019, the Hungarian insurance, funds and capital market sector once again closed a favourable year; however, at the beginning of 2020, the coronavirus appeared in Hungary as well. Owing to the precautionary measures taken in Hungary the number of the infected and the deceased as a result of COVID-19 was lower than in other European countries; however, the preventive and preparatory measures had major impact on the economy. In the MNB's Insurance, funds and capital market prudential and consumer protection report, in addition to presenting and analysing the data from 2019, we also touch upon the changes related to COVID-19 and already visible from the data for the first quarter of 2020.

By the end of 2019, gross financial assets of households, comprising financial instruments and the stock of dwellings, approximated HUF 98,000 billion, which represents a year-on-year growth of 10.6 percent. Last year, the growth in assets was mostly supported by – in addition to the stock of dwellings – the rise in the value of debt securities and other shareholdings. The largest growth was recorded in debt securities, but equities and other shares also increased substantially. These trends are attributable to the favourable economic processes that took place before the end of 2019 and the rise in wages, as a result of which shares and other equity generated more favourable investment result compared to other assets. The soar in debt securities was greatly attributable to the mid-year issuing of Hungarian Government Securities Plus.

In 2019, the premium income of the insurance sector was HUF 1,150 billion (and together with the branch offices exceeded HUF 1,200 billion), representing a growth of more than 10 percent year-on-year. Growth was driven by the non-life sector, primarily due to the increase observed in the motor insurance segment. The integration of the insurance tax also contributed to the growth in compulsory motor third party liability insurance (MTPL). In the life segment, similarly to the average of previous years, the most significant growth occurred in the traditional single and top-up premiums. Growth can be observed also in the volume of reserves due to the rise in the unit-linked reserves containing riskier assets as well, which, however, in the first quarter of 2020 started to decrease due to its sensitivity to the volatility of financial markets. The profitability of the insurance sector seems to stabilise at an outstandingly high level; in 2019 only one insurance company realised a loss. All this is accompanied by stable capitalisation level across the sector, exceeding the statutory requirement twice, and due to its favourable asset composition, it has not changed considerably even despite the market turbulence observed at the beginning of 2020. In the first quarter of 2020, reserves declined by some 10 percent as a result of the COVID-19 pandemic. This impact did not appear in the premium incomes; the quarterly growth of the life segment is 3 percent. In the first quarter the sector was stable, capitalisation level continues to exceed 200 percent, but the real economy effects may pose challenges already in the short run. In addition, the persistently low yield environment and the increasing case reserves of property insurances may represent risks. Furthermore, the MNB deems it important to reduce the risks resulting in the potentially significant breach of customers' interest.

In the voluntary funds sector both the number of institutions and the number of members decreased in 2019. The aging members represent major risk for the future sustainability of voluntary funds. In the voluntary pension fund sector the decline in members' payments is moderate; however, employers' contributions substantially declined, due to the change in the taxation rules applicable to the fringe benefit scheme. Although individual members' payments in the health and mutual aid fund grew, they were not able to offset the major decline in employers' contributions. The operation of the voluntary pension fund sector was profitable in 2019, where the yield deductions from the non-paying members had a major role. In 2019, the voluntary pension funds realised an asset-weighted average net yield of 9.84 percent at sector level, showing a real yield of 5.62 percent when adjusted for inflation. Based on the yields of 2005-2019, the average asset-weighted net rate of return at sector level, calculated from the average 15-year yield rates, is 6.45 percent, which – considering the 15-year average December/December inflation rate of 3.38 percent – represents a real yield of 2.97 percent. The health and mutual aid funds once again closed the year with negative operating result. In the voluntary pension fund sector major growth was registered in benefit payments in 2019. For the time being, the health emergency announced due to the spread of the coronavirus and the economic consequences thereof had no negative impacts on the payments to and disbursements from voluntary funds. This may have been mostly attributable to the proper application of the funds' risk management and communication techniques and to the fact that the members, in line with the objective of the voluntary pension fund product, act in line with their long-term interests. Nevertheless, compared to 2019 the balance of individual accounts (coverage reserve) declined. By the end of the first quarter of 2020, the amount of the voluntary pension fund sector's coverage reserve fell to HUF 1,403 billion, which falls short of the amount registered at the end of the previous quarter (HUF 1,507 billion) by 6.9 percent. The decline was caused by two factors. On the one hand, the extremely intensive fall in capital markets caused by the pandemic and the negative investment result of voluntary pension funds resulting from that, and on the other hand, the disbursements made in excess of membership fee payments. Approaching the non-payers and those with no fund membership remains outstanding priority for voluntary funds.

Due to the even more emphatic role of consumer protection than ever before, the key consumer protection issues, results and efforts of the past period appear distinctly in the report. The provisions of the ethical approach, introduced in recent years in the area of life insurances, resulted in significant changes in the transparency of costs and in the product features; the qualitative restructuring of the portfolio is also evidenced by the 2019 figures. The consumer-friendly approach appeared as the enhancement of the ethical rules, as part of which the concept of Qualified Customer Friendly Home Insurance was elaborated in 2019. Transparency increased also in the funds sector, as part of which the ACR_{PF}*[1] ratio was introduced. In addition to the consumer protection oversight of cross-border institutions, the MNB has continuously monitored the exit of the United Kingdom from the European Union in order to have the clearest possible picture of the potential effects impacting Hungarian consumers. The MNB oversees compliance with the provisions of the EU Directive on insurance distribution (IDD)[2]and of the EU Regulation on key information documents for packaged retail and insurance-based investment products (PRIIPs) [3]) since their entry into force and paid special attention to monitoring it in 2019 as well. While in several European countries intermediary oversight was introduced only after the introduction of IDD, this has been functioning in the MNB for already 6 years and now it reached a new milestone by developing and introducing a new, independent intermediary risk assessment methodology and risk map, having processed the experiences of past years. Concentration in the intermediary market, which characterised the market in previous years, continued in 2019 as well, which may have been contributed to at the insurance intermediaries by the growth in administrative burdens accompanying the implementation of IDD, while at the financial market intermediaries by the transformation of the building society scheme. Despite the institutional concentration – or perhaps due to this very reason – premiums of insurances mediated by brokers and multiple agents have been steadily increasing for already 8 years, with their total value having exceeded HUF 221 billion. The record high mediated premium is attributable to the extremely high, unprecedented in the past 10 years, 80 percent ratio of non-life insurances. The intermediaries specialised in the online conclusion of non-life insurances may be less affected by the pandemic situation, which may force an increasing number of market participants to implement innovations related to the online sales of insurances, including life insurances.*

[1] ACR: Annual cost ratio
[2] Directive 2016/97/EU of the European Parliament and of the Council on insurance distribution (IDD)
[3] Regulation 1286/2014/EU (PRIIPs Regulation – packaged retail and insurance-based investment products)

The number of non-banking group financial enterprises, i.e. not falling within consolidated supervision, moderately rose in 2019. Similarly to previous years, the activity of the institutions continues to be heterogeneous; it is dominated by loan and credit receivables, followed by receivables from financial lease, workout and current factoring. The institutions are still characterised by high concentration ratio; 80 percent of the portfolio can be connected to 25 financial enterprises. Most of these financial enterprises render financial services to non-financial corporations. In 2019, with the exception of the current factoring portfolio, growth in outstanding receivables continued and further cleansing could be observed in financial lease, credit and loan portfolios. The workout portfolio rose further, which is mostly attributable to the growth in the portfolio of typically well-capitalised financial enterprises with substantial market share. Compared to previous years, profitability significantly improved and there is also a minor growth in the number of institutions with positive pre-tax result. A significant part of the pre-tax profit was realised by financial enterprises engaged in workout and lending activity. As regards the liability structure, both the domestic and foreign credit institution liabilities as well as other and own sources of finance grew substantially. The statutory requirements related to the increasing of the financial enterprises' start-up capital changed from 2020. Roughly half of the financial enterprises not subject to consolidated supervision complied with the raised statutory requirements already at the end of 2019. The impacts of the coronavirus cannot be measured based on the data from the first quarter of 2020; however, the profitability impact of the emergency may complicate compliance with the capital adequacy requirement.

As regards the consumer protection activity of non-banking group financial enterprises, the MNB – similarly to previous years – paid special attention to the APR[4] calculation methodology applied by institutions granting low-amount, typically pawn loans, compliance with the statutory provisions related to the maximum APR and the practice of the relevant commercial communication information. In the workout sector, consumer petitions related to complaint management received special attention, and in respect of the activity the MNB issued its recommendation on the workout activity vis-à-vis consumers.[5]

In the capital market, the turnover of HUF 304,400 billion, realised by investment service providers in 2019, rose by 6 percent in total, and the market value of the managed customer securities portfolio of HUF 38,269 billion grew dynamically, by 11.3 percent compared to 2018. Based on the strong turnover, the investment firms sector's profitability reached a historic high in 2019; the after -tax profit of HUF 9.9 billion exceed the value registered in 2018 by 34 percent. At the end of 2019 all investment firms were adequately capitalised; the sector's capital adequacy ratio rose by 3.2 percentage points to 22.5 percent. In the first quarter of 2020, investment firms realised outstandingly high capital market turnover in the total amount of HUF 99,957 billion, exceeding the previous quarter by 29.5 percent, while in parallel with this the market value of the customer securities portfolio fell by 9.6 percent. The total turnover of BSE in the first quarter of 2020 exceeded the total turnover of the last quarter of previous year by 45.4 percent.

The investment fund assets amount reached HUF 10,262 billion at the end of 2019 may also be regarded as a historic high, representing a growth of 7.5 percent, essentially due to the growth of HUF 518 billion in the net asset value of the managed investment funds. In 2019 investment funds were characterised by positive yield effect of HUF 451 billion and by net positive capital inflow; however, the latter amounting to HUF 67 billion fell short of the 2018 level significantly, by roughly 75 percent, and within that by 90 percent in the case of real estate funds. On the whole, the profitability of the investment fund management sector grew significantly in 2019; the profit after tax of investment fund managers rose by 80.8 percent to HUF 46.5 billion. In the first quarter of 2020, the value of the assets management by investment fund managers decreased by 58 percent compared to the end of 2019, primarily due to the fall of 5.5 percent in the assets of the managed investment funds. This is attributable to the negative yield effect of HUF 341 billion, and to the net capital outflow of HUF 50 billion.

[4] APR: annual percentage rate of charge
[5] Recommendation No. 2/2019 (II.13) of the Magyar Nemzeti Bank on the workout activity performed vis-à-visconsumers

As regards the capital market consumer protection it should be noted that in 2019, in addition to treating the consumer protection topics with priority within the comprehensive inspections, a thematic review, initiated by the European Securities and Markets Authority (ESMA), was also conducted on the subject of compliance assessment. It is also important to note that in August 2019, the MNB issued a resolution restricting the distribution of contracts for differences (CFDs[6]) on a stand-alone basis, while in April 2020 it issued general product intervention resolutions with regard to contracts for difference and binary options. The recommendation issued by the MNB in April 2019 in respect of the distribution of the mutual fund shares of public open-ended real estate funds, in view of the major expansion of real estate funds and the high (small) investor exposure, is also worth mentioning.[7]

[6] CFD: Contract-for-difference

[7] Recommendation No. 5/2019 (II.13) of the Magyar Nemzeti Bank (IV.1.) of the Magyar Nemzeti Bank on issuing the shares of public, open-ended real estate funds.

New supervisory strategy – Stability and trust 2.0

2019 was an important year also in terms of the deputy governorship of the Magyar Nemzeti Bank in charge of financial institutions supervision and consumer protection. From 2 October of 2019 the Deputy Governor position is filled by Dr Csaba Kandrács, who after his appointment formulated the most important strategic goals of the 2020-2025 cycle and defined the milestones necessary for the attainment of those. During the development of the new strategy, in addition to the market, social and regulatory changes, the strategic goals stipulated in the Statute of the MNB and the MNB's Competitiveness Programme, the previous strategy also served as a reference, thereby ensuring continuity and building the supervisory objectives on each other. The previous strategy, for the period of 2014-2019, was approved by the Financial Stability Council in July 2014. The greatest challenge of the past six years was the full integration of the Supervisory Authority in the central bank, which was achieved entirely. In addition to achieving and maintaining price stability, the most important task of the MNB is to support and strengthen financial stability relying on the instruments available to it, and manage the impacts of the shocks affecting the financial system, as necessary. This can be achieved only through the cooperative work of the MNB's various areas, built on and supporting each other, and the past period clearly proved that the supervisory activity is an integral part of the central bank.

While the new strategy was developed, the vision and mission of the Supervisory Authority have also been updated, and the long-term objective is to have a developing, competitive and sound financial sector, supported, shaped and efficiently overseen by the MNB. To achieve this, it is necessary to support and deepen the stability of the financial system, with special focus on consumer protection, digitalisation and sustainability. In the spirit of this, at the end of 2019 the supervisory function has undergone an organisational transformation with a view to utilising the synergies between the prudential and consumer protection activity better; after merging these activities, they work in the same of organisational unit by sectors. In line with this the former Insurance, funds and capital markets risk report was also supplemented with the consumer protection risks. Stability and trust remain the key values of the Supervisory Authority, expected both from the supervised sectors and from itself. Further values to be enforced during the supervisory work include lawfulness, integrity, consumer-centeredness, innovation, sustainability, consistency and fair competition.

The new strategy also formulated specific tasks in respect of the supervised sectors and the Supervisory Authority; accordingly, in the next cycle special attention will be paid, within the market objectives, to the enhancement of the shock-absorbing capacity, the increasing of financing capacity of the financial system and, in the interest of customers, the ensuring of sound competition. The enhancement of the shock-absorbing capacity of the financial sector can be achieved by supervised institutions with stable capital position and the extension of the guarantee mechanisms to all sectors. Institutions must prepare for the risks appearing as a result of environmental anomalies, as it is also evidenced by the experiences related to the coronavirus; moreover in the past period actions against financial crime have also become important in the supervisory work, primarily in the area of the prevention of money laundering and terrorist financing. Increasing the financing capacity of the financial system is essential for the development and growth of the Hungarian economy, which may be achieved by ensuring the development and maintenance of sound balance sheet structure and portfolio quality and supporting sustainable growth by the Supervisory Authority. In the interest of the customers, insisting on sound competition has been a key objective for many years. In this area the goal is to strengthen transparency and develop homogeneous rules equally applicable to all actors, whether it is an institution with a great past active in the market for many years or a newly established company founding its strategy on the advantages of digitalisation. Naturally, as a supporting Supervisory Authority, it is important to strengthen competitiveness and innovation in all sectors, which should be achieved in a way that gives access for customers to easy-to-understand, simple products and to predictable and fast financial service provider processes.

As an organisational objective, strong consumer protection can be achieved by harmonising the expectations with regard to the fair conduct of service providers at sector and individual level, and consumer protection focusing on products. The strengthening of the risk-based supervision can be achieved by the improvement of the oversight activity, the application of supervisory instruments facilitating early intervention and by the enhancement of international cooperation, with special emphasis on home-host supervisory cooperation and cross-border activities. The means of firm and timely action and intervention include proactive, risk-focused supervisory communication and legal enforcement, and the strengthening of instruments of efficient crisis management. Within the framework of continuous development and supportive supervision, in the period ahead it is important to support and use useful innovations as well as to eliminate and prevent harmful ones; to foster the development of the legal framework for market requirements; to support financial awareness and in addition to preserving the gatekeeper role, to develop supportive, customer-friendly licensing procedures. As part of the active international and domestic regulatory role, proactive cooperation with the domestic and foreign peer authorities, peer supervisory authorities and advocacy organisations must be strengthened and the improvement of regulatory law should be supported using the supervisory experiences. The Financial Stability Council approved the supervisory strategy for the period of 2020-2025 in December 2019; it is also available on the MNB's website.

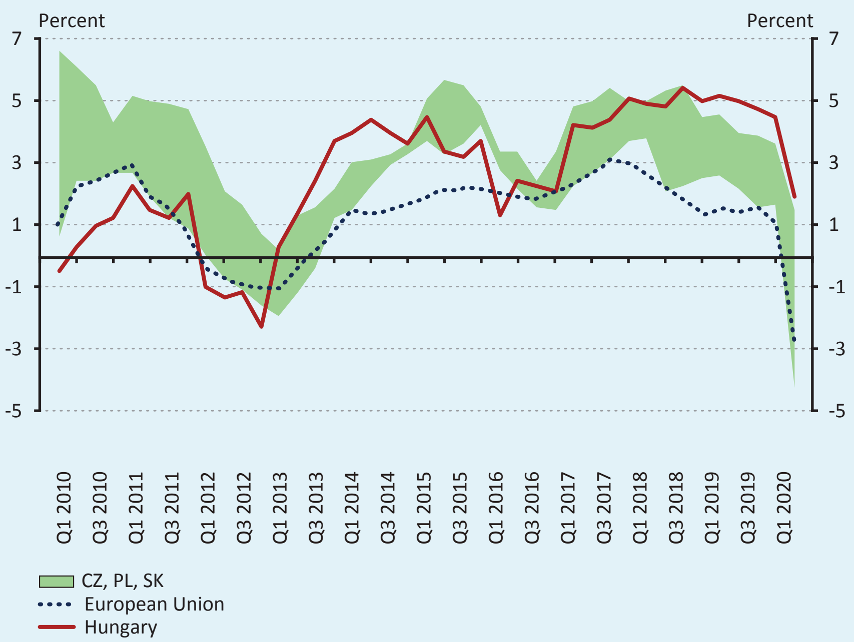
1 Macroeconomic environment and developments in household savings

1.1 INTERNATIONAL AND NATIONAL MACROECONOMIC TRENDS

1.1.1 The favourable trends of the past 5 years are threatened by risks

Based on the current projections of international institutions, as a result of the coronavirus pandemic, in 2020 global economic performance may decline to an even larger degree than during the 2008-2009 crisis (decline of -0.5 percent). In the first quarter, due to the restrictive measures, the economy of the United States contracted to a greater degree (-4.8 percent) on an annual basis than expected (-4.0 percent). Economic activity in China was interrupted for almost two months, and thus economic performance considerably declined (-6.8 percent). Based on seasonally and calendar adjusted data, the level of GDP in the European Union and in the euro area declined by 2.6 percent (Chart 1) and 3.1 percent, respectively, on an annual basis. Most of the large economies sank into recession (Germany: – 2.3 percent, Spain: -4.1 percent, Italy: – 5.4 percent, France: -5.0 percent). Countries by Visegrad region, Hungary and Poland registered a growth, while the level of GDP fell in the Czech Republic and Slovakia in an annual comparison. The Hungarian economy's growth surplus compared to the euro area exceeded 5.0 percentage points in the first quarter of this year. (Chart 1)

Chart 1
Annual change of the GDP



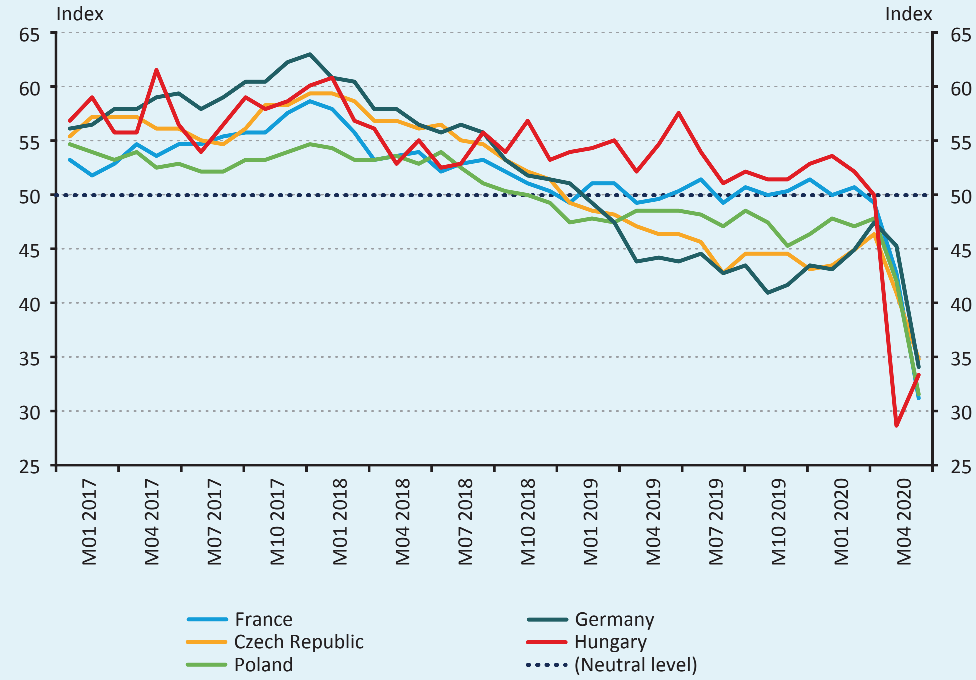
Note: Based on seasonally and calendar adjusted data.
Source: Eurostat

Based on the preliminary data, domestic GDP grew by 2.2 percent in the first quarter of 2020. The expenditure and output side structure of the economic growth is not yet known. From the expenditure side household consumption and, to a smaller degree, net exports may have contributed to the growth in GDP, while on the output side, accordingly to the preliminary release by HCSO, market services and industry supported growth. Domestic investment ratio dynamically rose during recent years, as a result of which in 2019 it stood at 28.6 percent, well above the average of the European Union and the countries of the region. All three sectors (corporations, government, households) made positive contributions to the rise in the investment rate. Growth in investments was considerably supported, in addition to the double-digit corporate loan dynamics realised in a favourable financing environment, by the central bank's programmes (FGS fix, BFGS). The expansion of household consumption was also fuelled by favourable trends in income, household loans – in part related to the prenatal baby support scheme – as well as by the high level of net financial worth and robust consumer confidence.

The Hungarian economy is still characterised by strong fundamentals. In addition to robust economic growth of the previous years, both household savings rate and the business investment rate stabilised at high levels, while the country's net lending remained persistently positive, and thus Hungary's external debt fell to a historic low – to roughly 8 percent of GDP – by the end of 2019. As a result of a disciplined fiscal policy, budget deficit is low, remaining around 2 percent of GDP over the past several years; and the government debt-to-GDP ratio has fallen continuously as well. In addition, the foreign currency ratio of the government debt has also significantly decreased in recent years.

In the short run, the coronavirus and the economic impacts of that may be regarded as the greatest risks. The pandemic hit the global economy in a weakened state (growth in 2019 hardly exceeded the recession threshold of 2.5 percent) and its negative economic effects appeared simultaneously in a wide range of countries due to the isolation measures and productions stoppages implemented as a result of the virus, and to the global interpenetration. The degree and protraction of the slump is also indicated, among other things, by the fact that global tourism has practically stopped, manufacturing expectations deteriorated further in April after the low registered in March in the large European economies and the countries of the region (Chart 2). There is currently an exceptionally large degree of uncertainty in judging the potential macroeconomic consequences and their time profile. Domestic vehicle plants – and several major actors of the supplier network – restarted production at the end of April/beginning of May after the stoppage for several weeks, while in parallel with the gradual easing of the restrictive measures hotels may reopen in May. However, as a result of the forced leaves and shop closings, performance of the domestic economy considerably declined in the second quarter.

Chart 2
Developments in the manufacturing purchasing manager indices



Note: Based on seasonally adjusted data.
Source: Bloomberg

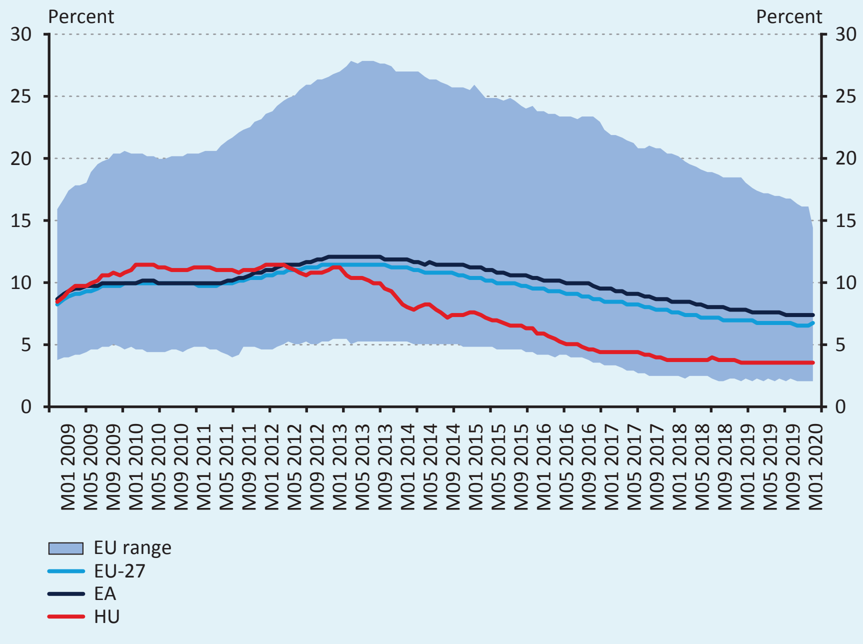
1.1.2 Labour market

The labour market of the European Union is characterised by a high degree of heterogeneity. Greece and Spain still have double-digit unemployment rate, while in the Czech Republic the ratio of the unemployed within the economically active population is merely 2 percent. In January 2020, the unemployment rate of the euro area stood at 7.4 percent (Chart 3).

In the past years, following a persistent and substantial growth in employment, the Hungarian labour market almost achieved full employment. In Hungary the unemployment rate stood at 3.4 percent in 2019, representing a historic low. However, in the first quarter of 2020, domestic unemployment rate (based on seasonally adjusted data) rose to 3.6 percent, representing a quarter-on-quarter growth of 0.2 percentage point. The small rise, despite the coronavirus pandemic, is due to the fact that those who lost their job did not look for new job actively, and thus the Labour Force Survey – in accordance with the international standard methodology – registered them as economically inactive rather than as unemployed persons. However, looking ahead further major growth may be expected in unemployment.

Due to the tight labour market conditions, nominal wages have increased at a rate over 10 percent for already three years. On the other hand, in January and February 2020, compared to previous years, both the national economy and the private sector were characterised by moderate, single-digit wage dynamics. Bonus payments falling short of the values registered in previous years also contributed to this. Further uncertainties in the development of wages include the lengthy corporate wage negotiations in the first quarter of this year and the economic impacts of the coronavirus pandemic.

Chart 3
Unemployment rates in the European Union



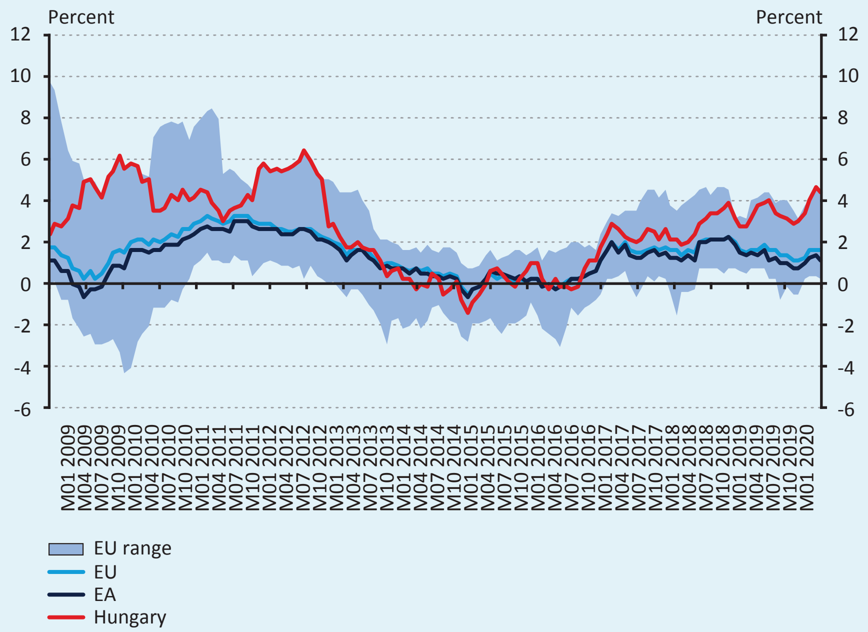
Note: Based on seasonally adjusted data.
Source: Eurostat

Forecasting the labour market trends in the current situation is also difficult. In the past months the number of people in employment decreased due to the coronavirus (particularly in the sectors affected by the isolation measures and production stoppages, and in the case of employees with fixed-term employment contract or spending their probationary period), corporations responded to the extraordinary situation in addition to the layoffs also in other ways (temporarily reduced working hours, more flexible employment and sending employees collectively on leave). In addition, the less favourable economic environment is also likely to influence wage setting. If corporations decide to pay lower wage supplement and bonus, it may further decelerate wage dynamics, while the widely announced state wage and job retention subsidies and schemes may provide support to the market.

1.1.3 Inflation developments

In the first months of the year, inflation remained moderate in the euro area as a whole. In most of the Member States the consumer price index remained below the 2-percent central bank target. Inflation, which in January reached 1.4 percent as a result of the increase in food and fuel prices, was by more than 1.0 percent lower in April, merely 0.3 percent. This was mainly attributable to the major fall in fuel and energy prices. At the same time, in the countries of the region, the rate of the increase in consumer prices in the first months of the year exceeded the central bank targets. Growth in inflation is primarily attributable to the volatile food and fuel prices; however, in addition to the temporary factors, strong domestic demand in the countries of the region also contributed to rising consumer prices. Due to the major decrease in fuel prices – in line with the changes in world market oil prices – in the spring months the inflation rates of the region countries returned or came close to the central bank tolerance bands (Chart 4).

Chart 4
Annual change of the harmonised index of consumer prices



Source: Eurostat

Last year, inflation in Hungary remained within the central bank's tolerance band, at 3.4 percent. However, in the first two months of 2020, due to the items strongly exposed to the world's commodity market conditions, characterised by highly volatile prices (food and fuel), it temporarily climbed above the central bank's tolerance band. In the months of spring, inflation considerable declined, and in April its year-on-year value was 2.4 percent. This is due to the major decline – 22.7 percent year-on-year – in fuel prices. Core inflation excluding indirect taxes moderately rose at the beginning of the year due to the growth in the prices of processed food and market services, and thereafter it stood on average at 3.8 percent. In the past months, the MNB-indicators capturing longer-term inflationary trends (the price index of demand sensitive products and the inflation of sticky-price products and services) remained practically unchanged.

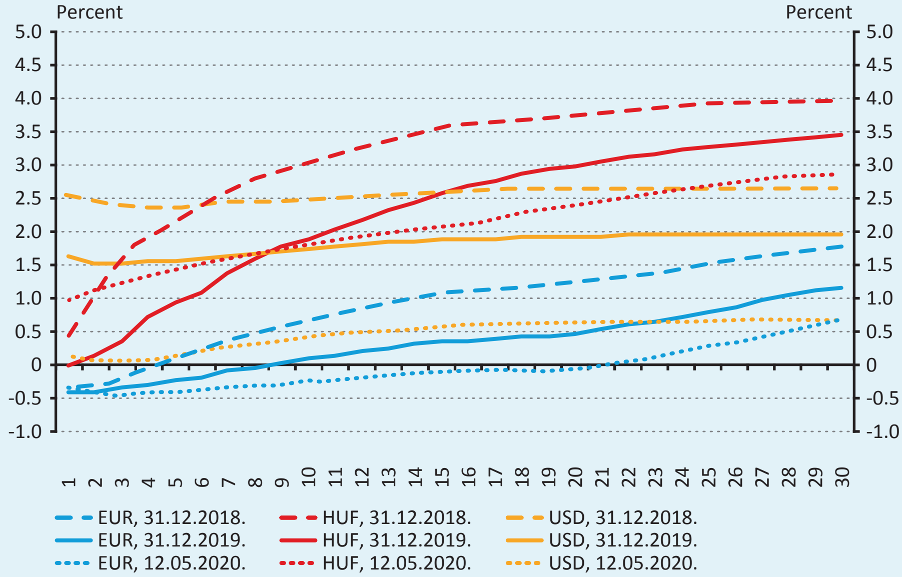
As the impacts of the coronavirus pandemic on the economy are unpredictable, there is significant uncertainty about the future development of inflation. As a result of the pandemic, commodity prices materially declined. The fall in oil prices – from USD 60/barrel registered at the beginning of the year below USD 30/barrel – is also explained by supply factors (failed negotiations on production cut) in addition to the declining demand. On the other hand, the world market price of the Brent crude oil was stabilised thanks to the OPEC+ countries reached an agreement on the cut of oil production at the beginning of April, which entered into force from 1 May. The inflation effect of the fall in oil prices was only slightly offset by the temporarily increased demand for certain essential articles (stockpiling); in addition, the temporary supply problems and disturbances in the global value chains temporarily increased the prices of some imported foodstuff, and looking ahead, may increase them further. It should be emphasised that in Hungary the weight of articles susceptible to cost fluctuations – unprocessed food and fuel – is significant by EU standards (13.1 percent in total), and thus occasional food or fuel price shocks have material impact on the developments in the consumer price index.

1.1.4 Indirect effect of the low yield environment

In addition to the macroeconomic developments, the low yield environment may also represent substantial risk for, amongst others, the European insurers. On the one hand, in the low yield environment (particularly if it declines further) the reinvested instruments' yield may fall short of the guaranteed yield levels in the already existing contracts. On the other hand, the decline of the risk-free interest rate term structure (RFR[8]), relevant for the purposes of reserve calculation, increases – through the discount effect – the institutions' Solvency II (hereinafter: S2) reserve. The growth in reserves reduces insurer' available solvency capital, and thus it may have negative impact on the capitalisation level.

During 2019 the RFRs decreased for the currencies relevant for the Hungarian insurance sector (EUR, HUF, USD) (Chart 5). However, at the beginning of 2020 the HUF RFR flattening – it rose at the short end and declined at the long end – while in the case of EUR and USD further decline is observed. Due the change of a different degree than that observed in developed countries, the risks of Hungarian insurers may have changed moderately, while the pressure on their parent companies – operating in Europe – increased in terms of maintaining their capital level and fulfilling their obligations.

Chart 5
Changes in the risk-free interest rate term structure



Source: EIOPA

1.1.5 Hungarian market yields are higher than those in most of the EU countries

For the insurance companies government securities are the instruments that represent the lowest risk. The developments in the yields on these substantially influences the institutions' capitalisation level and the fulfilment of the returns promised in the contracts. Government bonds differ by return at maturity and by country depending on the economic maturity and euro area membership (Table 1). In the more developed economies, government bonds with negative yields are available for most of the maturities (Germany, the Netherlands, Denmark, Switzerland). At the euro area members with

[8] RFR is the risk-free interest rate term structure used for the calculation of technical reserves

less developed economy (e.g. Ireland, Italy, Spain, Slovakia) insurers can still purchase long-term government bonds (from 10 and 15 years) with positive interest. Yields are somewhat higher in the countries deviating from the majority due to special reasons (e.g. Greece, United Kingdom) and in the developing, but non-euro area members (e.g. the Czech Republic, Poland, Hungary), which may make it easier for the local institutions to provide the guaranteed interest.

In the first months of 2020, yields on government securities varied by country groups. Those in the developed economies generally declined (e.g. in Germany and in the Netherlands the yield on 20-year maturity also turned negative), while the less developed euro area members registered a moderate rise in yields. In the developing countries of the EU outside the euro area yields usually rose (with the exception of the Czech Republic).

Table 1
Government bond yields by maturity

		1Y	2Y	5Y	10Y	15Y	20Y
EU - euro area	Austria	-0.292	-0.565	-0.451	-0.114	0.842	0.197
	Belgium	-0.522	-0.512	-0.311	-0.077	0.4394	0.676
	France	-0.486	-0.512	-0.376	0.017	0.339	0.556
	Germany	-0.641	-0.723	-0.730	-0.508	-0.327	-0.204
	Ireland	-0.456	-0.492	-0.162	0.190	0.459	0.628
	Italy	0.320	0.728	1.393	1.973	2.367	2.704
	Netherlands	-0.620	-0.650	-0.566	-0.289	-0.117	-0.026
	Portugal	-0.370	-0.285	0.230	0.883	1.282	1.608
	Spain	-0.374	-0.242	0.195	0.801	1.179	1.467
EU - non euro area	United Kingdom	0.054	0.026	0.046	0.243	0.522	0.664
	Bulgaria	-0.252	-0.211	0.177	1.055	-	-
	Czech Republic	-0.046	0.126	0.446	0.832	1.083	1.368
	Denmark	-0.497	-0.536	-0.504	-0.301	-0.089	0.0522
	Hungary	0.949	1.104	1.471	1.937	2.226	-
	Norway	-0.005	-0.020	0.022	0.304	-	-
Others	United States	0.136	0.159	0.337	0.641	0.851	1.191
	Japan	-0.181	-0.179	-0.135	0.008	0.240	0.381
	Switzerland	-0.717	-0.716	-0.681	-0.549	-0.406	-0.381

Note: Reference date: 31.05.2020
Source: EIOPA

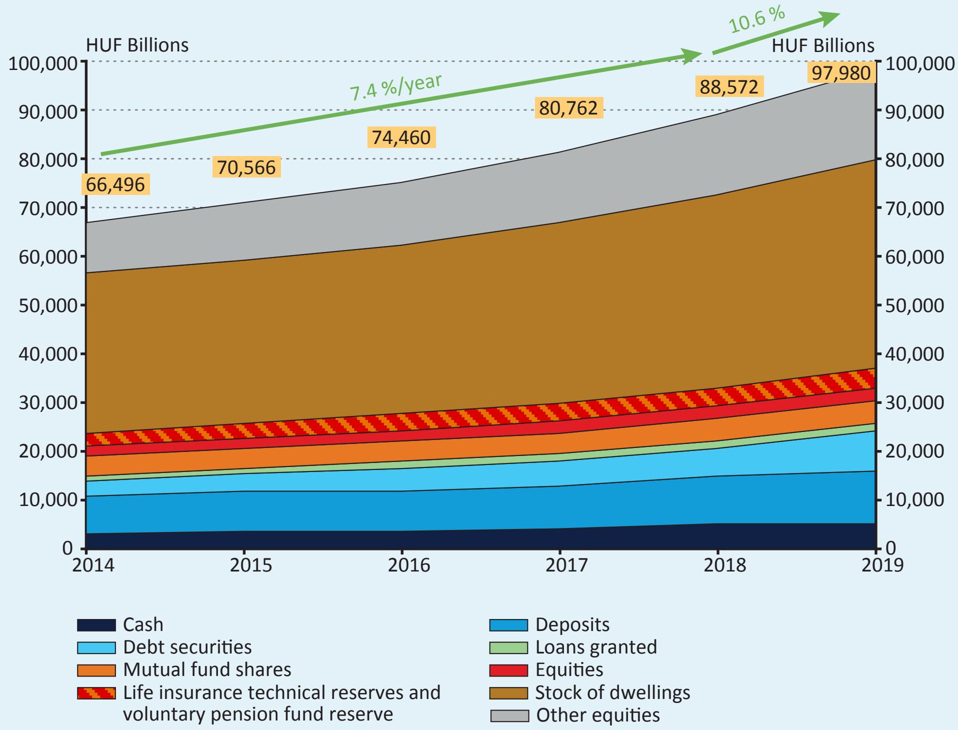
The yields and related risks presented above mostly affect the domestic insurance sector indirectly. The Hungarian institutions are subsidiaries almost without exception, the parent companies of which may also adjust the activity of the institutions in Hungary in order to ensure their own operation. On the one hand, upon an increase in the parent companies' capital requirements, withdrawal of capital from the Hungarian institutions through dividend payments exceeding the profit of the year may occur as an option. This effect may be mitigated by the MNB's recommendation on the maintenance of a volatility capital buffer, which prescribes a capital adequacy of 150 percent by default. On the other hand – in extreme cases – companies that are under strong group governance already now, may be transformed into branch offices, as a result of which not only the capital of the institution, but the direct oversight is also moved to another country.

1.2 DEVELOPMENTS IN HOUSEHOLDS' SAVINGS

1.2.1 Gross assets of households grew to almost HUF 100,000 billion

By the end of 2019, gross assets of households, comprising financial instruments and the stock of dwellings, approximated HUF 98,000 billion, which represents a year-on-year growth of 10.6% (Chart 6). In the past one year, the biggest contribution to the growth in assets was made, in addition to the stock of dwellings, by the rise in the value of debt securities and other equity (by HUF 7,600 billion in total, they accounted for 81 percent of the total growth). The most dynamic growth was registered by debt securities (38.5 percent), but shares and other equity also increased considerably (by 13.7 and 13.0 percent, respectively). The prior mentioned trends are attributable to the favourable economic processes that took place before the end of 2019 and to the rise in wages, as a result of which shares and other equity generated more favourable investment result compared to other assets. The soar in debt securities was greatly attributable to the mid-year issuing of Hungarian Government Securities Plus.

Chart 6
Developments in the gross assets of households



Note: The 2018 and 2019 data related to the stock of dwellings are MNB estimates.
Source: HCSO, MNB

In terms of liquidity, the growth in the stock of assets that may be liquidated in the short term (cash and deposits) fell short of the average (by 8.3 and 6.9 percent, respectively). The ratio of the assets that may be liquidated in the medium term (debt securities, mutual fund shares and equities) rose by 1.3 percentage points in 2019. At the same time, the ratio of limited liquidity assets (other equities, loans granted and stock of dwellings) decreased to a lesser degree, by 0.7 percentage point (to 64.2 percent).

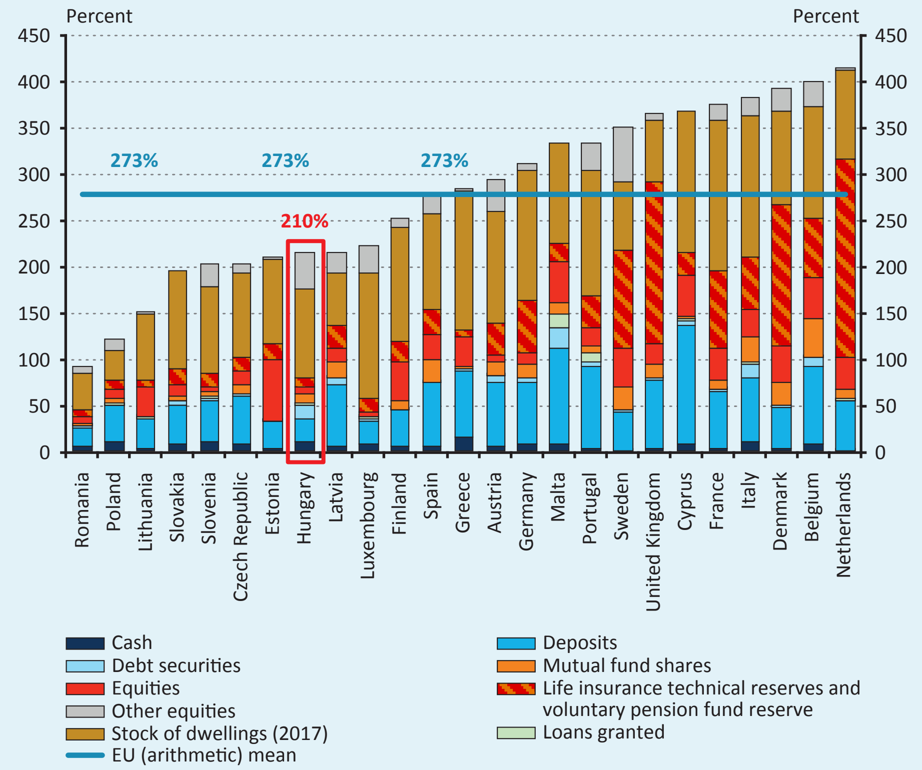
The life insurance and voluntary fund reserves, serving as means of long-term wealth accumulation, rose by almost the double of previous years' average (by 8.5 percent). As a result of the growth rate – being greater than before, but lagging behind the average of total wealth of households – the share of the asset category decreased to 3.9 percent, while within the gross financial assets of households[9] to 7.0 percent. As a result of the persistently favourable economic activity, in 2019 self-provision based on longer term products has presumably commenced among a broader range of households. The below-average dynamics may be partly attributable to the higher yield realisable and dynamic appreciation in other categories (e.g. equities). However, looking ahead, as economic growth is likely to come to a halt as a result of the spread of the coronavirus (COVID-19), it may lead to the depreciation and liquidation of assets, thereby reducing their portfolio.

[9] Financial assets here corresponds to total assets net of the stock of dwellings.

1.2.2 Gross assets to GDP ratio exceeding the regional average

Gross assets of Hungarian households amounted to 210 percent of GDP in 2018 (Chart 7), which put them to the edge of the last quarter of the European Union. The average of the gross assets of households within the EU – calculated with the arithmetical average of the countries – is 273 percent. The average for the countries of the region (the Czech Republic, Poland and Slovakia) is 169 percent, thus the assets of Hungarian households are higher – relative to their economic development – than that of countries of similar development level. At the same time, the Western European countries (e.g. Belgium, Denmark, the Netherlands, Italy) continue to have substantially higher assets compared to the Visegrad Group countries (these four countries have an average of 390% more).

Chart 7
Gross assets of EU households as a percentage of GDP, in 2018



Note: The stock of dwellings data relate to 2017.
Source: Eurostat

According to the GDP ratios of the individual categories, Hungary is still in the vanguard of holding cash and other equities (ranked 2nd among the countries of the EU in both categories). In terms of debt securities and loans granted, it also finished in the first three (ranked third in both cases). By contrast, in terms of deposits, equities, and life insurance and voluntary pension fund reserves Hungary is at the end of the ranking (ranked 23rd -24th in 2018). Hungarian households hold their assets in mutual fund shares (ranked 13th) and real estate (ranked 15th) around the average. On the whole, it is obvious that the ratio of highly liquid assets (cash) and assets of limited liquidity (other equity and loans) is outstanding by EU standards. On the other hand, the low ratio of assets for long-term wealth accumulation within the EU may show room for manoeuvre in the utilisation of the financial intermediary system, which may be enhanced by improving financial awareness.

2 The insurance market and its risks

2.1 OVERALL PICTURE OF THE MARKET

In 2019, the entire Hungarian insurance sector comprised of 33 supervised institutions, of which 22 insurers fall within S2. As regards the institutional form of the insurers 21 (20+1) of them operate in the market as joint-stock company, 2 institutions as large insurance union and 10 as small insurance union. Due to their size or activity 1 insurance joint-stock company and the 10 small insurance unions fall outside S2. Of the 22 institutions that fall within S2, based on the insurance segments there are 5 life insurers, 9 non-life insurers and 9 composite insurers. With effect from 1 July 2019 Ergo Életbiztosító merged with Generali Biztosító Co. as a result of which the number of life insurers decreased by 1 compared to the previous year. In 2019, premium income at sector level was HUF 1,150 billion, representing a year-on-year growth of 12.3 percent. The growth in premium income of the life segment (+ 7 percent) and the non-life segment (+17 percent) contributed to this in a proportion of 30-70.

Premium income in the non-life segment rose by 17 percent compared to the previous years, with some contribution to this by the insurance tax effective from 2019; however, presumably the segment would have realised a double-digit growth even without this. Also taking into consideration the Hungarian branch offices of insurers with registered office abroad, the premium income of the insurance sector is HUF 1,230 billion. The share of branch offices within the total premium income (6.4 percent in 2019) rose by 2.4 percent compared to the previous year. In 2019, the rise in the number of policies (+3.1 percent) fell short of the growth in premium incomes compared to the previous year. The growth is attributable almost in full to the non-life segment, which grew by 4.0 percent compared to previous year, while the life segment registered a decline of 1.2 percent. One reason for this may be that in the low yield environment Hungarian households gave preference to satisfying other consumer needs (e.g. home purchase) or to other forms of investment. The decrease in the number of life insurance policies may be partly attributable to ethical life insurance regulation, which, however, results in a more balanced structure and better retention rate. Hungarian insurers' return on equity at sector level (ROE in 2019: 24.2 percent) seems to stabilise in the last three years at a very high level, around 24 percent. Return on equity under S2 also shows a favourable picture (S2 ROE – 13.4 percent). Based on the shifts and profitability trends, an extremely positive picture unfolds in respect of the insurance sector, both at the level of institutions and the entire insurance sector.

Table 2
Key data of the insurance sector[10]

	2018	2019		
	Total	By institutions type		Total
Number of institutions*	33	Total S2 insurers	22 ↓	32 ↓
		Life	5 ↓	
		Non-life	9 –	
		Composite	8 –	
		Small insurance union	10 –	
	Total	**Life segment**	**Non-life segment**	**Total**
Premium income (HUF billions) *(including branch offices)*	1 024.1 *(1 067.2)*	*510.0* ↑ *(535.9)* ↑	*640.5* ↑ *(693.7)* ↑	*1 150.5* ↑ *(1 229.5)* ↑
Number of contracts (thousand pcs) *(number of contracts per capita) ***	13 918 *(1.46)*	2 361 ↓	11 993 ↑	14 354 ↑ *(1.47)* –
Technical provisions (HUF billions)	1 991.0	1 889.1 ↑	304.3 ↑	2 193.4 ↑
Balance sheet total (HUF billions)	2 715.4			2 932.1 ↑
Eligible own funds (HUF billions)	538.0			571.7 ↑
Capitalisation level (per cent)	216			204 ↓
Profit before tax (HUF billions)	72.7			81.0 ↑
Return on equity (ROE)	23.9%			24.2% –
Return on solvency capital (S2-ROE) ***	13.4%			13.3% –
	Small insurance unions			
	2017	2018 ****		
Number of institutions	16	10 ↓		
Premium income (HUF millions)	456	459 ↑		
Number of contracts (pcs)	1 088	1 001 ↑		
Return on equity (ROE)	8.0%	11.7% ↑		

Notes:
** The number of institutions does not contain one supervised joint-stock company falling outside S2.*
*** The ‘number of contracts per capita’ indicator was calculated by the total population data available on website of HCSO..*
**** In case of the S2-ROE indicator, the profit after tax was divided by the Solvency II eligible own funds.*
***** The 2019 data of the small insurance unions is not yet available.*
Source: MNB

2.1.1 The desirable trends have not started in all areas

In February 2018, the MNB published its paper entitled “10-year future of the insurance sector in 7 points” (hereinafter: FIS) on the future trends envisaged in the insurance sector (and partially the voluntary pension funds). The points included in the publication contain desirable trends and objectives formulated as expectations, which – as a sector-level strategic plan – may also serve as a guideline for market participants. Similarly to the previous year, we present developments in the FIS target figures in this year’s publication as well, evaluating those by the 10-year target values and the projected paths (all this is summarised in Table 3)[11].

[10] The publication contains unaudited data for the end of 2018.
[11] Upon backtesting considering the actual macroeconomic figures as necessary.

Table 3
Target values and actual data of the insurance sector

Objective to be achieved	Target variable	2018 actual data	2019 actual data	2026 target value
1. Wide-ranging self-provision *More savings, greater security*	life insurance and voluntary pension fund contracts/economically active persons	54.0%	**52.8%**	over **80%**
	ratio of reserves as a percentage of GDP (life technical reserve + voluntary pension fund individual accounts)	7.62%	**7.46%***	over **10%**
2. Market size convergence *Back to the forefront of the region*	Penetration (premium income/GDP)	2.43%	**2.46%***	over **3.0%**
3. Competitive market *Increasing competition*	Share of TOP5	59.9%	**59.5%**	below **55%**
4. Efficient sales *Half of sales over an innovative channel*	ratio of innovative channels	33% (2017)	**34%** (2018)	over **50%**
5. Economies of scale *Institutions operating more cost efficiently with dropping margins*	ACR values of UL contracts	0.53-9.97%	**0.92-5.52%**	**0.5-5.75%** steadily
	non-life combined ratio (net of tax)	78.2%	**80.5%**	**85-90%** steadily
	cost ratio	30.0% (2018)	**29.5%**	**20-30%** steadily
6. Fair and competitive profitability *Long-term confidence and stability*	ROE	23.8%	**24.2%**	**10-15%** steadily
7. Well-capitalised insurers Safe and prudent operation	capitalisation level	216%	**204%**	**>150%** steadily

dynamic path	**positive path**	**moderately positive path**	**negative path**

Note: Those actual data were classified into the 'moderately positive path' category whose direction of change was the same as the target, but their extent is below the projected path or their growth did not reach the growth of GDP. Values marked with an asterisk were evaluated according to trends projected in the publication.
Source: MNB

The coverage of life insurance and voluntary pension fund contracts fell in 2019 by 1.2 percentage points (to 52.8 percent). The number of contracts almost corresponds to that in 2016, but due to the rise in the number of the economically active persons the coverage rate became lower. For the time being no success was achieved in reaching the potential candidates for self-provision, or in the low yield environment the satisfaction of other consumer demands (e.g. home purchase) may have taken priority.

Despite the decrease in the number of contracts, life insurance reserves and voluntary pension fund reserves grew by 7.3 percent[12] (by HUF 237 billion) in 2019. Despite the low yield environment, the yields realised by the voluntary pension funds remained at a high level, similarly to the period before 2018, and contributed to the rise in savings. In the life insurance segment, the growth in premium income was fostered by the pickup in pension insurances, which may persist due to the long-term nature of the product type. However, of the three paths outlined in FIS, the volume of self-provision savings exceed only the level of the inflation-based trend, which amounted to 7.46 percent of GDP at the end of 2019. The decreasing value of the target variable under increasing volume is attributable to the more dynamic growth in real GDP than projected in FIS.

In 2019, penetration increased by 0.03 percent due to the fact that the growth of the sector exceeded the GDP growth rate. Premium income of insurers rose by almost the double of the growth registered in previous year (by HUF 126 billion), which fell short of the growth of the rising penetration specified for this year. As a result of the foregoing, penetration rose to 2.46 percent, which exceeded the empirical trend designated in FIS by 0.03 percentage point.

[12] Together with the branch offices 8.5 percent.

The share of the TOP 5 market participants in 2019 fell to the level registered in 2016, which differs from the projected path by 2 percentage points. In addition, the Herfindahl-Hirschman Index (HHI) remained essentially unchanged, which – together with the change mentioned above – reflects market acquisition by medium-sized insurers. Nevertheless, the merger of one of the market participants had no material impact on the value of the indicator.

In 2018, the ratio of innovative channels[13] in the composition of the insurance companies' sales channels was 34 percent.[14] This ratio declined further compared to the value recorded in 2016. For the time being, the sector is getting further away from the target of 50 percent projected in FIS. Presumably the incentives that could facilitate the more active use of these channels still have not develop.

Similarly to the previous year, the ACR values of the unit-linked contracts[15], affected by the MNB recommendation, do not depart from the limits specified in the MNB recommendation. There was a slight shift in the case of the highest ACR (from 5.40 to 5.52 percent). It may be necessary to review the justification for the permitted departures from the limits (+1.5 percent), since those are permanently utilised.

The sector-level combined ratio of non-life insurances rose year-on-year, and thus it came closer to the designated target band. However, despite the rise, the sector failed to make a significant shift from the level of 2016. This is caused by the fact that premiums followed the changes in claims and costs well, while there was still room for stimulating competition in the non-life segment.[16]

There was a shift of 0.5 percentage point in cost ratios in 2019 compared to the previous year and based on the sector level average it once again fell below 30 percent. The latter falls within the designated target band of 20-30 percent; however, insurers achieved this result not in the desired composition. While the 20 percent target level was realised in the life segment, the non-life segment is still characterised by a cost ratio of well above 30 percent.

The profitability of the sector remained in 2019 at a similar level as in the previous two years, which represented materially higher return on equity (ROE) than the designated target band (10-15 percent). For the time being nothing suggests that the increasing trend would turn into decrease and approach the target band.

As regards the sector-level capitalisation level, the designated target of over 150 percent was realised, similarly to previous years. The capitalisation level of almost half of the institutions exceeds 200 percent, and only one institution's capitalisation level was below 150 percent at the end of 2019. The breakdown of the institutions' capital position serves as a good foundation for the sector's safe and prudent operation.

2.1.2 Premium income reached HUF 1,200 billion

In 2019, the premium income of the insurance sector was HUF 1,150 billion in total, which is a 12.3 percent increase compared to the previous year (Chart 8). The dynamic trend of the past two years intensified, since calculated from 2016, in the past 3 years the sector's premium income was able to grow by 9.0 percent on average. In a breakdown by segments, the values rose by 17.0 percent in the non-life segment and by 7.0 percent in the life segment during the year. Growth exceeds that of previous years in both segments, only a part of which was attributable to external factors (in the non-life segment the extension of the insurance tax to the MTPL products).[17]

The growth of the sector exceeded that of the entire economy; accordingly, after the decrease in insurance penetration in 2018, it managed to rise once again in 2019 (by 0.03 percentage point). Accordingly, of the paths specified in FIS, it reached the empirical trend. The penetration rate of 2.46 percent exceeded the inflation-based trend by 0.39 percentage

[13] Innovative channels: bank assurance, direct sales, online intermediation.

[14] Due to the late receipt of the data reporting, the report does not deal with the sales mix of 2019, and thus in this publication we also have only 2018.

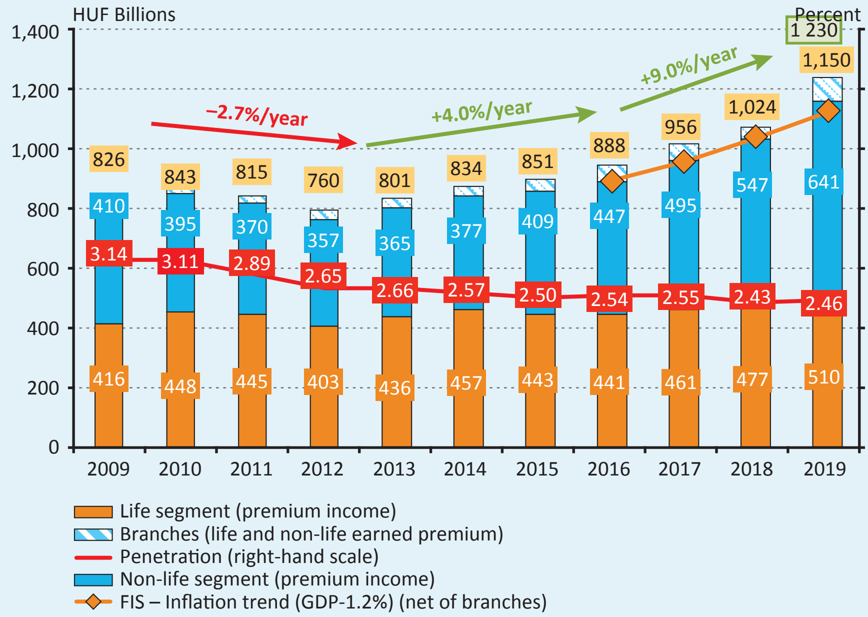
[15] Life insurance contracts with term of 10, 15 and 20 years, and whole-life contracts with term of 15 and 20 years.

[16] In the backtesting, the insurance tax – introduced in 2019 also for the MTPL products – was also taken into consideration relying on the accident tax revenues of 2018 in the central budget.

[17] According to our preliminary estimate, the extension of the insurance tax to the MTPL product may have justified an increment of HUF 37 billion.

point and the empirical trend by 0.03 percentage point. At the same time, it fell short of the rising penetration trend by 0.19 percentage point. For the realisation of the latter on year-on-year basis an additional HUF 17 billion would have been required.

Chart 8
Gross premium income and penetration in insurance sector



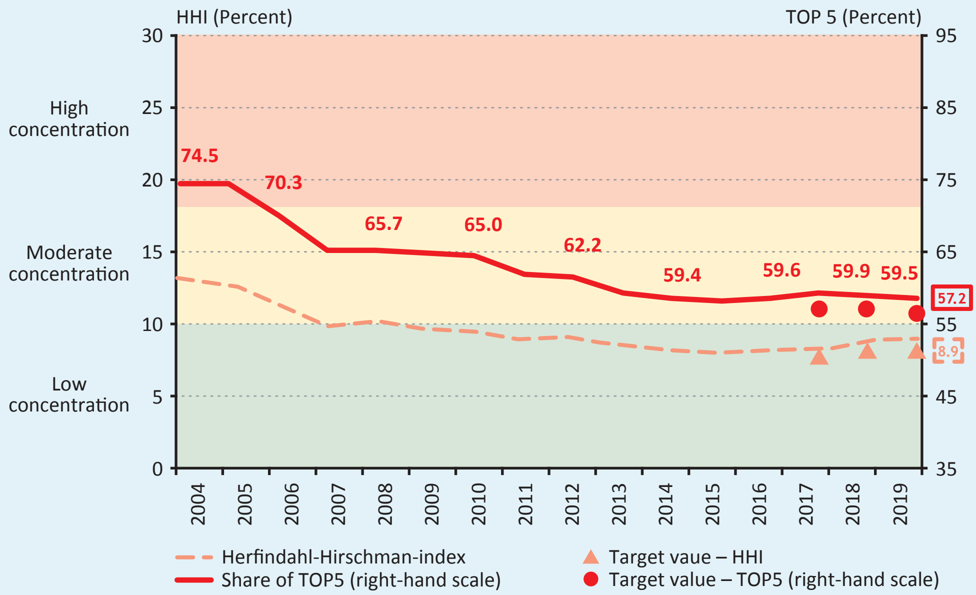
Note: Gross premium income in life and non-life segments, and gross earned premium for branch offices. The total value of the gross premium income at sector level, shown on the chart in a yellow rectangle, does not include the gross premium income of branch offices.
Source: HCSO, MNB

The performance of the insurance branch offices operating in Hungary also form part of the domestic sector. Taking this into consideration, the sector's premium income in 2019 was around HUF 1,230 billion. However, branch offices registered a growth of 17 percent. The dynamic growth may be attributable to the different composition of the branch portfolios than that of the insurance companies registered in Hungary, where non-life insurances account for almost 70 percent of the first.

2.1.3 Despite the merging of one institution, total market concentration moderately decreased.

The aforementioned merger had no material effect on the concentration ratio of the entire market. The share of the TOP5 market participants decreased slightly, by roughly 0.4 percentage point, in 2019, and thus it reached 59.5 percent (Chart 9). On the whole, the TOP5 institutions lost from their market weight both in the life and non-life segments. Only one of them was able to increase its share in the life segment. Medium-sized insurers were able to increase their market weight through the non-life segment. As the combined result of the foregoing, the HHI value also reflects a moderate decline in the concentration, with a change of 0.1 percentage point, and thus for the time being the value of the indicator remained in the low concentration band (below 10 percent). The actual data considerably exceeded the concentration path projected in FIS, but the change in 2019 was in the right direction.

Chart 9
Share of the TOP5 market participants and Herfindahl-Hirschman index (HHI) of the entire sector based on gross premium income



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

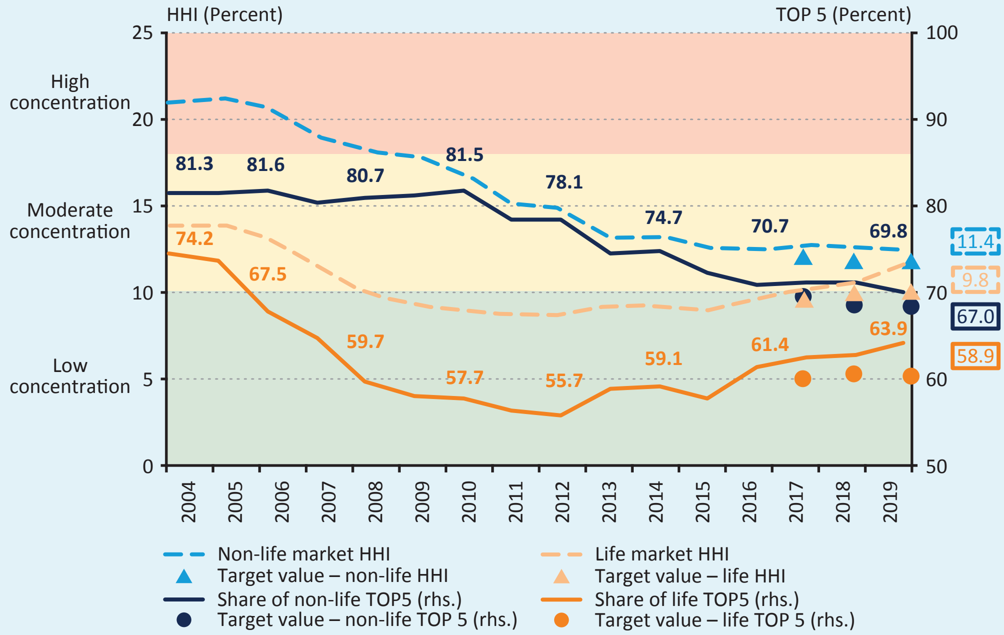
2.1.4 Convergence of the life and non-life segments may be observed in terms of concentration

In 2019, changes of opposite direction took place in the life and non-life segment (Chart 10). In the life segment, the share of the TOP5 institutions rose by 1.3 percentage points, which also contributed to the 0.7 percentage point increase in HHI. The changes were attributable to the outstanding market acquisition by one institution in the area of traditional life insurances, and to the moderate market acquisition by a few other institutions in the unit-linked products. Dominant part of the growth in shares originated from the life insurance premium income, rising across the sector.

On the other hand, in the non-life segment the ratio of the TOP5 insurers fell by 1.2 percentage points, while the HHI declined only moderately, by 0.1 percentage point, in 2019. The medium-sized non-life market participants were able to somewhat increase their share, in addition to the motor insurances (MTPL, casco), also in other product categories (e.g. home insurance, corporate property insurance). The decrease in the share of the market leader composite companies was partly mitigated by the increased MTPL premiums due to the insurance tax.

The actual figures exceeded the life and non-life segments' path projected in FIS. This may be attributable to the cumulated effect, according to which the actual figure exceeded the values in the FIS path in previous years as well. On the other hand, the changes in 2019 in the life segment were of opposite direction, while in the non-life segment they somewhat lagged behind the changes presented in FIS for this year.

Chart 10
Share of the TOP5 market participants and Herfindahl-Hirschman index (HHI) of the entire sector based on gross premium income by segment



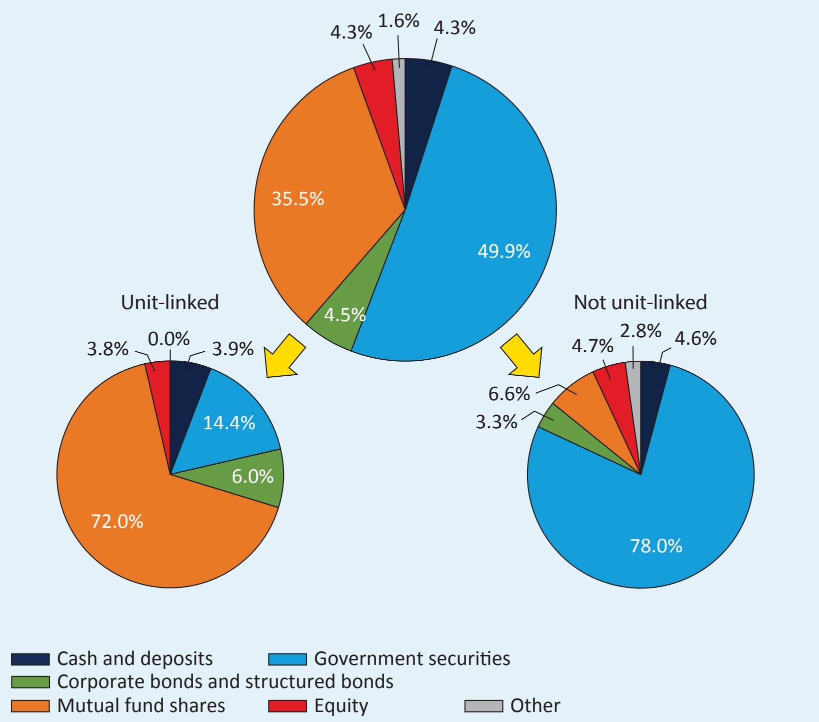
Note: The colour of the background illustrates the strength of concentration under HHI.
Source: MNB

2.1.5 Continued dominance of government securities

The value of the Hungarian insurance companies' total assets significantly grew (by +9.4 percent) in 2019 following the stagnation in 2018. 44 percent of the HUF 2,904 billion covers unit-linked life insurance reserves, while the remaining part comprised instruments underlying traditional life insurance and non-life insurance, as well as the institutions' own assets (Chart 11). 54.1 percent of the insurers' total assets comprised low-risk, conservative instruments (government securities, cash and deposits), which represents a 1.7 percentage point decrease compared to the previous year. The rest of the assets mostly consists of mutual fund shares, equities and corporate bonds (also structured bonds). In 2019, a reallocation of 3.2 percent took place in the composition of the assets underlying the unit-linked reserves between the lower-risk cash, deposit and government securities investments and the higher-risk equities, mutual fund shares, corporate and structured bonds to the benefit of the riskier instruments, thus the share of those rose to 81.7 percent (in the case of unit-linked insurances the risk arising from the change in the price of underlying instruments included in the asset fund is borne by the customer). 78 percent of the investments underlying the reserves for policies other than unit-linked insurance comprised government securities, which continues to be an outstanding ratio, even by European comparison.

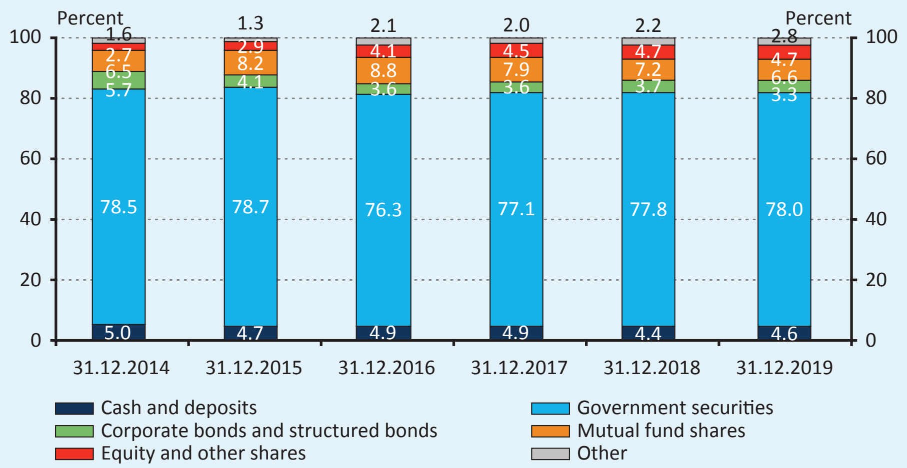
The low interest rate environment seen for many years challenged the insurance sector as well. Until 2016, the composition of the insurers' assets underlying the reserves for policies other than unit-linked insurance was characterised by a rise in the ratio of mutual fund shares and equities to the detriment of government securities and corporate bonds (Chart 12). The slow increase in the ratio of equities continued in 2019 as well. However, following the peak of 8.8 percent of mutual fund shares registered in 2016, it fell by 0.9 percentage point in 2017, by 0.7 percentage point in 2018 and by 0.6 percentage point in 2019. There is still no major realignment in the category of assets underlying the reserves for policies other than unit-linked insurance, which would imply "search for yield."

Chart 11
Asset composition of Hungarian insurers



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

Chart 12
Changes in the composition of assets underlying reserves other than unit-linked reserves



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

Box 1
Due to the fall in the yield of short-term government securities duration rose in the insurance sector

The yield and the market price of bonds move in the opposite direction. The higher the acquisition price of a bond is, the lower yield can be realised on it (assuming holding until maturity). From a different perspective, if the expected return on instruments of similar maturity and risk rises, the respective bond is able to realise this higher yield level, if it is purchased at lower price. The prices of government securities also change in accordance with the yield expectations; accordingly in the case of decreasing yield expectation investors will be willing to buy the respective government securities even at a higher price, while in the case of increasing yield expectations they will buy them only at a lower price. In the end this price increase or decrease will lead to the decrease/increase in real yields until such time as the actual yield approximate the expected level.

In professional terminology, duration is one of the general indicators of the sensitivity of the bond portfolio's price to the change in market yields. Duration is the arithmetical average of the residual maturity of a bond's or bond portfolio's cash flows (interest payment, repayment of the nominal value upon maturity) weighted with the present value of the payments. That is, the number of days until each cash flow must be determined and a weighted average must be calculated from them. For the purposes of the weighting, it must be examined how the present value of the individual cash flows relate to the present value of all cash flows. The modified duration calculated from this shows the change in the value of the bond or bond portfolio upon one-unit change in the market yield.

The lower the value of the duration is – and accordingly also of the modified duration – the less sensitive the bond or bond portfolio is to the change in the market yield, or the higher this value is, the higher its interest rate sensitivity is, and thereby also its riskiness.

In 2018, Hungarian government securities yields increased on all maturities. The largest growth (+ 137 basis points) was recorded on the 5-year maturity. However, during 2019 a decline commenced once again and yields fell back to the level registered at the end of 2017, which meant that the short-term yields fell close to zero (Chart 13). Thus – in accordance with the yield-price correlation described above – while in 2018 the yield increase depreciated the value of the formerly purchased government securities portfolios, in 2019, just in the other way round, the yield decrease appreciated it. Since under the unit-linked contracts the investment risk is borne by the customer, in the following we examine the not unit-linked instruments.

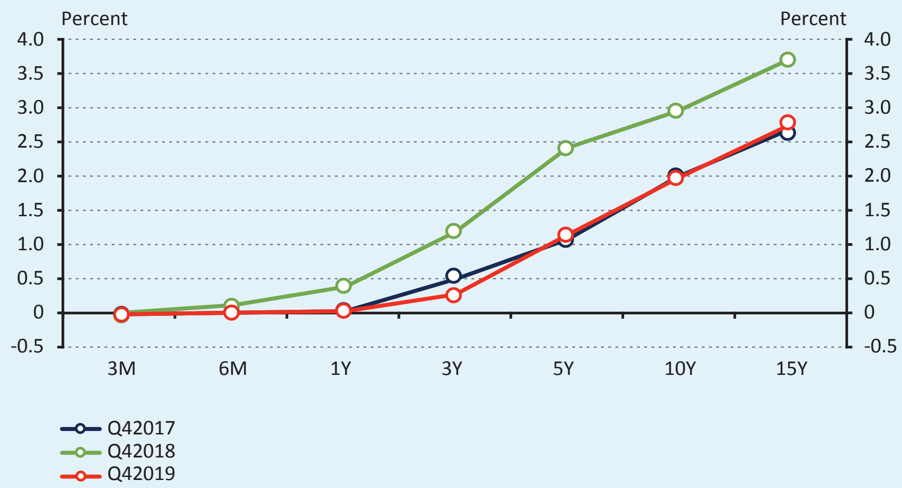
Coverage of not unit-linked life insurance reserves

Fixed-rate Hungarian government securities and discount treasury bills issued in forint account for 76 percent of the investments underlying the not unit-linked reserves of life insurances, and thus the change in the yield environment has considerable impact on the changes in these reserves. On 31 December 2018 the duration value of the sub-portfolio comprising of the aforementioned government securities and discount treasury bills was 5.31 years. In practice this means that an immediate yield change of 1 percent would have caused a price change of 5.15 percent, while an immediate yield change of 2 percent would have already entailed a price change of 10.37 percent. During 2019, the yields on maturities longer than one year fell roughly by 1 percentage point, while the value of the aforementioned sub-portfolio rose by 5.6 percent. It is clear that the value of 5.15 percent, calculated by the duration and the actual change are close to each other; the difference is mostly due to the fact that the yield change did not occur immediately, but gradually during the year, and apart from yield result, new capital investment also has a role. The fall in the yields on maturities less than one year close to zero caused a decline in the demand for discount treasury bills and only roughly 75 percent of the expiring instruments were renewed. As a result of the decreasing ratio of short-term government securities, by the end of the year, the duration value of the aforementioned sub-portfolio rose only by slightly more than one quarter, to 5.62 years.

Coverage for non-life insurance reserves

Fixed-rate Hungarian government securities and discount treasury bills issued in forint account for 65 percent of the investments underlying the non-life insurances, and thus the change in the yield environment has considerable impact on the changes in these reserves. On 31 December 2018 the duration value of the sub-portfolio comprising of the aforementioned government securities and discount treasury bills was 4.66 years. In practice this means that an immediate yield change of 1 percent would have caused a price change of 4.55 percent, while an immediate yield change of 2 percent would have already entailed a price change of 9.11 percent. During 2019, the yields on maturities longer than one year fell roughly by 1 percentage point, while the value of the aforementioned sub-portfolio rose by 8.99 percent. It is clear that there is a major difference between the value of 4.55 percent, calculated by the duration and the actual change, which is due to the fact that in addition to the price change new capital investment also considerably increased the portfolio value. The fall in the yields on maturities less than one year close to zero had no material effect on the size of discount treasury bill portfolio. The duration value of the sub-portfolio comprising of fixed interest rate Hungarian government securities and discount treasury bills issued in forint increased by less than 1 month to 4.72 years.

Chart 13
Development of reference yield curve



Source: MNB

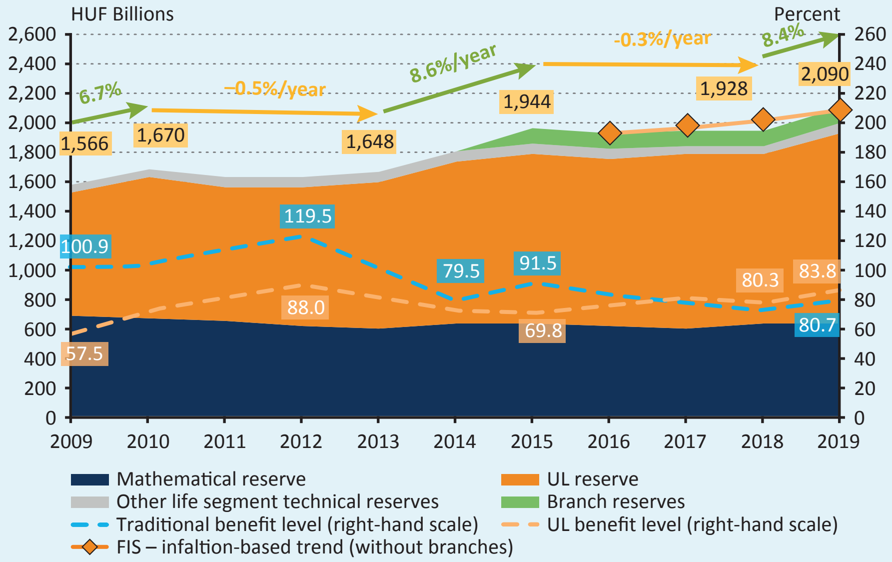
2.2 LIFE SECTOR

2.2.1 More slowly increasing reserves in the inflation-based trend

At the end of 2019, the life insurance accounting technical reserves (hereinafter: life insurance technical reserve) amounted to HUF 1,982 (including the branch offices: HUF 2,090) billion, which represents a significant – 8 percent (including branch offices: 8.4 percent) – growth compared to the previous year. The largest contribution to the growth in the life insurance reserves was made by the growth in the reserves of unit-linked (hereinafter: UL) products, which also follows from its proportion. The faster growth in the unit-linked reserves is partly due, in addition to the favourable premium and benefit trends, to the fact that these also include riskier assets (equities, investment funds), on which higher yield can be realised. Meanwhile, the assets underlying the reserves of traditional products, mostly comprise of risk-free assets, the yield on which is lower and lower. The largest part of the life insurance reserves (64.8 percent without branch offices and 61.5 percent with branch offices) is still linked to unit-linked products, and this ratio rose by 1.9 (together with the branch offices by 1.6) percentage points compared to the previous year. Mathematical reserves account for 32.1 percent (including the branch offices: 30.4 percent) of the life insurance reserves. The ratio of the life insurance reserves of the branch offices operating in Hungary is negligible (5.2 percent); the remaining 3.1 percent (2.9 percent together with the branch offices) of the reserves is linked to other life insurance reserves. [18] The reserves of unit-linked products rose by 11.3 percent (+ HUF 130.1 billion), the mathematical reserve rose – below the rate of the entire of life segment reserve – by only 2.1 percent (+ HUF 13.0 billion), while the other life insurance reserve rose by 7.6 percent (HUF 4.3 billion) compared to the previous year.

When examining changes in the life insurance reserves based on time series (without the reserves of branch offices), we identified several phases. (Chart 14) Between 2009 and 2010, growth rate of life insurance reserves was 6.7 percent. Growth was broken by the withdrawal of funds resulting from the early repayment of foreign currency loans at a preferential exchange rate; as a result of this, in the period of 2010-2013, life insurance reserves stagnated (annual average growth rate: -0.5 percent). From 2013 demand for life insurances once again increased due to the tax changes, which entered into force then. In terms of taxation, the advantage of the insurance became very significant. In the period of 2013-2015, the average annual growth of life insurance reserves was 9 percent. As a result of the tightening regulation related to the commission of intermediaries, the inflation and the low yield environment, life insurance reserves stagnated in the period of 2015-2018, which was broken by the growth in reserves observed in 2019. Hopefully this is the harbinger of the positive trend in the coming period. In FIS, three potential paths were projected with regard to developments in the self-provision reserves: inflation-based, empirical and international trend. In the case of the inflation-based trend, the amount of the reserves, without the branch offices, would be almost HUF 2,074 billion by the end of 2019, of which the level of the life insurance reserves fell short by a little less than HUF 100 billion.

Chart 14
Developments in life insurance reserves and the related insurance benefit levels



Note: Benefit level is the ratio of (loss payment until 2015) loss expenditure from 2016 and gross premium. Premium of branches has not been taken into consideration in calculation of benefit levels. Total value of life segment technical reserve, figures indicated in the yellow rectangle, includes reserves of the branch offices. The other life insurance technical reserve includes the following reserve components: Unearned premium reserve, outstanding claim reserve, reserve for premium refund depending on and independent of the profit, claim fluctuation reserve, extreme loss reserve, cancellation reserve and other technical reserves. The chart shows the Q4 data for each year.

Source: MNB

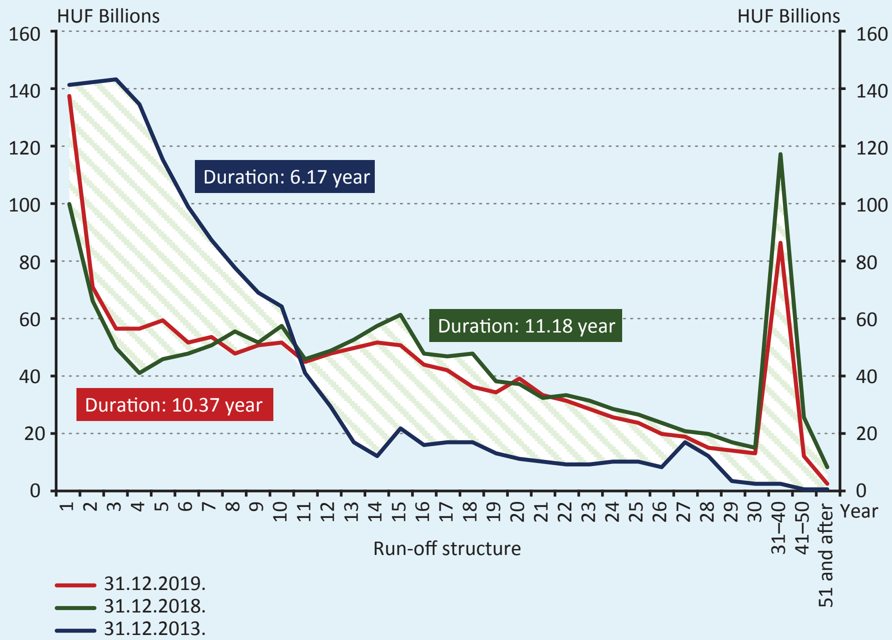
[18] Other life insurance reserves include the following reserve components: unearned premium reserve, outstanding claim reserve, reserve for premium refund depending on and independent of the profit, claim fluctuation reserve, extreme loss reserve, cancellation reserve and other reserve components.

Box 2

More cautious expectations with regard to the retention of unit-linked contracts

At the end of 2019, the duration of the unit-linked insurances calculated based on the maturity structure, declined to 10.37 years (Chart 15). The time weighted average of the estimated liabilities rising from unit-linked insurances[1] has been continuously increasing from 2013; this growth broke by the end of 2019. In the period of 2013-2018 the estimated run-off of the cash flows gradually decelerated and became balanced. In 2013, the duration of the unit-linked portfolio was 6.17 years and half of the estimated cash flows ran off by the 5th year and 90 percent thereof by the 17th year. By 2016, time weighted average of the liabilities already reached 8.58 years, and the continuous rise observed in the past years reached its maximum in 2018 (11.18 years). According to the approximations of 2016, 90 percent of the liabilities of the sector-level unit-linked portfolio materialised in the 25th year, while in 2018 already in the 30th year. The improvement in the balance of the cash flows was reflected by the fact that while in 2013 after the 30th year insurers practically had no considerable liability, from 2016 according to the insurers' expectations the estimated cash flow allocable to the period between years 31 and 40 year became larger and larger [2].

Chart 15
Run-off structure of the unit-linked life insurances at the end of 2013, 2018 and 2019



Source: MNB

Based on preliminary data, this growth dynamics broke by the end of 2019: compared to 2018, the estimated liability in the first year rose by HUF 38 billion (37 percent) by the end of 2019, which is almost fully attributable to two institutions. Primarily as result of this the cash flow run-off at the end of 2019 mostly resemble the 2017 dynamics, while the long liabilities (after the 23rd year) in 2019 fall short of both 2018 and 2017 (Chart 15).

The average age of the contracts terminated in 2018[3] in case of the regular premium, non-pension unit-linked products was 7 years, representing an improvement of 0.2 year compared to 2017. Differences may arise between the certain insurance companies due to the special features of the product portfolio and the cost structure, therefore the institutional values can vary between 3.7 and 10 years. The average age of the regular premium, unit-linked pension insurance policies terminated at the end of 2018 was merely 2.43 years, which is attributable to the product scheme and the young portfolio. The vast majority of the pension insurances is terminated through expiry.

The economic downturn caused by the COVID-19 pandemic in the first quarter of 2020 may have a negative impact on the retention of life insurances. Since 2017, the number of regular premium life insurances with saving elements terminated by surrender compared to the closing portfolio of the year is stable (3 percent). In addition to the impact of the capital market events, alternative investment opportunities may also jeopardise the stability of life insurance portfolios.

2.2.2 Outflow increased at the single premium products

In 2019, the growth in the single premium outflows was equally contributed to by the traditional and the unit-linked life insurance products. The degree of the claim payments connected to single premium products compared to previous years rose by 16.9 percent at the unit-linked products and by 81.7 percent at the traditional products. In the life segment the reasons for insurance benefit payments can be typically allocated to 4 groups: death, expiry, surrender and benefit payment due to other reasons. The main driver of the outflow, both at the unit-linked and at the traditional products, was the growth of surrenders exceeding the previous years (UL +34.2 percent, traditional + 92.7 percent). Since the surrenders account for a dominant part (89.0 percent in 2019) of the claim charges of single premium traditional life insurances, the growth in them had substantial effect on the single premium benefit payments. In the past period new investment opportunities appeared in Hungary that are more favourable than life insurances. It is clear also from the chart presenting the gross assets of households that the volume of debt securities has substantially increased compared to previous year, and in parallel with this the benefit outflow stemming from the surrender of single premium life insurances also significantly increased. As regards the current events, in the first quarter of 2020 the premium income connected to single premium and top-up products increased only by 12.6 percent year-on-year, the distribution of which is very unbalanced between the two product categories. While the premium income of the single premium traditional products rose by 28.5 percent compared to the first quarter of 2018, it decreased by 1.7 percent at the UL products. At the traditional products surrenders account for 81 percent of the growth in benefit payments.

As regards the entire life insurance market, in 2019 two-thirds (65.5 percent) of benefit payments stemmed from surrenders and one quarter of them (25.5 percent) from the expiry of the life insurance contracts. Thus 91.0 percent of the insurance benefit payments are linked to these two components. Compared to the previous year, payments due to surrender rose to 9.5 percent (by HUF 67.2 billion), while benefit payments due to expiry fell to 9.0 percent (by HUF -19.5 billion). In 2019, the ratio of benefit payments due to death was 6.9 percent (HUF 28.2 billion), which remained unchanged compared to the previous year.

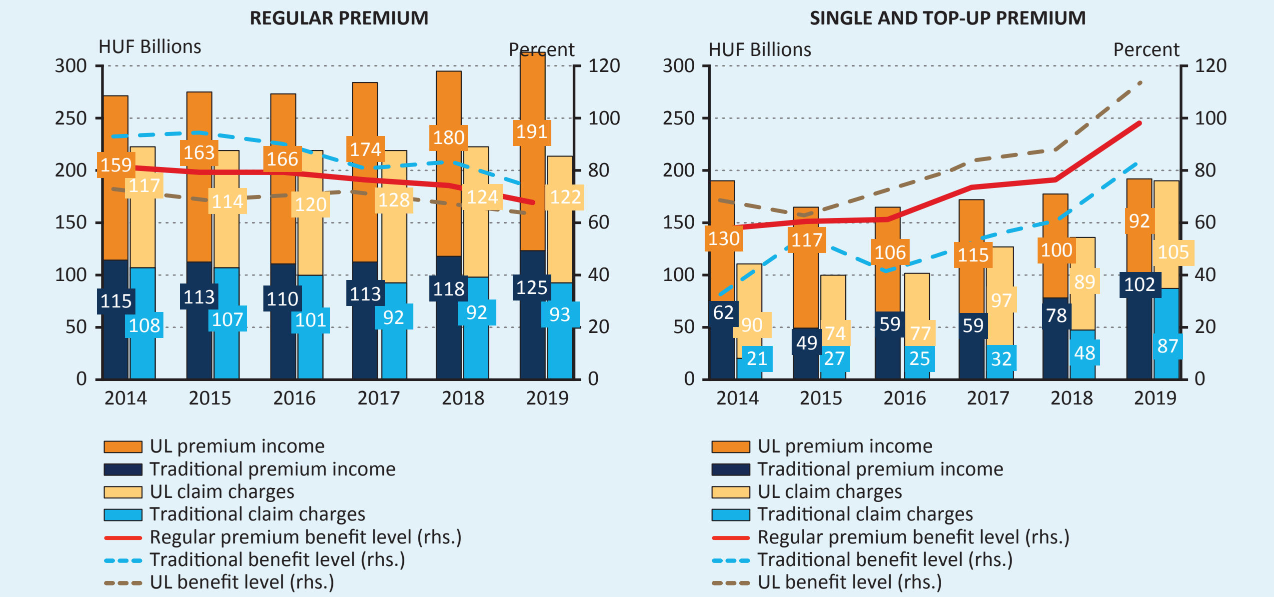
The ratio of single, top-up and regular premium life insurance products within the life segment's premium income fluctuates around 40-60 percent in the sector. In 2019, 62 percent of the life segment's premium incomes is connected to regular premium products. The remaining part of the life insurance premium incomes continues to be distributed between the single and top-up premium products at a ratio of roughly 70-30 percent. Naturally, striking changes in the life segment's premium income are typically caused by variations in single and top-up payments.

Similarly to the previous year, the opposite trend in the benefit level related to the regular premium and single premium life insurance products continued in 2019 as well. While the benefit level related to the regular premium life insurances decreased on average by 3.4 percent annually, the same at the single and top-up premium products rose by 14.2 percent in the period of 2014-2019.

The distribution of life insurance premium incomes was almost similar at products with similar premium payment frequency; in 2019 this has slightly changed. While the weight of the unit-linked product rose in the premium income from regular premium products (to a ratio of 61-39), the weight of unit-linked products fell by 8.6 percent (to 47.3 percent) in the premium income from single and top-up premium products, thereby continuing the trend of former years. Throughout the period under review, the share of unit-linked products in the regular premium incomes was around 60 percent. In the market of single and top-up premium products this ratio declined annually on average by 6.1 percent between 2014 and

2019. Accordingly, in 2019 premium income from unit-linked products no longer reaches half of the premium income from single and top-up premium products (47.3 percent). (Chart 16)

Chart 16
Developments of premiums written, claim charges and benefit level* in the life segment, by premium payment frequency



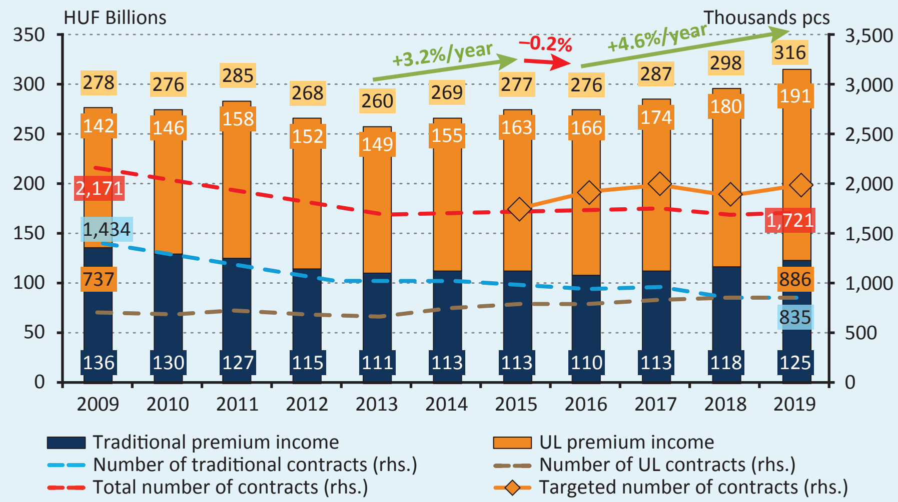
*Note: *The benefit level is the ratio of the claim charges compared to the gross premium income.*
Source: MNB

2.2.3 Rising regular premium income

The sector-level premium income of regular premium life insurance products was able in 2019 as well to continue its growth trend observed in previous years, amounting to HUF 316 billion, exceeding the amount registered at the end of last year by 6 percent. Despite the new, and very popular, investment form (Hungarian Government Securities Plus – (MÁP+)), which appeared in the savings market in 2019, the total premium income from regular premium products was able to exceed the previous annual growth by 2.2 percentage points. According to the trend of the previous five years, the market of regular premium products grew by 4.8 percent on average. This trend was broken between 2015 and 2016 only by a technical change caused by a "loss" of data resulting from the transformation of a major market participant into a branch office (thereby being removed from the supervisory competence). Unit-linked savings acted as the driver of growth; the growth rate of the premium income from these contracts follows the growth of the total regular premium income. As regards the number of contracts in the regular premium products in the life segment, no growth trend similar to the premiums can be observed (Chart 17). At the end of 2019, the size of the portfolio comprising of roughly 1,721,000 contracts falls short of the volume registered ten years ago. In the past decade, following the declining trend in the first years, the size of the portfolio was characterised by stagnation for a longer period. In 2019 the growth was merely 0.8 percent, which represents roughly 13,000 contracts. The growth in premium income in excess of the number of contracts also entails a growth in average premiums. Based on the data from the end of 2019, the premium income per contract in the market of traditional products is roughly HUF 150,000, while in the market of unit-linked contracts it exceeds HUF 215,000.

The values and changes presented above show currently decreasing penetration. Accordingly, the portfolio of the regular premium contracts still lags behind the value projected in FIS, which – under a life insurance coverage rate reaching 80 percent by 2026 – would be roughly 1.9 contracts now.

Chart 17
Development of regular premium income and number of contracts in the life segment



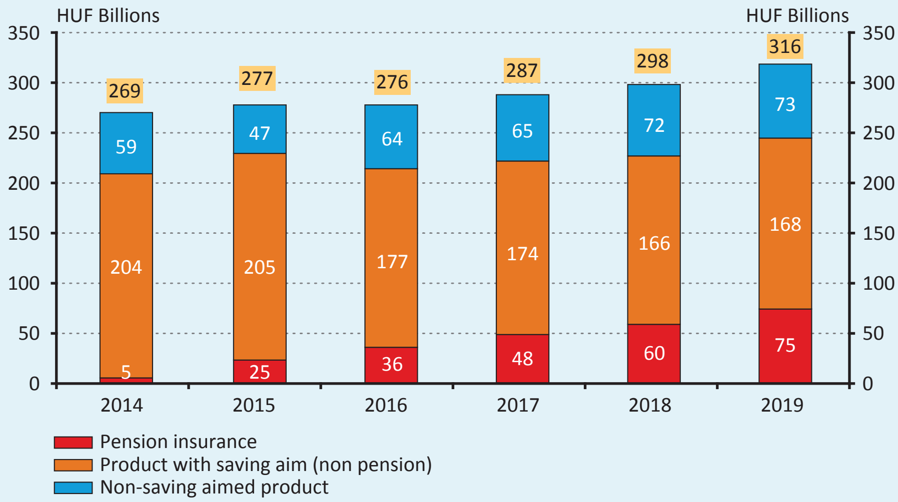
Source: MNB

2.2.4 One quarter of the regular life insurance premium income is connected to pension products

Pension insurances, in the classical sense, are available in the Hungarian insurance market since 1 January 2014, and since then they have become an important market actor. Although insurance products of pension purpose, not qualifying as pension insurances, were available before as well, the turn was generated by the new product concept and the tax credit of 20 percent. The amount of the tax allowances available in respect of the pension insurances already exceeds HUF 10 billion. In 2014, by publishing a recommendation, serving the long-term sustainability of several customer-friendly pension products, the MNB also contributed to the creation of stable market foundations. Following the introductory period of the pension insurance product, the premium income from regular premium pension product is rising continuously, and by the end of 2019 the annual growth rate exceeded 25 percent (Chart 18). The ratio of regular premium pension products is 23.8 percent, i.e. they have a share of almost one quarter in the total premium income from regular premium savings products; the ratio of regular premium non-savings life insurance product is almost the same (2019Q4, 24.0 percent).

The pension insurance products are still predominantly regular premium products; their ratio within the premium income from all pension insurance products is 86.2 percent, after registering an increase of 2.6 percentage points since last year. Regular premium pension insurances are also dominated by unit-linked products. 72 percent of the regular premium pension insurance portfolio comprises index-linked or unit-linked pension insurance products. The regular premium product schemes also dominate the products offered for sale. Each of the 12 insurers offering pension products offer this type of product, while at present 6 insurers are active in the market with single premium products. There is still room for further growth also for the smaller actors; the TOP5 market participants with the highest premium income, selling pension insurance, at present possess 63.3 percent of the total regular premium income.

Chart 18
Breakdown of gross premium income of regular premium life insurance according to saving aim



Note: The chart shows the Q4 data of the respective year.
Source: MNB

2.2.5 The 12-month regular premium of new acquisitions rose by more than 15 percent in the life segment

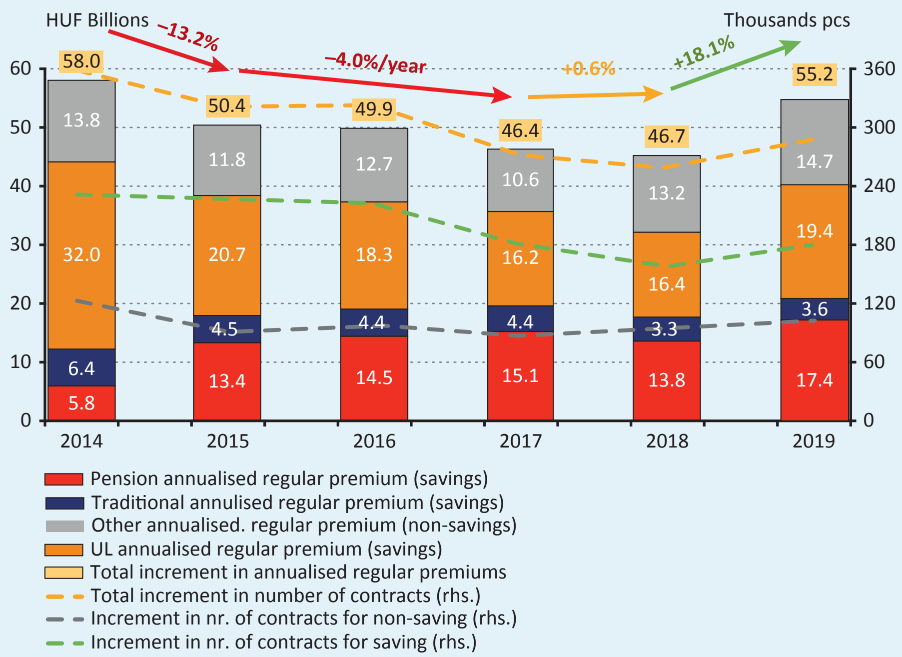
Recently the regular premium life insurance market has been characterised by a trend reversal. In 2019, the 12-month regular premium increment rose by 16.1 percent, which was not followed by the growth in the absolute value of the fall in the 12-month regular premium resulting from the loss of portfolio.

In the past 5 years the market was restructured in terms of life insurance products. The considerable increment in 2014 is attributable to the introduction of tax credit connected to pension insurances, after which continuous contraction was observed in the 12-month regular premium increment until 2017. It somewhat gives a different view when the decrease in the 12-month regular premium resulting from the loss of portfolio is also taken into consideration. In this respect, 2017 is a turning point, as since then the 12-month regular premium growth surplus exceeded that of 2014. Based on the data, on the horizon of 3 years it is already clear that the impact of the introduction of the ethical life insurance concept in 2017, contrary to the initial fears, did not materialise. In the past 5 years, overviewing the portfolio of the regular premium products, based on the 12-month regular premium a continuous decrease in the increment can be observed at the traditional products, which was exceeded by the decrease in 12-month regular premium resulting from the loss of portfolio every year. The decrease in the headway of regular premium traditional products may be partly attributable to the fact that the instruments underlying the reserves of these products are mostly risk-free assets, the interest realisable on which are increasingly lower. The prospect of the unit-linked products – not connected to pensions – is similar, but still different: although from 2017 the 12-month regular premium increment has been continuously increasing, even this was exceeded almost every year (with the exception of 2014) by the degree of the 12-month regular premium decrease resulting from the loss of portfolio. In the past 5 years, of the saving-type regular premium life insurance products, the headway of pension insurances – and particularly of the unit-linked pension insurance products – can be observed. The growth in pension insurances is also contributed to by the favourable tax environment through the potential personal income tax credit and by the ethical life insurance regulation. The observed growth is the direct consequence of the increased customer focus, which filters through to the entire operation, including sales.

The change in the contract number increment connected to regular premium products compared to the decrease in previous year was consistent with the growth in the 12-month regular premium increment in terms of its direction in 2019. As regards the number of contracts in the regular premium products in the life segment, no growth trend similar to the premiums can be observed. In 2019, the increment of regular premium life insurance contracts rose by 12.1 percent, contributed to by the growth in the increment connected to saving and non-saving products in a proportion of roughly

70-30 percent. As regards the size of the contract portfolio of regular premium life segment products, following the decreasing trend in the initial years of the past decade, stagnation was observed for a longer period, while the contract portfolio of the single premium life insurance continuously decreased in the past 5 years. Due to the economic impacts developed in the past period, in the life segment the objectives of insurers include the reduction of the dependency on single premium life insurance contracts, which is also reflected by the contract portfolio data of the following chart.

Chart 19
Increment in regular premium life insurance products by 12-month regular premium and number of contracts



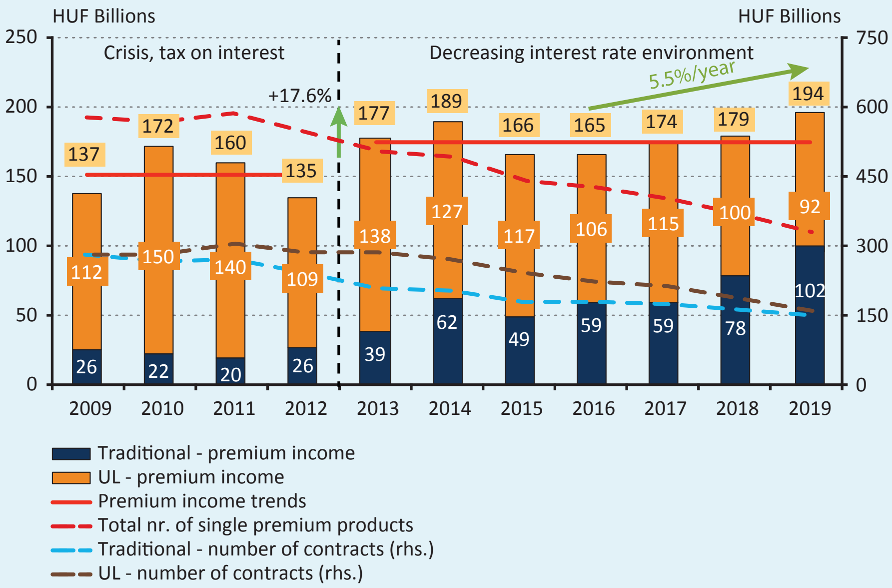
Note: The "other" category comprises the following insurance products: Death, annuity, group, health and credit and suretyship insurance products with death cover. 2019 based on data of Q4.
Source: MNB

2.2.6 Rising single and top-up premium income

By the end of 2019, the sum of the single and top-up premium income rose by 8.3 percent on an annual basis, and reached HUF 194 billion. The origin of the growth was the roughly 30 percent rise in premium income connected to traditional products. However, the single and top-up premiums of the unit-linked contracts once again follow a declining trend, and their amount fell below HUF 100 billion for the first time in the past decade. As the combined result of the two opposite trends it happened for the first time that the single and top-up premium income of traditional insurances exceeded the same premium income of unit-linked insurances, and thus the traditional premium income accounts for 52 percent of the total premium income.

When examining the trends of the past decade, two distinct periods can be observed, which considerably differ from each other both in terms of premium income and composition (Chart 20). In the period of the financial crisis and the introduction of the withholding tax on interest, the average periodic value of the single and top-up premium income in the life segment was much lower than in the period later; the average value between 2009 and 2012 was around HUF 135 billion. As regards the composition of premiums, the dominance of unit-linked single and top-up premium income can be observed, while the average ratio of the traditional premium incomes is around 20 percent within the portfolio. Premium incomes started to increase in the post-crisis years characterised by declining interest environment, registering an outstanding, 17.6 percent, increase between 2012 and 2013; moreover, the past four years are also characterised by an average growth of 5.8 percent. The period of 2013-2019 also resulted in a growth in the periodic average premium income; the average income in these years rose to HUF 177 billion.

Chart 20
Changes in single and top-up premium income and number of contracts in the life segment



Note: The premium income trend means the average of the premium income in the respective period.
Source: MNB

2.3 NON-LIFE SEGMENT

2.3.1 The insurance tax increased the weight of the compulsory motor third party liability insurance segment further

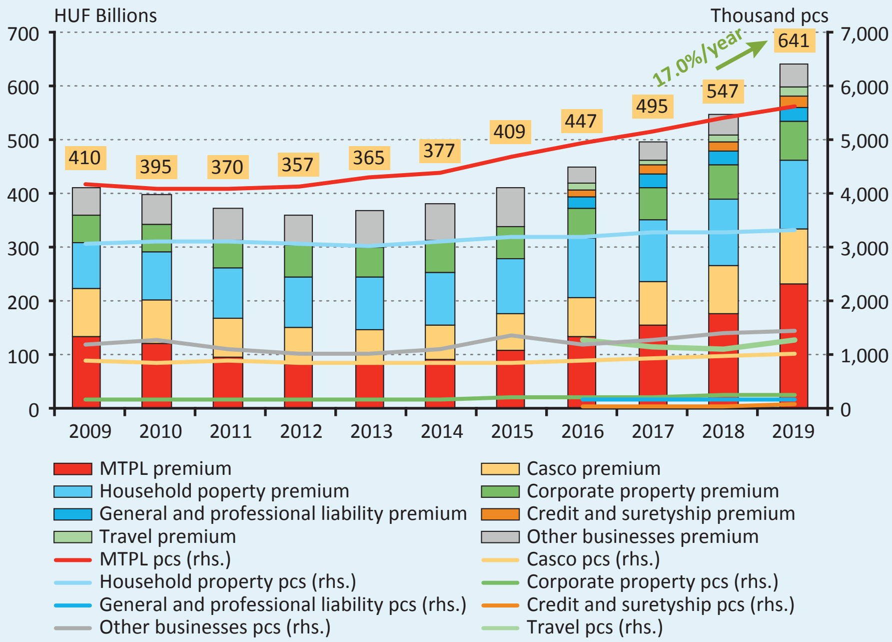
The growth of the non-life segment, seen since 2012, continued in 2019 as well (Chart 21). The growth rate of 17.0 percent compared to the end of 2018, was higher than before, corresponding to a growth of HUF 94 billion. The greatest contribution to this (HUF 56 billion) was made, in 2019 as well, by the compulsory motor third-party liability insurance (MTPL), being the largest business line. In 2019, the MTPL premium income accounted for 36 percent of the total premium income of the non-life segment and its contract portfolio accounted for 47 percent of the non-life segment's contract portfolio. The growth is partly attributable to a rise – also lasting since 2012 – in vehicles affected by MTPL and to the 23 percent increase in the 12-month regular premium per contract. At the and 2019 the MTPL portfolio comprised of 5.6 million contracts. The continuous increase in the number of cars newly put into service contributes to the rise in the portfolio. According to the HCSO data, in 2019 this already exceeded 314,000. The underlying reason for the major increase in the 12-month regular premium, and together with that in the premium income, is the insurance tax introduced on 1 January 2019 for MTPL products and integrated in the premium, to replace the former accident tax, paid in addition to premium.

As regards land vehicle casco, the growth in the 12-month regular premium per contract – similarly to previous years – lagged behind that of MTPL (9.5 percent). The number of contracts rose by 6 percent, which exceeds the rate registered for MTPL (3.7 percent). The ratio of second-hand cars within the cars put into service in Hungary for the first time peaked in 2015 (with 59 percent). This contributed to the slow increase in the land vehicle casco portfolio. Following this, the ratio started to decline and by 2019 it fell to 48 percent, which is a 7-year low. If this trend continues, the ratio of new cars may increase, which may facilitate growth in the casco portfolio.

The increase in premium income intensified in the area of household property insurances (primarily home insurances). The growth registered in 2019 as a whole was 6.9 percent, which is a 7-year high. The number of policies in the product category rose by 1.5 percent (by 47,000 pieces), which exceeded the past 10 years' average of 0.6 percent (18,000 per year on average). The growth in the contract portfolio was attributable to the increasing stock of dwellings besides a moderate increase in the willingness to take out insurances, since coverage in the housing market rose by 4.1 percentage points in the past 5 years.

In the area of corporate property insurances, accounting for 11 percent of the non-life segment's premium income, in 2019 the premium income of the product category rose by 9.4 percent after the moderate (3.5 percent) growth registered in 2018. Within the products with smaller share, payment protection insurances grew to the largest degree, by 16.1 percent, which may be supported by the pickup in lending. The 13.4 percent increase in travel insurances and the 4.1 percent rise in the general and professional liability insurances are also attributable to the dynamically growing economy. The remaining other products accounted for 7.1 percent of the non-life market in 2019, and they rose at a rate below the average – by 12.6 percent – during the year.

Chart 21
Changes in premium income and number of contracts of non-life segment by businesses



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

Source: MNB

2.3.2 Market concentration of the non-life segment products stagnated

The MTPL segment is extremely price-sensitive, since the price of the service is much more important for the contracting customers than the prospective quality thereof. Under the aforementioned features, there is room for price competition, which is also supported by the flexible capacity limit of insurers and active sales by brokers. In addition, the search for insurers offering more favourable price and the replacement of existing policies by cheaper ones form an integral part of public thinking. All these processes contributed to a decrease in the concentration ratio of the segment in the past 10-15 years (Chart 22). The declining trend halted in 2016–2017, since some of the institutions may have still been in the consolidation phase that followed the years with high loss ratio[19], while other institutions were able to sell at a lower price. In 2019 the HHI concentration ratio has not changed, while the weight of the TOP5 market participants rose by 1 percentage point within the segment.

At the casco insurances, contrary to MTPL, the prospective quality of the service and the brand are important factors, since customer take out the insurance for their own property. The price comparison applications of online brokers could foster competition. However, the declining direct ratio of the casco product category in the insurers' sales mix (Chart 57) and the declining ratio in electronic sales at insurance intermediaries (Chart 58) shows the underutilisation of the technological

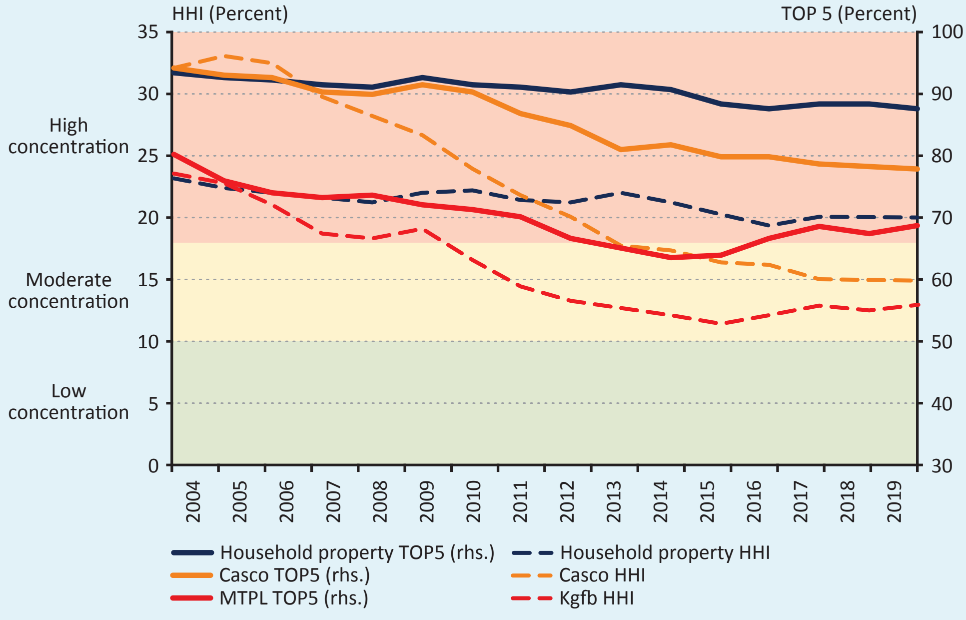
[19] See the period of 2012–2014 on Chart 24.

opportunity or a moderate decline in it. The fact that the declining trend of the two concentration ratios substantially decelerated in recent years may reflect this process. HHI and the TOP5 market share indices did not change significantly in 2019 compared to previous year (declined by 0.1 and 0.5 percentage point, respectively). The 1.9 percentage point rise in the casco loss ratio does not imply strengthening competition either.

As regards the household property insurance segment, the index stands at almost the same level in the band signalling a high concentration ratio – over 18 percent when considering HHI – and after 2018, it did not decline significantly in 2019 either (decreased by 0.1 percentage point). Although on the whole claim events were the highest in the past 8 years, the rise in premiums was consistent with this. As a result of the first, gross loss ratio reached 31.3 percent, after a minor, 1.5 percentage point, rise, but it still fell short of the average of the previous 8 years (35.3 percent). This moderate loss ratio – even despite the insurance tax – represents high profitability, which is a good incentive for several insurers to enter this segment.

In the future, competition in the household property insurance market may be boosted by the Qualified Customer Friendly Home Insurance (CCOI), announced by the MNB at the end of 2019; certification applications may be submitted from 10 January 2020. Insurers may become interested in obtaining the certification, which helps them prove to their consumers the high quality of their products, also acknowledged by the MNB. On the other hand, as the qualification spreads, the CCOI criteria may result in product supply of more standard content than before, thereby easing comparability, which may foster market competition and increase customer mobility.

Chart 22
Share of the TOP5 market participants and Herfindahl-Hirschman index of the non-life segment based on gross premium income by main businesses



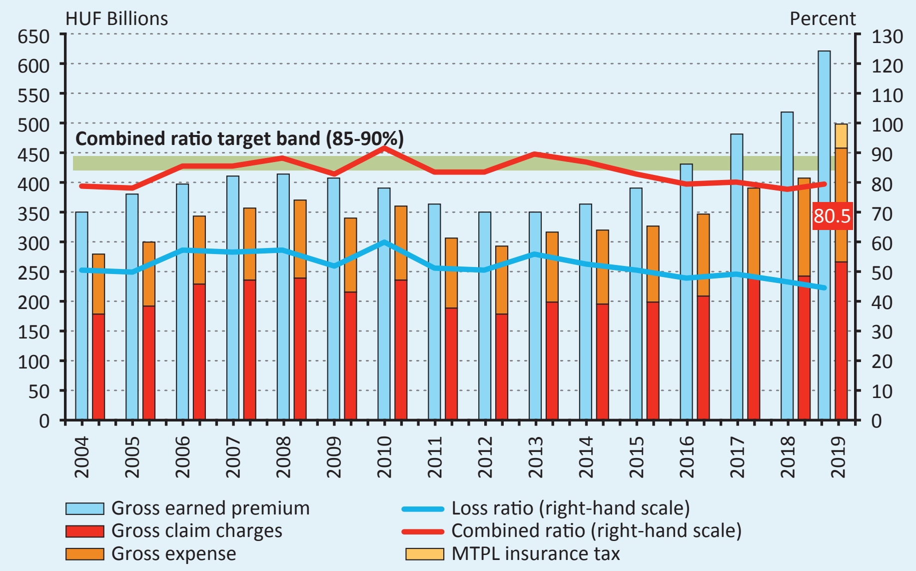
Note: The colour of the background illustrates the strength of concentration under HHI.
Source: MNB

2.3.3 The non-life combined ratio approximates the target band

In 2019, the sector-level combined ratio of the non-life segment fell to 74.6 percent, due to the introduction of the insurance tax, corresponding to the rate of accident tax, affecting the MTPL business. Claims and costs rose by 12.0 and 9.7 percent, respectively, (by 11.1 percent together), which was exceeded by the 16.5 percent growth in earned premiums. During the year, the new tax was integrated in all MTPL contracts upon renewal, which made major contribution to the rise in premiums. The tax rate, integrated in the premium, was taken into consideration based on the central budget's accident tax in 2018 and the insurers' regular date reporting. The combined ratio after this adjustment would by 80.5 percent (Chart 23), which is a correction compared to the 78.2 percent of 2018, but in historical terms it is one of the lowest values.

The proper backtesting of the target band of 85-90 percent, presented as ideal in FIS – similarly to the above – necessitates a combined ratio adjusted for the MTPL insurance tax. The change in 2019 may be identified as a shift towards the target band, but it materially falls short of the lower bound of 85 percent. With a view to reaching the target band, it may be necessary to take measures aimed at boosting competition in the non-life segment.

Chart 23
Changes in non-life combined ratio

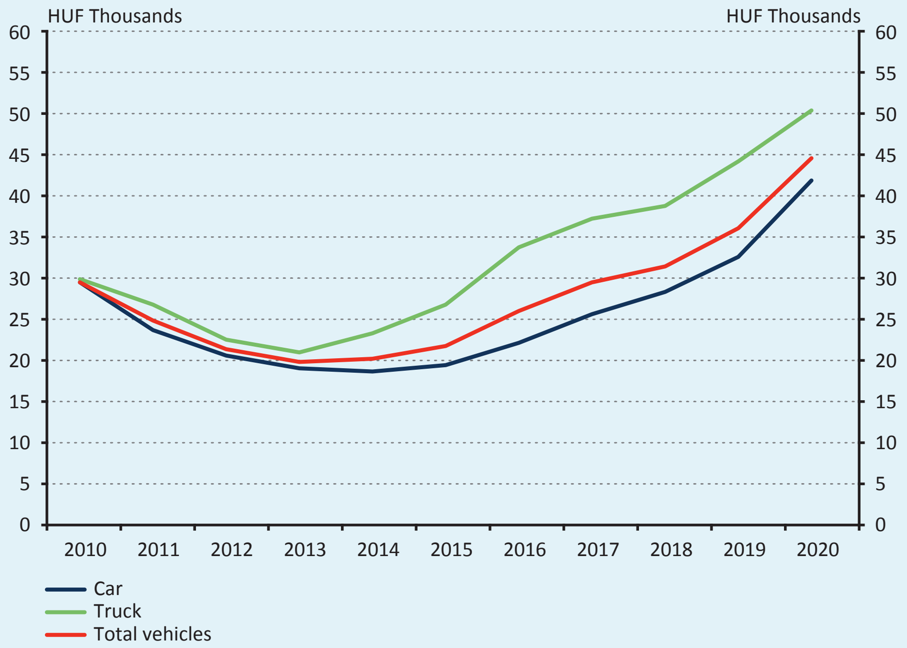


Note: The MTPL insurance tax of 2019 was estimated based on the accident tax of 2018 in proportion to gross earned premiums.
Source: MNB

2.3.4 The insurance tax substantially increased the 12-month regular premium per policy

Based on the January 2020 data, the average 12-month regular premium of the MTPL contracts increased further compared to the January 2019 data (Chart 24). The former accident tax ceased from 1 January 2019; from now on insurers are required to pay insurance tax in respect of the MTPL contracts, similarly to the other products. By 1 January 2020 this tax was integrated in the premium of all contracts, and thus the 12-month regular premium per policy – an important indicator of the MTPL product – becomes comparable in the next periods. The 2020 data for determining the premium income are not yet available; accordingly, the 12-month regular premium in this form is a more forward looking data in the report. Based on the data reporting, it cannot be established to what extent insurers transfer this tax to the customers, but it must be accepted that the premium level of the period of 2018-2020 is not comparable. The adequacy of the premiums can be verified based on other indicators of the MTPL products, such as the loss ratio, combined ratio, etc. and the profit and loss account. Based on the 2019 profit and loss account, the MTPL technical result is HUF 19.6 billion, which is almost 4 times higher than in the previous year. The profit/loss on ordinary activities (HUF 26.1 billion) is the double of the 2018 profit, which supports the adequacy of the premiums.

Chart 24
12-month regular premium per contract in individual vehicle categories



Note: On 1 January of the respective year. The premiums of 1 January 2020 are the premiums of policies with a renewal date of 1 January, increased by insurance tax.

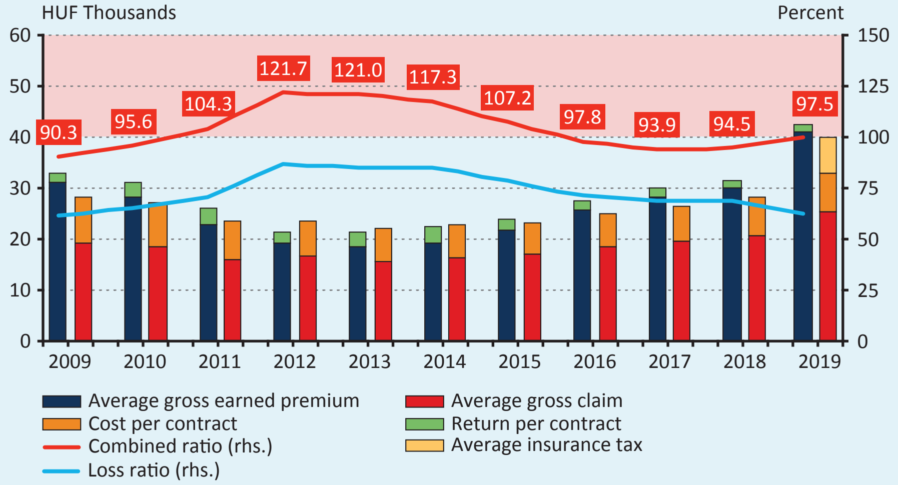
Source: MNB

2.3.5 Stable MTPL market, premium increase primarily due to the tax

In 2019, the loss ratio per contract did not change compared to 2018, although in previous years this figure shows an average growth of 5.5 percent (Chart 25). At the same time, the earned premium per contract has significantly increased due to the introduction of the insurance tax mentioned earlier. When calculating the combined ratio, the impact of the insurance tax may be taken into consideration only by estimations, since it was integrated in the premiums only after the renewal of individual contracts in 2019. The former intensive (over 10 percent) premium increases were justified by the fact that the segment's combined ratio between 2011 and 2015 was at an unsustainable level (over 100 percent). The business segment was able to consolidate by 2016 and remained stable thereafter. The premium increase observed in 2018, being more moderate than in previous year, may be a sign of increased price competition. Due to the integration of the insurance tax in the 2019 premiums on a continuous basis during year, no year-on-year comparison is possible, since neither the dynamics of determining the new premiums, nor the rate of charging the tax to the customers is known. [20] Accordingly, the direct change in the aggregated data does not show the actual change in the premium level, but it is clear that premiums rose to an adequate degree in the market as a whole, since ordinary profit/loss of the MTPL sector increased significantly – more than doubled – compared to the previous year. The combined ratio for 2019 includes the estimated value of the insurance tax.

[20] The listed items cannot be defined precisely from the supervisory data reporting related to the period of 2018-2019.

Chart 25
Changes in combined ratio of motor third-party liability insurance in Hungary

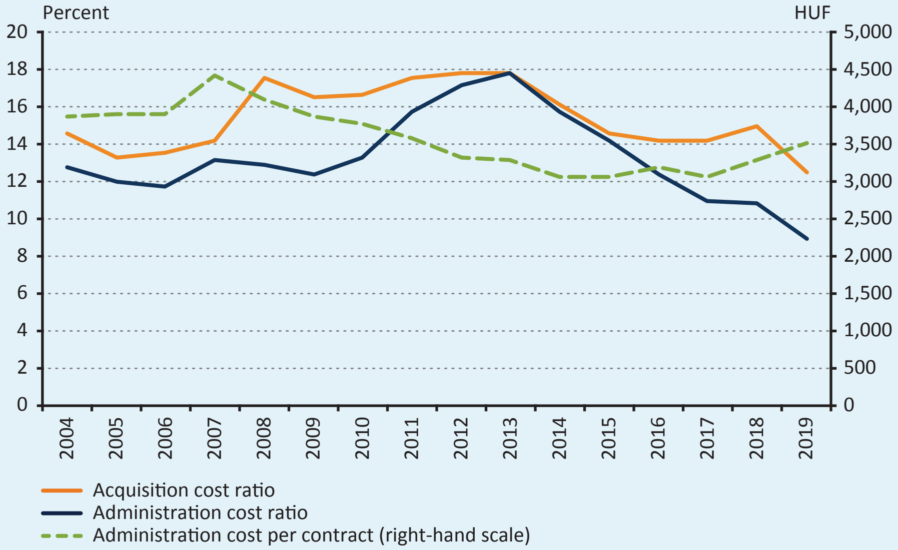


Note: The loss ratio values were adjusted for the change in outstanding loss reserves. The pink area in the chart denotes the band of combined ratio exceeding 100 percent. The insurance tax of 2019 was estimated based on the accident tax of 2018 in proportion to gross earned premium.
Source: MNB

2.3.6 Due to the premium increase the growth in costs is not reflected in the ratios

In 2019, the cost per contract exceeded the 2018 value by 5.4 percent, but this cannot be compared with the rate of the cost increase. Costs increased more significantly in 2018, but in previous years the rise in costs was usually in line with the rate of the premium increase. At the same time, the segment's cost ratio is in line with the ideal target of below 30 percent, set in FIS for non-life insurances. Based on the chart, the major fall in the 2019 cost ratios is primarily attributable to the comparison with the premium increased by the insurance tax (Chart 26).

Chart 26
Changes in the cost ratios of motor third-party liability insurance in Hungary



Source: MNB

Box 3
The central itemised MTPL database may reduce prudential risks

The MTPL contract management system introduced in 1991 contained the uniform tariffs announced by the decree of the Ministry of Finance, applicable to the entire market. The basis of this was the “Pillar” statistics, managed by the State Insurance Supervisory Authority, which contained the detailed periodic claim data of insurers offering MTPL This data collection was terminated in 2000, in parallel with the gradual liberalisation of the premiums. The full liberalisation from 2003 made it possible for the insurers to apply premiums aligned with their own portfolio and business strategy. However, this also meant that the product has become one of the areas of the insurance sector that carries the greatest prudential risk. Due to the low premiums applied in the hope of a fast portfolio growth, the price sensitivity of customers, the need to accept offers and the differences in the claim sizes (vehicle damage, bodily injury damage) and length of their run-off, insurers that failed to manage risks properly may have incurred major deficit or even default.

As the first domestic insurance “SupTech” instrument (Supervisory Technology, an innovative technology that supports financial supervision) in 2018 the Magyar Nemzeti Bank created, the granular database of compulsory motor third party liability insurances, with a view to reduce prudential risks. The MTPL insurers report MTPL contracts and claims data in granular form on quarterly basis. The database collects all contract and claim data of MTPL from 1 January 2011, with a level of details aligned with legislative and professional considerations, based on which the full history of the contracts and claims can be tracked. Since these are granular data, which can be aggregated arbitrarily, they can be widely used in the supervisory work. At the end of 2019, the database contains 1,364,553 claim events and 19,651,553 contracts for the purposes of analysis.

The use of the granular database provides the ability to monitoring of market trends (vehicle composition, premium level, claims, loss frequency movement analysis), analysis of the premium structure applied by the insurers, assessment of compliance with the accepted risks and adequacy of the reserves in respect of the claims with long run-off. It also becomes possible to analyse the segments, including the consistency of the premium and claim data of the fleet policies, the statistics of international claims, the frequency and volume of bodily injury damages and the adequacy of reserves. A lot more in depth analysis of the MTPL market became available through the granular database. Formerly, the MNB had no data in respect of the MTPL contracts distribution through regional categories. The central itemised MTPL database also contains data with regard to the contracts and claims by postal codes, which enable various analyses by regions.

2.4 PROFITABILITY AND CAPITAL POSITION

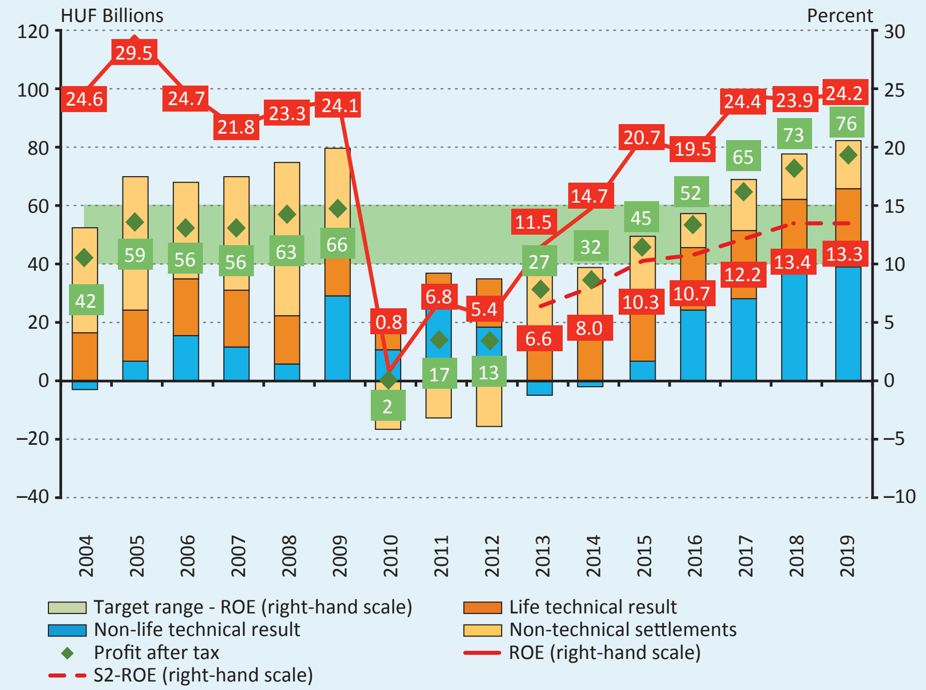
2.4.1 Profitability is at pre-crisis level

The insurance sector’s return on equity (ROE) has been increasing dynamically from 2010 until 2017. In the past three years this growth has halted and the ROE seems to stabilise at a very high level, around 24 percent; in 2019 it was 24.2 percent. The shift toward the target band of 10–15 percent specified in FIS did not commence in 2019 either. Based on Q4 2019 data, the after-tax profit of the sector broke the record also in 2019, with HUF 75.9 billion. This exceeded last year’s record of HUF 72.7 billion by HUF 3.2 billion. The growth in the market’s average return on premium (ROP), lasting since the 0.23 percent low registered in 2010, halted in 2019. The ROP of 6.59 percent realised in 2019 slightly falls short of the 2018 result of 7.12 percent. This is due to the fact that insurance sector’s premium income grew at a higher rate in 2019 than its profit. In 2019, the return on available solvency capital (S2-ROE [21]) appears as a new indicator, which presents the sector’s profitability based on the Solvency II solvency capital data. This indicator also shows an increasing trend in the past years, which is attributable to the fact that the growth in profit exceeds the growth rate of solvency

[21] The profitability indicator projected on the solvency capital available under Solvency II (S2-ROE) compares the profit after tax with the capital available under Solvency II. It should be noted that while the profit after tax includes the dividends payable, the dividends foreseeable by the insurers have already been deducted from the available solvency capital.

capital. This growth stopped in 2019, since the realised profit rose at a smaller rate (by 4.4 percent) than the available solvency capital (by 7.6 percent). The growth in profitability was caused by a major rise in non-life insurance results in 2019. While in 2013-14 the non-life segment realised a loss, at present 60 percent (HUF 40.8 billion) of the technical result of HUF 67.4 billion is attributable to this segment, which represents a growth of 12.5 percent compared to last year. The technical results of the life business also show continuous improvement; compared to last year a growth rate of 4.8 percent was observed (currently HUF 26.7 billion). (Chart 27)

Chart 27
Profitability of the Hungarian insurance sector and its composition



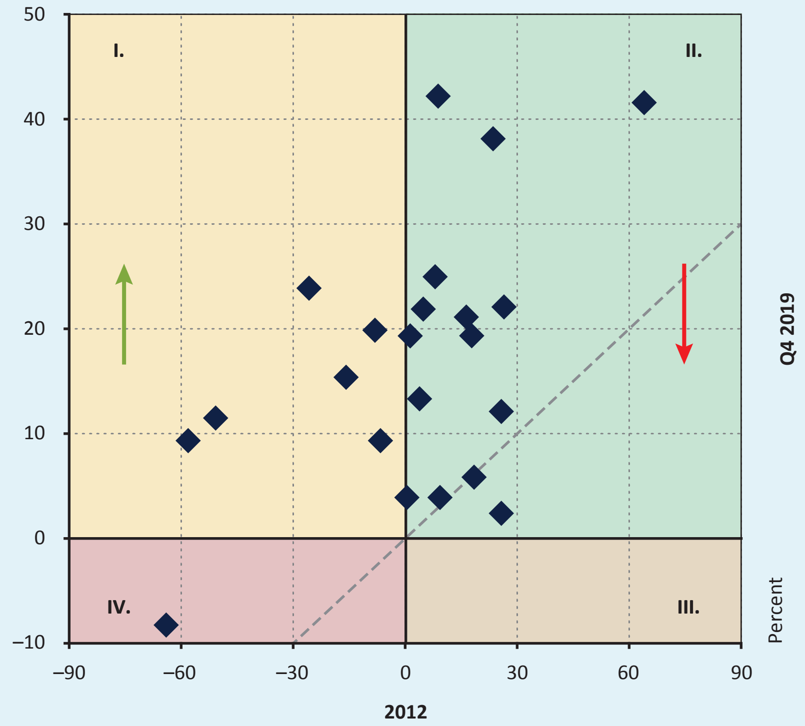
Note: The sector level ROE values (with the exception of 2019) were calculated on the basis of the annual audited data reporting, where equity does not contain the current year's dividend. At the S2-ROE index the profit after tax it is compared to the eligible own funds under Solvency II (2013–14 are estimated values).

Source: MNB

2.4.2 The profitability of Hungarian insurers changed for the better in most cases

At the level of institutions, the individual insurers' return on equity varies. In 2019, only one of the 22 insurers operated with a loss. In addition, 6 market participants managed to turn their negative return on equity registered at the end of 2012 into positive by Q4 2019 (Chart 28). No shift in the opposite direction was identified for any of the insurers. Based on the shifts and profitability trends, an extremely positive picture unfolds in respect of the insurance sector, both at the level of institutions and the entire market.

Chart 28
ROE value of Hungarian insurers



Source: MNB

2.4.3 The capital level of the Hungarian insurance sector exceeds the statutory requirements

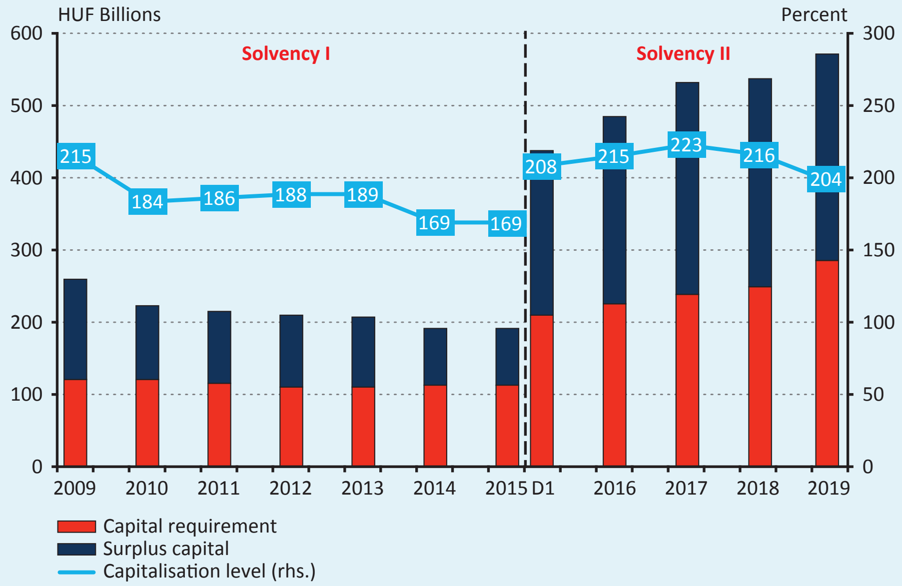
Since the introduction of Solvency II (2016) the capitalisation level of the Hungarian market at sector level is the double of the statutory value of 100 percent, exceeding 200 percent. Compared to the changeover from the Solvency I scheme (Day-1, D1), the capital adequacy ratio fluctuates in a narrow band: compared to the 208 percent, registered on 1 January 2016, the difference is merely 6 basis points at the end of 2019 (214 percent). It is clear from Chart 29 that in recent years both the solvency capital requirement and the solvency capital increased, i.e., the sector's capital holding is in line with the increasing risks.

The solvency capital requirement calculated with the standard formula is the volume of solvency capital the insurer needs to maintain to be able to cover major losses (loss occurring once in every 200 years) within a certain period (in the next 12 months).

The calculation with the standard formula is a modular approach, which breaks down the solvency capital requirement into risks and sub-risks, while the individual risks are measured through scenarios and shocks. After this it summarises the solvency capital requirements of the modules and sub-modules considering the diversification impacts. The MNB's recommendation No. 6/2016 was aimed at reducing the volatility within one year and the uncertainty inherent in the system, by recommending to insurers to recognise a 50 percent volatility capital buffer.

The capitalisation level of the Hungarian insurance sector complies with MNB Recommendation 6/2016 and substantially exceeds 150 percent. The sector also fulfils the vision outlined in FIS, which intends to establish a well-capitalised insurance sector through the capitalisation level being steadily over 150 percent. This capitalisation rate is similar to the values presented in the Financial stability report issued by EIOPA (December 2019).

Chart 29
Development of capitalisation rate at sector level



Note: the solvency capital requirement must be calculated only once a year, and thus the latest solvency capital requirement will appear in the annual data reporting related to the end of 2019. Therefore the capitalisation level values indicated in the chart may also change slightly.

Source: MNB

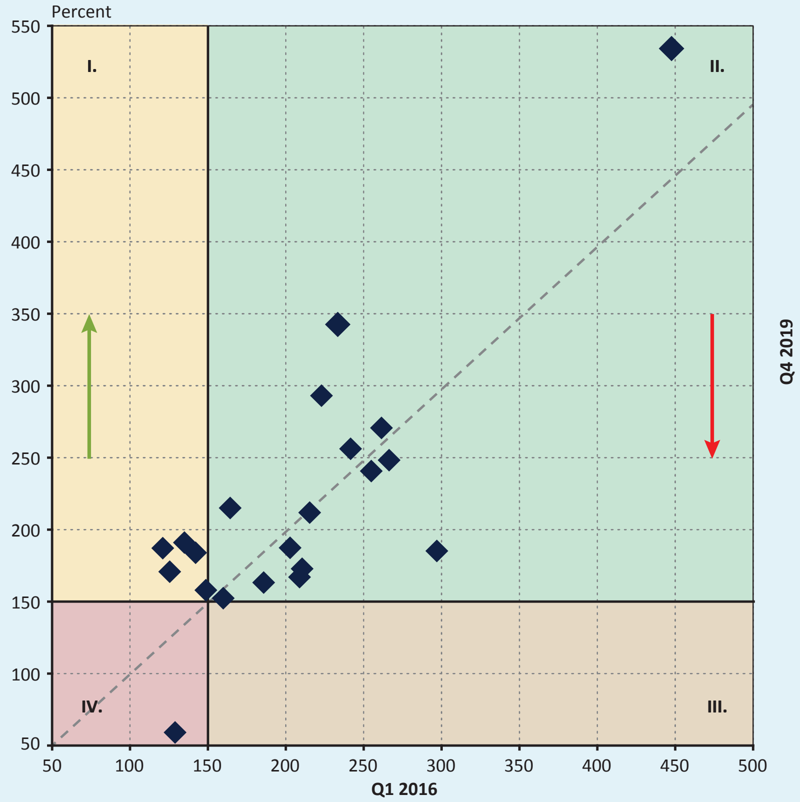
2.4.4 The capitalisation level of the vast majority of the market exceeds 150 percent

When examining the individual data of insurers, much larger differences can be identified (Chart 30). At the end of 2019 [22] one company failed to reach the statutory 100 percent, as its capitalisation level was 59 percent. This insurer submitted its recovery plan to the Supervisory Authority, which describes how it intends to comply with the statutory requirement in the short run. Its market share based on premium income is less than 1 percent. All other institutions exceeded the capitalisation level of 150 percent, specified in the MNB's recommendation, even the company that was in the band of 100-150 percent in previous year. By contrast, the capitalisation level of half of the institutions exceeded even 200 percent. Chart 29 reflects the shift compared to the Solvency II opening data reporting; the first quarter of the chart shows the companies that in the first data supply reported values below 150 percent, but in Q4 2019 already exceeded 150 percent. According to the recommendation, insurers are advised to keep volatility capital buffers to provide at least 90 percent protection against unexpected capital loss over a one-year horizon. If insurers are unable or unwilling to prove compliance with this requirement, the MNB recommends that the amount of volatility capital buffer held by insurers should reach at least 50 percent of their last reported solvency capital requirement.

The chart already shows the planned dividends; insurers reported planned dividends of HUF 61.1 billion in the Solvency II data reporting table; however, this amount may differ from the actual dividend payment and the annual data supply; accordingly the data may change in the future.

[22] Capital adequacy will differ in the 2019 annual data reporting from that shown under Q4 2019.

Chart 30
Individual capitalisation rates of insurers (2016 D1 and Q4 2019)



Source: MNB

2.5 RISKS OF THE INSURANCE MARKET

Risk category	Risk groups	Risk rating	Risk prospects	Evaluation in words
Business model	Environment Strategy, business plans Profitability	significant	increasing	• still low yield environment and volatility but 2019 was characterized by positive yields • high GDP growth data, positive profitability at sector level *Increasing volatility in the first half of 2020, shifting yield curves, decreasing portfolio data*
Corporate governance	Exercise of owner's rights Internal governance Risk assessment system and ORSA Internal control system	significant	stagnant	• owner's control and internal governance were adequate • deficiency in case of internal controls (capacity, operation, integration) • problems related to outsourcing The MNB expects no change in the short term.
Financial and operational risks	Insurance risk Market risk Credit risk Operational risk Other material risks	significant	increasing	• portfolios were overweighted by government securities • significant IT and portfolio management risk *Rising insurance and market risks in 2020.*
Capital and reserve risk	Capital Reserves	moderate	stagnant	• stable, high capitalisation level • adequate reserving in general *Capital position may remain stable at sector level.*
Market entry risk	Products Customers	significant	decreasing	• deficiencies at practical application of IDD and PRIIPs Enhanced supervisory focus and consumer-friendly products may reduce the risk in the longer term.

Note:
Degree of risk — *high*, *significant*, *moderate*, *low*
Direction of risk — *increasing*, *stagnant*, *decreasing*

As regards the external market and regulatory environment, to be taken into consideration upon the assessment of the business models, it can be stated that in 2019 the Hungarian economy rose by 4.9 percent on average. Based on the forecast included in the MNB's December *Inflation Report*, the MNB expects 3.5 percent growth in the coming years. At the same time, as a result of the global spread of the coronavirus (COVID-19), originating from China, significantly more moderate economic growth may be expected than forecast before, which may as well be a recession in 2020.

Under rising trend, inflation reached 3.4 percent on an annual average, while core inflation also rose, reaching 3.8 percent. The price change in a wide range of products contributed to the accelerating rise in the consumer price index, which was mitigated by the moderate inflation of fuel prices. Based on the forecast in the *MNB's Inflation Report,* inflation is close to the 3 percent central bank target. The aforementioned factors created a favourable market environment and conditions for players on the insurance market, which is expected to deteriorate simultaneously with the accomplishment of the economic impacts of COVID-19.

Based on the thorough analysis and assessment of the strategies applied by the institutions active in the insurance market it is obvious that the institutions place great emphasis on ensuring that the applied business model is aligned with their actual opportunities, including the available expertise, the exploitability of any group-level knowledge transfer and the availability of the solvency capital necessary for the expansion. However, insufficient competition often hinders growth. The MNB − responding to the need to stimulate competition, which also serves the interest of customers − after consulting the market participants, created its Qualified Customer Friendly Home Insurance concept in 2019. The objective of the concept was to ensure that customers receive the necessary level of insurance protection in lieu of a fair premium rather to support low-premium contracts. The MNB expects market competition to increase, based on which it may become possible to use the qualified customer friendly concept for other products as well.

In line with the experience of former years, profitability of insurers remains steadily strong. The paper entitled *"10-year future of the insurance sector in 7 points",* published by the MNB in February 2018, defined a steady 10-15 percent return on equity at sector-level as a fair, competitive and adequate profitability level. Based on the unaudited data, in 2019 the insurance sector's aggregated profit after tax amounted to HUF 76 billion, which at sector level represents return on equity (ROE) of 24.2 percent. This exceeds even last year's value, which was particularly high. The value of the average indicator was greatly influenced by the fact that the largest actors of the market are also the most profitable ones; the four insurers with the largest premium income accounted for two-thirds of the sector's aggregated profit after tax. At the only loss-making institution, the loss was attributable to the corporate governance and control shortcomings connected to cross-border insurance activity.

However, the favourable data of the past do not represent a guarantee for the future. Although the Supervisory Authority anticipates no change in the business models, the coronavirus pandemic in 2020, and the processes taking place as a result of that, also impacting the real economy, will represent a challenge also for the insurers. The negative impacts and the uncertainty changed the risk level related to business models and the insurers' profitability to significant and the outlooks to negative.

The owner's control and internal governance system of the institutions are adequate. As regards the regulation and independence of the internal control systems, experiences gained by the MNB during the onsite and offsite inspections show improvement, particularly in the area of organisation and capacity; however, the – occasionally – major difference between the essentially adequate internal regulations and the actual practice is still in the focus of the Supervisory Authority. Further improvement is necessary in respect of the in-depth discussion of reports prepared by persons in key positions and the integration of those in the decision process, and also in respect of the documentation of the comments and proposals made by such persons.

In 2019 risks resulting in the potentially significant breach of customers' interests were identified in several cases. In extreme, but not unprecedented, cases these shortcomings also jeopardised the proper operation of the respective insurance company in prudential terms. The MNB took immediate measures in these cases. In the MNB's opinion, despite the numerous positive experiences, there is a need for further systemic development, and thus no improvement may be expected in the risk level until the realisation of this.

Within the financial and operational risks the factor that impacts insurance risks in 2019in the non-life insurance market is the higher case reserve of property insurances than before. The risk prospects of the life insurance segment are particularly increased by the decline in new acquisitions, the potential change in customer behaviour, and particularly the potential increase in surrenders.

The persistently low yield environment also represents major market risk both in the life and non-life insurance segments: in the life insurance segment, the low yield potential that the insurers may guarantee, hinders the development of demand for traditional products, while in the non-life insurance segment it reduces the profit realised on invested assets. At present, no material shift can be observed at sector-level towards assets promising a higher yield; the investment strategy of Hungarian insurers can be still deemed conservative. Based on this, at present no increase in the credit risk arising from the default of the counterparty can be expected either. In the low yield environment the regulation of the institutions' investment decision-making processes and the proper operation of related controls continue to bear utmost importance. The significantly high level of operational risks continues to arise primarily from portfolio management and record-keeping, the operation of IT systems and the often inadequate level of IT security. Insurers manage liquidity risk – assessed among the other important risks – adequately in general, and they need to do so since a potential shift from the low-yield environment and a devaluation of interest-bearing assets upon a maturity mismatch of liabilities undertaken and invested assets, hedging the former, may become a risk jeopardising the insurers' capital position. According to the MNB's expectations, in the short and medium run, as a result of the persistently low yield environment and the epidemiological situation, the insurance and market risks may be even higher than now.

The consolidated capital adequacy ratio, reflecting the capitalisation level across the sector, is 214 percent, which evidences that, based on the trends of previous years, the indicator stabilised over 200 percent. The seemingly reassuring average values reflect both the available capital and the solvency capital requirement, and at individual level there are relatively large differences. With the exception of one insurer, the eligible solvency capital of all institutions exceeds their capital requirement, thereby complying with the statutory regulations. This is also the only institution that did not reach the level of 150 percent, specified in the MNB's capital buffer recommendation; the MNB applies crisis management at this institution, and obliged the company to prepare a recovery plan by 4 May 2020, and by then it also needs to satisfy the capital adequacy requirement.

Owing to substantial additional capital, the capital risk may be deemed stable and moderate, and based on present information, no deterioration in the risk rating is expected.

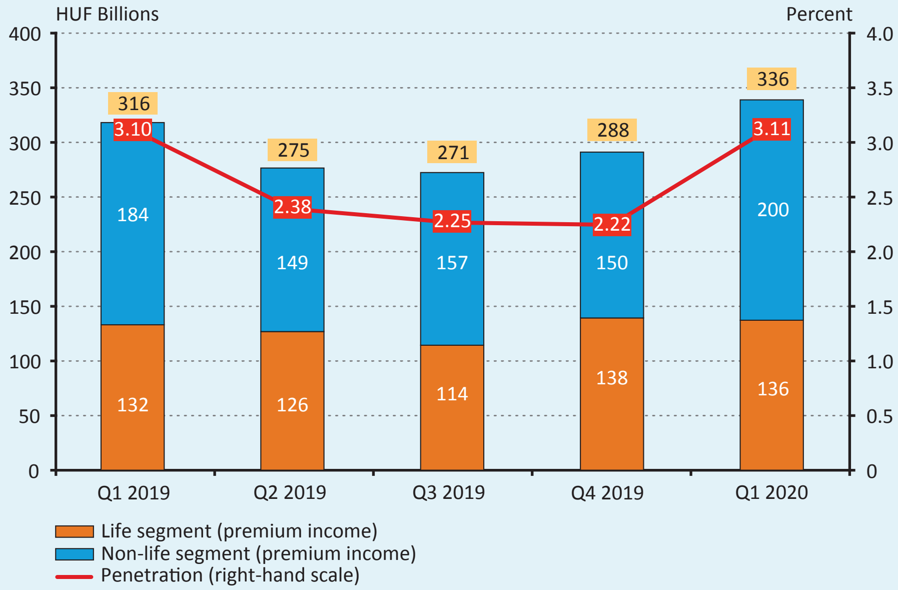
The consumer protection risks identified in connection with the products, and the nature and number of the infringements identified during the comprehensive audits show no deterioration compared to the previous risk level; at the same time, no material improvement can be identified either. The implementation of regulatory changes, entered into force in 2018 and designed to enhance the protection of customers' interests (PRIIPS, IDD), in the internal processes and practice – even despite the major efforts to ensure compliance – have not reduced customer risk materially for the time being. The regulatory changes that extend the need assessment and information obligations to be applied by the insurers during and after the conclusion of contracts, as well as the development and spread of the qualified customer friendly products are factors that strengthen the customers' position, and thus in the coming period they may reduce customer risk.

Box 4
The pandemic has both positive and negative impacts, but the insurance sector remained essentially stable

The pandemic has a dual effect: premium income rose, but the UL reserve decreased as a result of the decline in yields

The threat of the coronavirus pandemic and the real economy impacts are the determinant event of the first half of 2020. Based on the Q1 data, the growth rate of the insurance market fell to 6.3 percent in annual terms. However, the primary reason for this is the base effect of the insurance tax on MTPL. The impact of the COVID-19 pandemic did not appear in the sector-level premium income it the first quarter; the volume of the quarterly premium income is at the same level as in the first quarter of previous year (Chart 31).

Chart 31
Development of gross premium income and penetration in insurance sector



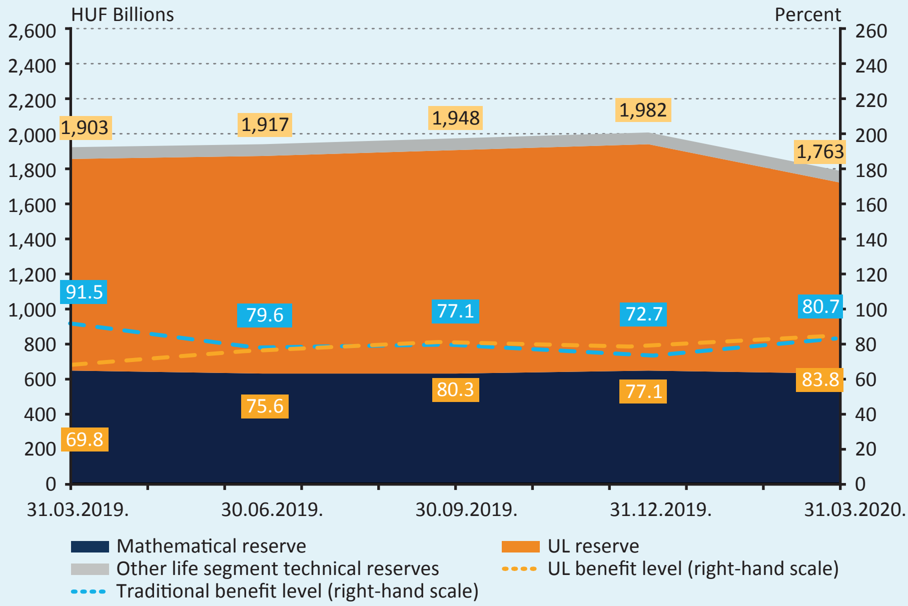
Source: MNB

The pandemic did not break the formerly presented positive trend of the change in premium income from regular premium life insurances; the year-on-year growth is 8.6 percent. On the other hand, the premium income from travel insurances declined by the end of the first quarter of 2020 as a result of the COVID-19 pandemic, and the product type registered a decline of 6.9 percent year-on-year. Foresee, the recovery of the product category may closely follow the lifting of the extraordinary measures taken in the pandemic situation.

Contrary to the expectations, the period of the pandemic did not increase the outflow of cash; in March and April the surrender rate fell short of that registered in the first two months of the year by 8 percent. The cash outflow resulting from the surrenders of regular premium life insurances peaked in March; however, the quarterly trend of the surrenders shows no major year-on-year discrepancy.

In the first quarter of 2020, the value of life insurance reserves fell by 10.8 percent compared to the figures at the end of 2019, which is almost fully attributable to the unit-linked products (Chart 32). Since this business line is sensitive to the change capital market yields, the volatility of the financial market resulting from the pandemic has the greatest impact on it. However, the capital market correction unfolded in April mitigated the degree of the decline.

Chart 32
Developments in life insurance reserves and the related insurance benefit levels



Note: Bbenefit level is the ratio of loss expenditure and the gross premium income. The other life insurance technical reserve includes the following reserve components: Unearned premium reserve, outstanding claim reserve, reserve for premium refund depending on and independent of the profit, claim fluctuation reserve, extreme loss reserve, cancellation reserve and other technical reserves.

Source: MNB

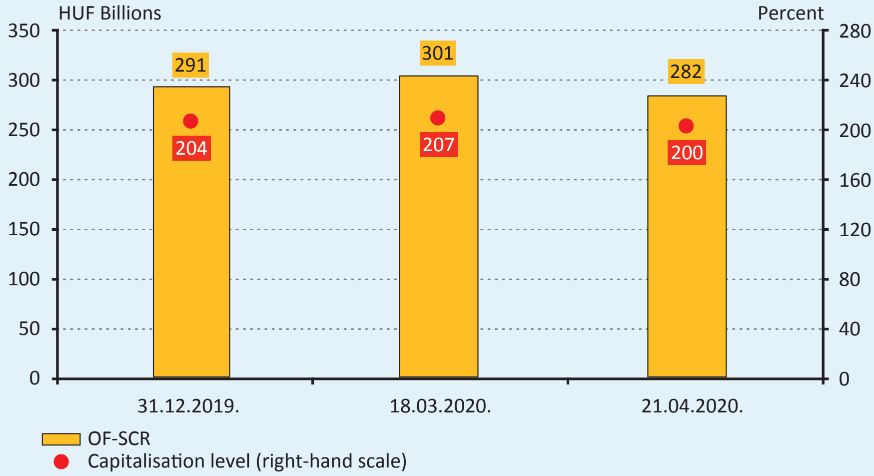
The capital position of the domestic sector remained stable

As a result of the COVID-19 global pandemic, the performance of the major equity indices drastically fell, while the over-one-year section of the government securities yield curve shifted downward by 100 basis points on average within a short time. Following the abrupt downturn, capital markets commenced corrections from the beginning of April 2020: the average performance of the major equity indices started to improve slowly, and the benchmark yield curve's 5-, 10- and 15-year points returned roughly to the values registered at the beginning of 2020. The abrupt yield changes resulted in the major volatility of the existing government securities portfolios; we examined the potential negative impact of this on the Hungarian insurance sector's asset portfolio dominated by government securities and thereby on the capital adequacy for the dates of 18 March 2020 and 21 April 2020.

At the end of 2019, domestic insurers' total assets amounted to HUF 3,050 billion, 56 percent of which comprised investments connected to non-unit linked insurances. Despite the persistently low yield environment almost 80 percent of the assets underlying the reserves for policies other than unit-linked insurance comprise of (mostly Hungarian issued) government securities, which is still outstandingly high even in a European comparison. At the end of 2019 the non-unit linked reserves amounted to HUF 995 billion, accounting for 45 percent of the total technical reserve.

However, due to the conservative asset composition the market turbulence in spring had lesser effect on the Hungarian insurance market. According to the MNB's estimation, the value of assets and reserves may have declined by 2.5 percent and roughly 8 percent, respectively, by 18 March 2020, as a result of which the sector-level solvency ratio may have increased from 204 to 207 percent. As a result of the capital market correction in April and of the flattening of the forint yield curve, on 21 April 2020 the estimated change in the value of assets and reserves is almost identical (- 1 percent); accordingly, based on the estimation, the capitalisation level registered at the end of 2019 would not decrease significantly (200 percent). Accordingly, the capital position of the Hungarian insurance market continues to be strong and stable, which is also evidenced by the fact that despite the stresses the capitalisation level would still exceed the level of 150 percent, expected by the MNB (Chart 33).

Chart 33
Change of surplus capital due to the change of the yield curve



Source: MNB

Extraordinary measures in the extraordinary situation

The MNB regards it as its key duty to monitor continuously the trends taking place in the economy and in the financial system as a result of the spread of the coronavirus, and to assess and identify the risks emerging as a result of the spread of the coronavirus; accordingly, in March 2020, the MNB notified insurers in a management circular of its expectations with regard to the mitigation of risks related to the coronavirus, the basic objective of which was to safeguard customers' assets and to ensure business continuity. The main requirements included that insurers should monitor with special care their invested assets, which have become more volatile due to the change in the economic situation, with special attention to the riskier instruments' industry, geographic, economic or owner dependencies, and follow potential cash outflow or loss of income. The MNB expected the insurers to make efforts to divert their customers towards the electronic and telephone channels, and to call their attention to the fact that life insurance investments are long-term savings, where the temporary investment losses are offset by the positive results of the years after. Furthermore, insurers are expected to develop and offer products providing real protection to the customers in difficult situation, and to pay special attention to the potentially increasing default risks connected to their surety insurances. Simultaneously with this, the MNB also examined the situation of insurers with larger portfolios in the sectors hit hardest by the virus and due to the change in the degree of risks, it called upon them in 5 cases to submit extraordinary own risk and solvency assessment (ORSA).

During April, the MNB once again called upon the Hungarian insurers in a management circular that – in view of the responsible and corporate governance considerations and the communication of the European Insurance and Occupational Pensions Authority (EIOPA) of 2 April 2020 on dividend payments and the application of the remuneration policy – to suspend their dividend and share repurchase payments and postpone the fulfilment of the variable remunerations specified in their remuneration policy, which was duly considered by the Hungarian insurers. As a result of the circular, almost 100 percent of the yet unpaid dividends were suspended.

In relation to the extraordinary situation, the MNB expected the insurers to inform the authority without delay if they identify any unfavourable trend. In line with this, a decision was also made on ordering weekly extraordinary data reporting, where the supervised institutions provide continuous information on their current situation. Based on the first pieces of information from this year, the negative impacts of the pandemic primarily appear in the life insurance reserves, but apart from that most indicators closed the quarter positively.

3 Voluntary Funds market and its risks

3.1 OVERALL PICTURE OF THE MARKET

At the end of 2019, 55 funds operated in the voluntary fund sector, compared to the 58 institutions registered at the end of the previous year, since in 2019 three institutions decided to merge with another fund. No new fund received an activity licence during the year, but the activity licence application of 2 institutions is under assessment. In 2020 the number of institutions is likely to decline further in view of the fact that 2 institutions decided on a merger with another fund, and 1 institution decided on its termination through dissolution without a legal successor. The economic effects of the epidemic developed as a result of the coronavirus may increase risks concerning the operation of funds, due to which further transformations may be expected (mergers, dissolutions).

Table 4
Key data of the voluntary funds sector

	Pension funds		Health and mutual aid funds	
	2018	2019	2018	2019
Number of institutions	37	36	21	19
Number of members (thousand persons)	1 134	1 111	1 044	1 022
Number of members paying membership fee (thousand persons | %)	570 50.3%	567 51.1%	503 48.2%	344 33.7%
Total funds portfolio (HUF billions)	1403	1527	66	65
Of this: Coverage reserve (HUF billions)	*1383*	*1507*	*61*	*61*
Asset value per contract (HUF thousands)	1219	1357	58	59
Membership fee payments (HUF billions)	113	101	52	46
Of this: Annual membership fee payments allocable to coverage reserve (HUF billions)	*108*	*97*	*49*	*43*
Claimed tax credit (HUF billions)	11	12	6	7
Payments against the coverage reserve (HUF billions)	91	127	52	53
Operating profit/loss (HUF billions)	0.26	0.62	-0.03	-0.55
Operating reserve (HUF billions)	15.3	16.6	4.9	4.4

Note: In 2019, of the 19 health and mutual aid funds, 2 operated in the form of health fund, 3 in the form of mutual aid fund and 14 in the form of health and mutual aid fund.
Source: MNB

Significant growth was observed in payments affecting the coverage reserve; while these payments in 2018 amounted to HUF 91 billion, in 2019 payments were made in the amount of HUF 127 billion. The major growth in payments against the coverage reserves was attributable to the rise in benefit payment expenses. In 2018 the members used benefit payments in the amount of HUF 45 billion, while in 2019 the voluntary pension fund benefit payment expenses rose by 54.3 percent and HUF 70 billion was paid. The outstanding value in 2019 is presumably primarily attributable to the negative yield of voluntary funds in 2018, but the emergence of the Hungarian Government Securities Plus (MÁP+) also may have exerted impact on the growth in voluntary pension funds' benefit payment expenses. The number of entrants was not able to offset the number of those who left the funds or received benefit payment, thus the number of the – anyway ageing – members declined further, which represents major risk in terms of the future sustainability of funds. In the voluntary pension fund sector the number of members declined by more than 23,000 compared to previous year. In recent years the number of members in the health and mutual aid funds sector increased, but in 2019 the number of members declined by 22,000. Reaching about 51,000 new entrants was therefore not enough to keep the membership level.

The continuously decreasing employers' contributions, as a result of the change of the tax regulation affecting the fringe benefit system, do not support voluntary funds either. Due to all this it may be assumed that in the coming years the voluntary fund market will be streamlined, mergers are likely to take place and the concentration ratio may increase.

3.1.1 Membership fee incomes declined in 2019 in both sectors

In 2019, in the voluntary pension fund sector the amount of both the individual contributions and the employer's membership fee contribution decreased. While the decline in members' contributions is minimal, employers' contributions substantially declined, due to the change in the taxation rules applicable to the fringe benefit scheme, mentioned earlier. In the case of the voluntary health and mutual aid funds, the decrease in employer's contributions is even greater, and although individual members' contributions increased, they were not able to offset the major decline in employers' contributions. In the health and mutual aid funds sector, due to the steady decline in employers' contributions, the individual role of members and approaching them become increasingly important. While in the voluntary pension fund sector membership fee payments allocable to the individual accounts (coverage reserve) already approximated HUF 110 billion in 2018, in 2019 individual and employer's contributions were credited to the institutions' individual accounts (coverage reserve) only in the amount of HUF 96.6 billion, which falls short of the values of 2018 and even of 2017.

By the end of 2019, the aggregated balance of voluntary pension funds individual accounts exceeded HUF 1,500 billion, and the assets per contract rose by 11 percent, reaching HUF 1,357,000. In 2019 voluntary pension fund benefit payments considerably increased; HUF 70 billion was disbursed in total. In 2018 and 2017 members used benefit payments in the amount of HUF 45 billion and 30 billion, respectively. The rise in the benefit payment expenses was caused mostly by the amount paid as lump sum benefit payment, which increased not only due to the rise in the number of members using the benefit, but also because these members – presumably after a longer accumulation period – claimed a higher pension benefit. The use of annuity benefits is still not popular among the members, and their ratio is negligible within the benefit expenditures.

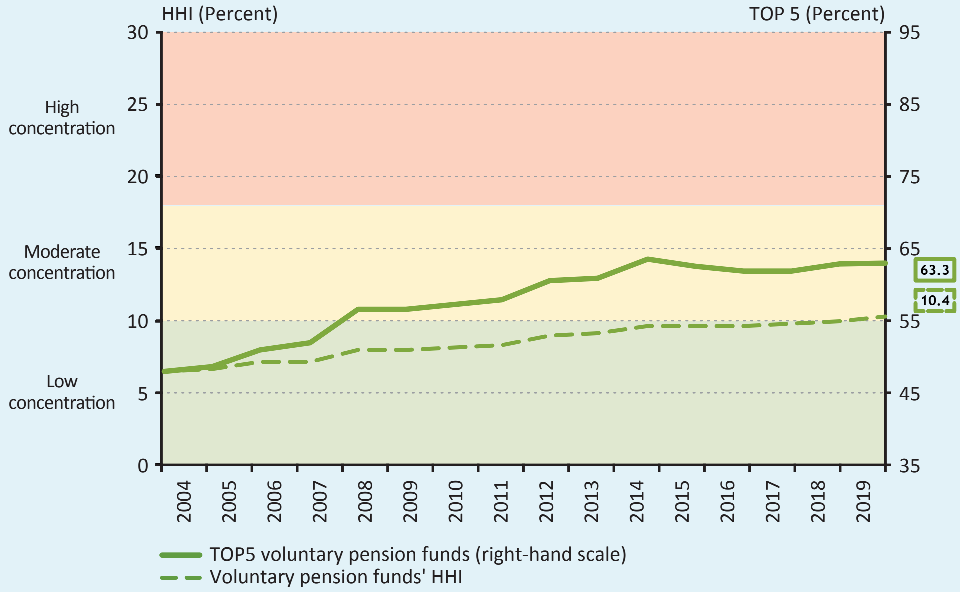
Following a decrease of HUF 721 million, the assets of health and mutual aid funds amounted to HUF 64.9 billion at the end of 2019, of which the assets allocable to the individual accounts (coverage reserve) amount to HUF 60.5 billion. The amount of benefit payments exceeded the sum of the members' and employers' contributions. The amount of benefit payments in the health and mutual aid funds sector stagnated in 2019 compared to previous years.

3.2 VOLUNTARY PENSION FUNDS

3.2.1 Voluntary pension funds exceeded the lower bound of the moderate concentration band

In the voluntary pension fund sector the number of funds declined by one in 2019. The decrease is the result of the merger of a smaller institution. The decision on terminating independent operation was primarily caused by economies of scale problems. In 2020 further increase in the level of concentration may be expected, since merger is likely to take place at several institutions.

Chart 34
Developments in voluntary pension fund concentration



Note: The colour of the background illustrates the strength of concentration under HHI. Contrary to the practice of previous years, this year quarterly data were used only in respect of 2019. The figures of previous years were updated with the annual audited data. Due to this, the chart may differ from that published last year.

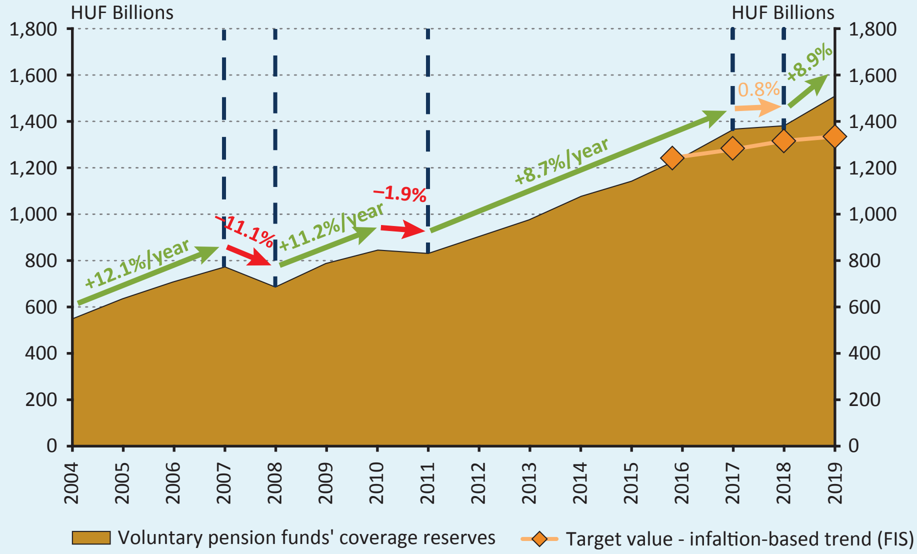
Source: MNB

The value of the Herfindahl-Hirschman-index (HHI), an index that shows market concentration ratio based on the payment of membership fee, moderately rose in 2019 (Chart 34), which is attributable to the merger mentioned above. The market share of the TOP5 funds, based on membership fee income, also increased compared to 2018. When analysing the concentration of membership fee payments it can be observed that 65 percent of the membership fee payments and 53 percent of the employers' contributions in the voluntary pension fund sector come from contributions related to the TOP5 institutions based on assets and number of members.

3.2.2 Dynamic growth in assets after the halt last year (decreasing contributions, but high yields)

At the end of 2019, the balance of the voluntary pension funds' individual accounts (coverage reserve) was HUF 1,507 billion, exceeding the value registered at the end of last year by 9 percent (HUF 1,383 billion). In 2019 the funds approximated the dynamics deemed desirable in the MNB publication entitled "10-year future of the insurance sector in 7 points", but due to the stagnation in 2018, of the projected paths they reached only the inflation-based trend. At the end of 2019, the sum of the individual accounts receivables of members entitled to payment or becoming entitled to payment within one year during the accumulation period was already close to HUF 1,281 billion. On the other hand, it is positive that a considerable number of the members entitled to payment have not yet decided to use their pension fund savings but rather intend to continue augmenting them in the funds scheme.

Chart 35
Developments in the voluntary pension fund coverage reserves



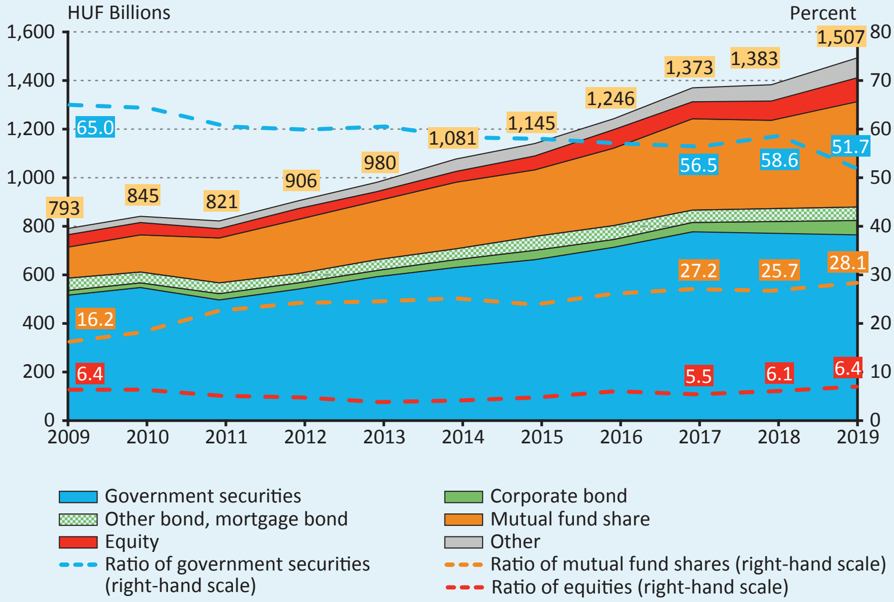
Source: MNB

3.2.3 Decrease in the ratio of government securities investments, increase in the ratio of mutual fund shares in 2019

Investments in Hungarian government securities still account for the largest part of the voluntary pension funds' individual accounts (Chart 36). Compared to the 58.61 percent registered at the end of 2018, direct government securities exposure fell by 6.9 percentage points in 2019, and thus at the end of the year it stood at 51.70 percent. Presumably, in order to offset the negative yields of 2018 and the due to persistently low interest environment, funds moved to riskier investments offering higher yields. In 2019, within the funds' portfolio the share of direct equity investments – owing to the further increase in the ratio of Hungarian equity investments – rose from 6.09 percent registered at the end of 2018 by 0.33 percentage point, and thus at the end of the year it stood at 6.42 percent. Of this 4.37 percent were Hungarian equities at the end of 2019, which represents a 0.37 percentage point growth from 4.00 percent registered at the end of 2018.

The indirect equity exposure of funds, through investment funds, is of similar magnitude as the direct equity exposure. At the end of 2019 it was 6.73 percent, dominant part of which (5.42 percent) is foreign equity exposure. This is due to the fact that funds usually reach the international equity markets through collective investment vehicles. The ratio of mutual fund shares within investment instrument categories rose from 25.65 percent to 28.10 percent, of which the ratio of domestic and foreign mutual fund shares was 18.08 percentage points and 9.98 percentage points, respectively. The ratio of corporate bond investments rose from 2.07 percent to 2.75 percent. By the end of 2019 the share of real estate investment funds within the funds' portfolio fell from 1.88 registered at the end of 2018 to 1.76 percent, while the ratio of direct real estate investments rose, albeit to a small degree, from 0.7 to 0.73 percent. Total real estate exposure (direct and indirect together) amounted to 2.48 percent at the end of 2019. The share of mortgage bonds in the funds' portfolio is negligible; it was 1.20 percent in 2018, while in 2019 it rose by 0.42 percentage point to 1.62 percent.

Chart 36
Distribution of the voluntary pension funds' investments by asset groups



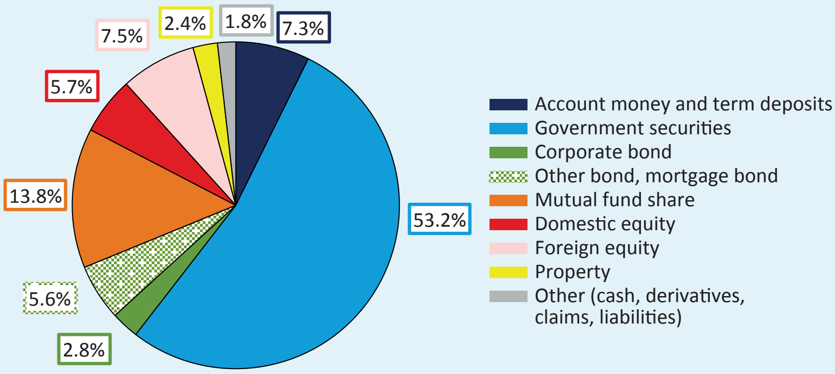
Source: MNB

Box 5
Analysis of the voluntary pension fund sector's portfolio composition, duration and direct risk exposures

The notion of duration is explained in detail in Box 1 entitled "Due to the fall in the yield on short-term government securities average duration rose in the insurance sector". The duration value of the forint-denominated fixed-rate Hungarian government securities portfolio of the voluntary pension fund sector was 4.23 at the end of 2019, which means that a 1 percent change in market yield would cause a price change of 4.18 percent in the portfolio. Compared to the 3.8 years registered at the end of 2018 a lengthening of almost six months took place, which was mostly caused by the fact that by the end of the year short-term yield fell close to zero, and due to this the funds sector usually renewed only a small part of its expiring discount treasury bill portfolio. The lengthening of the duration carries the risk that portfolios will become more sensitive to market yield changes. As result of the almost half-year lengthening in 2019, a 1 percent change in market yields would generate a price change greater by 0.46 percentage point compared to the end of 2018.

When compiling the investment portfolios it is often not possible to achieve the targeted market exposure through individual asset purchase, or it is possible only in lieu of transaction and other costs significantly reducing the yields. The duty of the institutions managing investment funds or other collective investment vehicles is to collect the free liquid assets of individual, private and institutional investors and compile from those – taking advantage of the economies of scale – well-diversified portfolios in cost-efficient manner, sharing the costs and yields. Based on the type of assets their underlying portfolio essentially contains, investments funds can be allocated to different categories, such as equity fund, bond fund, real estate fund. These indirect investment instruments are also included in the voluntary pension funds' coverage reserve investments – moreover, substantially deviating from the EEA average (4 percent), with a share of 28.10 percent, in the amount of HUF 423.5 billion on 31 December 2019. Of these foreign instruments amount to HUF 151.1 billion, which may be an efficient method for the portfolios to acquire exposure in foreign markets. The value of the investment funds issued in Hungary within the voluntary pension fund's coverage reserve was HUF 272.4 billion, which accounted for 18.10 percent of the total coverage reserve. The breakdown of these instruments shows that the funds' portfolios contain foreign instruments indirectly in a value of 11.43 percentage points, where the acquisition of exposures through investment funds may be indeed justified and cost-efficient. For the purposes of providing liquidity, funds kept on settlement accounts amount to 1.61 percentage points, which the investment funds need to be able to fulfil the potential mutual fund share redemption claims. Other items account for roughly 0.98 percentage point, which includes derivative products, loans granted, credits, tangible assets and receivables. However, the remaining 4.07 percentage point comprise of instruments issued in Hungary, which can be acquired directly as well in the domestic markets. Furthermore, the exposure of 18.10 percent includes indirect investment instruments of 3.75 percentage points, which means that investment funds also make investments in other investment funds, thereby creating exposures packaged many times over.

Chart 37
Distribution of the voluntary pension funds' investments by asset groups after breaking down the domestic investment funds

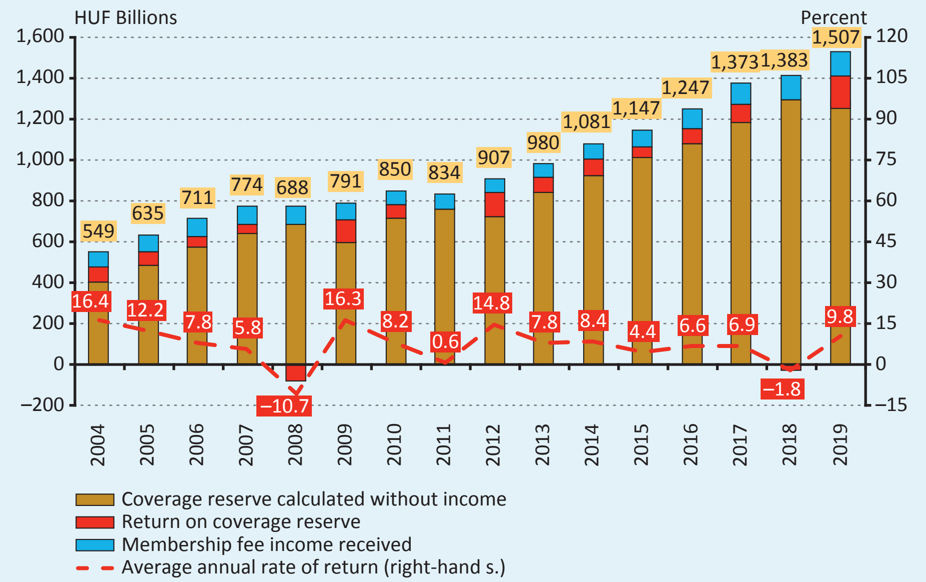


Source: MNB

3.2.4 Increasing fund assets: decreasing contributions accompanied by high yields

In 2019, the voluntary pension funds realised an asset-weighted average net yield of 9.84 percent at sector level, showing a real yield of 5.62 percent when adjusted for inflation (Chart 38). However, there are major differences between the yields of funds. In 2019, net yields on the voluntary pension funds' portfolios varied between 0.05 and 22.99 percent, while in 2018, only low-risk portfolios and a few absolute yield portfolios managed to realise a positive yield. It can be generally stated about funds that portfolios with higher equity ratio and risk profile performed better and realised higher yield in 2019, while portfolios of lower risk exposure, mostly containing government securities investments, realised lower yield. In 2019, funds produced high yields at sector level, but due to the economic consequences of the health emergency caused by the spread of the coronavirus, yield prospects for 2020 are not favourable.

Chart 38
Developments in voluntary pension fund coverage reserve, membership fee income, volume of yields and net annual average rate of return

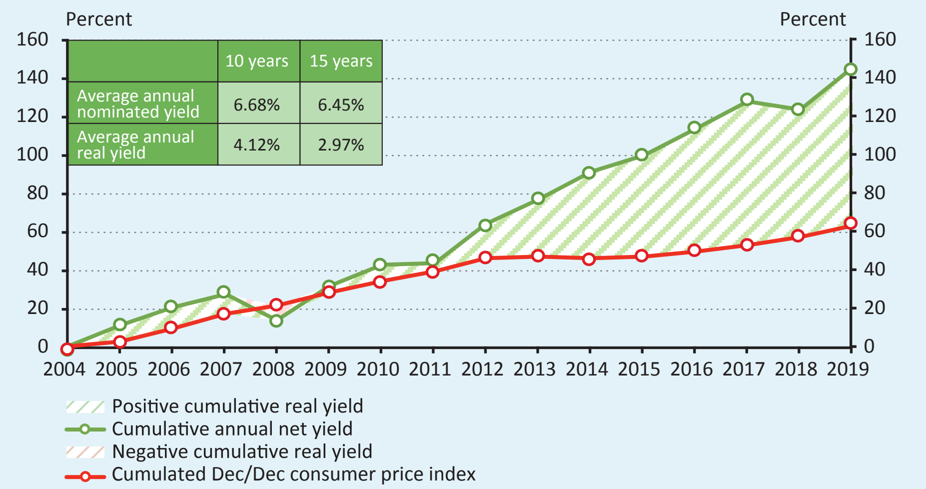


Source: MNB

The purpose of the pension fund savings is to supplement the pension materially in the years following the end of active employment. Following the negative yields realised in 2018 by voluntary funds, in 2019 funds realised high yields, which also evidences that the trends in voluntary fund savings should be assessed on a longer horizon. Weaker investment performance observed in certain years does not necessarily mean that the pension fund member will also face a loss upon using the future benefit or payment, since experience to date shows that the loss of periods of weaker performance was not only adjusted by the positive result of other years, but even exceeded it, thereby increasing the level of long-term savings in real terms as well.

Based on data supplied by the funds, the MNB has published the pension funds' 15-year average rates of return for four years now. Based on the yields of 2005-2019, the average asset-weighted net rate of return at sector level, calculated from the average 15-year yield rates, is 6.45%, which – considering the 15-year average December/December inflation rate of 3.38 percent – represents a real yield of 2.97 percent.

Chart 39
Long-term cumulated net yield of the voluntary pension fund sector



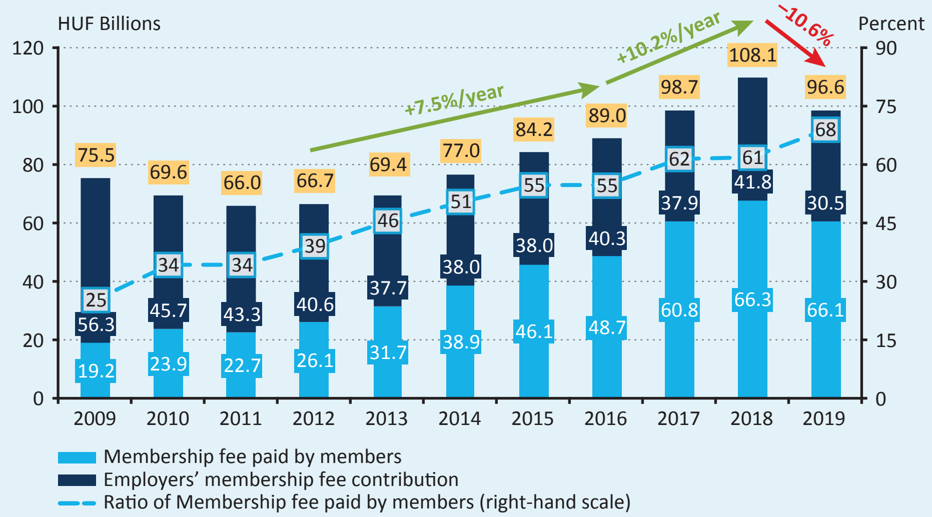
Source: MNB

Based on the strict, statutory cost constraints applicable to voluntary funds and the investment results measured in the longer term, pension funds may still be regarded as a favourable form of pension savings, in addition to the pension insurance and pension savings accounts of similar purpose.

3.2.5 Contributions fell by more than 10 percent

In 2018, the membership fee contributions credited to individual accounts (coverage reserve) of voluntary pension funds reached almost HUF 110 billion. However, in 2019 – after a considerable decline – only HUF 96.6 billion was credited to the individual accounts (coverage reserves) of voluntary pension funds, which falls short not only of the value registered in 2018, but also of that registered in 2017. Receipts were still dominated by individual contributions; individual membership fee incomes account for 68.4 percent of the total annual membership fee income. It can be observed that compared to 2009, the shares of the individual and employers' contribution almost fully swapped place in the sector. Namely, due to the higher tax burdens resulting from the change in the taxation rules applicable to the fringe benefit system, the rate of employers' membership fee contributions significantly decreased, registering a fall of 27 percent compared to previous year (Chart 40). It happened for the first time since 2011 that individual membership fee payments decreased, albeit to a minor degree (by 0.3 percent), and thus they were not able to offset the fall in employers' contributions. On the whole, the membership fee income credited to coverage reserves decreased by 10.6 percent compared to 2018. Due to the major decrease in employers' contribution, special emphasis will be placed on increasing the role of individuals in the future as well.

Chart 40
Membership fee income credited to the voluntary pension funds' coverage reserves, broken down by payers



Source: MNB

3.2.6 No significant change in the ratio of members not paying the membership fee

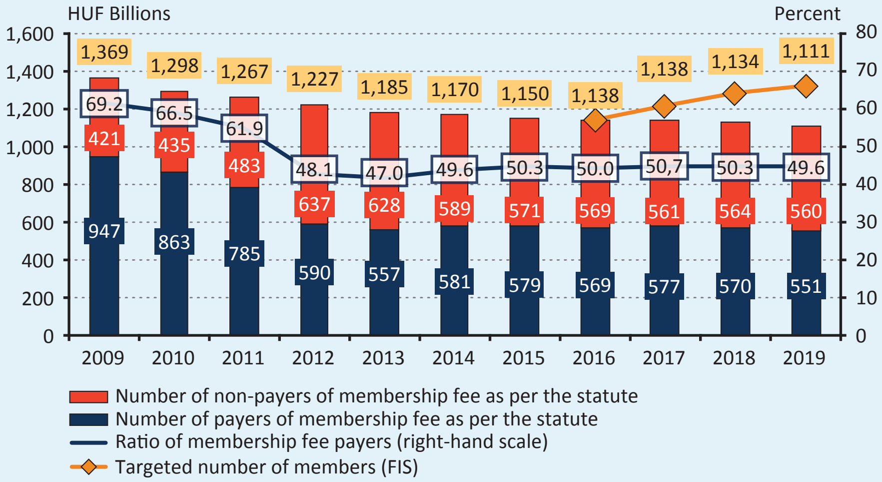
In the voluntary pension fund sector the ratio of non-payer members, calculated in accordance with the statue, peaked in 2013 at 53 percent, followed by a decline; in 2019 roughly half of the members paid membership fees. The proportion of members classified as non-payers based on the statute decreased to a small degree compared to the previous year (Chart 41). The number of members steadily decreases in the sector and it moved further away from the path presented and deemed ideal in FIS (10-year future of the insurance sector in 7 points – With a self-provision outlook), and the ratio of membership fee payers fell by almost 20 percentage points in this period, which carries special risks. Approaching non-payer members and fostering their activity remain a priority.

In 2019, the number of members decreased by 23,000 in the voluntary pension fund sector, caused by the fall in the number of new entrants, by the rise in the number of those who cancelled their membership due to using the pension benefit and by the number of those leaving the fund. In 2018 pension funds registered almost 39,000 entrants, while in

2019 only 32,000 persons established member relationship. In 2019, of the new entrants 21,000 members joined through recruiters. The number of entrants alone may be deemed positive, but it does not improve the current condition of the voluntary pension fund sector, since funds are unable to stop the rise in the level of the average age of members and the decrease in the number of members.

With the rise of the average age in the pension fund sector, the number of members entitled to pension benefit also increases continuously; in parallel with this, the number of members terminating their membership due to using the pension benefit is also likely to rise. This impact may be mitigated by the fact that the legislative changes effective from 1 January 2016, substantially expanded the options of members reaching retirement age. The members entitled to pension, after withdrawing part of the balance on the individual account, may leave the remaining part of their savings in the fund, treating their savings in the fund as a kind of investment opportunity. Based on feedback from market participants, an increasing part of the eligible members use this option; however, for this pension funds need to realise good yields on a continuous basis. Periods that are less successful in terms of investments may undermine eligible fund members' confidence in pension funds as a form of saving.

Chart 41
Membership fee income credited to the voluntary pension funds' coverage reserves, broken down by payers



Source: MNB

The ratio of the non-payment of membership fees has fluctuated around 50 percent in the past 6 years, which may still be deemed high and represents a risk in terms of funds long-term operation. According to the business model of the voluntary funds, the operating expenses must be covered by the amount deducted from the members' payments. Yet in this way non-payers do not contribute to operations. To cover operating expenses the law permits the funds to deduct from the yield realised on the savings of non-paying members, up to the part that may be deducted from the minimum membership fee for operation. This solution helps finance the operation of the fund, and facilitates that any non-paying members also contribute to the operating expenses; however, this does not entirely cover the risk arising from the non-payment of the membership fee. If no sufficient yield is accumulated on the savings of a non-paying member – because due to the balance of the member's individual account and/or the unfavourable developments in the money and capital market environment the realised yield is low – the fund is unable to deduct the costs mentioned above. The majority of the funds make attempts to motivate non-paying members in a positive manner – i.e., with reminders, notices and promotions – to pay the membership fee, and thus funds treat part of the passive members as a potential base for replacement.

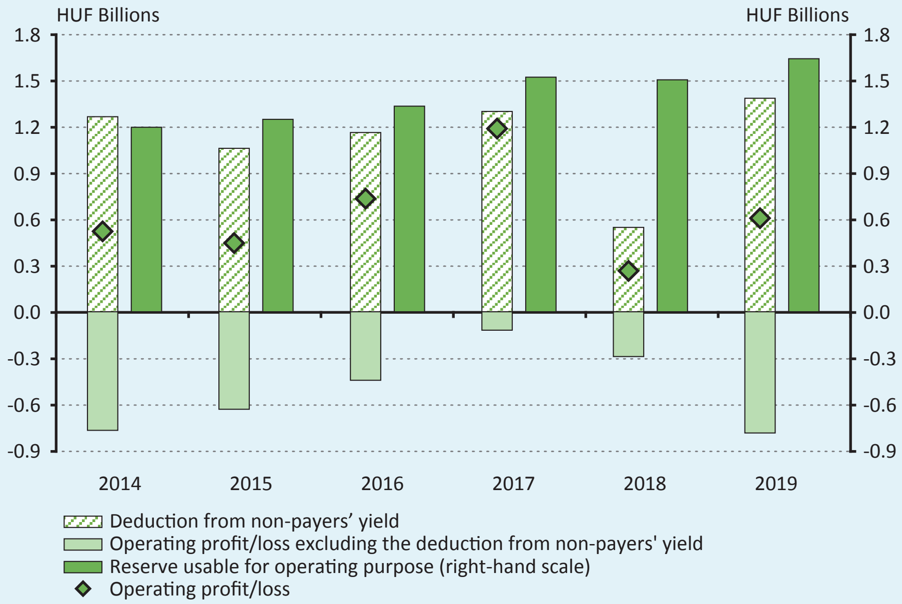
3.2.7 Voluntary pension funds still realise positive operating result

The operation of the voluntary pension fund sector was profitable in 2019, where the yield deductions from the non-paying members had a major role, which was possible as a result of the high yields realised by the funds. Fourteen out of the 36 voluntary pension funds had a negative operating result in 2019. The funds that realise negative operating result in the longer run should reconsider their operating conditions (more actively approaching non-payers, restructuring of the operating cost model).

At the end of 2019, the operating reserves of the voluntary pension fund sector registered a year-on-year growth of 8.5 percent at sector level.

However, there are major differences between the funds in terms of the sustainability of operation calculated assuming full loss of operating incomes; this is presented by Chart 42. By accumulating sufficient operating reserves, funds may secure their own operating conditions and continuity of operations in potential negative periods.

Chart 42
Changes in operating profit/loss of voluntary pension funds



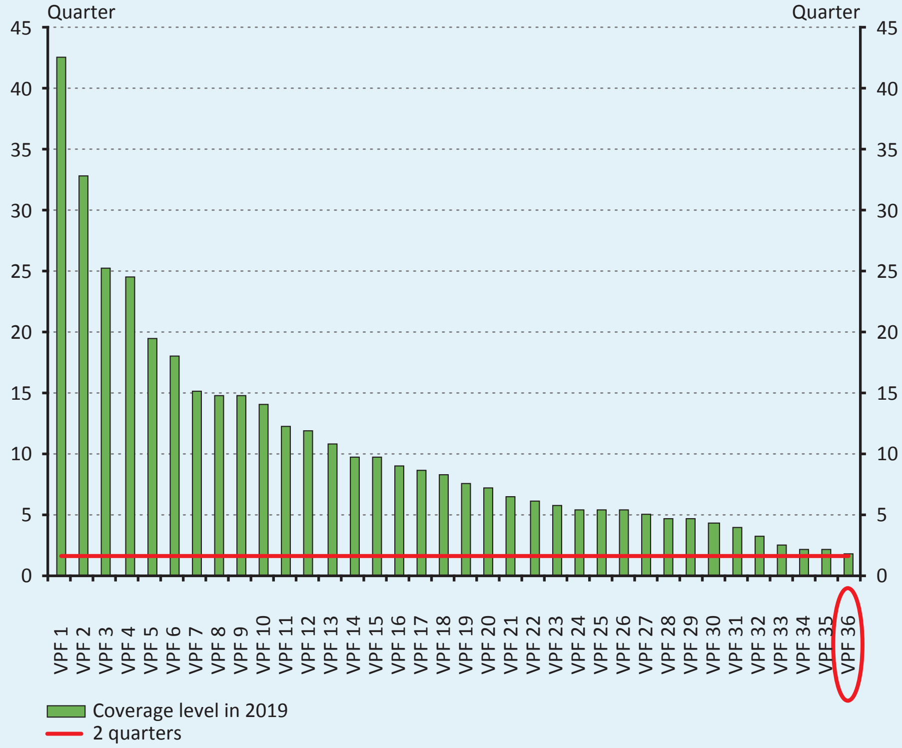
Source: MNB

3.2.8 The number of institutions with inadequate coverage level decreased

From the second quarter of 2017 the MNB developed an index that measures the operating coverage of funds. The index sets out from the balance of the funds' reserves available for operations at the end of the reporting period and from the current and the average operating expenses of the previous three quarters, assuming a fall in operating incomes to zero. Based on the index, the reserves available for operations should ensure the institution's operation for at least 6 months (two quarters) assuming full loss of operating incomes.

It may be regarded as a favourable trend that in 2019 the number of voluntary pension funds with inadequate coverage level decreased by 3, and thus at the end of 2019 there was only 1 institution that did not have of the prudentially expected two-quarter operating reserve, assuming the full loss of operating incomes.

Chart 43
Coverage levels of voluntary pension funds



Source: MNB

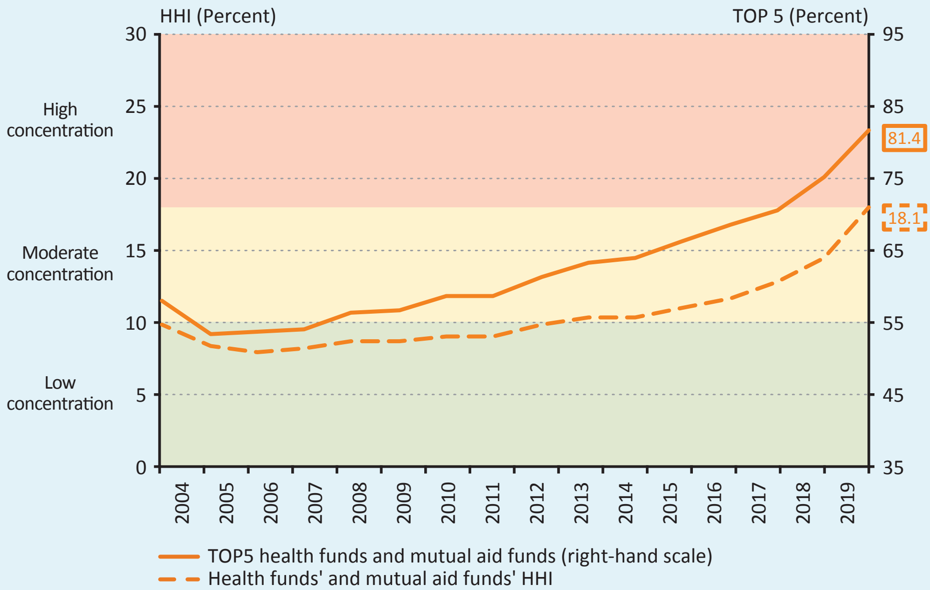
3.3 HEALTH AND MUTUAL AID FUNDS

3.3.1 Concentration continues to increase – TOP5: 75 percent 81.4%

The concentration ratio increased both in the health and mutual aid fund sectors (Chart 44). In 2019, the rise in the concentration ratio is mostly attributable to the merger of a larger fund, as the acquiring fund has become the institution with the largest membership of the sector as a result of the merger; in addition, a small institution also merged. When analysing the concentration of membership fee payments we found that 83 percent of the membership fee payments and 77 percent of the employers’ contributions in health and mutual aid funds sector come from contributions related to the TOP5 institutions calculated on the basis of assets and membership.

Smaller funds are unable to compete with institutions of at least medium size and nationwide network either in the rendering of services or in the related supplementary services of conveniences (e.g. innovative health funds services, discounts available at private healthcare institutions). Health and mutual aid funds that have the support of a bank and insurance background institutions can access members more easily and employers are also keener on concluding the contracts with funds that have a nationwide network rather than with small institutions, with limited capacity for innovation.

Chart 44
Developments in the health and mutual aid funds' concentration



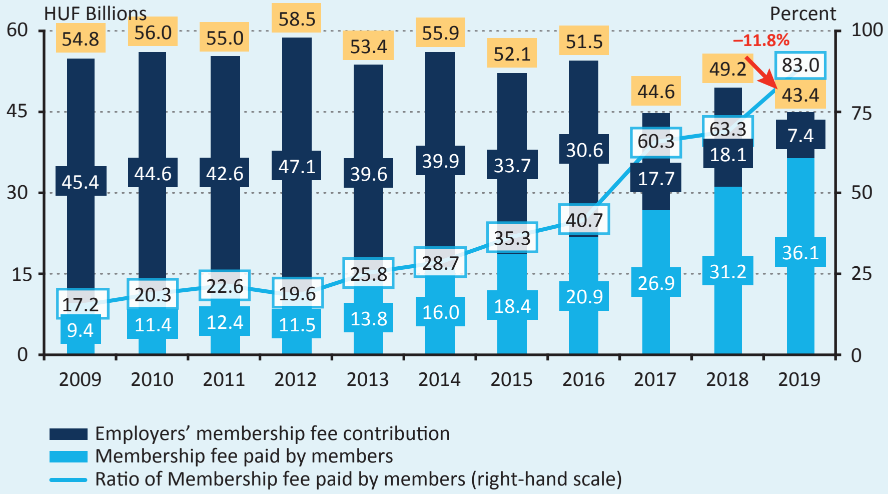
Note: The colour of the background illustrates the strength of concentration under HHI. Contrary to the practice of previous years, this year quarterly data were used only in respect of 2019. The figures of previous years were updated with the annual audited data. Due to this, the chart may differ from that published last year.

Source: MNB

3.3.2 The amount of employer's contribution significantly decreased

In 2019, substantial – 15.7 percent – growth was observed in the individual contributions credited to the coverage reserves of health and mutual aid funds compared to previous year (Chart 45). It may be regarded as a favourable trend that individual membership fee payments in 2019 were almost four times higher than in 2009. However, the amount of employers' contributions fell by 59.2 percent in 2019 compared to previous year, due to the change in the taxation rules applicable to fringe benefits. Employers' contributions merely account for 17 percent of the annual membership fee income. Compared to 2009 the share of individual and employers' contributions completely swapped places; employers' contributions are about to disappear and special emphasis is placed on the members' individual payments. The membership fee incomes credited to the coverage reserves of the health and mutual aid funds registered a total decline of 11.8 percent compared to 2018, as the growth in individual contributions was not able to offset the major fall in employers' contributions. The membership fee payments are still distributed unevenly (seasonality) during the year between the individual quarters. Almost half of the individual annual contributions is still received by the health and mutual aid funds only in the fourth quarter; the ratio of employers' contributions shows smaller volatility in the individual quarters. Benefit payments were made almost in the same amount as last year (HUF 51 billion), which substantially exceeded the membership fee income allocable to the coverage reserve (HUF 43.4 billion).

Chart 45
Membership fee income credited to the health and mutual aid funds' coverage reserves, broken down by payers



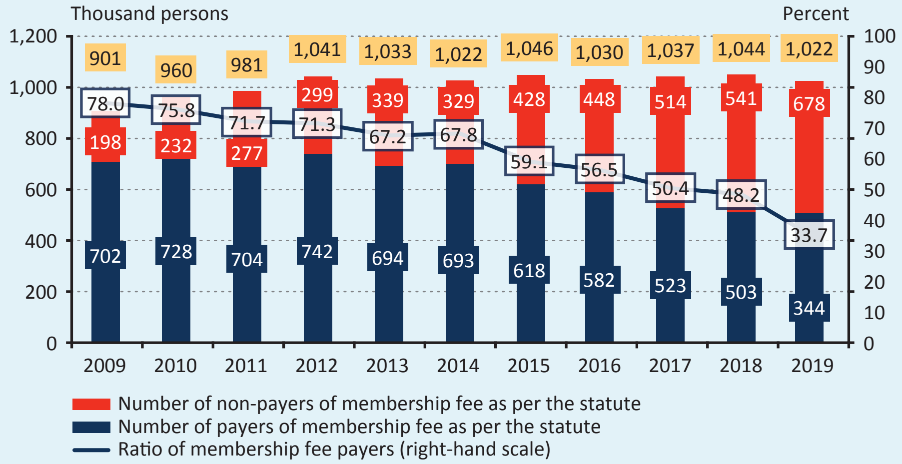
Source: MNB

3.3.3 Despite the rise in individual contributions, the ratio of regular payers of membership fee significantly decreased

The number health and mutual aid fund members decreased by 22,000 in 2019, which was primarily due to exclusion for non-payment of the membership fee (36,000 persons) and the number of members leaving the funds (31,000 persons). Thus the reaching of roughly 51,000 entrant fund members was not sufficient to maintain the level of the membership' numbers. Roughly 30,000 of the entrants joined the funds through recruiters. The ratio of membership fee paying members decreased by almost 14.5 percentage points by the end of 2019 (Chart 46). The reason for this may be that presumably there is a high ratio of members in the sector who make no individual contribution and only augment their assets in the funds through the employers' contributions. Employers' contributions substantially decreases, or even ceased as a result of the change in the taxation regulation applicable to fringe benefits, and thus in parallel with the ceasing of the employers' contributions at certain fund members, they became non-payers due to the absence of their individual contributions.

The consequences of non-payment (e.g. deduction from the yield of minimum membership fee portion usable for operation purposes) are defined in the individual funds' statutes. Several funds believe it is not worth keeping non-payer members with a low balance in such a way that the costs related to them are financed from the membership fees paid by active members; if their statute permits it, they will terminate the membership of these members. Last year several funds opted for exclusion due to non-payment; nevertheless, the membership fee payment ratio deteriorated even further. In 2009, 48 percent of the membership qualified as payers according to the statute, while in 2019 only 33.7 percent of them were paying members. In the past 10 years – with the exception of 2014 – members' willingness to pay has been steadily deteriorating, despite the fact that the amount of individual membership fee income has been rising dynamically in the past years. Awareness of part of the members increased and they also make substantial surplus contributions in addition to the standard membership fee; however, the surplus contributions are primarily received from the regular payers of membership fee, rather than being the result of non-payers becoming paying members. The growth in individual membership fees across the sector may be regarded as a positive trend in its own right; however, in terms of the breakdown of members it also carries a risk, as it may lead to the polarisation thereof due to the foregoing. Experience shows that in respect of managing non-payers, funds also take into consideration that non-payers may start to pay membership fees once again as a result of changes in their income, health and family situation, which later on may have a positive effect on the fund's operation.

Chart 46
Developments in the number of members not paying health and mutual aid fund membership fee



Source: MNB

3.3.4 Increasing demand for preventive benefits and for benefits related to children or housing

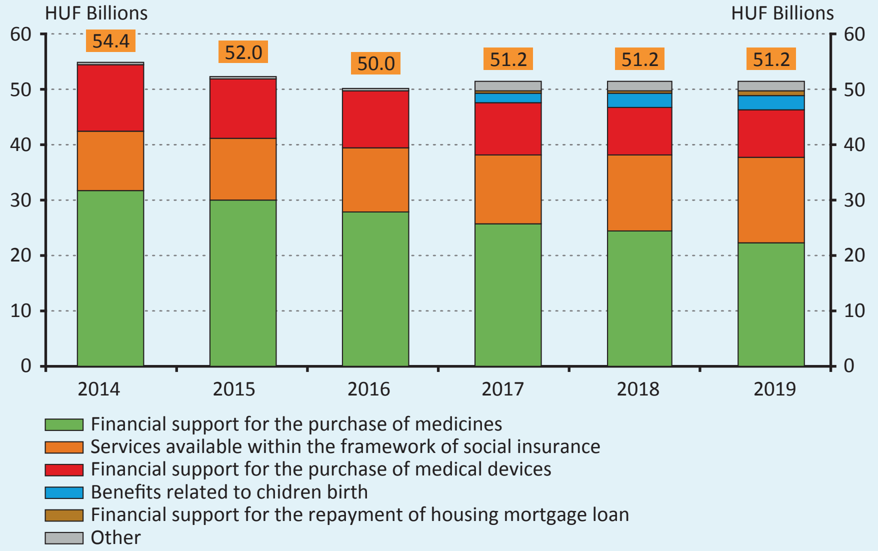
In Hungary, the health system is financed from the central (general government) and local government budget, the budget of the Health Insurance Fund, households' direct payments and from payments of voluntary healthcare financing sub-sectors. The largest part of the voluntary healthcare financing sub-sectors is represented by the healthcare expenditures of the voluntary health funds and the mutual aid funds, operating since 1993. 14 of the funds holding an activity licence operated as a health and mutual aid fund, 3 as a mutual aid fund and 2 as a health fund at the end of 2019. Almost all of the larger funds with nationwide coverage became mixed funds; the institutions operating solely as health funds or mutual aid funds were specialised in a limited range of services.

Of the health and mutual aid fund benefits financial support for the purchase of medicines still accounts for the largest part, at 44 percent after a decrease in the ratio by 4 percentage points, followed by healthcare services at 30 percent after an increase in the ratio by 4 percentage points, (e.g. dentist, diagnostic medical imaging) and financial support for the purchase of therapeutic equipment at 16 percent after a decline in the ratio by 1 percentage point.

There was no significant change in the composition of services; at the same time, the restructuring of the benefit expenditures, observed in previous years, continued in 2019 as well (Chart 47). In 2019, the share of the financing of healthcare services rose to 30 percent from 21 percent registered in 2015, while the share of financial support for the purchase of medicines and therapeutic equipment declined from 76 percent to 60 percent. It should be noted that special nutriments or vitamins purchased for preventive purposes also belong to the category of financial aid for the purchase of medicine.

In parallel with the expansion of the health funds' range of activity, growth can be observed in mutual-aid-fund type benefit payments related to childcare and assistance for the repayment of home mortgage loans. Payments of benefits related to childcare rose from 4.6 to 5.3 percent, while the share of amounts paid as assistance for the repayment of home mortgage loans increased from 0.9 percent to 1.4 percent in 2019. These benefit payments are expected to grow further in 2020. Some of the funds, mostly those with an insurer background expanded their benefits with payment of premiums for health insurance financing services (sickness insurance). In return for an insurance premium, the fund's contracted insurance company partner undertakes to provide the benefits specified in the insurance terms and conditions upon the occurrence of the claim events.

Chart 47
Developments in the health and mutual aid funds' benefit payments



Source: MNB

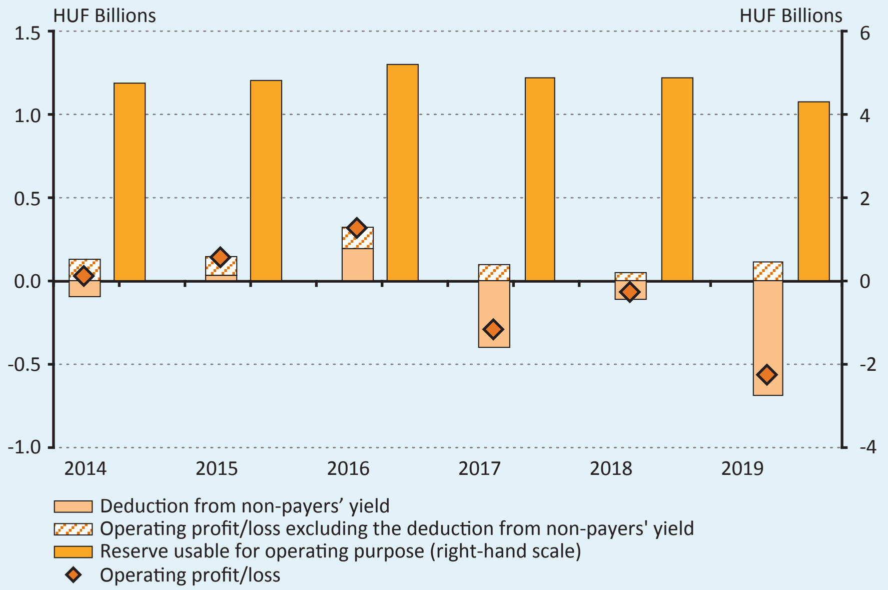
3.3.5 Health and mutual aid funds continue to realise operating losses

The operating profit/loss of the health and mutual aid fund sector turned negative in 2017, also taking into account the amounts deducted from the yield of non-paying members for operation, and funds were also unable to realise a profit in 2018. The health and mutual aid funds closed 2019 as well with negative operating result, but compared to previous years the operating loss is much higher. In 2019, at 11 out of the 19 health and mutual aid funds, the operating revenues were lower than the operating expenditures. At some of the funds the negative operating result was caused by the fact that with a view to eliminating the shortcomings detected by the MNB examinations and approaching the younger generation they started major investments, e.g. in the area of IT infrastructure. The funds that realise negative operating result in the longer run should reconsider their operating conditions (more actively approaching non-payers, restructuring of the operating cost model).

At the end of 2019, the operating reserves of the health and mutual aid fund sector registered a year-on-year decrease of 11 percent at sector level.

By recognising sufficient operating reserves, funds may secure their own operating conditions and continuity of operations in potential negative periods. However, in recent years operating reserves have been decreasing across the sector in the voluntary health and mutual aid fund sector. If this trend continues, certain funds may not be able to respond to environmental, market and other changes flexibly, which may impact their operation and the sustainability of their business model negatively. However, there are major differences between the individual funds in terms of the sustainability of operation calculated assuming full loss of operating incomes; this is presented by Chart 48.

Chart 48
Changes in operating profit/loss of voluntary health and mutual aid funds

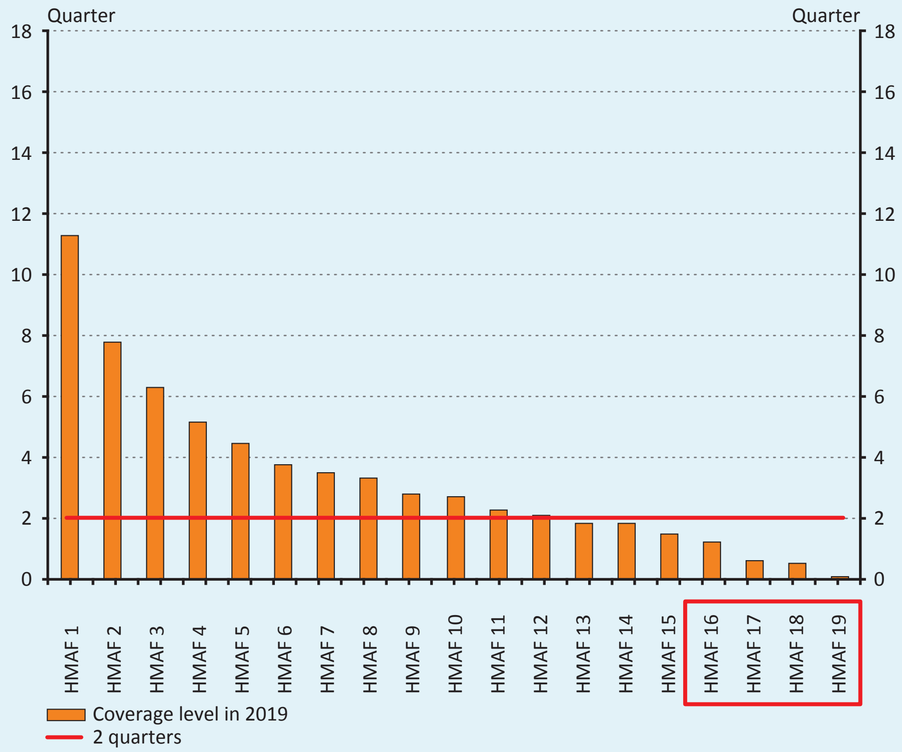


Source: MNB

3.3.6 The number of institutions with inadequate coverage level decreased

It may be regarded as a favourable trend that in 2019 the number of health and mutual aid funds with inadequate coverage level decreased 3, and thus at the end of 2019 there were only 4 institutions that did not have the prudentially expected two-quarter operating reserve, assuming the full loss of operating incomes.

Chart 49
Coverage levels of voluntary health and mutual aid funds



Source: MNB

3.4 RISKS OF THE VOLUNTARY FUNDS MARKET

Risk category	Risk groups	Risk rating	Risk prospects	Textual evaluation
Business model	Environment Strategy, business plans Sustainability of operation	🟠	⬆	• low interest environment, volatility, GDP growth, high yields • significant operating loss in the health and mutual aid fund sector *In H1 2020 negative yields will be expected that may affect unfavorably the business model and sustainability of funds.*
Corporate governance	Exercise of owner's rights Internal governance Risk management system Internal control system	🟡	➡	• participation rate is low at the general meetings • the documentation of the audit activity of the Audit Committee is not always adequate *The quality of internal audit activity needs to be further improved in a significant number of voluntary funds.*
Financial and operational risks	Insurance risk Investment risk of operational and liquidity reserve Operational risk	🟡	⬆	• shift towards more active investment strategies • having regard to positive investment result there was a possibility for yield deduction from non-payers • impact of the change in the fringe benefit regulation: significant decrease in the employers' membership fee contributions • decreasing membership, in the health and mutual aid fund sector the ratio of paying members has significantly decreased *Increasing risk prospects due to the anticipated unfavourable investment results.*
Sustainability and reserve risk	Coverage reserve (individual account) investment risk Capital Operating and liquidity reserve	🟠	⬆	• the number of funds with inadequate coverage level has decreased, concentration has increased further • large benefit payments in the voluntary pension fund sector *Due to the low yield environment, the yields deducted from non-payers are likely to be negligible in 2020, which may also impact the institutions' operating reserves negatively.*
Market entry risk	Products Customers	🟢	⬆	• low number of consumer complains • implementation of voluntary pension fund ACR through recommendation: the average ACR values of the voluntary pension fund sector are outstandingly favourable among the supplementary pension savings *In view of the introduction of group health insurance services and the presumed negative yields, the number of complaints may increase.*

Note:

Degree of risk — *high* 🔴 *significant* 🟠 *moderate* 🟡 *low* 🟢

Direction of risk — *increasing* ⬆ *stagnant* ➡ *decreasing* ⬇

Fund contributions decreased despite the GDP and wage growth in 2019. The change in the taxation regulation applicable to the fringe benefit system had major impact on membership fee incomes, as employers' membership fee contributions significantly decreased. The emergency developed due to the spread of the coronavirus may have negative impact also on the funds' strategy and business model; due to the yield losses some of the funds may need to reconsider their strategy and operating conditions. There are still potentials in the recruitment of members; reaching of the young generation is extremely important.

The functioning of the delegate scheme is still problematic; the election of delegates is not regulated properly in certain cases and the structure of delegate districts is disproportionate at some places; the delegate system elaborated due to the low member attendance at the general meetings does not improve significantly the representative ratio either.

There are still shortcomings in the internal control systems; the documentation of the audit activity of the Audit Committee is not always adequate; the monitoring of the internal audit findings is not continuous. The quality of internal audit activity still calls for improvement at most funds.

In the case of the contracts concluded with external fund partners, the accountability for the agreements is still not always guaranteed and certain invoices for services are paid without confirmation of fulfilment.

Due to the negative yields in 2018, funds started to implement more active investment strategies in 2019; they moved towards riskier investments offering higher yields in order to offset the negative yields of previous year. Based on the operating coverage indicator the operation of certain funds remains risky due to the low level of available reserves; however, the number of funds with insufficient operating reserves decreased by 6, and thus only 5 funds' operating coverage level falls short of the prudentially expected two quarters, assuming the full loss of operating incomes. At these funds customised measures should be applied, (e.g. support by the background institution; prescribing liquidity reporting obligation, supervisory authority letter).

The MNB identifies it as a risk that due to the economic effects of the coronavirus pandemic membership fee contributions, and together with that the amount of the operating incomes may decrease, and if in 2020 the investment result of the voluntary funds will be negative, they will not be able to enforce the yield deduction from the non-payers either.

In the voluntary pension fund sector high amounts of lump sum benefits and disbursements after the expiry of the waiting period were paid, which may have been attributable to the negative yields in 2018 across the sector and the emergence of the Hungarian Government Securities Plus (MÁP+).

Further increase in the concentration ratio is expected, as several smaller institutions will terminate their operation through merger.

The supervisory inspections identified significant shortcomings in connection with the IT systems. At part of the funds virus protection is inadequate, and the security risk analysis of the IT system is not performed with the required frequency.

The MNB introduced the annual cost ratio for pension fund products (pension fund ACR) through a recommendation. Relying on the pension fund ACR, the costs of the products can be expressed in a simple form comparable with the life insurance products, in a single value. The institutions submitting pension fund ACR data reporting cover 99.94 percent of the sector based on the number of members. The fund ACR values show that the annual cost ratios of the voluntary pension fund sector are prominently favourable in the area of supplementary pension savings.

In the case of the voluntary pension funds, upon reaching retirement age still only a small part of the members opt for the annuity benefit; the online pension calculators, already applied by some of the funds, may help to strengthen this trend.

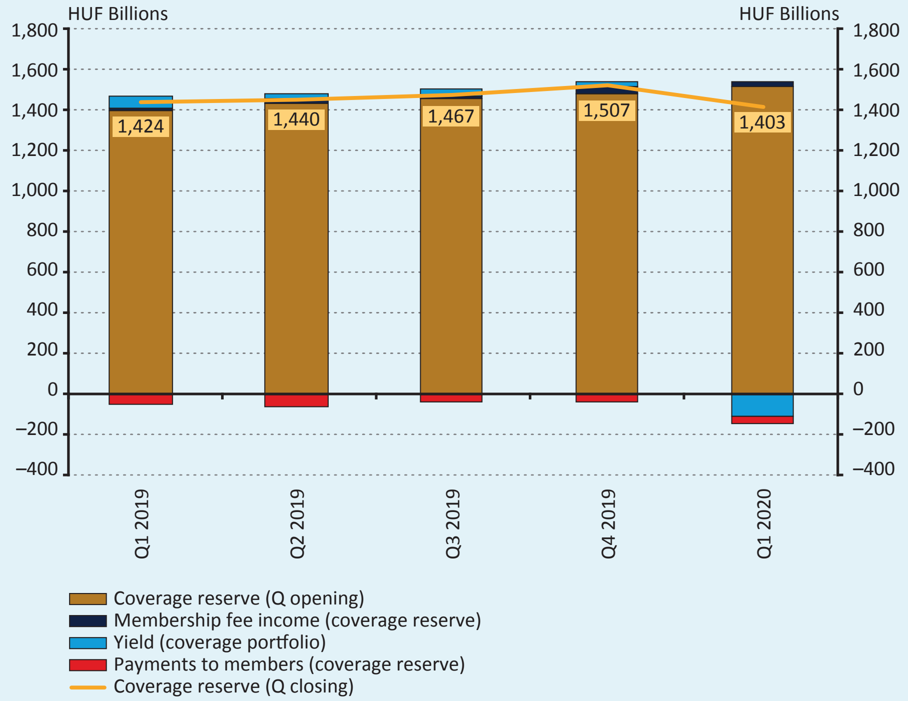
Of the product and service types offered by the health and mutual aid funds, the purchase of medicines and therapeutic equipment, as well as the use of healthcare services, still account for the largest part. However, several benefits available from the health and mutual aid funds are still not well known; in respect of these, the institutions launched various marketing campaigns and are developing collective services offered at preferential prices. However, a more intensive supply of information to members is essential for use of the fund benefits of mutual aid nature.

Box 6
The negative impact of the pandemic appeared only in the reserves, while no risks emerged in the contributions and disbursement in the voluntary funds sector

Voluntary pension funds

In the first quarter of 2020, the number of members stagnated in the voluntary pension fund sector and half of the members qualified as paying members. The membership fee contributions credited to the coverage reserve was higher by 12.3 percent year-on-year. The sum of the individual membership fee incomes and of the employers' membership fee contributions exceeded those registered in the first quarter of 2019 by 12.4 percent and 12.2 percent, respectively. Nevertheless, compared to 2019 the balance of individual accounts (coverage reserve) decreased. By the end of the first quarter of 2020, the amount of the voluntary pension fund sector's coverage reserve fell to HUF 1,403 billion, which falls short of the amount registered at the end of the previous quarter (HUF 1,507 billion) by 6.9 percent, and also of the amount registered in the first quarter of 2019 (HUF 1,424 billion). The decrease was caused by two factors. On the one hand, the extremely intensive fall in capital markets caused by the pandemic and the negative investment result of voluntary pension funds resulting from that, and on the other hand, the disbursements made in excess of membership fee payments. The investment result of the voluntary pension fund sector in the first quarter of 2020 was negative due to the impact of the pandemic on the capital market; however, it should be noted that owing to the diversification of the funds' portfolio, the dominance of lower-risk assets and the appreciation of the euro and dollar against the forint, the institutions incurred lower investment losses than the decline in the capital market indices (CETOP20: -32.42 percent, BUX: -28.10 percent, EURO STOXX 50: -25.65 percent, MSCI EM: 23.87 percent, MSCI WORLD: 21.44 percent, S&P500: -20.00 percent). Disbursements from the individual accounts (coverage reserve) and benefit expenditures fell short of the year-on-year value by 14.9 and 9.4 percent, respectively, i.e. no outflow of assets from the voluntary pension fund sector commenced. Following the first quarter of 2020, the value of the voluntary pension fund sector's coverage reserve started to increase moderately after the decline resulting from the impact of the coronavirus pandemic. (Chart 50)

Chart 50
Cash flows of the voluntary pension funds' coverage reserves



Source: MNB

In the first quarter of 2020 the direct government securities exposure was 53 percent, representing a decline of 4.5 percentage points compared to 57.5 percent registered in the first quarter of 2019. Within the funds' portfolio the ratio of direct equity investments (6 percent) has not changed year-on-year. The ratio of mutual fund shares and corporate bonds within the investment asset categories rose from 27.1 to 27.8 percent and from 2 to 3 percent, respectively, in the first quarter of 2020, year-on-year.

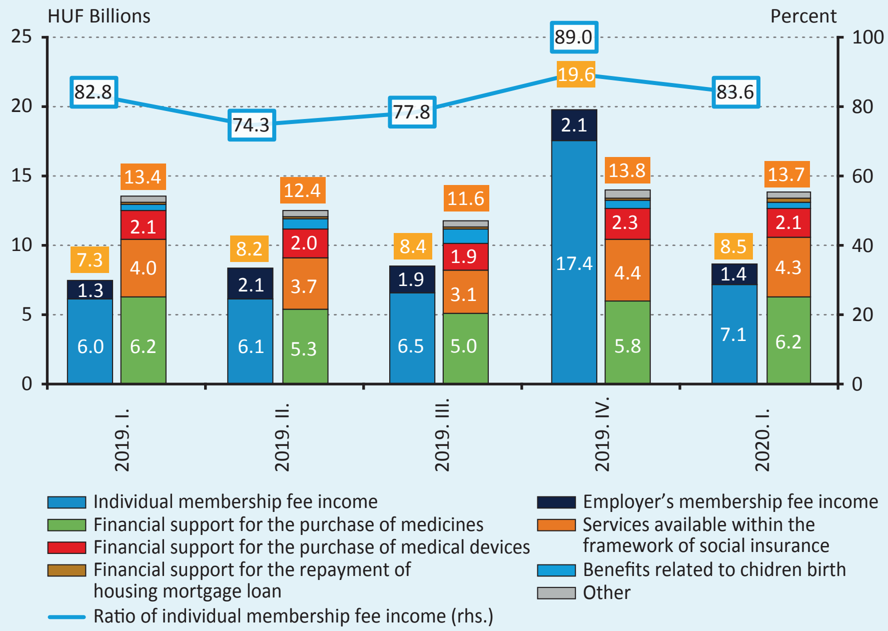
In the first quarter of 2020, 22 voluntary pension funds realised an operating loss; however, in this period, yield deduction from non-paying members could be enforced, albeit to a small degree, as a result of which the sector-level operating result became positive. In the first three months of 2020, the operating reserve at sector level declined by 2.7 percent compared to the end of 2019. At the end of the first quarter of 2020, the prudentially expected two-quarter operating reserve requirement, assuming the full loss of operating incomes, was not satisfied by 3 institutions; accordingly, these funds must sort out their operating conditions in order to raise their operating reserves to the required level.

For the time being, the health emergency announced due to the spread of the coronavirus and the economic consequences thereof had no negative impacts on the payments to and disbursements from voluntary pension funds. However, it should be noted that it will be possible to identify the potential negative effects of the coronavirus on the voluntary pension fund sector only in the knowledge of the funds' data reporting related to the second quarter of 2020. Prior to that, and in order to ensure that the MNB can identify the potential negative effects and risks immediately, without delay, it performs daily or weekly (depending on the institution size) monitoring among the voluntary pension funds based on a dedicated questionnaire. The responses given to the questionnaire show that no panic and mass cash withdrawal by fund members commenced; based on the reports of the institutions, disbursements by funds did not rise significantly, which may have been greatly attributable to the proper application of risk management and communication techniques by the funds, and also to the fact that the members act with due awareness and in line with the objective and long-term interests of the voluntary pension fund product. The MNB ordered extraordinary data reporting related to the disbursements by the funds among the voluntary pension funds, the purpose of which is to monitor the volume of disbursements from the sector on a weekly basis. The already received data show that for the time being the spread of the coronavirus has no major effect on the contributions to and disbursements from the funds.

Health and mutual aid funds

In the first quarter of 2020 the number of members increased by 5,534 in the health and mutual aid fund sector. The ratio of non-payers is 54.6 percent, exceeding the year-on-year value by 3.8 percent. A rise of 16.3 percent, year-on-year, was observed in the contributions credited to the coverage reserve of the health and mutual aid funds sector. The amount of the membership fee paid by members and of the employers' membership fee contribution exceeded the values registered in the first quarter of 2019 by 17.4 and 11.1 percent, respectively. Disbursements against the coverage reserve increased by 1.8 percent year-on-year. (Chart 51)

Chart 51
Changes in the benefit payments and membership fee incomes credited to the coverage reserves of health and mutual aid funds



Source: MNB

In the first quarter of 2020 the breakdown of benefit payments by funds is similar to that in the first quarter of 2019. However, compared to the fourth quarter of 2019, a change in the area of using the financial support for the purchase of medicines can be observed, which resulted from the emergency announced due to the coronavirus. After the announcement of the emergency, part of the health and mutual aid fund members suddenly started to stockpile medicine, trying to avoid any potential shortage of supply. As a result of this, a temporary rise – lasting a few days – in the benefit expenditures used for the support for the purchase of medicines was observed, and the ratio of the support for the purchase of medicines within benefit expenditures rose to 45.5 percent, representing a growth of 3.1 percentage points compared to data registered in the fourth quarter of 2019. The ratio of healthcare services decreased from 32.1 percent to 31.1 percent, while the financial support for the purchase of therapeutic equipment fell from 16.7 percent to 15.1 percent compared to the fourth quarter of 2019.

The health and mutual aid fund sector was characterised by an operating loss also in the first quarter of 2020; moreover, the operating reserve at sector level fell by further 3.2 percent compared to the end of 2019. The number of institutions that do not have the prudentially expected operating reserves sufficient for two quarters, assuming the full loss of operating incomes, is still 4.

4 Insurance, fund, consumer protection and intermediary risks

The Magyar Nemzeti Bank started a new 6-year cycle from 2020, in the strategic objectives of which – in line with "stability and trust" core values – consumer protection received even greater attention than before. In this ideology, the prudential and consumer protection supervision are equal tasks that reinforce each other, reflecting the conviction that the prosperity of market institutions can be achieved only upon the simultaneous realisation of prudent operation and consumer-centric approach.

The achievements of the previous cycle, e.g. the effects of the ethical regulation introduced in the area of life insurances are indisputable and exemplary. After the assessment of the initial status – the institutional integration of the financial supervision in the activity of the Magyar Nemzeti Bank – the primary objective was to ensure that the consumer protection activity reaches the same level in terms of organisation, audit methodology and efficiency as the prudential supervision. Following the successful implementation of this, from 2019 the two areas continue their operation integrated also in terms of organisation, taking even more advantage of the functional synergies and relations with the market participants and eliminating the potential redundancies. The new structure also maps the expectation of the EU professional organisations better. EIOPA provided positive feedback already during its 2018 country visit and in its repeated reports afterwards concerning the cooperation of the consumer protection and prudential areas of the Hungarian supervisory authority, and it definitely welcomed the integration in 2019. In line with this, the domestic professional organisations also formulated positive expectations with regard to the organisational changes and the consumer protection principles laid down in the new strategy of 2020.

4.1 CONSUMER PROTECTION REMAINS A KEY FOCUS-AREA IN THE SUPERVISORY STRATEGY

4.1.1 Increasingly complex tasks of growing volume – New strategic focuses

In recent years, the MNB's consumer protection activity – also in connection with the change in the domestic and EU regulatory environment and the spread of innovative products and sales method, digitalisation and environment-conscious trends – has broadened and become more complex. In 2019, the MNB's customer protection department received 551 consumer petitions related to the insurance market, 31 to the funds sector and 10 to the activity of independent intermediaries, as well as 5,283 customer service requests related to insurers, 234 to funds and 103 to intermediaries (of which 1,168 was received in email, 3,775 over the phone, and 677 in person). Due to the new challenges and expectations, proactive audit planning based on the identification and assessment of risks affecting a wide range of consumer gained increasing importance, which is equally based on numerical analysis (identifying outliers, atypical patterns or distinct trends) and on the summary of received customer enquiries and reports, the identification of problem accumulation or joining the collective EU audit activities. The increasingly complex tasks inevitably call for new approaches and solutions in certain elements. The inspection of the due application of POG, i.e. product oversight and governance guidelines, pervade the MNB's supervisory activity.

4.1.2 Strengthening of consumer-centric approach

Together with the organisational restructuring, certain methodological changes and shifts of emphasis may be also traced in the daily activity, such as the integration of individual petitions in larger audit topics, including a slightly different approach to the "ne bis in idem" principle than before and together with that the investigation of the submitted petitions to a larger degree than before. The even more effective inspection methodology – more efficient for the consumers in respect of their individual goals – is increasingly emphasised (including the provision of information to the petitioner consumers as soon and as clearly as possible about their options in the MNB's procedures and the other available legal remedies and enforce their interests). There are also tangible changes in the more active use of the forms of communications other than those formally closing the inspections – order, resolution – perfectly supplementing those (e.g. management letters, consumer protection warnings, actions brought in the public interest). The MNB is firmly committed to fostering the finding of reassuring solutions for all parties through its daily activity also beyond its administrative instruments, without coercive force, by purely outlining the options.

Box 7
Assessment of welcome calls from a new perspective

In 2019, the MNB also assessed with special care the implementation of its Recommendation 8/2016 (VI.30) issued earlier in connection with the unit-linked life insurances. In Section 54 of the recommendation issued for the purposes of monitoring sales and identifying misselling or inadequate selling, the MNB outlined the expectation that within the 30-day notice period available to the consumer after the conclusion of the contract, the insurer should ascertain through a recorded welcome call, using a predetermined series of questions, that the customer is aware of its long-term – which may as well be regular – obligations, and in the course of this the insurer should ascertain that the contract has been made in accordance with the customer's transaction will.

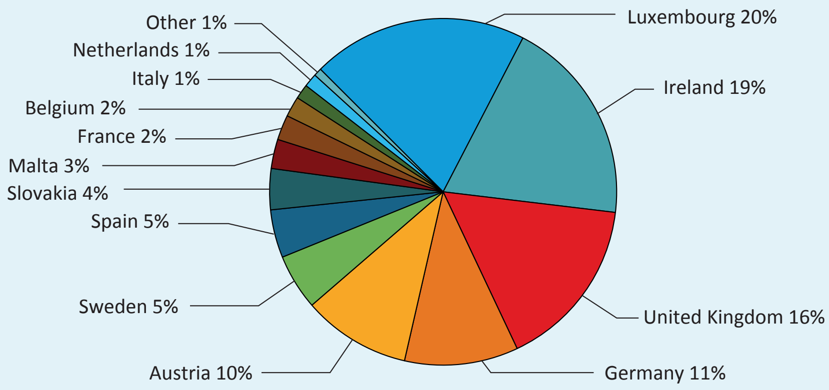
Listening to the recorded call is a very important contribution to the reconstruction of the facts stated in the petitions and in the proof of the often contradicting statements. Based on the individual petitions for consumer protection proceedings, the MNB detected in the insurance sector different quality in the welcome calls made after the conclusion of the unit-linked contracts, and therefore it inspected the implementation of the practice expected in the recommendation within the framework of an ex officio consumer protection thematic review. The review proved the different practice of the financial service providers, and therefore the MNB ponders additional measures in order to standardise the practice.

The topic of the "exit calls", to be elaborated and introduced on the model of the welcome calls, is a similarly progressive initiative, the use of which has been already raised by the MNB before as a means to the use of which the respective institutions should give consideration during the investigation and assessment of certain individual, petitioned cases, but in the future it will press for the comprehensive and standard use of it in the insurance market. These voice recordings, recorded at times close the provision of the service, may also provide the MNB with useful information for supervisory purposes – in the identification and understanding of wider trends, and major market impacts influencing the attitude and acts of consumers, as well as in the assessment of specific individual petitions, but it offers even greater benefits to institutions wishing to improve customer experience through better and better services and cooperative communication, interested in the protection of their portfolio and to the consumers expecting the most precise information and assistance even in this last phase of the cooperation. Upon the uniform and proper implementation of exit calls, institutions can survey the motivations of their customers using the service, the reasons for stopping the cooperation (with special view to surrenders before maturity), and at the same time may provide information on the contractual rights and obligations, the exact parameters of the surrender, and particularly on the amount effectively available to the consumer. The reassuring clarification of these groups of questions cover a major part of the petitions received by the MNB; therefore, according to the future expectations of the MNB, the exit calls must be carried out at most benefit payments at maturity and at each of surrenders before maturity. Naturally, during the elaboration and application of the system, the data processing and data protection aspect must be also taken into consideration, bearing in mind the types of rights and opportunities the respective institutions have for contacting the consumers after the end of the contractual relationship.

4.2 SPECIAL FOCUS ON THE INSTITUTIONS RENDERING CROSS-BORDER SERVICES

Pursuant to the relevant EU laws, the MNB has limited instruments for the prudential supervision of institutions rendering cross-border services; nevertheless, compliance with consumer protection requirements is a basic expectation. In view of the fact that all financial service providers performing insurance activity in Hungary – irrespective of the registered office or corporate form – are subject to the same consumer protection rules, with a view to protecting the rights of consumers, the MNB continues to act consistently and firmly also against those insurance service providers registered abroad that operate in Hungary in breach of the statutory requirements.

Chart 52
Breakdown of Hungarian cross-border activities by countries



Source: EIOPA

Since the opening of the Hungarian market also to institutions pursuing cross-border activity, the legal framework developed in the same way as the inspection methodology and – when necessary – intervention and sanctioning tools. The case of the Romania-based Astra Insurance created a precedent. Following the withdrawal of the parent insurance company's licence and its liquidation, the Hungarian branch office of the insurer was not authorised to continue its activity either. Simultaneously with the withdrawal of the activity licence, the MNB – with special view to the fact that the branch office managed a large portfolio of compulsory motor third party liability insurance in Hungary – launched targeted inspection and ensured the payment of the MTPL claims through temporary measures, and thus no Hungarian consumer suffered any loss.

The supervision and inspection of institutions rendering cross-border services was a key duty in 2019 as well, with special regard to contractual terms and conditions departing from the standard practice, investment target groups representing particularly high risk or sensitive target groups in need of special protection. Within the framework of this, the MNB conducted two ex officio consumer protection targeted inspections at an insurance company rendering cross-border services, distributing life insurance products. In view of the communication practice identified during the inspections, the MNB prohibited – until the restoration of the lawful condition – the distribution of the respective insurer's certain unit-linked life and pension insurances in Hungary, because it found that the customer information documents related to those do not specify clearly whether the insurer undertakes any capital or yield guarantee. In the case of another product of the insurer, the MNB also adopted temporary measures to prevent the distribution of the new product, since according to the identified data the documents to be provided on a mandatory basis, presenting the essential features of the insurance products, such as the Annual Cost Ration (ACR) notice, presenting the expected costs, and the Key Information Document (KID) presenting the future performance of the underlying asset funds contained – misleading – information based on calculations performed with the use of erroneous methodology. Based on erroneous methodology, the Insurer presented to its customers lower costs and in certain cases unreal anticipated amount on maturity.

4.2.1 Impact of Brexit on Hungarian consumers

The MNB continuously monitors the exit of the United Kingdom from the European Union (Brexit) in order to have the clearest possible picture of the potential effects impacting Hungarian consumers. The exit materialised with effect of 31 January 2020, while the transitional period lasts until the end of this year. Following the acceptance of the proposal on the exit, the MNB contacted the insurers with permanent establishment in the United Kingdom, active in the Hungarian market in the form of cross-border services. The enquiry was sent to 26 insurers, 11 of which sent detailed information both on the contracts managed by them and on the measures becoming necessary due to the Brexit. Based on EIOPA's data from the end of 2018, the value of gross written premium in the Hungarian market (corporate, retail, reinsurance) was HUF 25.2 billion. The received answers imply that in the area of direct insurance they provide insurance protection essentially for the corporate sector in the property insurance, general and professional liability insurance business lines (86 contract, gross written premium: HUF 816.5 million).

In the retail area, the business lines in which the insurers were active vary. In the non-life segment mostly health insurance contracts were concluded (134 contracts, gross written premium HUF 124.5 million), while in the life insurance segment we have knowledge of 2 group insurance contracts (life insurance and pension insurance, sum insured HUF 166.5 million). Based on the data available to us it can be stated that the impact of the United Kingdom's exit has limited impact on Hungarian consumers; nevertheless, the MNB will continue to pay special attention to the potential effects of Brexit on Hungarian consumers.

4.3 CONSUMER-FRIENDLY APPROACH AT THE INSURERS

The ethical regulation was introduced in 2017 for life insurances, and among other things, the consumer protection measures of the MNB decree issued on the subject of the life insurance need assessment, brought major changes in the transparency of costs and in the product features, thereby exerting clearly positive impact on the affected markets. However, in addition to the positive changes, there are still problems that call for assessment and intervention. With a view to eliminating the undesirable phenomena, the MNB acts both within its inspection and regulatory powers – in addition to utilising its classic administrative instruments, taking advantage of the wide range of its option, fostering the development of products and processes best for the consumers and improving the conduct and approach of market participants through recommendations, certifications, education campaigns for the population and warnings.

4.3.1 Qualified Customer Friendly Home Insurance scheme

To this end the Qualified Customer Friendly Home Insurance application scheme was developed and finalised in 2019. As the first step of elaborating the framework, the MNB summarised its audit findings, market analyses and also performed consumer surveys. Experiences show that essentially there was no serious consumer dissatisfaction, but in respect of the pricing of the home insurance products and the claim settlement process numerous unfavourable market practices were identified, which was essentially attributable to the low intensity of competition; moreover, the unfavourable market practices resulted in excessive cost level and latent over-insurance, and ultimately low loss ratio. In order to reverse the adverse processes and stimulate the home insurance market, the MNB – building on the success of its Qualified Customer Friendly Housing Loan certification scheme – created the Qualified Customer Friendly Home Insurance (CCOI) concept. The MNB specified the certification criteria also considering family-friendly, green and digital aspects. The consumer-friendly home insurances will provide customers with higher quality service compared to the products presently available on the market, without unnecessary covers and surplus expenses, in easily comparable manner, guaranteeing customer-friendly service.

The CCOI certification prescribed minimum requirements for the insurers, departure from which is permitted only to the benefit of the customer. This ensures that products of higher service quality, more easily comparable by the customers come on to the market, which may be customised with additional riders, thereby facilitating the selection of the scheme that best fits the individual needs. The CCOI simplifies the administration related to the product and reduces the turnaround time. Customers can communicate with the insurer in fully digital form, starting from requests for information through the submission of declaration of claim settlement documents to the cancellation or amendment of the contract. In the case of priority claim events jeopardising subsistence, the insurer appoints a dedicated claim settlement contact person for the customer for the entire claim settlement processes and fosters the solution by disbursing a claim advance.

Table 5
Features of the consumer-friendly product

CURRENT PRODUCTS	MFO
✗ The range of exclusions is high	✓ Minimalized exclusions
✗ Cancellation only for anniversary	✓ More flexible (quaterly) cancellation
✗ Claim services complained by consumers	✓ Generous service (least 50% loss ratio)
✗ Additional coverage offered in the package	✓ Freely choosable additional coverage
✗ Payment at obsolete value	✓ Guaranteed payment at new value
✗ Overinsurance due to disproportionate value tracking	✓ Value tracking based on fair value
✗ Lower premium for new clients	✓ Equal treatment of old and new clients
	✓ Quick claim settlement
	✓ Designated contact person, advance loss payment – in case of existential losses
	✓ Easy to understand informing
	✓ Family-friendly, green and digital solutions

Source: MNB

It is the definite intention of the MNB to extend its certification scheme to additional product types and product groups, taking into consideration the special features, elements that call for improvement and trends of the respective markets. In the area of casco insurances there are other unfavourable trends (e.g. high ratio of absence of cover related to old cars), while the loss ratio calculated for the entire portfolio cannot be deemed low at this product type. In addition to the foregoing, consideration should be given to the elaboration of the consumer-friendly certification framework also in the area of payment protection insurance or travel insurances. In the case of other product groups, where due to the market characteristics – or often due to the special features of the relevant legislative environment – the certification framework may not be the most efficient way of intervention, the MNB also assesses the possibility of regulatory arrangements, with the involvement of peer organisations in the preparation of proposals.

4.3.2 Impact of the Ethical life insurance concept

In accordance with the provisions of its previous supervisory strategy, with a view to restoring and reinforcing trust and fostering transparency, the MNB elaborated its ethical life insurance concept in 2015 along the principle of fair treatment.[23] The elements implementing the objectives of the concept (tightened investment rules, transparency of cost, stricter cost control) entered into force gradually from 2016, while the MNB expects compliance with related requirements from 1 January 2017. In order to strengthen the trust of customers in insurance products and thereby to build long-term, stable portfolios, the MNB formulated in the unit-linked recommendation – amongst others – its requirements related to the products, sales and investment management. The recommendation also formulates requirements with regard to the maximum value of the unit linked life insurances' annual cost ratio (ACR) on various maturities, which plays special role in the cost control of saving life insurances.

As a result of the compliance with the ACR limit, there was a spectacular decrease in the ACR values and in the past 3 years they stabilised at the present level. While at the end of 2015 ACR value varied between 0.5 and 13 percent, by 2019 this scale shrank to 4.6 percent, primarily due to the termination of the distribution of products with excessive ACR values. In 2019, even the maximum of the ACR values belonging to all asset funds of all products are below the most stringent ACR limit[24]. At the end of 2019 the average ACR value also declined compared to 2015; however, in this case the decrease is much smaller, which evidences that the average was distorted only by a few outliers already in 2015.

[23] The elements of the ethical life insurance concept include the transparency of costs, minimum limits for surrender value, ACR limits, cancellation of initial units at the unit-linked products and the "principle of best execution".
[24] Value of ACR for 10 years 4.25 percent (in justified cases with departure 5.75 percent).

Table 6
Key figures of the saving-type regular premium life insurances since the introduction of the ethical concept

Saving-type life insurances (regular premium)	31.12.2015	31.12.2019	Change	Effect
Average ACR (minimum – maximum)	4.29% (0.5% – 13.29%)	3.56% (0.9% – 5.52%)	-16.9%	↑
New acquisition (number of contracts)	228 940	182 547	-20.3%	↓
Annualised regular premium per new contract (HUF)	168 425	221 377	31.4%	↑
New acquisition (Annualised regular premium in HUF)	HUF 38 559 million	HUF 40 412 million	4.8%	↑

Source: MNB

Before the introduction of the ethical concept, numerous concerns arose in connection with the life insurance sector, jeopardising market growth. The data from 2019 also evidence that although the number of the newly concluded, regular premium savings life insurance declined by 20 percent compared to the end of 2015, the 12-month regular premium per new contract rose to HUF 221,000 (+31 percent), which well reflects the qualitative restructuring of the portfolio (Table 6). Based on the foregoing it is clear that the ethical concept fosters the swap of the old low-premium contracts for the new, high-premium contracts in the portfolio through it long-term reliability. It is important to ensure that apart from the premium competition insurance services also compete, thereby providing customers with proper value proposition.

4.4 INCREASING TRANSPARENCY AT THE FUNDS

Among other things, it is the key duty of the MNB to strengthen consumers' financial awareness. Proper information provided on products increases the reputation of products, while the easily available information suitable for comparison facilitate the consumers' informed choice. Growth in consumer awareness fosters market competition, and it may encourage service providers to develop more cost-efficient products. In the case of long-term savings product, customers are burdened by several different types of costs. Due to the complex cost structure of products, the comparison of fees burdening the customers may be complicated, and therefore it is justified to elaborate an indicator that expresses the impact of the various costs and fees as a single figure.

The annual cost ratio (ACR), applicable to savings products, is present in the insurance market since 2010. The purpose of ACR is to present the costs of the respective products in a simple and comparable form, as a single value. The application of ACR significantly increased the transparency of costs related to insurance products. Due to the fact that the ACR indicator is well-known and widely used in the insurance sector, the MNB deemed it practicable to apply a similarly ACR calculation also for the long-term savings products, i.e. the voluntary pension fund savings (fund ACR). Point (53) of Section 1.6 "Improve the competitiveness of the insurance and funds sector" of the Competitiveness programme in 330 points, issued by the MNB, proposes to enhance the system of the Annual Cost Rate (ACR) and extend it to the pension funds sector. According to the Competitiveness programme "...it would be advisable to extend the application of ACR also to funds, to ensure the implementation of comparability as widely as possible. Higher level of comparability increases customer confidence and thereby the commitment to long-term products." The MNB initiated the introduction of the application of the Fund ACR (ACR_{PF}) in September 2019 through a recommendation, a supervisory regulatory instrument with no mandatory power on the overseen entities and organisations.

The MNB – striving to providing consumers with the fullest possible information – calculates and publishes cost ratio, i.e. the voluntary pension funds' fee burden ratio. The purpose of the fee burden ratio is similar to that of the fund ACR: to present the fees burdening members annually, and deducted from the members' payments and investments, and to compare them among the individual funds. In 2018 the MNB enhanced the calculation methodology of the fee burden ratio, by elaborating the adjusted fee burden ratio. The MNB calculates the fee burden ratio and the adjusted fee burden ratio every year from the data of the voluntary pension funds' annual accounts for the previous year. In respect of the fees connected to investments the fee burden ratio takes into consideration only the costs appearing directly at the funds. The yield on the fund's investment portfolio may be reduced by indirect investment costs (e.g. the fund management fee of the investment funds included in the fund's portfolio), which are not included in the fee burden ratio. Owing to the method of calculating the fee burden ratio, it provides a value reflecting the costs for the entire fund, without differentiating between the individual portfolios at funds with optional portfolios. At the funds with optional portfolio, the costs of the individual portfolio usually differ due to the different asset management costs of the individual portfolios. From the member's perspective it may be also important to compare the costs of the individual portfolios and also of other funds' portfolios of similar risk.

Both the concept and methodology of calculating the fund ACR differs from the calculation of the fee burden ratio or the adjusted fee burden ratio. The calculation of the fund ACR uses a model-based approach and it defines the long-term savings of a hypothetic fund member, using the parameters typical for the respective product. The calculation of the fund ACR expresses the costs deducted from a member's contributions and savings, in a single figure. The calculation of fund ACR is performed on a typical example, where we assume that during the given accumulation period the member pays the fund membership continuously, regularly with monthly frequency. For the purposes of calculating the fund ACR, the presumed monthly membership fee is HUF 25,000, which corresponds to the monthly premium of the regular premium life insurances under the ACR decree. According to the model's assumption, the member pays the presumed membership fee throughout the membership period and before reaching eligibility for the pension benefit – during the accumulation period – withdraws no funds from the savings under any title.

The recommendation proposes that funds operating an optional portfolio scheme should calculate the ACR value for each optional portfolio separately, since usually the costs connected to the investments of the various portfolios differ. Accordingly, the calculation of the fund ACR usually returns a different figure for the various portfolios of funds operating an optional portfolio system. According to the recommendation, the fund ACR calculation also takes into consideration the indirect costs of the fund's investments (the costs of the investment funds included in the portfolio of the respective fund).

When calculating the fund ACR – similarly to the methodology described in the ACR decree applicable to pension insurance products – we define the average annual return that the investment assets comprising the coverage reserve of the respective pension funds should realise as a minimum in order to ensure that the fund member gets back, as a lump sum pension benefit, the contributed membership fees increased by the risk-free return. Namely, the calculation of the fund ACR is based on the calculation of an internal rate of return, similarly to other cost indicators used in the financial sector (such as the APR used for bank loans).

In view of the long-term nature of pension fund products, the recommendation determines the calculation of the fund ACR for period of 10, 20 and 30 years, i.e. the hypothetic member in the model calculation joins the pension fund at the age of 35, 45 or 55. According to the recommendation, the calculation of the fund ACR takes into consideration all costs burdening the member. The calculation also includes, in addition to the indirect asset management costs (e.g. asset management fee, custodian fee), the indirect costs of investments in collective investment vehicles (e.g. investment funds) (e.g. fund management fee of funds), the fee deducted from the membership fee for operation and in the liquidity reserve, the enrolment fee and the fee charged upon benefit payment. The fund ACR calculation – similarly to the methodology prescribed in the ACR decree applicable to insurers – contains no such costs that may occur during the accumulation period depending on the customer's decision (e.g. cost of portfolio switching). The calculation of the fund ACR – in the same way as the ACR calculation applicable to insurance products – ignores the potential tax and contribution burdens, or tax allowances connected to the contributions, since these may change independently of the fund, depending on the rules of taxation,

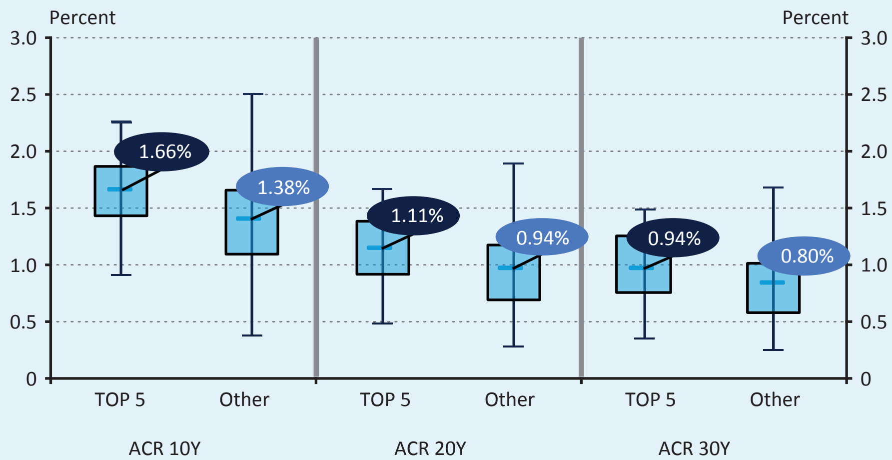
According to the recommendation, the funds submit the calculated fund ACR value to the MNB, and the funds that also have a website, publish the ACR value on their websites. In order to provide consumers with proper information, the MNB publishes on its website the ACR values submitted by the funds. The MNB expects the funds to use the recommendation from 1 January 2020. The recommendation proposed to perform the calculation of the fund ACR for the first time by 28 February 2020, and submit the result of the calculations to the MNB. According to the recommendation, funds review the ACR calculation annually and they submit the result of the calculations to the MNB.

The voluntary pension fund sector received well the introduction of the fund ACR and almost all funds applied the recommendation. 33 of the 36 voluntary pension funds presently operating in the market calculated the ACR_{PF} values and submitted the relevant data reporting by the deadline of 28 February 2020, proposed in the recommendation. The institutions submitting ACR data reporting cover 99.94 percent of the voluntary pension fund sector based on the number of members. According to the submitted data, the 10-year ACR_{PF} values vary between 0.33-2.52 percent, the 20-yeaer ACR_{PF} values between 0.23-1.89 percent while the 30-year ACR_{FP} values between 1.19-1.68 percent. The value of the average 10-year ACR_{PF} is 1.47 percent, the value of the average 20-year ACR_{PF} is 0.99 percent, while the value of the average 30-yaer ACR_{PF} is 0.84 percent.

At the funds operating an optional policy system it can be observed that the ACR value of lower-risk portfolios, usually comprising of mostly or fully government securities or money market investments, is lower than the ACR value of portfolios with higher equity investment content. This is due to the fact that that asset management cost of portfolios with higher equity content is higher. The funds apply the provisions of MNB Recommendation 12/2016 (XII.1.) on the setting up and operation of the optional portfolio system of voluntary pension funds, according to which "upon developing the asset-proportionate costs, those are expected to be proportionate to the nature and composition of the assets (holdings) and to the complexity of its management; accordingly, different asset management fees may be also specified for the individual optional portfolios". The distribution of the voluntary pension funds' ACR value is illustrated by Chart 53, breaking down the sector into the 5 largest funds covering 69 percent of all members, and to the other smaller funds.

In the recommendation the MNB proposes to the institutions that in the disclosure they should warn consumers that upon selecting the fund products apart from the fund ACR they should consider other aspects as well. The long-term yield of the fund and of the respective portfolio has major effect on the amount of the future pension payment. The MNB publishes on its website the short (1-year) and longer (10- or 15-year) historic yields annually. When selecting the fund or the portfolio, the investment risk of the respective portfolio is also an important consideration; moreover, members may also take into consideration the quality of the services rendered by the fund when making their choice.

Chart 53
ACR values of voluntary pension funds on 10-, 20- and 30-year horizon



Note: On the candlestick chart the line in the middle together with the values belonging to it denotes the arithmetic mean of the ACR value in the individual categories. The lines on the top and in the bottom of the candlestick show the smallest and greatest ACR values within the group. The columns constituting the body of the candlesticks show the two middle quartiles within the ACR values of the institutional groups, i.e. 50 percent of the ACR values within the group fall between the bottom and top of the columns.
Source: MNB

4.5 EUROPEAN CONSUMER PROTECTION TRENDS, IDD25 AND PRIIPS IN PRACTICE

In the insurance market – as a result of the EU legislative process aimed at the protection of the retail investors – following the entry into force in 2018 of the EU regulation containing standard requirements for the information and distribution processes of packaged retail investment products and of the EU insurance distribution directive prescribing the creation of standard notices and the publication of the intermediaries' commission, an obligation to provide written information of defined format and content has been introduced. The purpose of this is to ensure that the information document easies for the consumers the comparison of products and thereby to contribute to informed investor's decisions. Pursuant to the new regulation, EIOPA and the member states' supervisory authorities had the opportunity to restrict or prohibit

[25] IDD: Insurance Distribution Directive; Directive 2016/97/EU of the European Parliament and of the Council on insurance distribution

(even in advance) the distribution of investment products that raise investor protection or financial stability concerns. The MNB has supervised since the effective date and monitored in 2019 as well with special care compliance with the provisions of IDD and the PRIIPs regulation, both in the assessment of individual petitions related to contracts concluded under the new regime and in the comprehensive inspections.

When developing the key information document (KID), which according to the requirements should not exceed three pages, the objective of the legislator was to enhance the transparency of the information on the products' risks, performance and costs by information provided in an easy-to-read, concise and transparent form, and facilitate better understanding and comparability of risks related to investments in PRIIPs, thereby supporting the making of informed investment decisions.

During the inspections the MNB found that the KIDs still exceeded the volume limits, particularly in the case of those insurance products that offer several underlying investment opportunities, which thus do not ease the overview and comparability. It is also a frequent problem that the applied wording is not properly structured and is written using difficult-to-understand legal terms. It is still typical that the KID is handed over right before signing the proposal, which – in the MNB's opinion – does not qualify as "in due course".

Box 8
EIOPA thematic review of travel insurances

With the involvement of the Member States, EIOPA conducts every year a broader thematic review, covering the entire European Union. The reviewed topics are determined by the Board of Supervisors (BoS) comprising the executives delegated by the individual Member States. Based on the decision of BoS, the thematic review of 2019 dealt with the assessment of the consumer protection aspects of travel insurances.

In cooperation with the Member States' supervisory authorities, the EIOPA asked for qualitative and quantitative data reporting from the market participants of the Member States. The review identified the problem of high commission structure and of the business model built on high commission and low loss ratio, which is clearly against the best interest of consumers. Sales typically shifted towards online brokers, where the requirements towards the products include high commission and low price rather than – in accordance with IDD – the good service quality supporting consumers' interests.

In connection with the travel insurance thematic review closed in July 2019, the EIOPA formulated a warning towards the market participants concerning the management of high commissions and compliance with IDD. The most important message of the warning is that the present travel insurance products, sales models and established practices do not comply with the IDD's principle requirements, according to which upon the sales of insurance, market participant are required to act "in the best interest of the customer".

Based on the results of the EIOPA thematic review, the MNB added the assessment of travel insurance products to the target areas to be managed with special care in 2020, based on which the consumer protection area during the comprehensive reviews also assesses the adequacy of travel insurance products in all cases.

4.6 INSURANCE INTERMEDIARIES[26]

4.6.1 Institutional concentration in the insurance intermediary market

Contrary to the stagnation observed in previous year, in 2019 the number of licensed intermediaries declined in the insurance market. One reason for this is that as a result of the transposition of the EU directive related to the distribution of insurances (hereinafter IDD or insurance distribution directive) in the Hungarian laws, in addition to the higher protection of consumers' interests, the intermediaries' other tasks and administration burdens increased (e.g. training, record-keeping),

[26] The tied agents directly linked to a credit institution or insurance company fall outside the analyses included in the section of the risk report dealing with intermediaries.

as a result of which several insurance intermediaries decided to transfer their portfolio to other intermediaries. With this the IDD may have also contributed indirectly to the development of more cost efficient and in the longer run more sustainable operating models. The number of natural persons within insurance intermediaries remained practically unchanged.

Table 7
Key data of insurance intermediaries

	Insurance intermediary	
	2018	2019
Number of institutions	451	**431**
Broker	*407*	*391*
Multiple agent	*44*	*40*
Multiple special intermediary	-	-
Number of natural persons (persons)	13 927	**13 926** –
Commission income (HUF billions)	76.2	**87.5**

Source: MNB

Box 9
First experiences of idd in Hungary give rise to additional inspections

The introduction of the insurance distribution directive generated a number of new regulations with consumer protection focus in the Hungarian regulatory frameworks, also in respect of the insurance intermediaries. When framing the directive, the key consideration – in addition to provide consumers with better information and treat consumers' interests as a priority – was to increase consumer confidence and regulate the distribution of insurance products even more uniformly. The consumer protection measures created through IDD, such as the suitability and appropriateness assessment prior to concluding the contract, the possibility of intermediation without advisory services and making the method of remuneration more transparent, encourage insurance intermediaries to operate even more prudently. Transparent operation increases consumers' confidence and reducing the largest consumer protection risk (e.g. misselling) threatening insurance intermediaries to the minimum, in the long run equally serve the interest of the intermediaries and the consumers.

The IBIP regulation,[4] introduced simultaneously with IDD, also emphasises the importance of consumers' interest, and thus one of its most important provisions applicable to distributors of insurance-based investment products – including the insurance intermediaries – is the management and regulation of conflicts of interest.

Although Hungary transposed the directive by the deadline (23 February 2018), at the recommendation of the European Parliament and 16 Member States, finally the Commission postponed the deadline for the application of IDD to 1 October 2018, and thus the MNB, despite the fact that the amended Insurance Act was already in force, allowed to the actors of the sector additional time for preparation until 1 October 2018. However, the MNB launched several inspections also before that, but mostly in 2019, to assess compliance with the provisions of IDD, including the conflict of interest regulation. In 2019, the MNB closed 6 targeted inspections, where it reviewed the internal regulations related to the management of conflicts of interest and it identified infringements. Of these it is worth mentioning a targeted inspection at a domestic insurance intermediary multiple agent, where due to the infringements identified in connection with the management of conflict of interest situations, the MNB imposed both supervisory and consumer protection penalties. The inspection found that the multiple agent is simultaneously a direct and indirect owner of an insurer and the multiple agent failed to manage the resulting conflict of interest properly in its regulation. The insurance intermediary paid higher commission to its agents for the sales of the products of the insurer showing an overlap among the owners compared to the other insurances it distributed, and the multiple agent also failed to regulate this conflict of interest situation properly. The MNB classified the infringements as so serious that it suspended the further distribution of the insurer's products already during the inspection.

Based on the findings of the inspections, the MNB verifies the implementation of and continuous compliance with the consumer protection requirements prescribed by IDD systematically and consistently.

4.6.2 Increasing commission incomes, mixed overall picture

2019 shows a mixed picture in the insurance intermediary market both in the life and non-life segments. Non-life insurance commission incomes amounted to HUF 64.1 billion after a growth of 15.6 percent, while mediated premiums rose by 17.7 percent to HUF 175.5 billion. The growth was observed at motor insurances and corporate and institutional liability insurances. A large part of the growth was attributable to the compulsory motor third-party liability insurances, which under a growth of 6.6 percent in number of policies registered an increase of 27.6 percent in the premium of referred portfolio, reaching HUF 91.9 billion. The number of casco motor liability insurances rose by 21.2 percent, with HUF 31.2 billion of premium of mediated contracts, representing a growth of 24.5 percent year-on-year. The number of corporate property insurances decreased by more than 11 percent, nevertheless mediated premiums rose by 9.1 percent. Home insurances registered a single-digit fall both in terms of quantity and mediated premium; the MNB's certified consumer-friendly home insurance scheme may help reverse this negative trend. The number of travel insurances policies rose by 9.1 percent, while mediated premiums dropped by 9 percent, which implies stronger competition in the online space and price-sensitive consumer habits. In the life insurance segment, the commission income of HUF 23.4 billion exceeded that of last year by 12.6 percent, despite the fact that mediated premiums fell by 8.4 percent. The major, over 70 percent, growth in the number of traditional life insurance policies is mostly attributable to a single intermediary; the premium of these products is lower than the market average, and thus no similar increase can be observed in the insurance premiums. The growth in commissions is explained by the 8.1 percent rise in acquisition commissions to a smaller degree, and by the 16.8 percent rise in retention commissions to a larger degree. The proportionately higher retention commission is attributable to the cap on acquisition commission under the ethical concept, which points to the development of a sounder incentive system.

Table 8
Sales data of insurance intermediaries

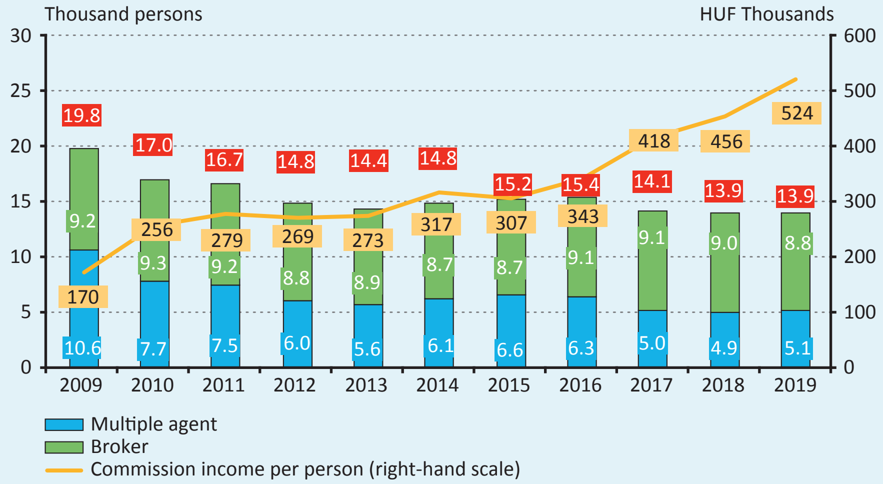
	Value of contracts HUF billions		Number of contracts pcs		Commission income HUF billions	
	2018	2019	2018	2019	2018	2019
Non-life segment	149.2	**175.7**	2,354,771	**2,511,624**	55.5	**64.1**
Compulsory motor third-party liability insurance	72.0	91.9	1,369,616	1,460,159		
Home insurance	4.8	4.6	115,193	112,773		
Casco motor liability insurance	25.1	31.2	178,941	216,900		
Corporate and institutional property insurance	23.9	26.1	63,246	56,076		
Travel insurance	4.9	4.5	412,295	450,308		
Other non-life insurance	18.6	17.5	215,480	215,408		
Life segment	49.6	**45.5**	125,763	**138,965**	20.8	**23.4**
Traditional life insurance	4.3	4.2	38,626.0	65,826		
Unit-linked life insurance	40.4	37.5	83,854.0	70,119		
Other life insurance	4.9	3.7	3,283.0	3,020		

Note: The value of commission income also includes retention and target commission, in addition to the acquisition commission.
The sum of the part figures may differ from the value of the main categories due to rounding.
Source: MNB

4.6.3 Steady intermediary headcount, increasing efficiency

The decreasing trend observed in the number of multiple agent and broker natural persons halted in 2019. The number of multiple agents seems to stabilise in 5,000 persons; under steady total headcount, there was a minimal increase in their number, while the headcount of brokers decreased at a similar rate (Chart 54). In parallel with the stagnation in headcount, the improvement in professional attitude in the intermediary market continued, reflected by the trend increase in the monthly commission per person.

Chart 54
Changes in the number of insurance intermediary natural persons and the monthly commission income per person

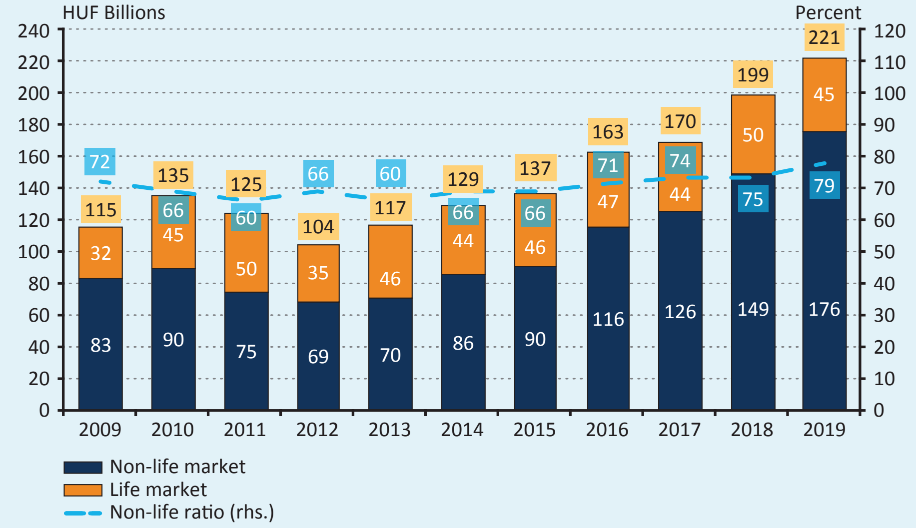


Source: MNB

4.6.4 New historic high despite the fall in life insurance intermediation

The premiums of insurances mediated by brokers and multiple agents have been steadily increasing for already 8 years, with their total value having exceeded HUF 221 billion (Chart 55). The record high mediated premium is attributable to the extremely high, unprecedented in the past 10 years, 80 percent ratio of non-life insurances. The picture is mixed; while non-life insurance premiums rose by 17.7 percent, life insurance premiums registered a major, 8.4 percent, decrease. The drivers of growth are the motor liability insurances. Last year the growth in the motor vehicle market and the increase in insurance tariffs together resulted in a double-digit increase in the total mediate premium income. The soaring demand for loans, despite the increasing wages, and the more attractive than before public savings alternatives had unfavourable impact on the distribution of insurances for saving purposes. The largest, HUF 2.9 billion, decline in the area of life insurance intermediation, is attributable to the fall in the sale of the aforementioned unit linked life insurances.

Chart 55
Changes in insurance premiums mediated by brokers and multiple agents



Note: The data shown in the chart contain the insurance premium of the contracts mediated in the reporting year (new acquisition).
Source: MNB

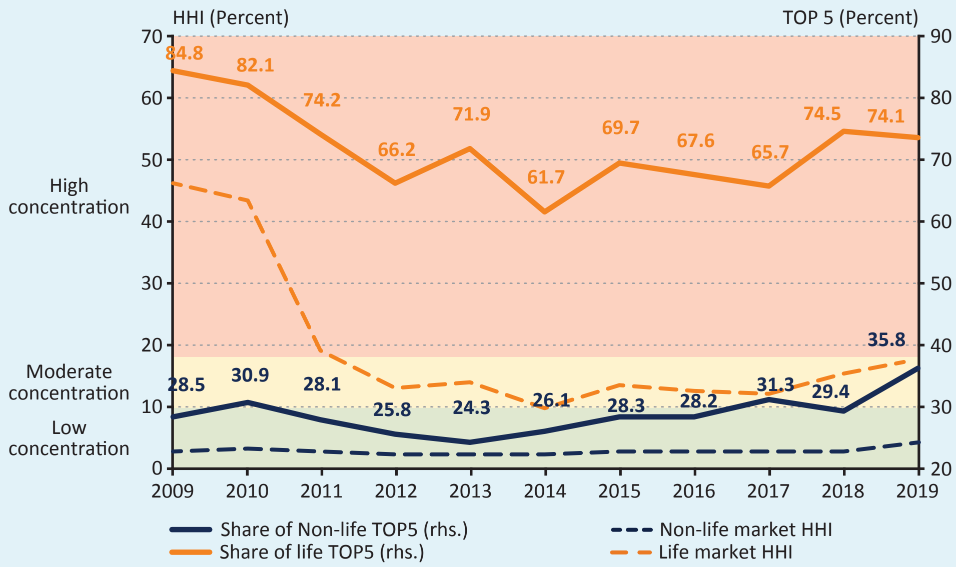
4.6.5 Strengthening concentration ratio in both intermediary segments

In 2019, the market concentration of independent insurance intermediaries, calculated on the basis of gross premium income and 12-month regular premium rose both in the life and non-life segments (Chart 56). In the non-life segment the value of the Herfindahl-Hirschman index (HHI) jumped to a 10-year high (3.7 percent), which was attributable to the additional market acquisition of the largest market participant. At the upper 10 percent of the intermediaries [27] the rise in mediated premium exceeded that of the entire market on the whole, which implies substantial restructuring. According to composition, motor insurances contributed to the strengthening of concentration the most; however, large actors performed better than the average in the case of other products as well (e.g. home insurance, corporate insurances). The share of the TOP5 market participants – similarly to HHI – reached a historic high (35.8 percent), which – at some of the actors – is attributable to the advantages of online intermediation. The permanence of the advantages so acquired and of the concentration level depends on whether in the future the rest of the market participants act upon this innovative sales method. At the same time, on the whole, based on the HHI value, the non-life market may still be deemed to have low concentration level.

In the life segment the two concentration ratios show somewhat contrasting change in 2019. On the one hand, the share of the TOP5 market participants – similarly to previous years – somewhat corrected downward after the rise in 2018. On the other hand, contrary to this, the value of HHI rose further (to 17.1 percent), approximating the upper bound of the moderate concentration level (18 percent). Almost half of the decrease in mediated premiums occurred at the top 10 percent of the life segment market participants[28],which was primarily suffered in excess of the market average in the unit-linked product category. On the other hand, at the traditional products the largest actors compensated their market position through sales exceeding the average, which may explain the strengthening of the HHI value.

[27] Based on the mediated non-life premiums, this included the 41 largest insurance intermediary undertakings.
[28] Based on the mediated premiums in the life segment, this included the 28 largest insurance intermediary undertakings.

Chart 56
Share and Herfindahl-Hirschman index of the TOP5 independent insurance intermediaries based on gross premium income and 12-month regular premium, by segments

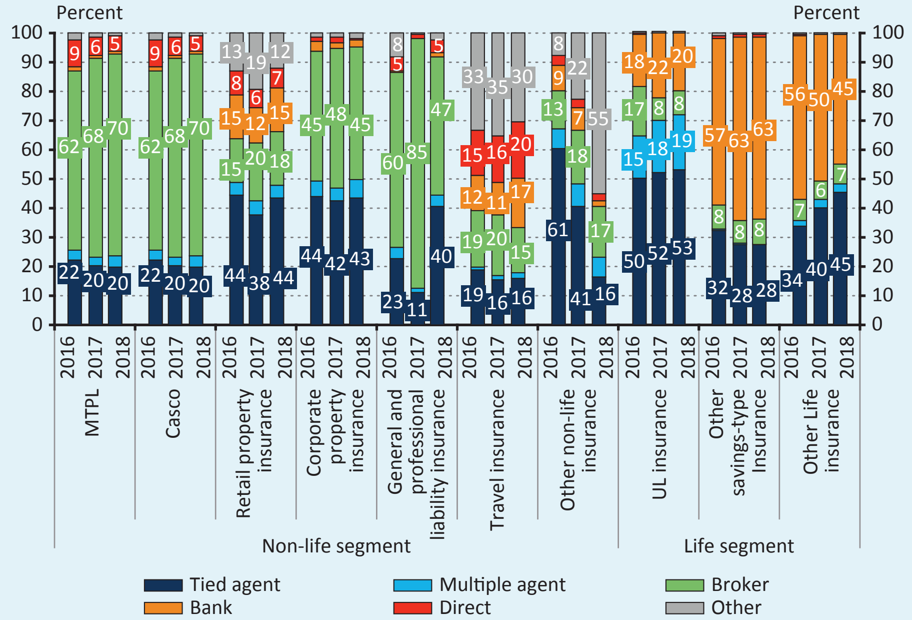


Note: The colour of the background illustrates the strength of concentration under HHI.
Source: MNB

4.6.6 The ratio of intermediation by brokers rose further at motor insurances.

In the insurers' sales mix the ratio of brokers and multiple agents substantially differed by product categories in 2019 as well (Chart 57). Sale by brokers was traditionally high in the non-life segment. In the case of compulsory motor third party liability insurances (MTPL) and casco insurances (70-70 percent) brokers had a determinant share. Brokers' share in the general and professional liability insurances, which formerly also exhibited substantial broker share, significantly decreased (by 38 percentage points), which was mostly attributable to the headway of tied agents and to small degree of multiple agents (40 percent) and to the headway of the direct channel (5 percent). Brokers' share declined moderately – by a few percentage points – in the other non-life products (retail property, corporate property, travel insurance), while at the life insurance products it essentially remained unchanged by categories. The ratio of multiple agents within the sales mix usually rose by 1-2 percentage points by products in the non-life segment, which in view of the low bases may be regarded as tangible increase. In the area of life insurances a more moderate rise was registered in the ratios of multiple agents at the unit-linked products and other life insurances, while at the other savings life insurances they continued to be present as a marginal channel in 2019 as well.

Chart 57
Life and non-life insurance channel mix and changes in the ratio of broker counterparties based on their number

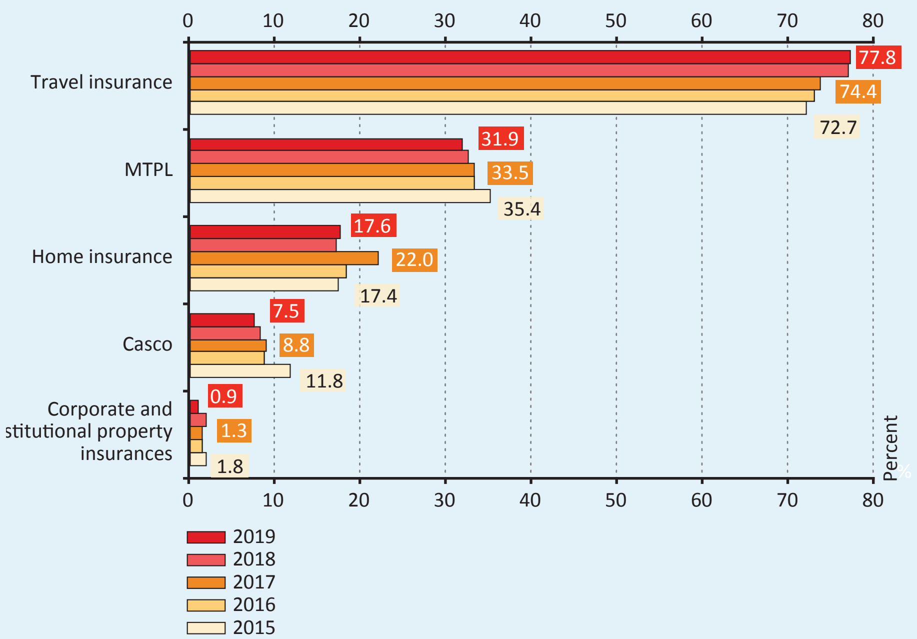


Source: MNB

4.6.7 Only the travel insurances are more popular in electronic form

In terms of online sales, travel insurance continues to be the most popular, as the ratio of electronic sales increases year by year. By contrast, despite the expectations, the ratio of online sales in the mediation of motor liability insurances is continuously decreasing (Chart 58). No "online breakthrough" has taken place concerning the distribution of life insurances and corporate insurances, and the online offering is also negligible.

Chart 58
Ratio of electronically mediated non-life insurance contracts (by number of policies, ratio within the mediated contracts)



Source: MNB

4.7 FINANCIAL INTERMEDIARIES[29]

4.7.1 Financial market intermediaries easily adapting to changes

It had a favourable effect on the intermediary sector that in recent years average wages steadily rose and customers increasingly confidently undertook medium- and long-term commitments.

2019 brought major changes to financial market intermediaries in several respects. On the one hand, the transformation of the building society market generated challenges for many intermediaries; as a result of the drastic fall in the sales of building society products, the sector realised a loss in commissions of almost HUF 6 billion in 2019. On the other hand, growth in lending, the emergence of new loan products and the further decrease in the APR of personal loans in 2019, the increase in volume and the consumers' increasing willingness to purchase cars were partially able to offset the loss suffered due to the building societies, and thus at annual level the sector suffered a decrease in incomes only in the amount of HUF 0.3 billion.

Table 9
Sales data of independent financial market intermediaries

	Value of contracts HUF billions		Number of contracts pcs		Commission income HUF billions	
	2018	2019	2018	2019	2018	2019
Corporate credits, loans and financial lease	159.5	**202.9** ↑	19,621	**28,683** ↑	2.5	**2.5** –
Total household credits and loans	333.2	**519.3** ↑	178,809	**192,815** ↑	8.3	**13.1** ↑
of this: Mortgage	*287.6*	*372.9*	*27,359*	*33,273*	*5.0*	*6.5*
Motor vehicle	*0.5*	*2.6*	*284*	*912*	*0.01*	*0.60*
Personal loans	*19.5*	*95.4*	*10,266*	*19,404*	*0.8*	*2.9*
Credit card	*9.6*	*2.8*	*33,563*	*17,880*	*0.8*	*0.3*
Other	*16.0*	*45.6*	*107,337*	*121,346*	*1.8*	*2.8*
Total household financial lease	54.3	**72.1** ↑	20,952	**25,541** ↑	1.2	**1.8** ↑
of this: Real property	*2.3*	*4.9*	*155*	*309*	*0.04*	*0.08*
Motor vehicle	*51.6*	*65.8*	*20,665*	*25,053*	*1.1*	*1.7*
Other	*0.4*	*1.4*	*132*	*179*	*0.004*	*0.009*
Deposit and payment account	-	-	115,874	**70,826** ↓	0.62	**0.91** ↑
Building society	420.3	**10.3** ↓	84,352	**1,811** ↓	6.1	**0.1** ↓

Note: Hire purchase financial market intermediaries are not obliged to supply data. The value of commission income also includes retention commission, in addition to the acquisition commission.
Personal loans: Institutions partially report the Prenatal baby support loans also in this row
"Other" within household loans in addition to the Prenatal baby support loans stated in this row, institutions mostly report hire purchase loans
Source: MNB

It is also important from the customers' perspective that intermediaries were able to respond to market changes rapidly and efficiently, as they managed to satisfy even the increased interest of customers resulting from the emergence of the loan products and steadily high willingness to buy home. Within the credit products there is a palpable restructuring, which occurred not only as a result of the transformation of the building society scheme. In addition to the still rising volume of classic household mortgage loans, the number of Prenatal baby support loans also increased significantly. A large part of the decline in credit cards is attributable to administrative reasons, since one of the largest intermediaries engaged in credit card sales has become a tied agent, and as such the contracts referred by it no longer appear in the analysis of this area; however, the number and contracted amount of mediated personal loans considerably rose (the Prenatal baby support loans are partly also included in this category).

[29] Intermediaries include the legal entities that hold an MNB licence in the insurance or financial market and distribute competing products in respect of the given product group. Tied agents directly linked to a credit institution or insurance company fall outside the analyses included in the section of the risk report dealing with intermediaries.

4.7.2 Increasingly concentrated institutional and headcount data the financial market intermediaries

Following the stagnation in the previous period, a moderate decrease can be observed in the number of institutions, while as regards the changes in the number of natural persons, following the minimum decrease in previous years, now a downward break can be observed. While this number at the insurance intermediaries is roughly the same, at the financial market intermediaries a decrease of 5.2 percent was registered and their commission income practically stagnated.

The MNB's dedicated intermediary oversight function verifies the continuous existence of statutory operating conditions; in the absence of those, the intermediary licence may as well be gradually phased out; in 2019, the MNB withdrew the licence of 18 intermediaries on the financial market, in the vast majority of the cases due to the failure to comply with the reporting requirement.

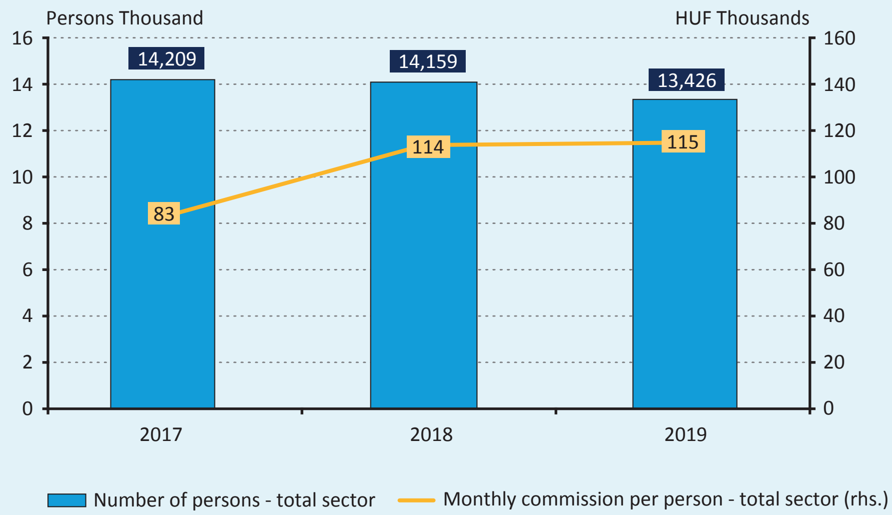
Table 10
Key data of independent financial market intermediaries

	Financial market intermediary	
	2018	2019
Financial market intermediary	561	553
Broker	*10*	*12*
Multiple agent	*391*	*384*
Multiple special intermediary	*5*	*6*
Hire purchase intermediary	*155*	*151*
Number of natural persons (persons)	14,159	13,426
Commission income (HUF billions)	18.7	18.4 –

Note: Hire purchase financial market intermediaries are not obliged to supply data.
Source: MNB

Based on the picture unfolding from the figures obtained from the institutions' data supply, intermediaries at systemic level adapted well to changes resulting from the transformation of the building society scheme, while the number of natural person intermediaries slightly decreased.

Chart 59
Number* of financial market intermediaries and monthly commission per capita



*Note: * The number of financial market intermediaries was adjusted subsequently, necessitated by the amendments caused by the data reporting decree. The adjustment had no impact on the trends.*
Source: MNB

Due to the decreasing headcount data and the practically stagnating commission incomes, although the commission income per capita was unable to continue the distinct rise registered in 2018, it was still able to exhibit minor growth.

4.8 RISKS OF INTERMEDIARIES

While in several European countries intermediary oversight was introduced only after the introduction of IDD, this has been functioning in the MNB for already 6 years and now it reached a new milestone by developing and introducing a new, independent intermediary risk assessment methodology and risk map, having processed the experiences of past years. The experiences of the intermediary-specific risk assessment and the prospects resulting therefrom are summarised in the table below.

Risk category	Risk groups	Risk rating	Risk prospects	Textual evaluation
Business model	Environment Strategy, busines plans Sustainability of operation	●	↑	• unchanged legal environment; challenges related to compliance with IDD in the area of insurance intermediaries *Based on the prospects at the beginning of the year – due to the development of the pandemic – changes are likely to take place in the macroeconomic and market environment.*
Corporate governance	Owner's control Internal governance Conflicts of interest Compliance	●	→	• shortcomings in the internal regulations, the regulation of processes and the management of conflicts of interest in the insurance intermediary area *Thematic review in 2020 with a view to improving the management of conflicts of interests across the sector.*
Financial and operational risks	Material conditions Registration requirements Qualification requirements Registers Trainings, courses Data supply	●	↑	• basic compliance with material conditions across the sector • the register of trainings and courses is regularly incomplete *Intermediaries' revenues are likely to decrease in the area of life insurance and lending. The capital position of smaller intermediaries may worsen; the consolidation of the sector may continue.*
Market entry risk	Service delivery Marketing, customer acquisition Complaints management	●	↑	• complaint management is not always adequate; occasionally the needs assessment and customer information is also incomplete *As regards the market entry risk, the pandemic is likely to have negative impact on the delivery of services, marketing and customer acquisition.*
Partner (product owner) risks	Portfolio quality risk Dependency risk	●	→	• no major systemic risk is identified in terms of portfolio quality and dependency risk *No tight dependency or the development of product owner risk can be expected at sector level.*

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

As regards the legal and regulatory environment, no major change occurred in respect of the insurance and financial market intermediaries; however, based on the feedback from insurance intermediaries, compliance with the requirements specified by IDD applicable to insurance intermediaries, effective from February 2018, continues to represent major challenges for the actors of the sector. In view of this, during its inspections conducted at intermediaries, the MNB continues to focus on the inspection of full compliance with the regulatory requirements.

The functioning of the internal governance system is also problematic. Based on the targeted inspections conducted at intermediaries we found that there were shortcomings in the internal regulations and the regulation of processes at several institutions – both insurance and financial market intermediaries – and also in the management of conflicts of interests, particularly at the insurance intermediaries.

In the case of the material conditions, no market-level shortcomings or risks were observed – apart from a few individual cases – in connection with the compliance with capital requirements and legal requirements, and the reporting of master data. Based on the targeted inspections in 2019, the training registers are often incomplete.

The capitalisation level of the major, above-average intermediaries is well above the statutory limit, while the capital position of smaller intermediaries is likely to worsen, and the consolidation of the intermediary market may continue.

Inspection experiences related to the service delivery by the institutions show that complaint management was inadequate in several cases, and there are also shortcomings in the needs assessment and customer information.

On the other hand, the shortcomings mentioned above may lead – through piling up on or departing from each other – to the absence of compliance with basic operating conditions, as it did happen at an insurance broker. During the targeted inspection conducted at the company holding a broker activity licence, the MNB found that the broker failed to comply with the conditions applicable to its operation, according to which acting on behalf of the customers it must identify the product that best fits their needs, since it failed to analyse and deliver sufficient number of competing insurance proposals. It was found during the inspection that in fact the broker mediates the products of a single insurer, and thus it performs its activity as a tied agent. Following the inspection – in view of the findings made by the MNB – the company returned is broker activity licence and in the future it will pursue its activity as the tied agent of a single insurer. The MNB reminds the insurance and financial market intermediaries, also in connection with this case, of the importance of selecting the proper type of activity and of the compliance with that, and of the possibility to change the form of activity, if necessary.

5 Financial enterprises not belonging to a banking group, and their risks

5.1.1 Overall picture of the market

This section presents the key data of financial enterprises that do not belong to a banking group, i.e., they are not subject to consolidated supervision, and the change in those data. The audited data for 2019 were not yet available when this report was prepared, and thus the analysis is based on unaudited data from the end of 2019. For the purpose of the analysis, with a view to eliminating the distorting effect, the data of two financial enterprises pursuing special activity, not related to the usual course of business of financial enterprises, has been ignored.

Table 11
Key data of financial enterprises not belonging to a banking group

	2015	2016	2017	2018	2019
Number of financial enterprises not belonging to a banking group*	223	217	217	223	225
Total assets of financial enterprises not belonging to a banking group (HUF billions)*	1,164	1,094	1,107	1,139	1,519

*Note: * Based on the data of the financial enterprises performing their data reporting obligation for the reporting period*
Source: MNB

In 2019, three financial enterprises terminated their activity or merged; however, the number of institutions rose due the newly established companies or the transfer of certain financial enterprises to the non-banking group. Most of the licensed financial enterprises and those being in the process of licensing, following the trend of previous years, submitted licence application for the pursuance of workout or lending activity.

The total number of non-banking group financial enterprises, i.e. not falling within consolidated supervision, was 228 in 2019. It is typical of the sector under review that the composition of the portfolio stemming from the financial services activity pursued by the individual financial enterprises may be amended and restructured even within the year. The activity of these institutions continues to be heterogeneous; however, more than half of the institutions are specialised institutions, and pursue purely a single type of financial services activity. In 2019, most of the specialised institutions pursued workout activity, followed by the granting of credits and loans.

5.1.2 Change in the legal requirements applicable to capital

The statutory requirements related to the increasing of the financial enterprises' start-up capital [30]changed from 2020. The financial enterprises already holding a licence must reach, in two steps, a start-up capital of HUF 75 million and then HUF 100 million by 2026, while those holding a licence for lending activity, the statutory amount of the start-up capital is HUF 100 million and later HUF 150 million. Based on the currently available data, more than 90 percent of the supervised institutions held an MNB licence for the granting of credits and loans, and more than half of those complied or would have been able to comply with the raised start-up capital requirement of HUF 150 million, to be fulfilled by 31 December 2026, form the operating profit or retained earnings, already on 31 December 2019. Half of the financial enterprises not holding a licence for granting credits and loans, i.e. 11 institutions complied or would have been able to comply with the raised start-up capital requirement of HUF 100 million, to be fulfilled by 31 December 2026, form their own funds, already at the end of December. Based on the profitability data related to 2019, further 30 financial enterprises may be capable of fulfilling the raised capital requirement from own funds, while at the rest of the institutions capital increase

[30] Based on the provisions of Section 292(4)b) and c) of Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises

by the owner may become necessary. Compliance with the capital requirements may be further complicated by the – potentially long-term – impact of the emergency situation announced due to the spread of the coronavirus on profitability.

5.1.3 Dynamically growing outstanding receivables

The breakdown of the financial services activities pursued by non-banking group financial enterprises did not change significantly compared to the previous year; outstanding receivables were dominated by credit and loan receivables in 2019 as well (46 percent), followed by financial lease (32 percent), workout (17 percent), and current factoring (5 percent (Chart 60). The share of other receivables is still negligible. When analysing the disbursed receivables it can be concluded that financial enterprises still typically tend to render financial services to non-financial corporations.

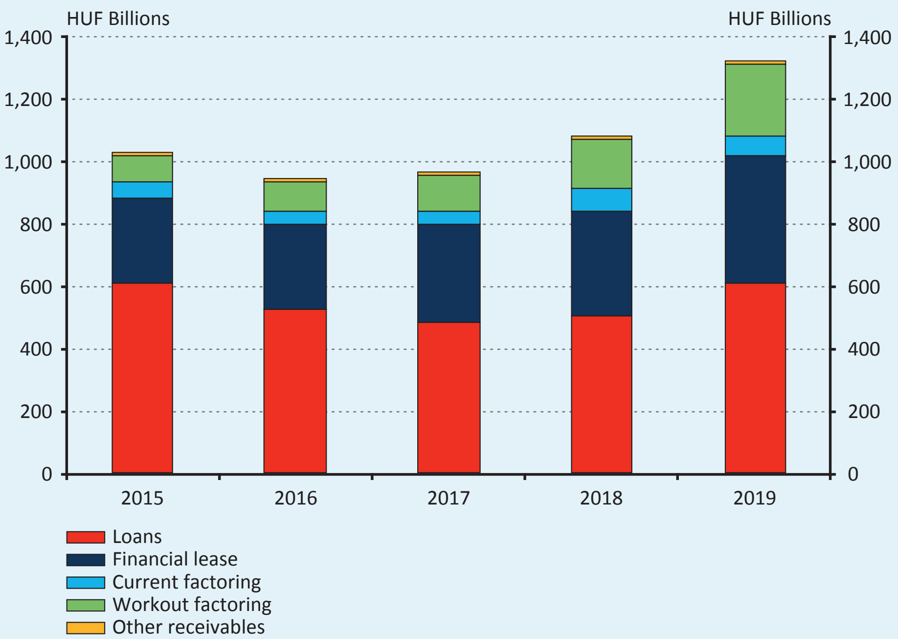
The activity of institutions not belonging to a banking group is characterised by high concentration in terms of outstanding receivables; 80 percent of the portfolio is linked to 25 financial enterprises. In 2019, with the exception of current factoring, the growth in outstanding receivables continued.

Among the financial enterprises pursuing lending activity, the trend observed in 2018 continued also in 2019, namely under a negligible growth in outstanding lending to households, outstanding lending to non-financial corporations grew by a considerable amount. While in 2018 the ratio of such loans within the loan portfolio was 44 percent, by 2019 this rose to 58 percent.

In 2019, financial lease disbursed to households and non-financial corporations increased. The financial lease portfolio is still dominated by services rendered to corporations; 70 percent of the lease portfolio comprise of motor vehicle lease. Large financial enterprises pursuing motor vehicle lease usually render financial lease services both to corporations and households.

In 2019, the workout portfolio considerably rose further, which is mostly attributable to the growth in the portfolio of typically well-capitalised financial enterprises with substantial market share. The market still sees an opportunity in the pursuance of workout activity, which is also evidenced by the number of licence applications for this type of activity. Current factoring at the non-banking financial enterprises declined, which is mostly attributable to the fall in the current factoring portfolio of a single institution.

Chart 60
Developments in the outstanding receivables of financial enterprises not belonging to a banking group



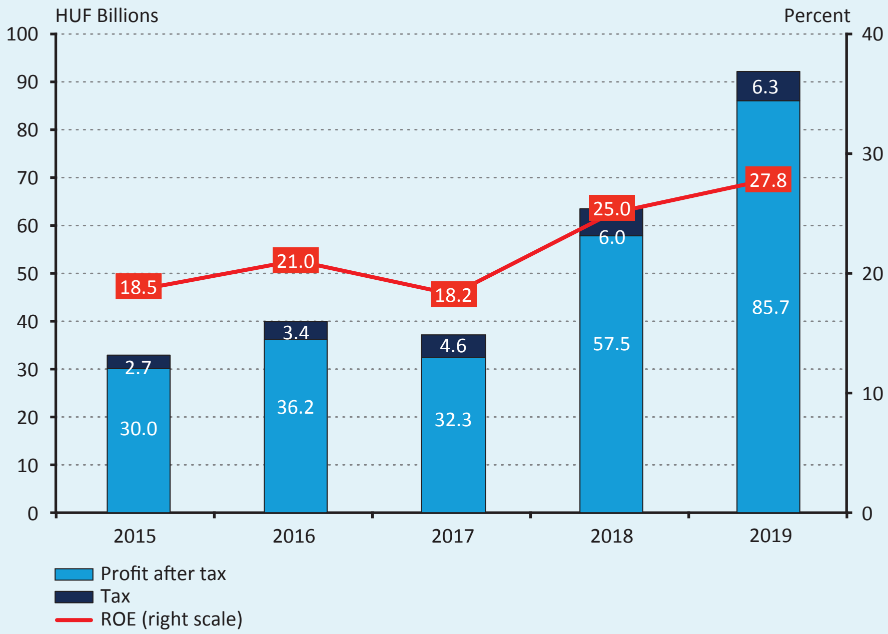
Source: MNB

5.1.4 Vigorously improving profitability

Compared to previous years, profitability significantly improved; in addition, the number of institutions realising a profit before tax also rose moderately, amounting to 81 percent of the institutions in 2019 (Chart 61). Based on the after-tax profit of 2019, non-banking group financial enterprises are still characterised by heavily concentrated market, albeit the concentration ratio declined compared to previous years. While in 2018 six non-banking group financial enterprises realised a balance sheet profit over HUF 1 billion, this number rose to 8 in 2019. When examining the after-tax profit further, the 10 companies reaching the highest profit after tax, accounted for 81 percent of the profit of the sector under review in 2019.

A significant part of the pre-tax profit was still realised by financial enterprises engaged in workout and lending activity, while the highest losses were also suffered mostly by financial enterprises engaged in lending. The MNB deems it particularly important that the presently loss-making financial enterprises or those without proper earnings potential operate profitably in the future to ensure that the financial enterprises are able to comply with the statutory requirements of the Credit Institutions Act pertaining to the increased equity. The measures taken due to the coronavirus have negative impact also on the profitability of financial enterprises, since numerous small enterprises have strained profitability and liquidity situation. These enterprises may also face difficulties when trying to raise bridging financial funds.

Chart 61
Profit/loss of financial enterprises not belonging to a banking group



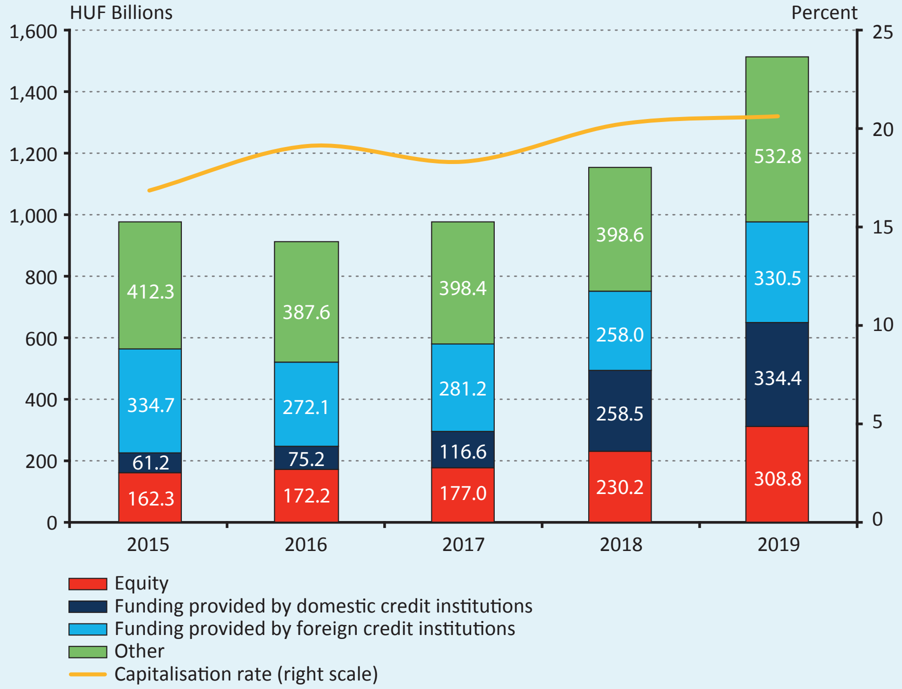
Source: MNB

5.1.5 Domestic refinancing funds provided by credit institutions substantially rose, accompanied by recovering growth in equity

In 2019, substantial growth was observed in the volume of refinancing funds; credit institution funds considerably increased, which primarily impacted financial enterprises pursuing financial lease and lending activity. Within the funding provided by foreign credit institutions, both the domestic and foreign credit institution liabilities as well as other and own sources of finance grew substantially (Chart 62).

Among the financial enterprises not belonging to any banking group – due to the change in the range of institutions under review – major changes were observed in 2016, due to which the balance sheet total of the sector decreased, while the capitalisation ratio substantially increased. In addition to the growth in credit institution and other funding, from 2017 equity has been also rising continuously, which is mostly due to the profitable operation of financial enterprises pursuing workout, lending and financial lease activity; however, the rate of increase in equity consistently falls short of the rate of increase in credit institution and other liabilities, and thus the sector's capitalisation level has been continuously rising from 2017. For 2019 it should be noted that the information related to equity is based on preliminary, unaudited data, and thus it does not reflect the impacts of the potential dividend payments in 2019.

Chart 62
Capitalisation level of financial enterprises not belonging to a banking group



Source: MNB

5.1.6 Vigorous growth in outstanding corporate lending

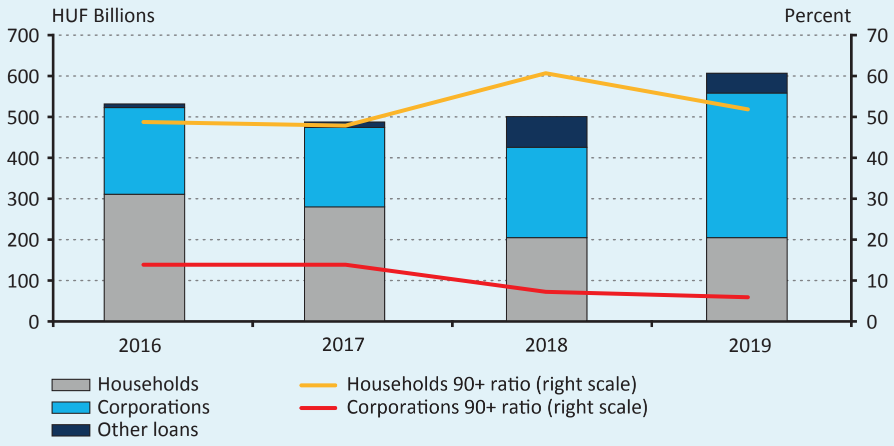
The growth in outstanding lending, registered in 2018, continued; at the end of 2019 a total of 130 of non-banking group financial enterprises, i.e. not subject to consolidated supervision, pursued lending activity. In 2019, the portfolio under review was augmented by the outstanding receivables of two financial enterprises pursuing lending activity; the activity is still characterised by high concentration, as two-thirds of the portfolio was disbursed by 14 financial enterprises (Chart 63).

The growth in the outstanding lending to corporations is characterised by the fact that it is mostly attributable to the growth in the lending portfolio of 5 financial enterprises, and on the one hand it is related to the motor vehicle financing activity, and on the other hand the rise in the portfolio of other loans granted by a single financial enterprise also represents a high share.

Decline in pawnbroking continued in 2019 as well; decrease can be traced both in the number of financial enterprises pursuing this activity and in the portfolio disbursed by them. As regards the composition of collaterals, it is still dominated by precious metal collaterals (99 percent).

The cleansing of the portfolio of household loans overdue for more than ninety days is mostly attributable to the improvement in the portfolio of two financial enterprises. It should be noted that the high non-performing ratio of the portfolio disbursed and managed by the institutions is also due to the fact that certain financial enterprises only manage their mostly overdue portfolio and make no new disbursements. The cleansing of the portfolios is attributable to the operation of the institutions and to a smaller degree to portfolio cleansing. When examining the overdue ratio of corporate loans we found that the vigorous growth in outstanding lending has offset the growth in the portfolio past due for 90 days or more.

Chart 63
Composition of the credit portfolio of financial enterprises not belonging to a banking group



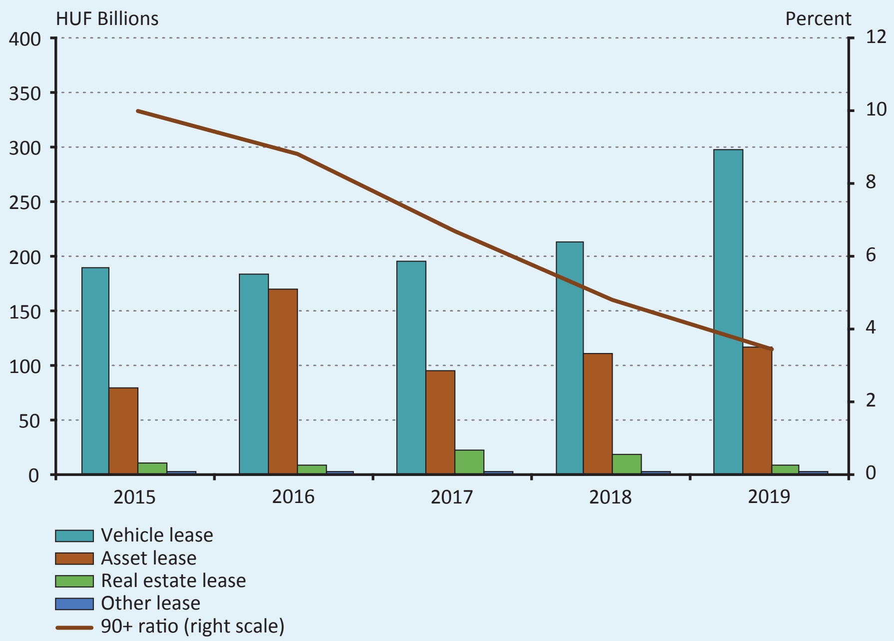
Source: MNB

5.1.7 Soar in motor vehicle lease

The financial lease activity pursued by financial enterprises not belonging to a banking group, i.e. not subject to consolidated supervision, is also characterised by high concentration; the TOP10 actors manage 96 percent of the entire portfolio under review. In 2019, further dynamic growth was observed in outstanding receivables; two dominant financial enterprises were able to achieve substantial increase in their portfolio, and an institution that formerly operated as credit institution was transformed into a financial enterprises in 2019.

The lease portfolio of financial enterprises was dominated in 2019 as well by motor vehicle lease, with a share of 70 percent, followed by asset lease with a share of 28 percent, while the share of real estate is merely 2 percent after the decline. In 2019 the cleansing of the portfolio continued, both in respect of the customers using the lease (households, enterprises) and of the lease purpose (motor vehicle, asset, real estate lease) (Chart 64).

Chart 64
Composition of the lease portfolio of financial enterprises not belonging to a banking group



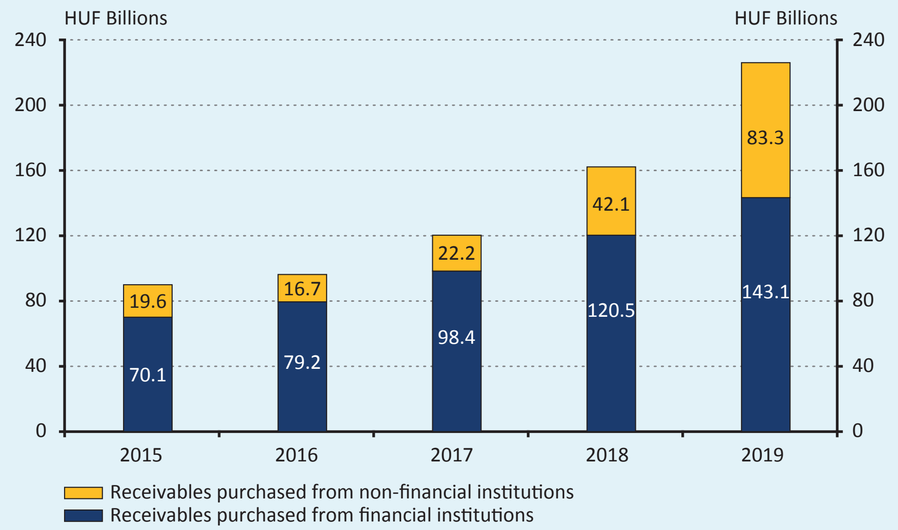
Source: MNB

5.1.8 Continued dynamic growth in portfolio purchased for workout

Continuing the previous trend, the sector still exhibits expanding activity, also reflected by the major year-on-year growth in the after-tax profit of financial enterprises pursuing workout activity. 28 percent of the portfolio purchased from financial or other enterprises, or acquired in another way in 2019 appeared as portfolio increment, since simultaneously with this a large part of the receivables were settled or closed by other means. In 2019, portfolio growth in excess of HUF 1 billion was achieved only by 7 financial enterprises not belonging to a banking group.

As regards the composition of the managed portfolio, in terms of the volume of contracts, outstanding receivables purchased from non-financial institutions were dominant. Since the receivables purchased from financial institutions are typically of higher amount, based on the number of contracts they account for 41 percent of the total outstanding receivables, and 63 percent of the value of the portfolio, and within that the ratio of receivables from household mortgage loans is 40 percent.

Chart 65
Composition of the workout portfolio of financial enterprises not belonging to a banking group



Source: MNB

5.1.9 Consumer protection activity related to non-banking group enterprises

With a view to ensuring the long-term, prudent operation of financial enterprises and protecting consumers, the MNB continuously assesses the domestic and international market trends, monitors and audits the institutions' lawful operation, their communication channels and the content of those, and during certain licensing procedures also the proper development of the regulations. In addition, the MNB summarise the incoming customer enquiries and notifications, and based on those it makes efforts to pursue as efficient as possible prudential and consumer protection activity and active communication. In recent years the consumer protection and prudential supervision became tightly connected. In addition to the classic administrative inspection activity, continuous oversight and addressing problems as part of that are matters of priority. The MNB launches administrative inspections, due to its preventive – and as necessary – sanctioning impact, in justified cases, upon suspected infringements. Recently, the measures addressing risks affecting a wide range of consumers and influencing the long-term stable and prudent operation of financial enterprises bore utmost importance.

Similarly to previous year, the MNB paid special attention to the inspection of the methodology used for the calculation and determination of APR on small-amount, typically pawn loans, the compliance with the statutory provisions applicable to the maximum APR and the related commercial communication practice.

The inspection of the communication practice was an additional important element of the supervisory activity, since within the small-amount loans, in the case of pawn loans, upon redeeming the pawned article from pawn, the consumers may be hit hard by the interests, fees and commissions charged for the delay, and in the case of forced sale, by the omission of proper information on the forced sale procedure and the fulfilment of the settlement obligation. Accordingly, the MNB continuously monitors the announcements published on the website of pawnbroking financial enterprises as well as the advertisements published on the internet and through other communication channels, and initiates proceedings against the infringing institutions as necessary.

In the workout sector – maintaining the practice of previous years – the consumer petitions related to, primarily complaint management, the practice of financial enterprises engaged in the purchase and management of overdue receivables, received special attention. MNB Recommendation 2/2019 (II.13) on the Workout activity vis-à-vis consumers, which entered into force on 1 May 2019, was issued with a view to preventing problems related to workout.

During the inspections launched against financial enterprises, the primary areas of inspection included the infringements noticed during the continuous oversight, and – based on customer reports – primarily in the case of financial enterprises granting small-amount unsecured loans or pawn loans, the information provided during the commercial communication with regard to APR and the calculation of default interest, as well as the compliance with the statutory provisions related to CCIS and PTI; in addition, targeted inspection and proceeding at consumer requests aimed at the complaint management procedure were launched against several financial enterprises.

During the MNB's continuous oversight activity, the MNB sent 74 management letters to the institutions and issued 12 consumer protection warnings in order to ensure the long-term, stable and prudent operation of financial enterprises and protect consumers' interests. Almost half of these consumer protection warnings outlined reproachable conduct that affected a wide range of consumers in connection with the financial enterprises' complaint management activity.

6 Capital market and its risks

At the end of 2019, 33 investment service providers were active on the Hungarian capital market. In 2019, as a result of the termination of one credit institution, the number of credit institutions providing investment services declined by one to 21, while the number of investment firms decreased by two to 12 due to the consolidation process. The HUF 38,269 billion volume of customer securities managed by investment service providers – HUF 34,674 billion by credit institutions and HUF 3,595 billion by investment firms – exceeded the HUF 34,383 billion value of customer securities registered in 2018 by 11.3 percent. The number of securities accounts further decreased in 2019. The capital market turnover of HUF 304,400 billion realised in 2019 by the supervised institutions exceeds the turnover of 2018 by 6 percent in total, due to the growth of the OTC derivative turnover of the credit institutions.

Table 12
Key data of investment service providers

Investment service sector	2018			2019		
	Credit institutions	Investment firms	Total	Credit institutions	Investment firms	Total
Number of institutions (pcs)	22	14	36	21	12	33
Customer securities portfolio (HUF billions)	30 735	3 648	34 383	34 674	3 595	38 269
Number of securities accounts managed (thousand pcs)	1 465	254	1719	1 456	216	1 672
Capital market turnover (HUF billions)	254 005	33 217	287 222	274 256	30 172	304 428
Profit after tax (HUF millions)		7 408			9 895	
Capital adequacy ratio (percent)		19,3%			22,5%	

Source: MNB

The assets of HUF 10,262 billion managed by 48 investment fund managers reached a historic peak at the end of 2019 as it exceeds the previous year's value by 7.5 percent. The growth is primarily attributable to the 7.9 percent rise in the net asset value of investment funds – which represents 73 percent of the total increase, thus the assets managed in investment funds exceeded HUF 7,000 billion for the first time (HUF 7,077 billion). In relative terms, the largest growth was registered in the assets of voluntary pension funds (+9.4 percent). Assets managed in private pension funds and in insurance portfolios also increased, both of them by an annual 7.6 percent. Assets managed in other portfolios further declined in 2019, by a decreasing rate of 10.8 percent after the 52.8 percent decrease registered in 2018, but overall it had no major effect, since the HUF 255 billion managed stock in other portfolios has only 2.5 percent of the total assets managed by investment fund managers.

Table 13
Key data of investment fund managers

Investment fund management sector	2018	2019
Number of institutions (pcs)	44	46
Number of funds managed (pcs)	624	646
Volume of assets managed (HUF billions)	9 570	10 262
Profit after tax (HUF millions)	25 712	46 498

Source: MNB

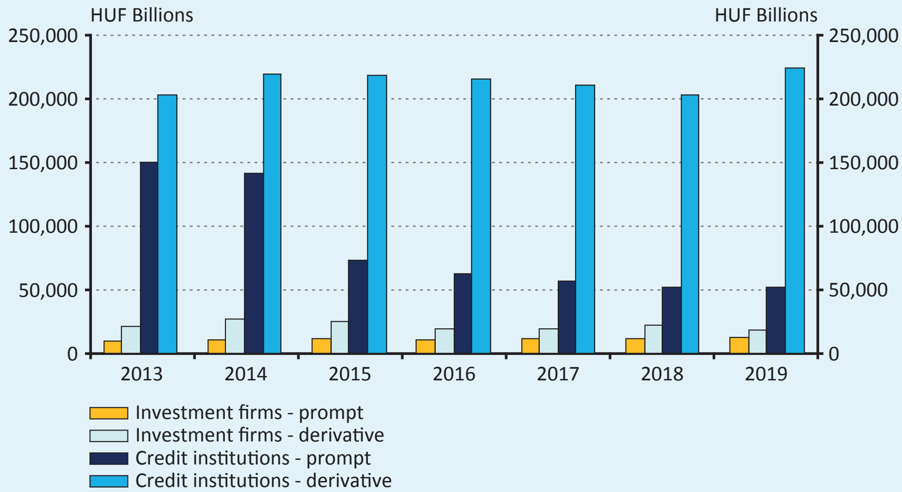
6.1 INVESTMENT SERVICES MARKET: TURNOVER AND BALANCES

6.1.1 The turnover of the capital market's stock exchange segment declined in 2019, while OTC turnover increased

Investment service providers – credit institutions providing investment services and investment firms – realised a total capital market turnover of HUF 304,400 billion in 2019, which exceeds the turnover realised in 2018 by 6 percent. The growth is attributable to the rise in credit institutions' capital market turnover: credit institutions' capital market turnover of HUF 274,300 billion in 2019 exceeds the amount of HUF 254,000 billion realised in 2018 by 8 percent, while the capital market turnover of investment firms declined by 9.2 percent in 2019 (Chart 66). In the case of the credit institutions, the growth in capital market turnover is originated from the rise in OTC derivative turnover by 12.4 percent (in 2018 the turnover was HUF 195,500 billion, while in 2019 it raised to HUF 219,700 billion), while the other capital market sub-sectors registered a decline: credit institutions' OTC prompt capital market turnover fell from HUF 50,400 billion registered in 2018 to HUF 49,800 billion (-1.3 percent), credit institutions' stock exchange prompt turnover of HUF 1,416 billion of 2019 fell short of the value registered in 2018 by 2.6 percent, while credit institutions' stock exchange derivative turnover dropped by 48 percent in 2019 (turnover was HUF 6,400 billion in 2018 and HUF 3,300 billion in 2019).

The decrease in the capital market turnover of investment firms is practically attributable to the fall in the derivative market turnover: investment firms' stock exchange derivative turnover of 2,4560 billion and OTC derivative turnover of HUF 11,900 billion, registered in 2019, fell short of previous year's turnover by 4.4 and 16.5 percent, respectively. In 2019, six investment firms were active in the stock exchange and OTC derivative market. The 6.8 percent decline in investment firms' stock exchange prompt turnover was offset by 6.4 percent growth in the OTC prompt turnover. On the whole, it can be stated that in 2019 the stock exchange segment of the capital market – both in the case of the stock exchange prompt and the stock exchange derivative turnover – returned to the level of HUF 12,000 billion, which was typical between 2014 and 2017: the domestic investment service providers' stock exchange prompt turnover of HUF 5,965 billion and stock exchange derivative turnover of 5,787 billion fell short of the values registered in 2018 by 7.7 and 35.5 percent, respectively.

Chart 66
Developments in the capital market turnover



Source: MNB

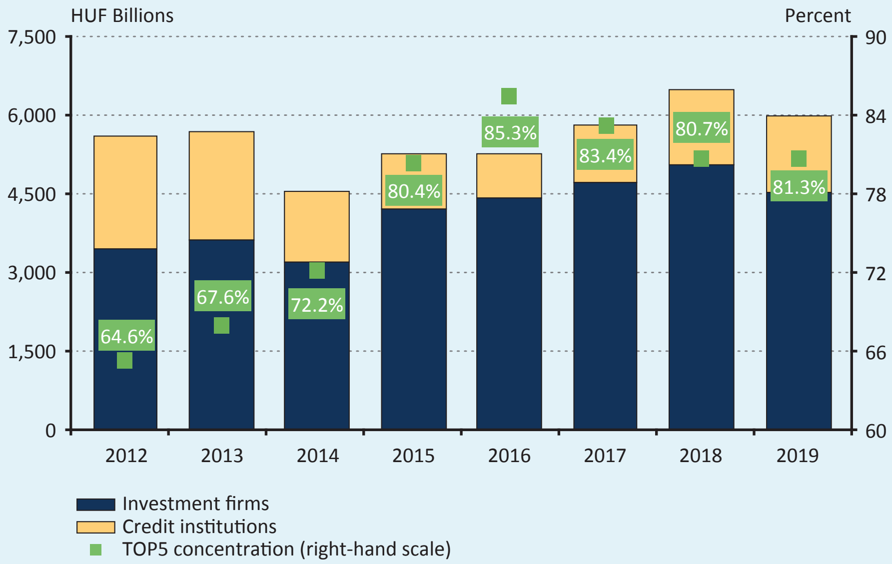
6.1.2 Overall, the share of investment firms in the stock exchange turnover increased in 2019

The trend of previous years continued in 2019: the share of investment firms in the stock exchange prompt turnover fell from 78.1 percent registered in 2018 to 76.9 percent by 2019 – in 2016 and 2017 it amounted to 84.3 and 81.1 percent, respectively. The 48 percent fall in stock exchange derivative turnover is essentially connected to one credit institution: accordingly, the share of investment firms in the stock exchange derivative turnover rose from 28.6 percent registered in 2018 to 42.4 percent by 2019, while overall the investment firms' stock exchange derivative turnover fell from HUF

2,568,000 billion registered in 2018 to HUF 2,456,000 billion. Essentially, the decline is related to two investment firms – in the capital market's stock exchange derivative segment 6 investment firms were active in 2019 and their composition remained the same since 2018.

The concentration of stock exchange derivative turnover decreased: the share of the top five investment service providers realising the highest stock exchange derivative turnover decreased from 78 percent of 2018 to 75 percent by 2019. Contrary to the trend observed in previous years, the fall in the concentration of stock exchange prompt turnover stopped in 2019: the share of the top five investment service providers realising the highest stock exchange prompt turnover was 81.3% in 2019, exceeding the concentration ratio of 2018 by 0.6 percentage point (Chart 67). While the composition of the top five investment service providers realising the highest stock exchange prompt turnover was constant between 2015 and 2018, in 2019 a new credit institution, rendering investment services, took the fourth place, replacing another credit institution rendering investment services. The composition of the top three investment service providers was constant in 2019 as well – the composition is constant since 2012, while those ranked first and second in 2018 swapped place in 2019. Four of the top five investment service providers realising the highest stock exchange prompt turnover are investment firms.

Chart 67
Stock exchange prompt capital market turnover and concentration

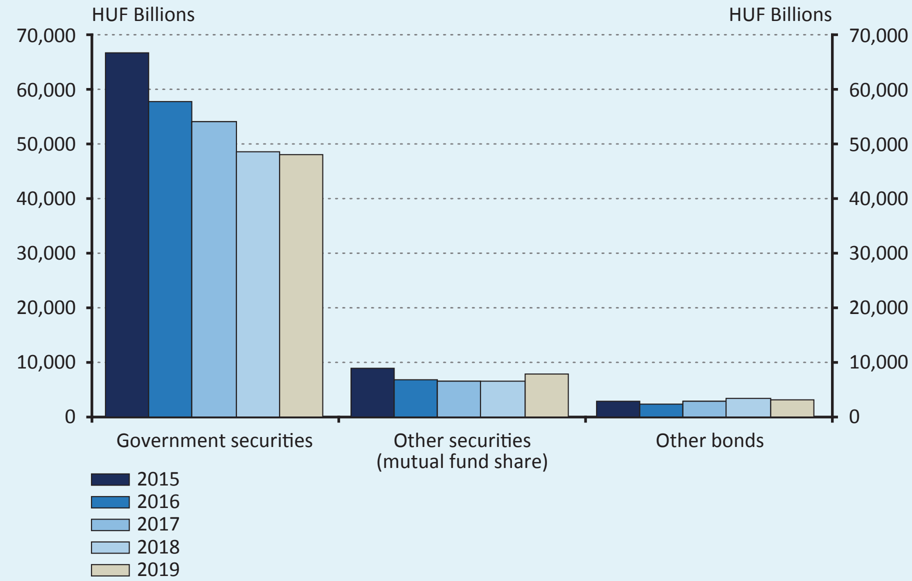


Source: MNB

6.1.3 Decreasing concentration ratio in the prompt capital market turnover

The OTC prompt market is still dominated by credit institutions, covering 87.1 percent of OTC prompt turnover, which represents a moderate decline compared to the 88.8 percent registered in 2018 (89.1 percent in 2017). The year-on-year growth of 0.6 percent in the OTC prompt turnover in 2019 is attributable to two contrasting effects: while credit institutions' OTC prompt capital market turnover fell by 1.3 percent, investment firms' OTC capital market turnover rose by 15.9 percent. The growth observed at investment firms is practically linked to two investment firms – in 2019, in the OTC prompt capital market segment, similarly to 2018, 10 investment firms were active. The concentration ratio of the OTC prompt capital market turnover considerably declined in 2019: the top five market participants covered 64.7 percent of the prompt OTC turnover, which falls short of the value registered in 2018 by 5.9 percent, while in 2016 and 2017 it was 70 percent. The composition the top five investment service providers realising the highest OTC prompt turnover has not changed compared to 2018 in 2019 either. The prompt OTC capital market turnover, similarly to previous years, were dominated by government securities in 2019 as well, with a share of 81 percent, followed by mutual fund shares with a ratio of 13 percent: a declining trend can be observed amongst government securities both in terms of absolute value and in ratio. (Chart 68)

Chart 68
OTC prompt turnover by types of securities



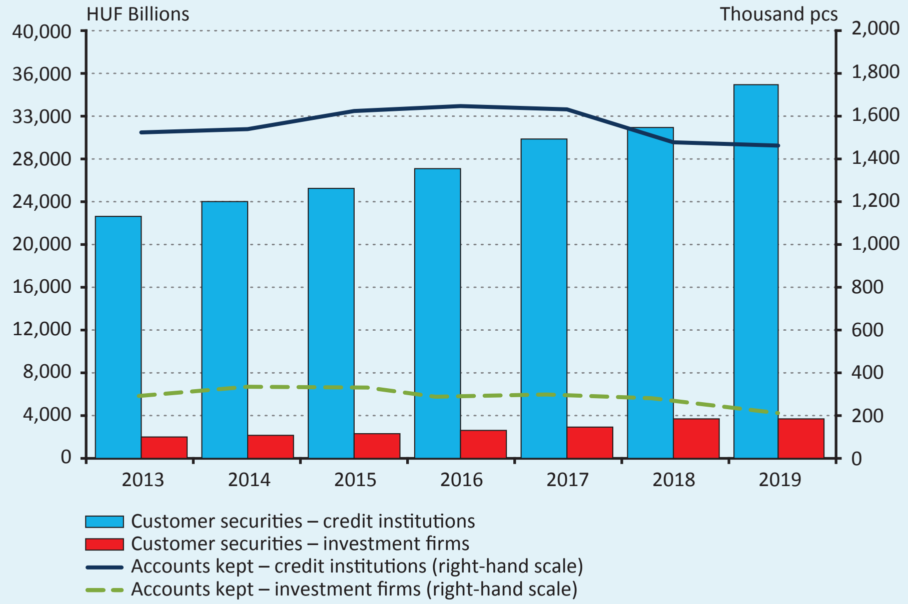
Note: due to their negligible OTC turnover equities are not included in the chart
Source: MNB

6.1.4 The portfolio of customer securities is at a historic peak at sector level

In 2019, the market value of customer securities at managed by investment service providers – credit institutions and investment firms – increased dynamically: the value of HUF 38.269 billion in December 2019 exceeded the amount of HUF 34,383 billion at the end of 2018 by 11.3 percent. The customer securities of HUF 34,674 billion, managed by credit institutions at the end of 2019, exceeded the value of HUF 30,735 billion in 2018 by 12.9 percent. In contrast, the balance of the customer securities portfolio managed by investment firms in 2018 fell by 1.5 percent: the balance of HUF 3,595 billion in December 2019 falls short of the 2018 value by HUF 53 billion – this is explained by the return of one investment firm's activity licence, as a result of which the customer securities managed by it was transferred to a credit institution rendering investment services under a transfer contract. Accordingly, contrary to previous years, in 2019 the ratio of customer securities portfolio managed by investment firms within the total value of customer securities fell from 10.6 percent registered in 2018 to 9.4 percent, but it still exceeds the values of previous years (2017: 8.8 percent, 2016: 8.5 percent, 2015: 8.0 percent, 2014: 7.6 percent).

In 2019, growth was observed in all asset categories of the customer securities portfolio of credit institution: within the amount of HUF 3,938 billion, HUF 2,013 billion related to equities (+19.1 percent), HUF 995 billion to mutual fund shares (+ 16.2 percent), HUF 553 billion to government securities (+ 4.5 percent) and HUF 360 billion to other bonds (+21.3 percent). The relatively small increase in government securities (in 2018 the portfolio increased by 13.4 percent, i.e. HUF 1,440 billion) is explained by the increased household demand for the new Hungarian government securities issued by the Hungarian State Treasury with favourable interest conditions, entitled Hungarian Government Securities Plus. The 1.5 percent decrease in the customer securities portfolio of investment firms is essentially attributable to the fall in the mutual fund shares portfolio, while the portfolio of other asset categories increased. The number of customer securities accounts managed by investment service providers decreased further in 2018, albeit at a declining rate: while in 2018 the number of customer securities account fell by roughly 10.5 percent, in 2019 the fall declined to 2.6 percent. The number of customer securities accounts managed by credit institutions fell minimally, by 0.6 percent, to 1,456,000 (corresponding to 9,000 accounts) by the end of 2019, while investment firms registered a decrease of 38,000 accounts (in 2018 the decrease was 45,000) and thus the closing stock of 216,000 at the end of 2019 corresponds to a year-on-year decrease of 14.9 percent (Chart 69).

Chart 69
Customer securities portfolio

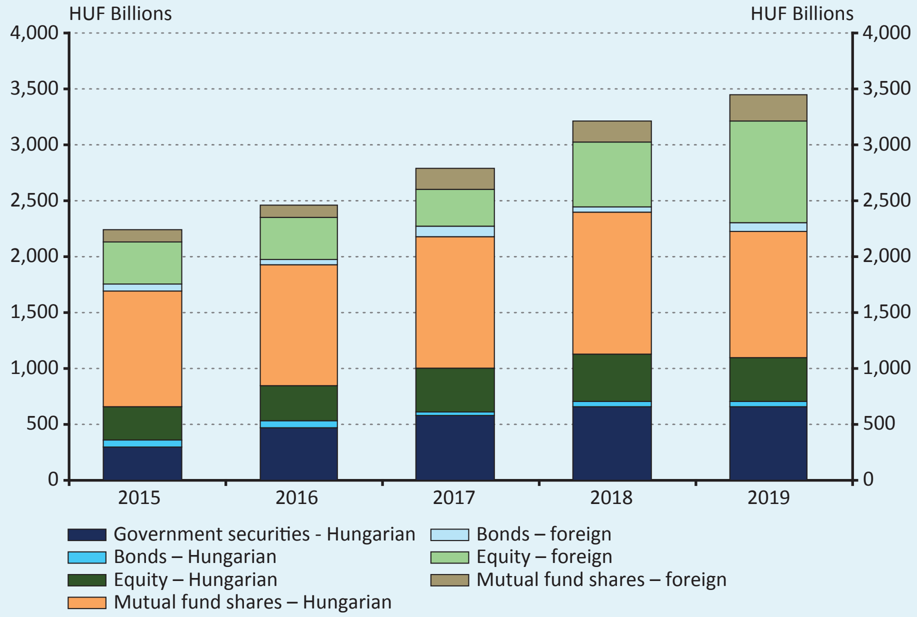


Source: MNB

6.1.5 The share of Hungarian issuers within the customer securities portfolio of investment firms decreased, but it is still high

Within the investment firms' customer securities portfolio of HUF 3,595 billion the mutual fund shares asset class holds still the highest share, with 38 percent in 2019 (2018: 39.9 percent), followed on the second place by the equity asset class with 36.6 percent (2018: 35.8 percent), on the third place by the government securities asset class with 20.4 percent (2018: 18.1 percent) and on the fourth place by the corporate bond asset class with 3.5 percent (2018: 3 percent). The decrease of HUF 53 billion observed in 2019 at investment firms is attributable to the decrease of HUF 90 billion (6.2 percent decrease) in mutual fund shares and HUF 62 billion (53.9 percent decrease) in other securities, while the government securities portfolio rose by HUF 74 billion (11.2 percent), the bond portfolio by HUF 16 billion (14.9 percent) and the equity portfolio practically stagnated. When examining the breakdown of asset classes by resident and non-resident sector, similarly to previous years, within the government securities asset class, in the investment firms' customer securities portfolio Hungarian government securities accounted for 99 percent of the entire government securities portfolio. Within the mutual fund shares asset class the ratio of Hungarian mutual fund shares decreased in the investment firms' customer securities portfolio: the ratio of 82.6 percent at end of 2019 fell short of the value registered in 2018 by 4.4 percentage points. In the investment firms' equity portfolio major restructuring can be observed, which essentially relates to one institution. While in the past years the share of Hungarian issuers steadily increased – it was 43.3 percent in 2015, 45 percent in 2016, 53.7 percent in 2017 and 56.6 percent in 2018 – in 2019 it fell by 26.3 percentage points to 30.4 percent. (Chart 70)

Chart 70
Customer securities portfolio by asset classes

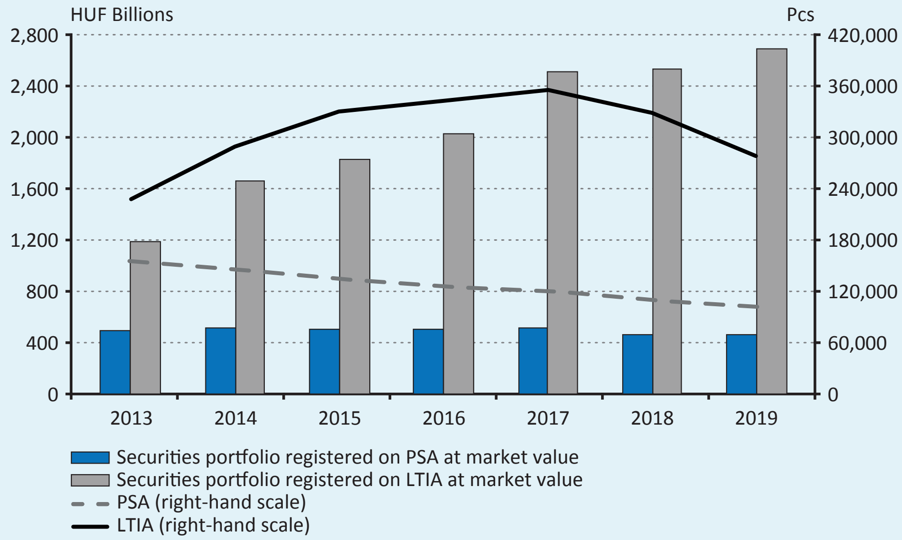


Source: MNB

6.1.6 The number of long-term investment accounts declined further

The number of securities accounts kept in the form of long-term investment accounts (LTIA) declined further in 2019. The 281,000 LTIAs kept by investment service providers at the end of 2019 fall short of the portfolio of 331,000 accounts registered at the end of 2018 by 50,000. The fall of 15.1 percent registered in 2019 exceeds the decline in of 2018 by 7.4 percent (the growth in 2017 was 4 percent, 3.5 percent in 2016, 14.3 percent in 2015 and 27 percent in 2014). In relative terms, the decrease was greater at the investment firms – the investment firms' closing stock of 88,000 at the end of 2019 falls short of the 2018 closing stock by 20.1 percent, while in absolute terms the fall practically characterised the credit institutions – credit institutions' closing stock of 193,000 falls short of previous year's closing stock by 28,000 (-12.7 percent). The growth rate of the securities portfolio registered on LTIA accelerated in 2019: the HUF 2,715 billion closing stock of securities registered on LTIA in 2019 exceeded the closing stock of HUF 2,549 billion in 2018 by 6.4 percent, which exceeds the 2018 growth rate by 5.9 percent (the growth rate in 2017 was 24 percent and in 10.7 percent in 2016). In accordance with the foregoing, the average securities portfolio per LTIA rose from HUF 7.7 million registered at the end of 2018 to HUF 9.7 million by the end of 2019. In line with the previous years, the fall in the stock of pension savings accounts (PSA) continued in 2019 as well: the stock of 104,700 accounts in 2019 falls short of the 2018 value by 7.5 percent, while the PSA stock fell in 2018 by 6.8 percent, in 2017 by 4.5 percent and in 2016 by 8 percent. The decline affected primarily the credit institutions: In 2019 the PSA portfolio registered by credit institutions fell by 8.3 percent, whereas investment firms only registered a decline of 5.3 percent. The decline at the investment firms occurred at one institution. (Chart 71)

Chart 71
LTIA and PSA accounts, and the portfolios held on the accounts



Source: MNB

6.2 REGULATED MARKET

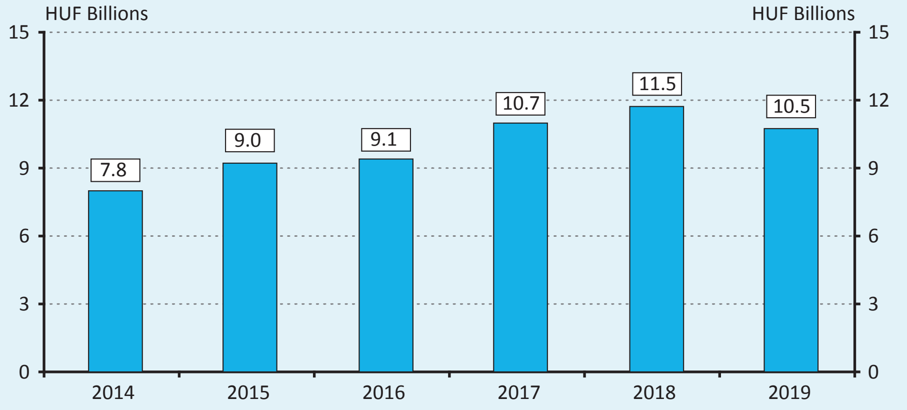
6.2.1 Declining turnover on the prompt market of the Budapest Stock Exchange (BSE)

In 2019 the turnover of the Budapest Stock Exchange declined by 6.1 percent compared to 2018, while in 2018 and in 2017 it was characterised by a growth of 2.8 and 3.1 percent, respectively. The decline was significant particularly on the prompt market: the 2019 prompt securities turnover declined by 10.1 percent compared to 2018, while turnover on the derivatives market decreased only by 1 percent. The fall of HUF 299 billion in turnover on the prompt market is attributable to the decline of HUF 216 billion (7.7 percent) in the turnover of Hungarian equities and the nose-dive in mortgage bond turnover: while in 2017 mortgage bond turnover was negligible (HUF 70 million), in 2018 it skyrocketed to HUF 60 billion, which then fell by HUF 59 billion in 2019 to HUF 648 million.

The remaining decline of HUF 24 billion in the prompt securities turnover is explained by the fall of 24.4 percent in the turnover of certificates. Despite the fall in the turnover of Hungarian equities, the share of Hungarian equities in the total prompt turnover continued to increase, albeit minimally, in 2019 to 97 percent from 96.8 percent of 2018 (2017: 94.6 percent). The concentration of the trading turnover of the members of the prompt section increased further in 2019, albeit at a moderate rate: the turnover generated by the top five stock exchange members covered 81.5 percent of the entire prompt market, which exceeds the value of 80.9 percent registered in 2018 by roughly 0.6 points, while this ratio in 2017 was 76.9 percent. The composition of the top four stock exchange members remained constant in 2019 compared to 2018, while their order has changed.

The decline in the turnover of the derivatives market continued in 2019 as well: the total derivative turnover of HUF 2,318 billion in 2019 fall short of the total turnover of HUF 2,341 billion registered in 2018 by 1 percent. The decline in the total turnover of the derivatives market was caused by a 14.4 percent decline in the turnover of equity futures (2018: HUF 316 billion; 2019: HUF 270 billion) and a 12.1 percent decline in index-based futures (2018: HUF 159 billion; 2019: HUF 140 billion), which could not be offset by the 2.2 percent rise in foreign exchange futures (2018: HUF 1.844 billion; 2019: HUF 1.884 billion). In 2019 the derivative market was still characterised by strong concentration: the turnover generated by the top five stock exchange members covered 87.9 percent of the turnover of the entire derivative market, which exceeds the 2018 figure of 86.4 percent by 3.3 percentage points (Chart 72)

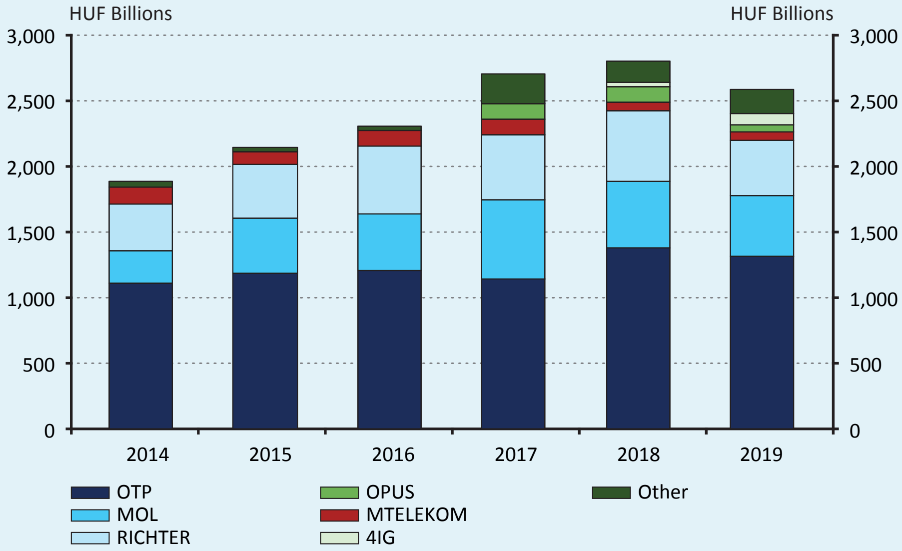
Chart 72
Average daily equity market turnover of the Budapest Stock Exchange



Source: Budapest Stock Exchange

In terms of issuers, in the equity market turnover the composition of the top three equities of the largest turnover – OTP, MOL, Richter – remained unchanged in 2019, but their order has changed: OTP is still on the first place, while Richter – ranked second in 2018 – slipped to the third place in 2019 and it was replaced by MOL, ranked third in 2018. The equity market was still characterised by high concentration: the share of the three issuers in the total equity market turnover fell from 84.7 percent registered in 2018 to HUF 83.4 percent by 2019. A decline was observed at all three issuers, but it was particularly large in the Richter equities, the annual turnover of which fell by 20.1 percent (it was HUF 531 billion in 2018, and HUF 424 billion in 2019), followed by MOL, the turnover of which fell by 8.6 percent (2018: HUF 507 billion; 2019: HUF 464 billion) and finally by OTP, which registered a decline of 4.8 percent (2018: HUF 1,370 billion; 2019: HUF 1,305 billion). The turnover of OPUS, which was ranked fourth based on turnover in previous years, plunged by 52.5 percent in 2019; after the turnover of HUF 114 billion in 2018, in 2019 its turnover was HUF 54 billion, and it was replaced by the equity of 4IG (2018: HUF 31 billion; 2019: HUF 82 billion). The turnover of the MTelekom equity decreased further in 2019 as well, from HUF 75 billion registered in 2018 to HUF 61 billion in 2019 (-18.5 percent). The turnover of the other issuers rose by HUF 22 billion to HUF 185 billion in 2019 (+13.6 percent), which was essentially attributable to the soar in the turnover of the Est Média equity by 172.9 percent (after a turnover of HUF 13 billion in 2018, a turnover of HUF 37 billion in 2019).

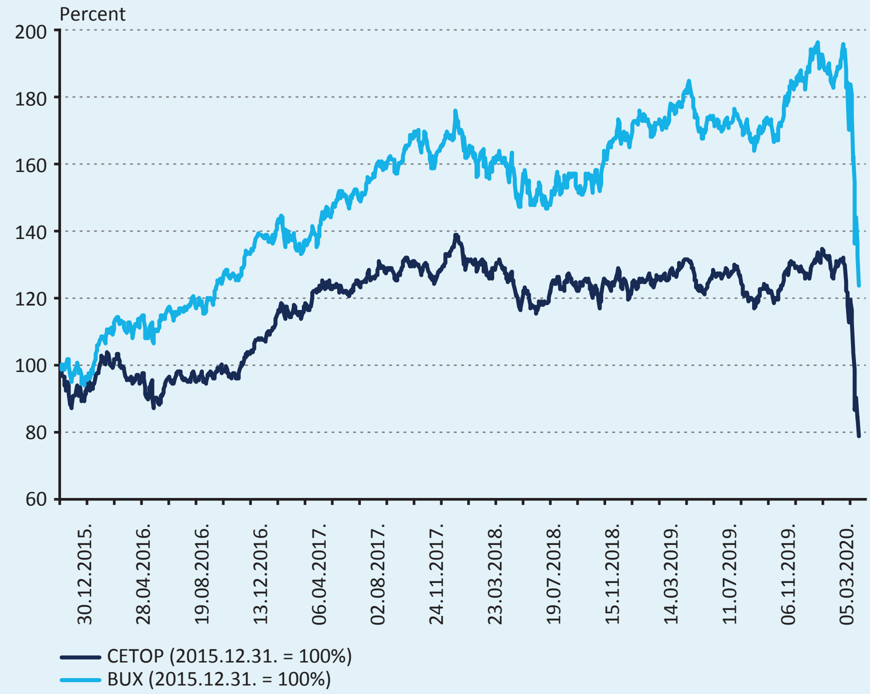
Chart 73
Annual stock exchange turnover of issuers



Source: MNB

In 2019 the BUX index rose by 17.7 percent from the closing value of 39,139 registered at the end of December 2018 to the closing value of 46,083 points at the end of December 2019. The growth is essentially attributable to the increase in the price of OTP Bank Plc. In 2016 and 2017 the BUX index rose by 33.8 and 23 percent, respectively, while in 2018 it registered a negligible decrease of 0.6 percent. By contrast, in the first quarter of 2020, the BUX index – in line with the international trends – was characterised by increased volatility and major decline: the closing value of 33,135 on 31 March 2020 falls short of the value registered at the end of 2019 by 28.1 percent (Chart 74).

Chart 74
Changes in the BUX and CETOP indices



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

Source: MNB

6.2.2 In 2019 three new issuers' equity was listed on BSE's trading venues

In 2019 the equities of the MKB Bank Plc were listed on the main market (i.e. Xbud) of the Budapest Stock Exchange, while on the market of the Xtend multilateral trading system of the Budapest Stock Exchange, created for small and medium-sized enterprises the equities of two issuers were listed (Cyberg Corp. Nyrt, GOPD Nyrt.). In 2019 there were 11 private capital increases in total. Contrary to the one delisting in 2018, no delisting event took place in 2019.

6.3 RISKS AFFECTING INVESTMENT FIRMS

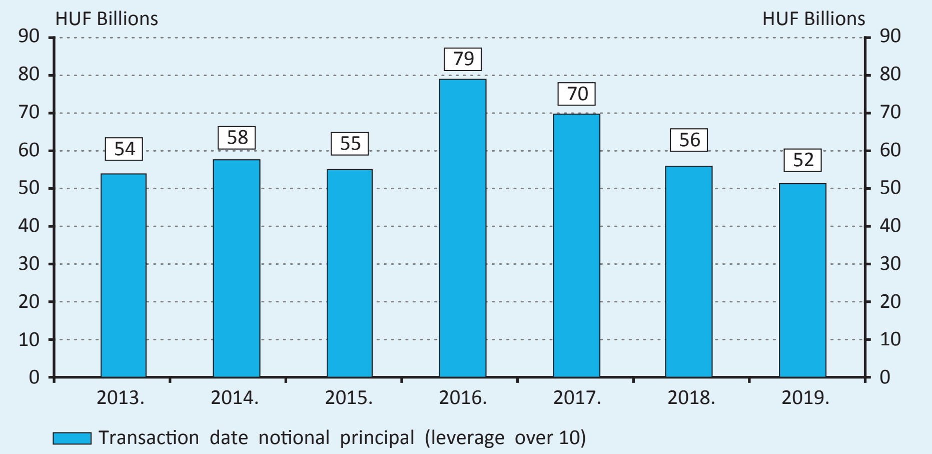
6.3.1 Further decline in white label portfolios at investment firms

White-label product is a service where an investment service provider sells a trading platform developed by a third-party investment service provider under its own brand and business name, which platform facilitates a wide-range of trades on the international equity and bond market, and trading with derivatives. The customer signs a contract with the Hungarian investment service provider, and the assets of the customers are placed by the external service provider on omnibus accounts, opened under the name of the Hungarian investment service provider, as client. Accordingly, the credit and counterparty risks of customers using white-label services and the investment service providers rendering such services are higher than usual.

The number of independent – i.e., without banking background – Hungarian investment firms rendering white-label services remained unchanged – three – in 2019. In 2019, the trading volume of leveraged OTC transactions, executed within the framework of services built on white-label schemes – primarily comprising of CFD[31] positions, which are of speculative nature and particularly high risk – continued to decline. The declining trend in the volume of CFD trading is primarily the result of the product intervention measure of the European Securities and Markets Authority (ESMA), effective from 2 July 2018 and maintained for 12 months, followed by the maintenance thereof by the MNB from 2 July 2019, within national scope of competence. As a result of the product intervention, the risk of the full loss of the capital invested considerably decreased, since the investment firms offering CFD trading are obliged to provide protection against negative account balance, and upon reaching 50 percent of the initial margin, necessary for the opening of the CFD position, ensure the automatic closing of the position. An additional investor protection achievement of the product intervention is that it considerably tightened the conditions of trading under the formerly extreme – even 500-fold – leverage, by increasing the initial margin requirements (e.g. in the case crypto currency-based CFDs maximum twofold leverage is permitted). (Chart 75)

Within the scope of its supervisory activity, the MNB continues to pay special attention to the services built on white-label scheme, offered by the domestic capital market actors (a dominant element of which is that these service providers are still obliged to recognise additional capital requirement) and to inspection of compliance with the product intervention requirements applicable to CFD trading.

Chart 75
Transaction date notional principal of white-label products



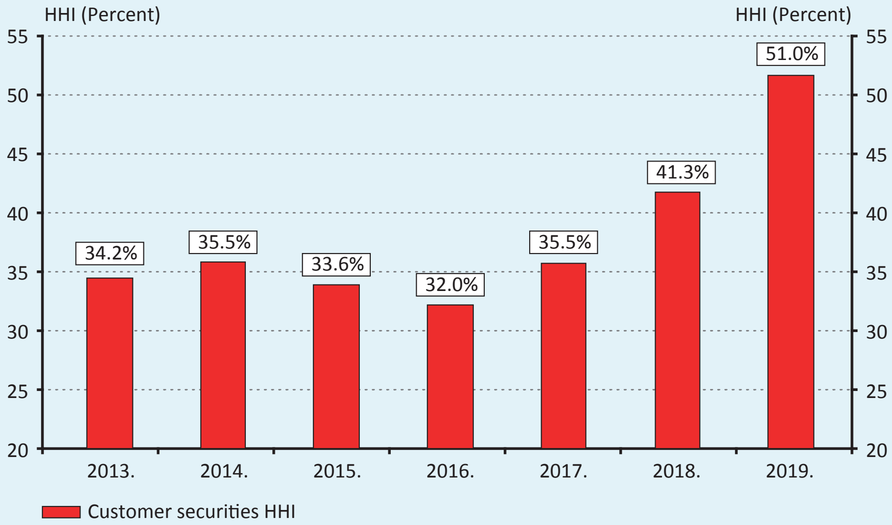
Source: MNB

6.3.2 The decreasing trend in the market share of small investment firms continued in 2019

The concentration ratio of the investment firms' customer securities portfolio, calculated in accordance with the Herfindahl-Hirschman index (HHI) registered a trend growth from 2016, and the growth also continued in 2019: the HHI of 32 percent in 2016 rose to 51 percent in 2019 (Chart 76). The rise in market concentration is explained by the fact that after 2016 major consolidation took place in the Hungarian capital market: 10 of the former 15 non-bank investment service providers survived until 2019, and the customer portfolio managed by the investment firms that left the market was transferred to other service providers.

[31] CFD: contract-for-difference – see Box 11 Contracts for difference (CFD) and binary options)

Chart 76
Market concentration of customer securities portfolio

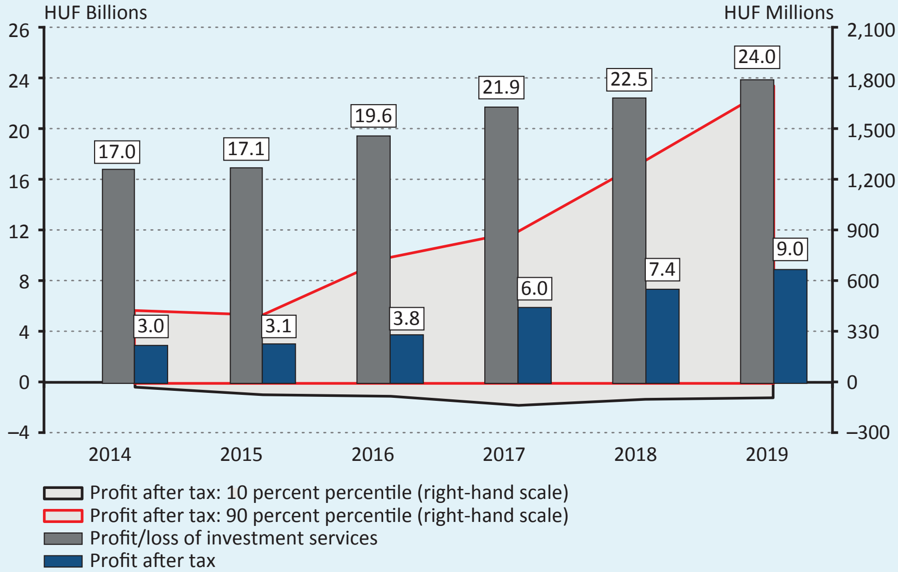


Source: MNB

6.3.3 On the whole improving profitability at sector level

In 2019 the income of the investment firm sector – including branch offices – dynamically rose: the after-tax profit of HUF 9.9 billion in 2019 exceeds the after-tax profit of HUF 7.4 billion registered in 2018 by 34 percent (the annual growth rate in 2018 and 2017 was 24.1 percent, in 2017 55.8 percent and in 2016 25.6 percent) and reached a historic peak at sector level. The after-tax profit of 9 of the 12 investment firms that operated at the end of 2019, rose, while the after-tax profit of 3 investment firms decreased. This is a major improvement compared to 2018, since then 7 investment firms registered a decrease in the after-tax profit, while the profit after tax rose only at 5 investment firms. The income concentration of the investment firms sector declined further in 2019: the share of the combined after-tax profit of HUF 8.2 billion of the top three market participants based on after-tax profit decreased to 82.8 percent of the entire sector's after-tax profit, from 91.7 percent recorded in 2018, and the combined after-tax profit of the top five market participants with the highest after-tax profit declined to 96.9 percent of the entire sector's after-tax profit from 102% registered in 2018. The decline in the concentration is explained by the fact that in 2019 none of the investment firms realised a loss, and on the other hand the profitability of small investment firms increased. (Chart 77)

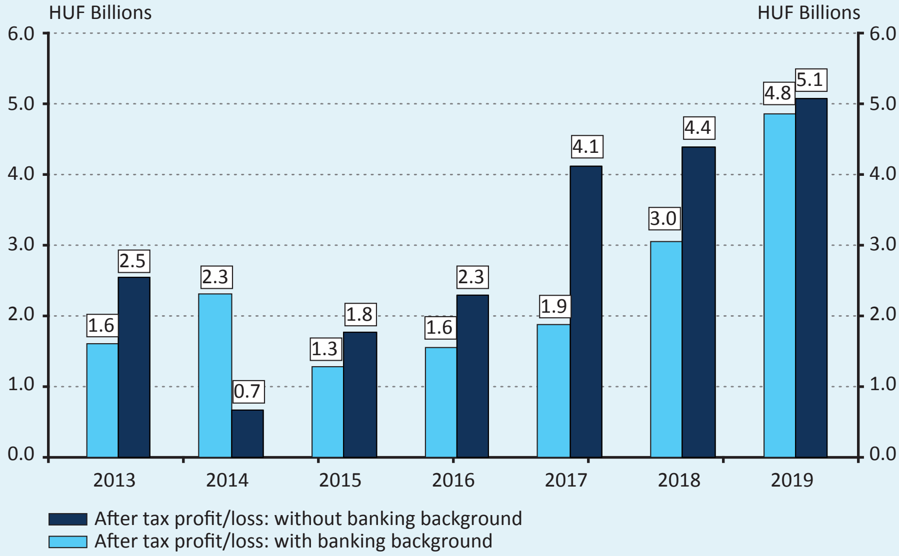
Chart 77
Profitability of investment firms



Source: MNB

Consolidation continued in the investment firms sector: In 2019 one investment firm with relatively large customer securities portfolio (Magyar Posta Befektetési Zrt.) and the branch office of a foreign investment firm with no customer securities portfolio (Hungarian Branch Office of Admiral Markets UK Limited) ceased their activity. The investment firms that returned their activity licence realised a loss in the past years as a trend (-HUF 145 million in 2016, – HUF 344 million in 2017 and – HUF 243 million in 2018). The improvement in the profitability of the investment enterprise sector at sector level is also evidenced by the fact that in 2019 the profitability of independent investment firms not belonging to a banking group soared in 2019: the after-tax profit of investment firms not related to a banking group soared from HUF 3 billion registered in 2018 to HUF 4.8 billion by 2019 (a growth of +59 percent). (Chart 78)

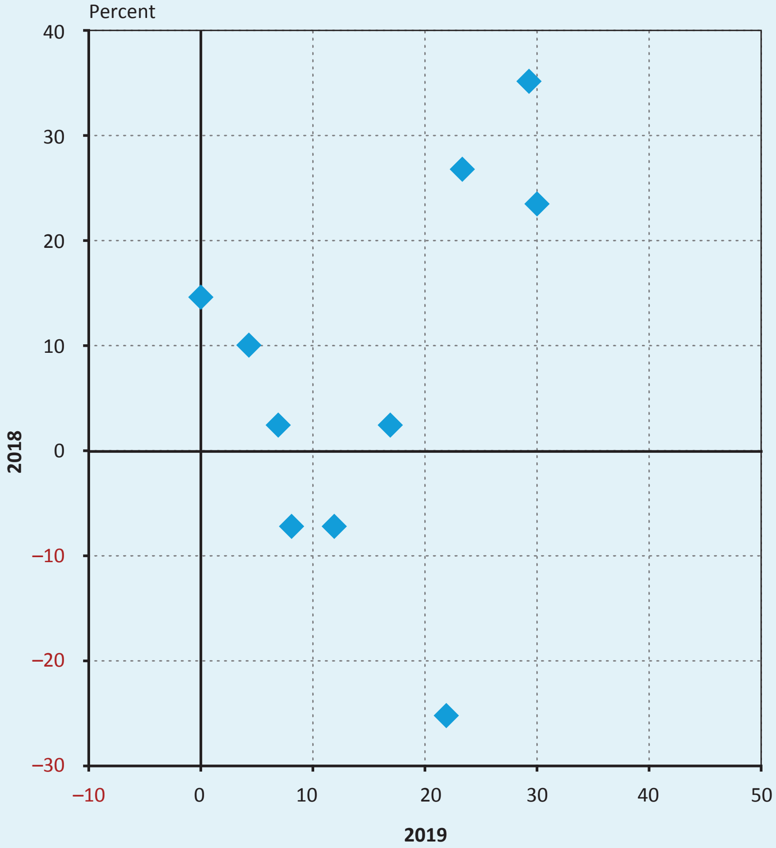
Chart 78
After-tax profit/loss of investment firms with and without a banking background



Note: the institutions with banking background also include branch offices
Source: MNB

Contrary to the 4 loss-making investment firms in 2018, in 2019 only one investment firm realised a loss. This recently established investment firm (it received the activity licence in 2017) has no customer portfolio, keeps no customer accounts and at the beginning of 2020 its activity licence was temporarily suspended in view of the irregularities found related to its operation. The improvement in the sector-level profitability is also evidenced by the after-tax return on equity (ROE): Chart 79 shows that investment firms cluster to the right from the vertical zero axis.

Chart 79
ROE value of investment firms (percent)

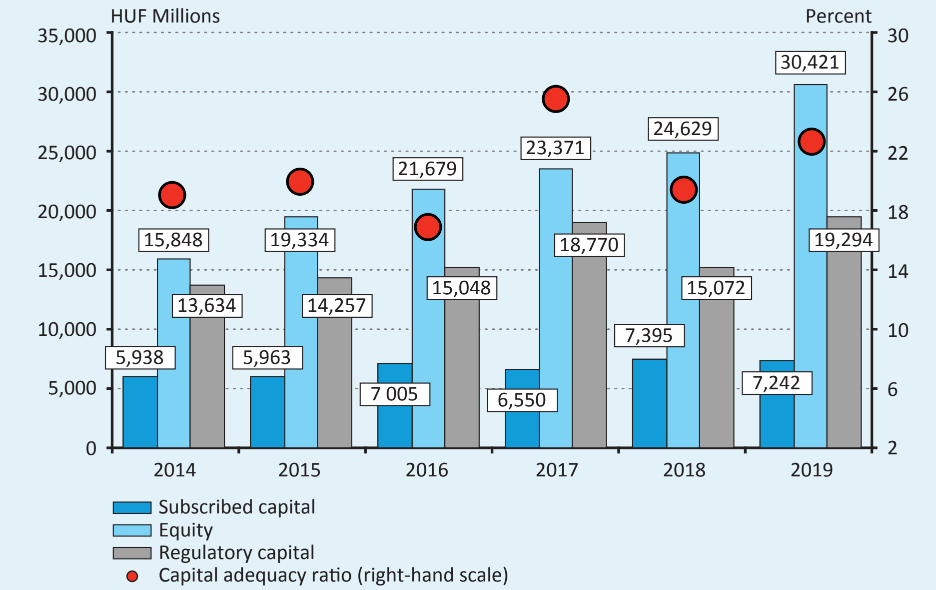


Source: MNB

6.3.4 Capital adequacy increased at sector level

The registered capital of investment firms fell from HUF 7.5 billion of 2018 to HUF 7.2 billion in 2019: the decline is attributable to the withdrawal of the activity licence of 1 investment firm. By contrast, the equity of investment firms substantially – by some HUF 5.8 billion (by + 23.5 percent) – increased. The degree of the growth is essentially due to 1 institution; however, it can be established that the equity of 9 of the 12 investment firms that held an activity licence at the end of 2019 increased compared to the previous year. The capital adequacy ratio of the investment business sector rose from 19.3 percent registered at the end of 2018 by 3.2 percentage points to 22.5 percent by the end of 2019, which slightly exceeds the average of previous years. The rise in the capital adequacy ratio is essentially attributable to the growth in the available own funds of 2 institutions. The available own funds of 3 investment firms decreased, and the activity licence of 1 of these was suspended at the beginning of 2020. All the 11 investment firms with a registered office in Hungary had an adequate capitalisation level at the end of 2019, but in the longer-term capital adequacy problems may arise at two investment firms. In 2019, 8 of the 10 investment firms with registered office in Hungary and also operating in 2020, have to comply with the capital requirement calculated on the basis of risk exposure, while in the remaining 2 cases the 2020 capital requirement comprises the statutory initial capital requirement, as a higher limit. Compared to 2018, the latter fell by 3, in view of the fact that the operating licence of 1 investment firm was withdrawn, while the capital requirement of 2 other investment firms, calculated on the basis of risk exposure, exceeded the statutory initial capital requirement at the end of 2019, albeit only to a minimal extent.

Chart 80
Capital and capital adequacy ratio of investment firms



Source: MNB

6.4 SECTOR LEVEL RISK MAP OF THE INVESTMENT FIRMS

Risk category	Risk groups	Risk rating	Risk prospects	Textual evaluation
Market risk	Uncertain turnover trend			• the broadening of the household government securities supply represents substantial competition for the investment services built on the classic foreign currency and equity trading, entailing higher turnover *The economic activity caused by the coronavirus pandemic shifted the risk averse attitude experienced before toward higher risk appetite, hoping to realise profit on the bear market*
Credit risk	Placement of customer funds with third parties			• because of the intervention decisions, tightening the conditions of retail CFD trading, the volume of incurred losses decreased *The risk arising from leveraged trading and risk of incurring higher loss than the capital invested may arise with a greater probability under extraordinary, turbulent market circumstances*
Profitability	MiFID II/MiFIR compliance			• Continuous compliance with the MiFID II/MiFIR regulatory framework necessitates increased human and IT resources at the investment firms, which has a bearing on profitability *In connection with the IFR/IFD regime, Class2 investment firms must develop new capital calculation methodology, which may necessitate one-off extra human resource expenditure and potential IT developments.*
Capital adequacy	Decreasing profitability			*The decreasing profitability of small and medium-sized investment firms may have a negative impact on their capital position as well.*
Market entry risk	Products Customers			• the controlling environment related to the use of third-party inducements and the related record-keeping requires extra resources from the service providers (see more transparent cost structure)

Note:
Degree of risk — *high* — *significant* — *moderate* — *low*
Direction of risk — *increasing* — *stagnant* — *decreasing*

Overall, compliance with the MiFID II/MiFIR regulatory requirements still require major resources at the investment firms, with special regard to the development of internal regulations related to the use of inducements, the cost allocation procedure and registers. The crowding-out effect of the broadening household government securities vis-à-vis the classic capital market investments and increasing uncertainty in the equity markets may have negative impact on the transaction volume managed by investment firms and on the profitability of companies.

6.5 FUND MANAGEMENT MARKET AND RISKS AFFECTING INVESTMENT FUND MANAGERS

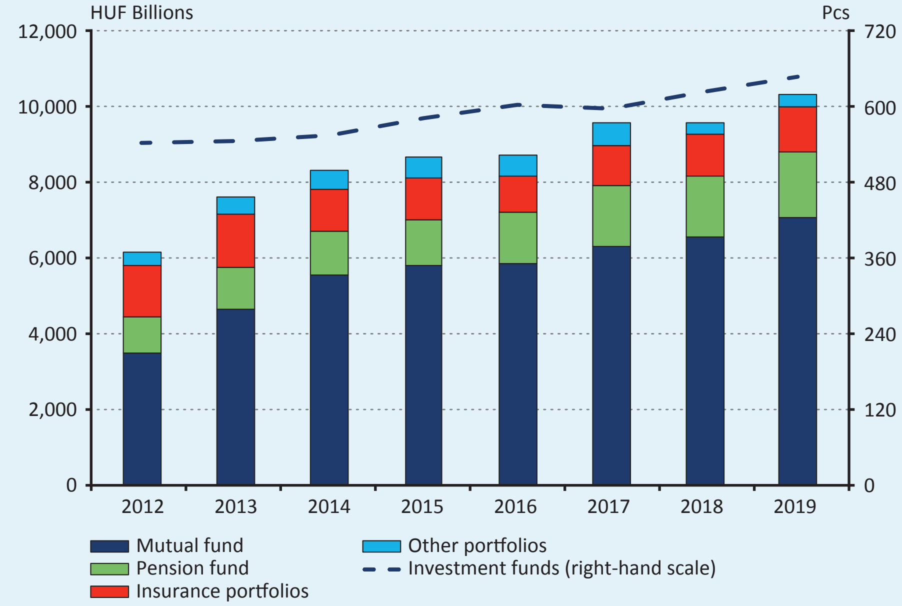
6.5.1 Vigorous growth in the assets managed by investment fund managers

The number of investment funds rose from 624 registered at the end of 2018 to 646 by the end of 2019. As a result of the increased investor interest in real estate funds, restructuring continued: while in 2019 the number of real estate funds rose by 34 and reached 136 – both in 2016 and 2017 the number of real estate funds rose by 20, and in 2018 by 32 – the number of securities funds decreased by 12. However, it should be noted that the number of public real estate funds – also available to small investors – did not change in 2019.

The assets managed by domestic investment fund managers reached a historic high at the end of 2019, i.e. the halt observed in 2018 – when the assets managed by investment fund managers fell minimally, by roughly 0.2 percent (by HUF 21 billion) – was only a onetime phenomenon: the amount of HUF 10,262 billion managed assets at the end of 2019 exceeds the value of HUF 9,549 billion registered in 2018 by 7.5 percent. The growth is basically due to the HUF 518 billion (7.9 percent) increase in the net asset value of investment funds, representing 73 percent of the total increment in absolute value. (Chart 81)

In relative terms, the largest growth was observed in the assets of voluntary pension funds managed by the investment fund managers: the HUF 1,427 billion managed assets of voluntary pension funds registered at the end of 2019 exceeds the assets of HUF 1,304 billion of 2018 by 9.4 percent. The growth of HUF 123 billion in the managed assets of voluntary pension funds accounts for 17 percent of the increment of HUF 712 billion in the total assets managed by investment fund managers. The growth in the assets of voluntary pension funds is practically attributable to investment yields. In line with this, the key underlying reason for the growth of +7.6 percent in the managed assets of private pension funds in 2019, is the investment performance: private pension funds' managed assets of HUF 269 billion in 2019 exceed the value of HUF 250 billion registered in 2018 by HUF 19 billion. The assets managed by investment fund managers in insurance portfolios – similarly to the previous two years – continued to increase also in 2019: the portfolio of HUF 1,197 billion exceeds the value registered in 2018 by 7.6 percent. The growth is practically related to two investment fund managers with insurance background. Assets managed in other portfolios further declined in 2019, albeit at a declining rate: the fall of 52.8 percent registered in 2018 declined to 10.8 percent by 2019, but overall it had no major effect, since the stock of HUF 255 billion managed in other portfolios accounts for only 2.5 percent of the total assets managed by investment fund managers.

Chart 81
Assets managed by investment fund managers and the number of investment funds



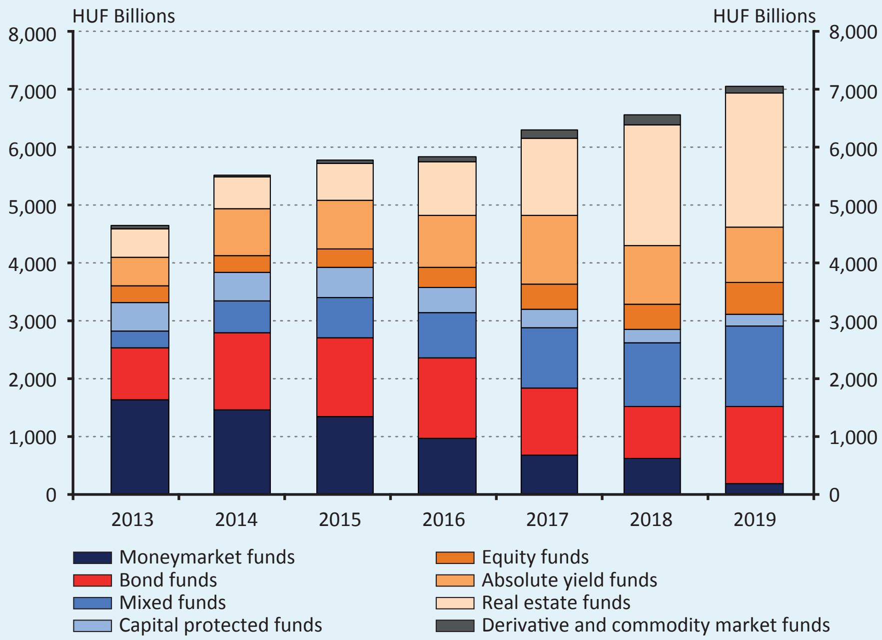
Source: MNB

6.5.2 Beside a new historic peak, investment funds were characterised by restructuring

The net asset value of investment funds registered a vigorous growth in 2019: the portfolio of HUF 7,077 billion exceeded previous year's value of HUF 6,558 billion by 7.9 percent and represents a new historic peak. The growth in the assets of investment funds is basically justified by the positive yields realised on the investments: accordingly, the growth of HUF 518 billion in net asset value is attributable to the positive yield effect of HUF 451 billion and the positive net capital inflow of HUF 67 billion. It appears that in 2019 the managed assets of investment funds investing in interest-bearing assets – i.e. liquidity, money market, short-term, long-term bonds, bonds without duration target – stabilised: while in 2018 the net asset value of these investment funds decreased by HUF 314 billion, in 2019 this remained practically unchanged – the stock of HUF 1,524 billion at the end of 2019 fell short of the value registered in 2018 only by HUF 1 billion. However, within the category of funds investing in interest-bearing assets there was a major restructuring: the assets managed in liquidity and money market funds fell by 76 and 64 percent, respectively, corresponding to a decrease of HUF 289 billion and HUF 146 billion, while the net asset value of short-term bond funds rose by 77 percent (HUF 410 billion). This is due to the fact that from 21 January 2019 , it is mandatory to apply the rules of the new EU regulation applicable to money market funds, which impose additional compliance requirements and significantly tighten the operating conditions of money market funds; consequently, the vast majority of the former liquidity and money market funds decided to alter their investment policy, and thus they were transferred to the short-term bond fund investment class.

There was a strong demand for mixed funds also in 2019: overall, the assets managed in mixed funds increased by HUF 285 billion to HUF 1,388 billion (+25.8 percent). The growth in mixed funds was attributable to the rise in the assets managed in the balanced mixed funds and bond-heavy mixed funds: in 2019 the assets managed in balanced mixed funds increased by 27.7 percent (HUF 170 billion), while the assets managed in bond-heavy mixed funds were up by 24.7 percent (HUF 95 billion). Contrary to the decrease of 2 percent registered in 2018, the net asset value of equity funds increased in 2019 by 23.5 percent – the closing balance of HUF 556 billion exceeds the value of managed assets of 2018 by HUF 106 billion: the growth is essentially attributable to the yield effect. The fall in assets, characterising capital protected funds in the past four years also continued in 2019: the net asset value of capital protected funds of HUF 206 billion in 2019 falls short of the value registered in 2018 by 2.6 percent. In accordance with the previous trend, the growth in the net asset value of real estate funds – funds investing in direct and indirect real estate – continued in 2019 as well: the managed assets of real estate funds in the amount of HUF 2,309 billion in 2019 exceeds the closing balance of previous year of HUF 2,092 billion by HUF 217 billion – the 10.4 percent growth in the net asset value registered in 2019 falls short of the growth rates of 40-55 percent observed in the previous three years; nevertheless, the share of real estate funds in the total net asset value of investment funds reaches 32.6 percent (2018: 31.9 percent). (Chart 82)

Chart 82
Breakdown of the investment funds by investment policy



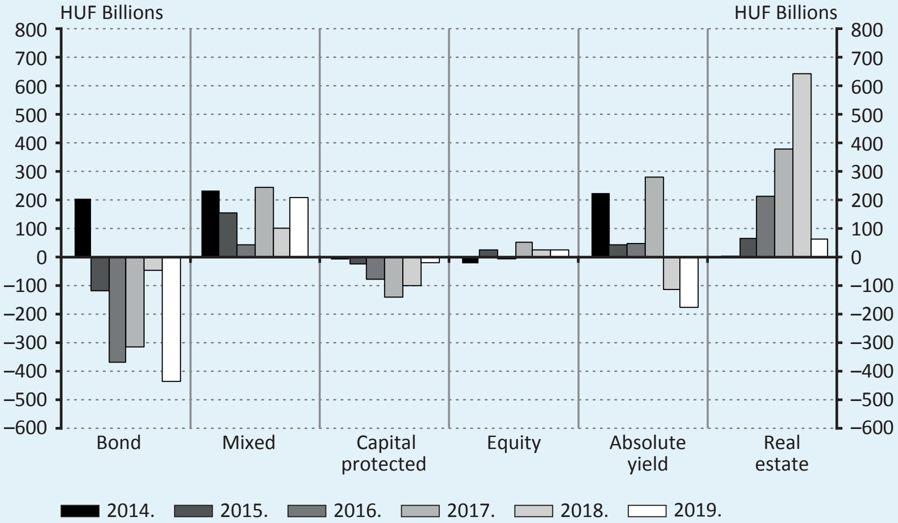
Source: MNB

6.5.3 Moderate capital inflows into investment funds in 2019

Overall, investment funds were characterised by positive capital inflow in 2019 as well, but it fell short of the values registered in previous years: the HUF 67 billion net capital inflow of 2019 significantly falls short of the values of HUF 270 billion and HUF 260 billon registered in 2017 and 2018, respectively (in 2016 it was HUF 156 billion). When looking at the detailed data of the aggregated net capital inflow, in 2019 the restructuring of investors' interest could be observed: while in 2016-2018 real estate fund enjoyed strong demand from investors, in 2019 the focus of investors' interest shifted to mixed funds. Liquidity and money market funds were characterised by strong outflow in 2019 (HUF -436 billion), since from 21 January 2019 the rules of the new EU regulation related to money market funds must be applied, which entails additional compliance requirements. However, the outflow was only of technical nature; the vast majority of the former liquidity and money market funds decided to alter their investment policy, and thus they were transferred to the short bond fund investment class, which also explains the net capital inflows to bonds funds in the amount of HUF 395 billion in 2019.

In 2019, mixed funds (bond-heavy mixed fund, balanced mixed fund, dynamic mixed fund) registered a total capital inflow of HUF 208 billion, which is more than the double of the capital inflows observed in 2018: investors' interest in mixed funds is also evidenced by the fact that net capital inflow as a ratio of the managed assets reached 19 percent. The net capital inflow essentially affected the balanced mixed funds (HUF 132 billion) and the bond-heavy mixed funds (HUF 68 billion). As a result of the trend demand for mixed funds, in the past 6 years there was an almost five-fold rise in assets managed. Divestiture continued at the absolute yield funds: the net divestiture of HUF -122 billion registered in 2018 increased to HUF -155 billion by 2019. In 2019, equity funds registered a net capital inflow of HUF 23 billion, which practically corresponds to the HUF 25 billion of 2018. (Chart 83)

Chart 83
Net capital flows of investment funds



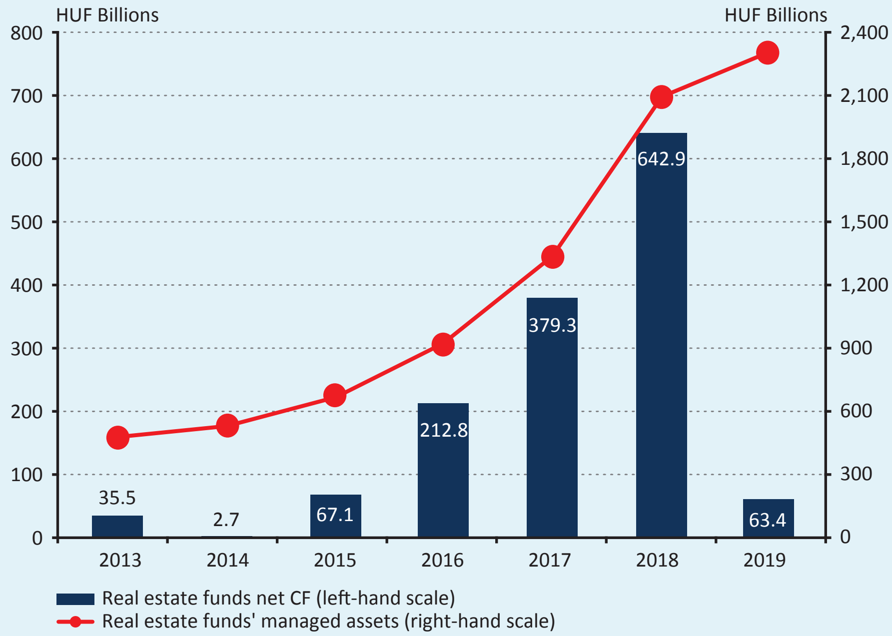
Source: MNB

6.5.4 Net capital raise at real estate funds substantially decreased in 2019

In the case of real estate funds, the net capital inflow of several hundred billion forints, which characterised the previous years, did not materialise in 2019: the net capital inflow of HUF 63 billion in 2019 falls short of the level registered in 2018 by 90 percent, and practically corresponds to the net capital inflow of HUF 67 billion registered in 2015 (this value in 2016 was HUF 213 billion; in 2017 HUF 379 billion; in 2018 HUF 643 billion). At the funds investing into direct real estate, the net asset value rose from HUF 1,830 billion of 2018 to HUF 2,092 billion by 2019; net capital inflows contributed HUF 120 billion to the growth of HUF 261 billion; while the remaining HUF 141 billion is the investment yield realised on the managed portfolio. The net asset value of funds investing into indirect real estate fell by HUF 45 billion in 2019, from HUF 262 billion of 2018 to HUF 217 billion, which is attributable to divestiture (HUF -57 billion). The net capital inflow of HUF 120 billion registered in 2019 by funds investing in indirect real estate substantially falls short of the record highs of HUF 534 billion and HUF 293 billion registered in 2018 and 2017, respectively. Of the HUF 120 billion net capital inflow, HUF 160 billion is connected to private real estate funds, while in 2019 capital of HUF 40 billion was withdrawn from nine public open-ended funds. The capital withdrawal was observed in June 2019 and in the third quarter of 2019, and it is closely related to the implementation of the distribution limit prescribed in the MNB recommendation[32], and also to the emergence of the Hungarian Government Securities Plus Hungarian government securities. (Chart 84)

[32] See Box 12: Recommendation No. 5/2019 (IV.1.) of the Magyar Nemzeti Bank on issuing the shares of public, open-ended real estate funds.

Chart 84
Portfolio and net capital inflows of real estate funds



Source: MNB

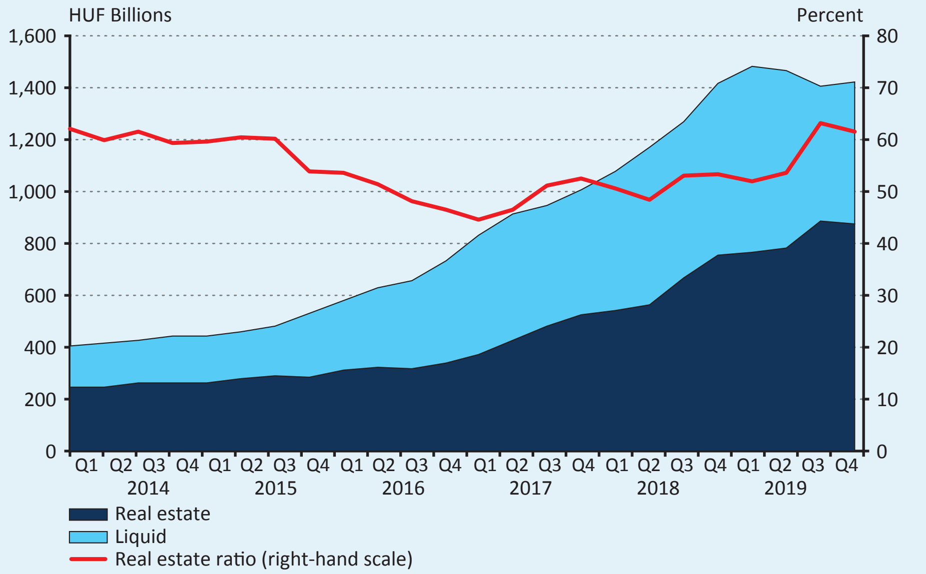
6.5.5 The former dynamic growth in the portfolio of public real estate funds stopped

Within the portfolio of real estate funds – i.e. funds investing in direct real estate – the share of public real estate funds decreased further in 2019 as result of the proportionately higher growth of private real estate funds: the 68 percent share of public real estate funds in 2019 (HUF 1,422 billion) falls short of the 77.3 percent share (HUF 1,415 billion) registered in 2018 by roughly 9.4 percentage points, and by 15.6 percentage points of the 83.6 percent share registered in 2017. The decline is partly attributable to the MNB recommendation issued in spring 2019, related to public open-ended real estate funds[33], and partly to the emergence of the Hungarian Government Securities Plus household government securities, as a result of which the former dynamic growth in the portfolio of public real estate funds stopped.

Due to the Hungarian Government Securities Plus, issued and introduced by the Hungarian State Treasury in the second half of 2019, many investors in public real estate funds redeemed their mutual fund shares and invested the capital in Hungarian Government Securities Plus. As a result of the foregoing, from mid-May 2019 public real estate funds observed major capital outflows and due to this the positive net capital inflows registered in previous years (HUF 268 billion in 2017 and HUF 380 billion in 2018) became negative in 2018 (HUF -40 billion). As a result of the capital withdrawal from public real estate funds, the ratio of real estate investments compared to the net asset value of public real estate funds rose from 53 percent of 2018 to 61 percent by 2019 (Chart 85). Public real estate funds were characterised by strong concentration in 2019 as well: the top three public real estate funds with the highest net asset value accounted for 76.8 percent of the public real estate funds' total net asset value, which fell short of the level registered in 2018 by 1.5 percentage points.

[33] See Box 12: Recommendation No. 5/2019 (IV.1.) of the Magyar Nemzeti Bank on issuing the shares of public, open-ended real estate funds.

Chart 85
Real estate investment portfolio of public real estate funds and the ratio thereof compared to net asset value

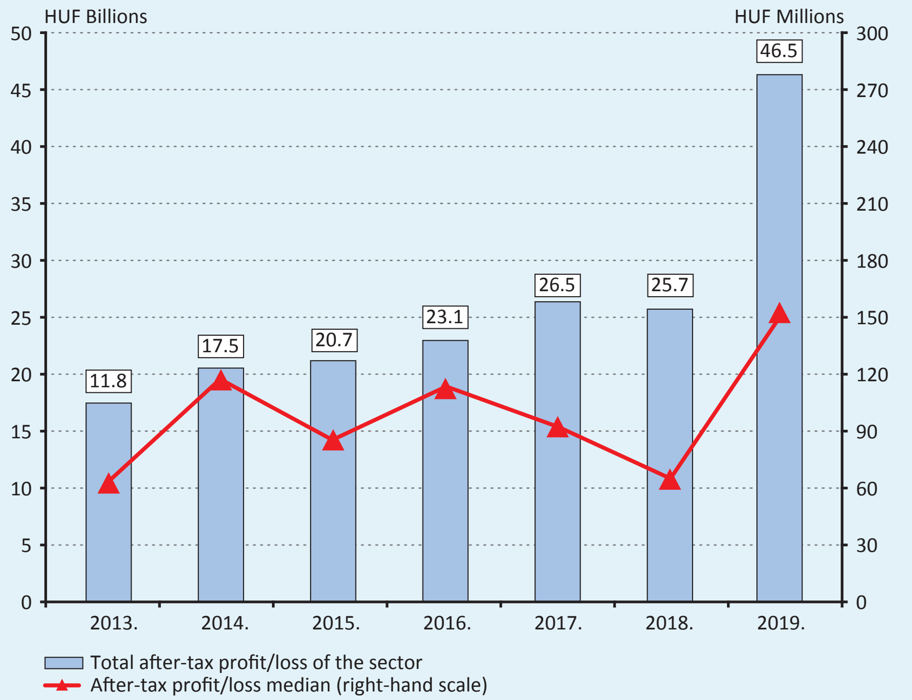


Source: MNB

6.5.6 Significantly increasing profitability in investment fund management sector

The after-tax profit of investment fund managers soared from HUF 25.7 billion of 2018 by 80.8 percent to HUF 46.5 billion in 2019. The growth is essentially attributable to two factors: on the one hand, the after-tax profit of the market-leader fund manager – partly due to one-off effects – increased considerably compared to the level registered in 2018, and on the other hand the profitability of the sector also improved on the whole, due to the rise in the managed assets.

Chart 86
Profitability of investment fund managers

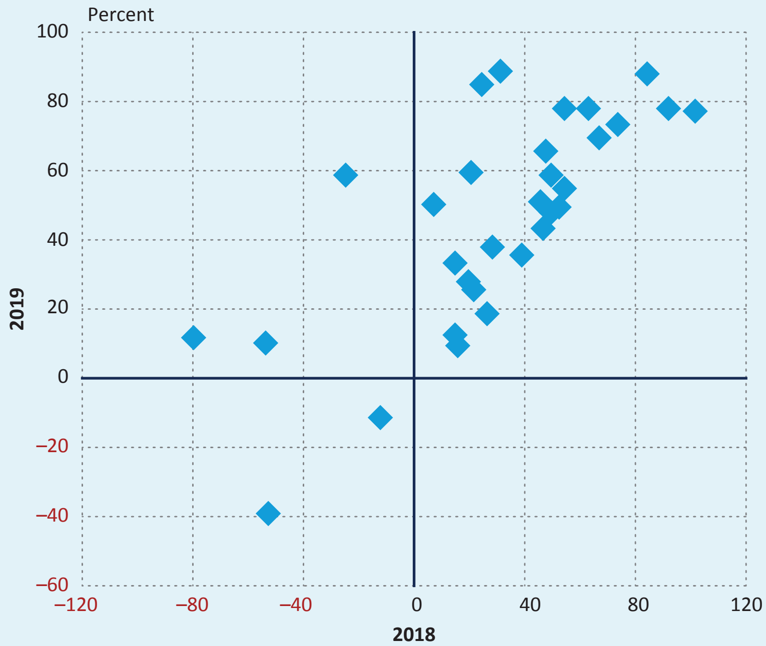


Source: MNB

Due to the aforementioned effect, the income concentration ratio of the sector substantially increased in 2019: the top five market participants with the highest after-tax profit accounted for 68.7 percent of the entire sector's after-tax profit in 2019, which exceeds the previous year's figure by 12.3 percentage points. In 2019 the number of loss-making fund managers rose from 7 registered in 2018 to 9. In 2019, the after-tax result of the loss-making fund managers was a loss of HUF 395 million, which practically corresponds to the after-tax loss of HUF 398 million realised in 2018 by loss-making fund managers. Eight of the 9 loss-making investment fund managers commenced their operation in 2019; the loss-making operation is explained by the incurred startup costs.

The business model of the investment fund managers was characterised by strong profitability in 2019 as well, also evidenced by the high level of the ROE indicator, i.e., after-tax profit to equity ratio: Chart 87 only shows the investment fund managers that were active in both 2018 and 2019 and whose activity licence was not withdrawn in 2019.

Chart 87
ROE value of investment fund managers (percent)



Source: MNB

6.6 SECTOR LEVEL RISKS OF INVESTMENT FUND MANAGERS

Risk category	Risk groups	Risk rating	Risk prospects	Textual evaluation
Market risk	Low interest environment, yield hunting attitude, liquidity of real estate funds	●	↓	• the low interest environment and the particularly high yield on household government securities, as well as the coronavirus pandemic, supported net capital outflow from certain funds *As a result of the turbulent market environment caused by the coronavirus pandemic, the assets managed in the investment funds declined after the initial shock, but the market seems to calm down in the short run.*
Profitability	Market yield environment	●	→	• in 2019 the profitability of the fund management sector significantly improved; however, the competition generated by the yields realisable on household government securities still represent challenges *A potential change in the market environment may represent a risk for the prices of securities and of the real estate sector*
Corporate governance	Compliance: MiFID II , tightening international requirements	●	→	• in connection with MiFID II, statutory compliance around inducements carries challenges primarily for the distributors, and particularly for the fund managers *Compliance with the tightened international requirements may represent further challenges also for the money market funds.*
Operational risk	Risk management systems	●	→	• at some of the fund managers, the risk management, liquidity management and back office processes call for enhancement *ESMA places increasing emphasis on the topic of liquidity, which is also justified by the coronavirus pandemic*
Capital adequacy	Profitability	●	→	• the fund management sector closed a positive year in 2019, as because of which the capital position also improved on the whole; at present – at the vast majority of the fund managers – there are major reserves

Note:

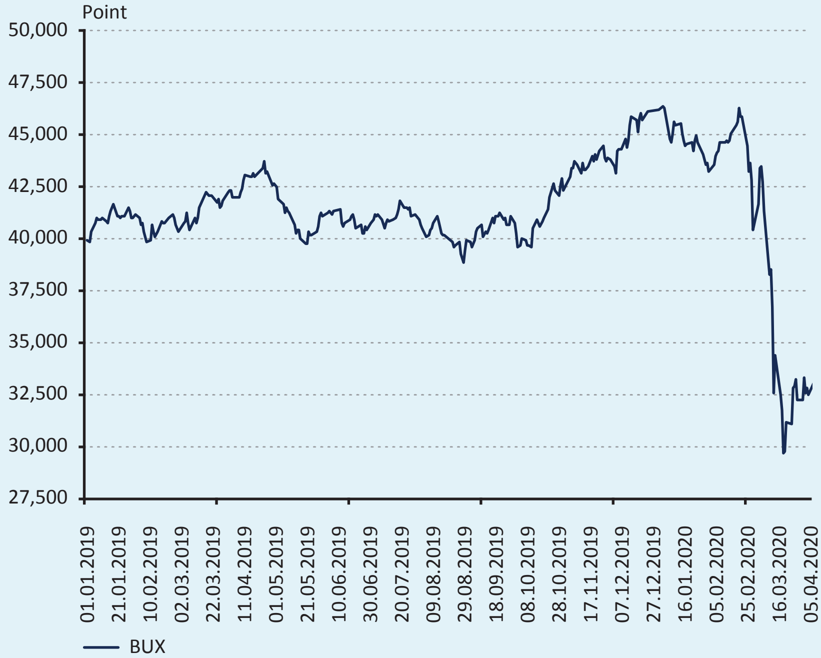
Degree of risk	*high* ●	*significant* ●	*moderate* ●	*low* ●
Direction of risk	*increasing* ↑	*stagnant* →	*decreasing* ↓	

Compared to previous year, in 2019 the risk rating of the investment fund management sector was changed for the profitability and capital adequacy risk, while it remained unchanged for corporate governance, market risk and operational risk. The rating of market risk is still high, because the low interest environment and the outstanding yield on household government securities boosted net capital outflows from certain funds. The negligible yield on government securities and deposit products available to funds, encourages fund managers to assume risks, and thus in the case of a potential recession funds may become more vulnerable. The largest risk attached to the operation of the public, open-ended real estate funds is still the mass redemption of mutual fund shares, i.e. the liquidity risk, which may lead to forced sales of less liquid assets in large volumes. However, at present real estate exposure is low, the funds hold large volume – more than the statutory requirements – of liquid assets, which mitigates the risk. The rating of the profitability risk changed from significant to moderate, since in 2019 the profitability of the fund management sector significantly improved; however, the competition generated by the yields realisable on household government securities still represents challenges. A potential change in the market environment may represent a risk for the price of securities and the real estate sector. The rating of the capital adequacy risk also changed, from moderate to low, since in 2019 the sector closed a positive year, as a result of which the capital position also improved on the whole – at present major reserves are available at the vast majority of the funds managers. In the case of the corporate governance risk, the MiFID II regime effective from 2018, and particularly the topic of inducements, represent major challenge primarily for the distributors, but particularly also for the fund managers. Compliance with the tightened international requirements may represent further challenges also for the money market funds.

Box 10
Impact of the coronavirus pandemic on the hungarian capital market

The impact of the economic crisis resulting from the coronavirus pandemic also appeared in the capital markets. Accordingly, in the first quarter of 2020 stock exchanges were characterised by increased volatility and major – 30-40 percent – fall: the closing value of 33,135 point of the BUX index on 31 March 2020 is lower by 28.1 percent compared to the closing value at the end of 2019. (Chart 88)

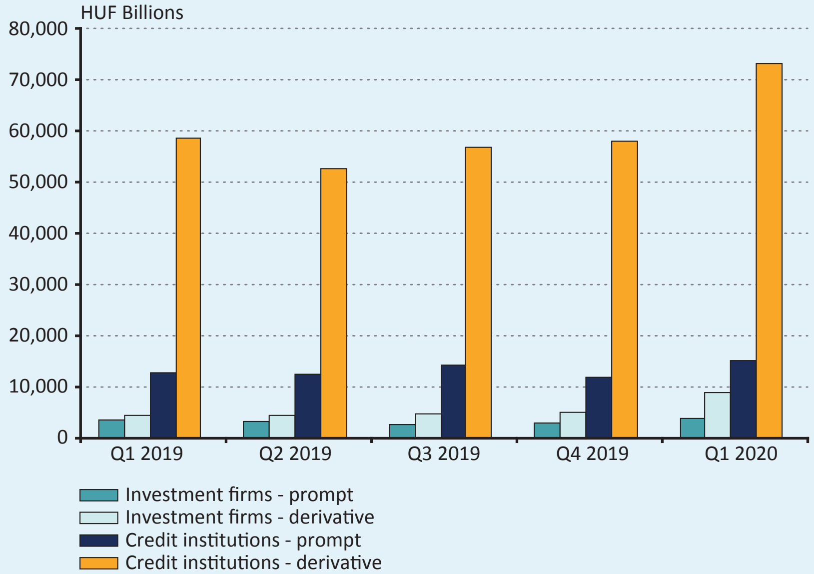
Chart 88
Impact of the coronavirus pandemic on the BUX index



Source: MNB

On the Hungarian capital market, the fall of capital market prices takes place under outstandingly high capital market turnover increase. In the first quarter of 2020, the investment service providers – credit institutions rendering investment services and investment firms – realised a total turnover of HUF 99,597 billion on the capital market, which exceeds the year-on-year capital market total turnover of the first quarter of 2019 by 27.3 percent and is higher by 29.5 percent quarter on quarter. In the first quarter of 2020 stock exchange turnover registered an outstanding growth: compared to the first quarter of 2019, the stock exchange prompt turnover was higher by 66 percent (by 85.5 percent compared to the previous quarter), while the stock exchange derivative turnover was higher by 27 percent (by 47.5 percent compared to the previous quarter). At the same time the OTC turnover also registered a growth: in the first quarter of 2020, the OTC prompt turnover and the OTC derivative turnover exceeded the turnover values of the first quarter of 2019 by 10.8 and 26.8 percent, respectively (registering a quarter-on-quarter growth of 21 and 27 percent). The largest growth was realised in the credit institutions' stock exchange prompt turnover, which practically doubled in the first quarter of 2020: while in previous years the credit institutions' stock exchange prompt quarterly total turnover moved between HUF 250 and 350 billion, in the first quarter of 2020 this soared to HUF 753 billion. The stock exchange prompt turnover of investment firms also registered vigorous growth: the stock exchange prompt turnover of HUF 2,027 billion of investment firms in the first quarter of 2020 exceeded the average quarterly total turnover of HUF 1,150 billion of the previous five years by roughly 75 percent. In the case of forwarded orders an extremely high growth was registered in the turnover data of the first three months of 2020: compared to the first quarter of 2019, forwarded turnover rose by 290 percent (by 150.6 percent compared to the previous quarter). The extremely high growth is essentially linked to the Hungarian branch office of one investment firm. It should be noted that based on the trends of the past years, 96-98 percent of the turnover of forwarded orders were carried out by investment firms. (Chart 89)

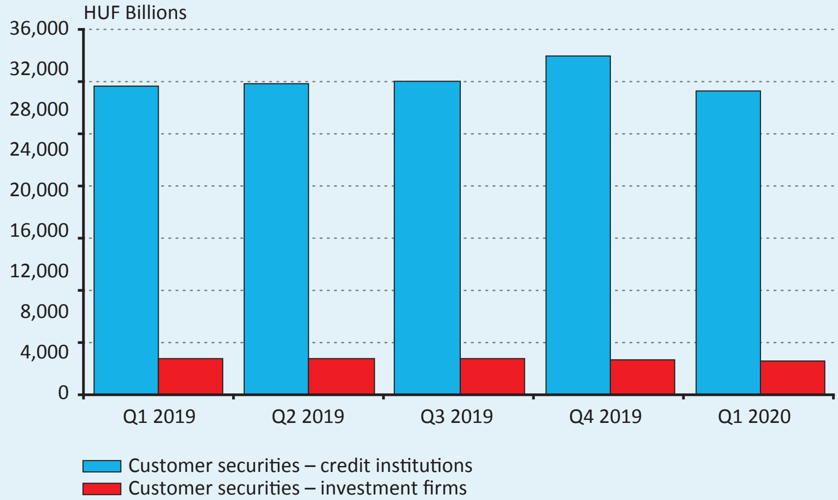
Chart 89
Developments in the capital market turnover



Source: MNB

In line with the fall in capital market prices, in the first quarter of 2020 the customer securities portfolio, managed by investment service providers – credit institutions rendering investment services and investment firms –, calculated at market value, was characterised by a significant fall: the customer securities portfolio of HUF 34,607 billion at the end of March 2020 falls short of customer securities portfolio of HUF 38,269 billion, registered at the end of 2019, by HUF 9.6 percent – practically, the customer securities portfolio fell roughly to the levels observed at the end of 2018 just in one quarter. The fall observed in the first quarter of 2020 was stronger at the credit institutions: in the first quarter of 2020 credit institutions' customer securities portfolio declined by 10.3 percent to HUF 31,086 billion, while the investment firms' customer securities portfolio contracted by 2.1 percent in the same period and closed at HUF 3,520 billion. The stronger fall in credit institutions' customer securities portfolio is explained by the customers' diversified equity portfolio representing a wide range of issuers. (Chart 90)

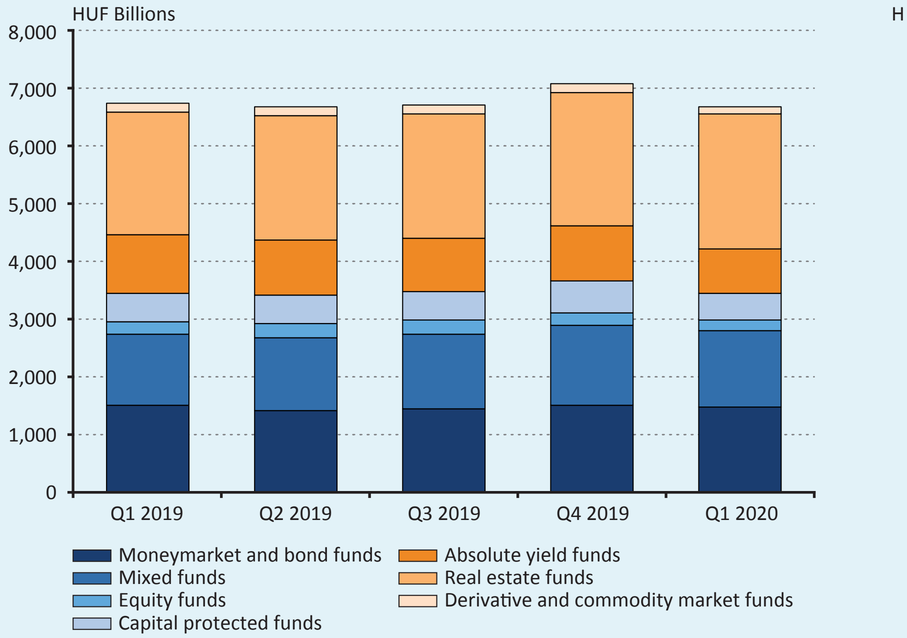
Chart 90
Customer securities portfolio



Source: MNB

The decline in capital market prices exerted material negative effect also on the investment fund manager sector, and accordingly, the increasing trend of the assets managed by investment fund managers broke. The historic high of assets managed by investment fund managers at the end of 2019 in the amount of HUF 10.262 billion declined by 5.8 percent to HUF 9,666 billion in the first quarter of 2020. In relative terms, the largest fall was observed at the private (8.6 percent) and voluntary pension funds (7.2 percent) and in the insurers' portfolio (7.3 percent); however, the share of the assets managed in these portfolios in the amount of HUF 2,680 billion – private pension funds: HUF 246 billion, voluntary pension funds: HUF 1,324 billion, and insurance portfolios: HUF 1,110 billion – in the total managed assets was only 27.7 percent in the first quarter of 2020. In absolute terms, the greatest fall was observed in the assets of investment funds managed by investment fund managers: in the first quarter of 2020, the asset of investment funds decreased by HUF 391 billion to HUF 6,686 billion – which represents a fall of 5.5 percent. The fall in the assets of investment funds in the first quarter of 2020 is essentially attributable to the negative yields realised on the investments: accordingly, the fall of HUF 391 billion in net asset value is attributable to the negative yield effect of HUF 341 billion and the net capital outflow of HUF 50 billion. The largest losses – both in relative and absolute terms – were realised by the equity funds and the absolute yield funds (-21.8 and 17.1 percent, respectively), but yields were typically negative practically in all asset classes. (Chart 91)

Chart 91
Changes in the assets of investment funds



Source: MNB

6.7 CAPITAL MARKET CONSUMER PROTECTION

6.7.1 Restructuring of the organisation related to the consumer protection oversight

In the second half of 2019 – in line with the MNB's supervisory strategy for the period of 2020-2025, a key objective of which is to ensure efficient consumer protection – the MNB implemented changes with regard to the organisational framework of the consumer protection oversight activity, as part of which, among other things, the capital market consumer protection organisational unit was integrated in the prudential supervision area of the capital market sector. The purpose of the organisational change was to ensure that the ad hoc consumer protection reports and consumer complaints are integrated in the oversight activity as efficiently as possible, and that the consumer protection topics become increasingly stressed components of also the comprehensive prudential inspections conducted in accordance with the MNB's annual audit plan.

Accordingly, as a result of the organisational changes, the topics related to the inspection of compliance with the consumer protection requirements of MiFID II/MiFIR were integrated more deeply in the comprehensive inspections conducted in 2019, including also the inspection of compliance with the statutory requirements connected to product governance, investment advisory services and preliminary customer information. During the comprehensive inspections, the MNB placed special emphasis on the customer information practice applied upon the sales of high-risk leveraged products.

6.7.2 Consumer protection complaints

The number of petitions related to the capital market, received by the MNB's customer service, somewhat declined; in regard the subject of those, the main reason is still the disputes related to settlement, followed by the obligation to provide information. Regarding the capital market petitions received by the MNB, contrary to decreasing trend in the number of petitions lasting several years, in 2019 a minor growth was observed.

Based on the complaint statistics of investment firms we found that the number of complaints rose compared to 2018, and similarly to previous years, the most typical problems included the rates of commissions, costs and fees (22 percent), electronic services (10 percent), order execution (9 percent) and service quality (9 percent). On the other hand, the number of complaints submitted to credit institutions rendering investment services stagnated compared to the previous year.

Compared to the other financial sectors, consumers assume the greatest risk in the capital market sector, and therefore the fact that the number of complaints submitted to investment service providers increased, but in parallel with this the number of petitions submitted to the MNB decreased, may indicate that in most of the cases the institutions were able to manage the consumer disputes adequately, to the satisfaction of consumers.

6.7.3 Compliance assessment thematic review

In addition to strengthening the consumer protection topics in the comprehensive inspections, in 2019 the MNB – at the initiative of the European Securities and Markets Authority (ESMA), aimed to strengthen convergence among national supervisory authorities – inspected within the framework of consumer protection thematic reviews at several investment service providers the practice aimed at the mandatory assessment of the customers' knowledge and experience related to financial instruments prior to product sales without rendering investment advisory service (appropriateness assessment). During the thematic review, the MNB also identified several good practices as well as practices that represent consumer protection risk. The MNB regarded it as a positive practice that the inspected service providers obtain the information necessary for performing the appropriateness assessment for all products they distribute – including also the non-complex financial instruments – and, in compliance with the MNB's relevant recommendation, they update the information available in connection with the customer's product knowledge and experience every three years and perform new assessment. However, the MNB identified it as a practice representing consumer protection risk that during the appropriateness assessment service providers overly rely on the customers' declaration and self-assessment, and typically fail to integrate – product group-level – control questions in the process of assessing the investors' knowledge.

In 2020, the MNB will launch a new consumer protection thematic review, this time for the purposes of verifying the capital market actors' prior information practice applied during product sales through investment advisory services (suitability assessment), which will make the review and rating of the preliminary information practices (appropriateness and suitability assessment) by the MNB complete.

6.7.4 Product intervention

The MiFID II regulation expanded the consumer protection instruments of ESMA and the national supervisory authorities, since it allows the restriction or even prohibition of products or distribution practices when they entail or may entail major consumer protection risks.

In 2018 ESMA, taking advantage of this authorisation, with the active support of the national supervisory authorities, introduced product intervention measures and prohibited the advertising and sales of binary options to retail customers, while it introduced restrictive measures for CFDs to reduce the risks inherent in the structure of the product. Restrictions included the capping of leverage, which – depending on the underlying asset – represented different rates, the protection against negative balance, which limited the rate of the loss, and also mandatory warnings of risk, which also contain the ratio of loss-making customers.

The decisions of ESMA were in force for 1 year; after their lapse, product intervention was transferred to the competence of the national supervisory authorities. Then, in the summer of 2019, the MNB, similarly to other Member States and in line with ESMA's opinion – according to which all Member States need to implement equivalent or stricter product intervention measures – in the case of CFDs introduced restrictions with content corresponding to the ESMA decision in respect of four domestic investment firms and credit institutions. In spring 2020, the MNB extended the scope of this measure to cover all potential domestic and cross-border market participants, and, with certain exceptions, it also banned the distribution of binary options to household customers.

Box 11
Contracts for differences (CFD) and binary options

Contracts for differences (cfd) and binary options are derivative products; their value depends on the value of another asset (underlying asset), i.E. It can be derived from that. These products are traded independently; the underlying asset is typically not possessed by either of the parties in the transaction. The underlying assets are primarily currency pairs, commodities (e.G. Oil, gold), indices or individual equities. The products are built on the price expectations of the underlying assets, and the profit or loss depends on whether at expiry the price will be higher or lower than at the time of concluding the deal. Profit may be realised also on the fall in the underlying asset's price. The customer is at one side of the transaction, and usually the service provider is on the other side thereof. It should be noted that the conclusion of cfds and binary options represents commitments for both parties. Typically both products are traded intraday, the maturity may be as short as 1 minute.

Contract for difference – CFD

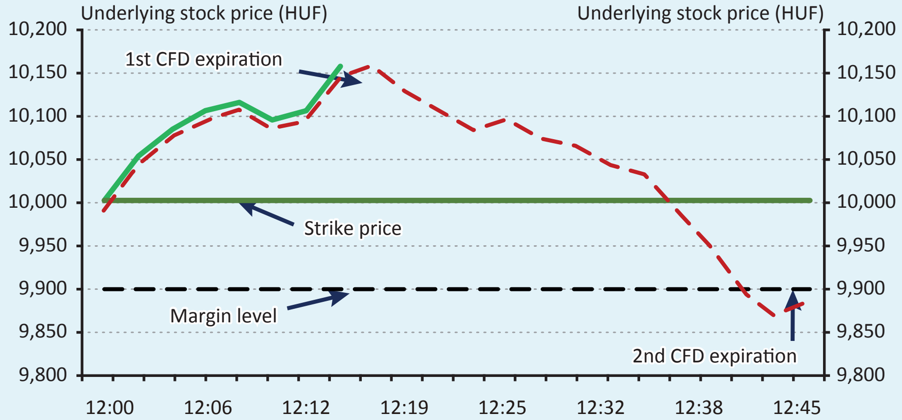
The purpose of cfd is to track the price of an underlying asset without possessing the underlying asset, where the buyer and seller of the cfd exchange the difference between the product's strike price and the price prevailing at the expiry of the cfd; namely the underlying asset is not exchanged, only financial settlement is performed.

Cfds are usually leveraged transactions, which means that positions higher than the amount deposited on the account may be also taken, or in other words, a position of particular size may be taken also in possession of lower capital. Cfds are available at different rates of leverage; before the esma's product intervention decision, transactions could be concluded with leverage as high as 1:500, while after that the leverage may not exceed the ratio of 1:30. The size of the leverage shows the volume of change caused in the invested amount by one unit of change in the price of the underlying asset, in the case of 30-fold leverage (1:30) a shift of 1 percent in the price of the underlying asset results in a price change of 30 percent. The leverage greatly increases the profit or loss realisable on the underlying asset, the greater the leverage, the larger the risk assumed by the investor. The amount placed for opening the position is referred to as initial margin; the leverage can be calculated by dividing the position taken by the initial margin. The initial margin provides cover for the event when the price of the underlying asset moves unfavourably for the investor; if the margin level falls below a certain rate, the service provider may close the position before expiry or call upon the customer to provide additional margin, upon the payment of which the position may be held further.

Example of the operation of cfd:

The investor assumes that the price of an equity will rise in the next 1 hour, therefore he opens two cfd positions, one for 15 minutes and one for 45 minutes. If at the service provider the equity cfd is available with leverage of 1:100, the current price of the equity is huf 10,000 and the investor places the order for 1,000 pieces of equity, then both cfds result in taking a position of huf 10,000,000, which necessitates an initial margin of huf 100,000 for each of them. The equity price develops as shown on the chart below:

Chart 92
Example of the operation of cfd



The first cfd expires after 15 minutes, when the price is huf 10,150. Then the profit realised per equity is huf 150, while on 1,000 equities it is huf 150,000. Although the price of the underlying asset rose only by 1.5 Percent, projected on the initial margin it generates a yield of 150 percent.

The second cfd would expire after 45 minutes, but due to an unfavourable shift in the price, the position reaches the margin level a few minutes before the expiry. Then either the full initial margin is lost, or the position may be maintained by providing additional margin, hoping for a price rise. By maintaining the position, according to the example, the price at expiry is huf 9,890; accordingly, the loss realised by equity is huf 110, while on 1,000 equities it is huf 110,000. Although the price of the underlying asset decreased only by 1.1 Percent, projected on the initial margin it generates a yield of -110 percent.

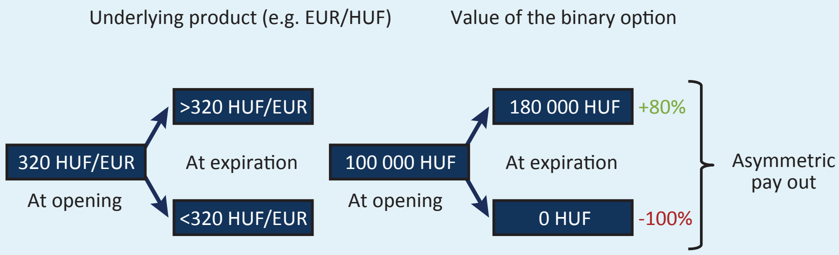
Binary options

In the case of binary options – contrary to cfds – it usually does not matter how much the price of the underlying asset have moved upon expiry compared to the strike price; the only thing that matters for the transaction is the direction of the move. The payment is determined in advance; the two potential outcomes is a fixed profit (which is typically lower than the capital invested) or the loss of part or all the capital invested. In terms of consumer protection, the most disquieting feature of the product is that payments are typically asymmetric, i.E. For the investor to break even, he needs to make profit more often than to make loss. Due to this, the features of binary options are often compared to gambling; due to this, before 2018 in the united kingdom their oversight belonged to the uk gambling commission instead of the financial supervisory authority.

Example of the operation of binary options

The investor expects the forint to depreciate in the next 5 minutes, therefore he opens a binary option position of huf 100,000. When opening the position, the exchange rate is huf 320/eur; if 5 minutes later the exchange rate is higher, the service provider pays huf 80,000, in addition to returning the investor’s initial investment of huf 100,000. If the exchange rate is lower, the investor loses his invested huf 100,000.

Chart 93
Example of the operation of cfd



6.7.5 Recommendation related to real estate funds

The expansion of the public and private real estate funds was significant in the past 5 years, with an almost four-fold increase in the portfolio in total. Due to the major (small) investor exposure, in spring 2019 the MNB issued its recommendation on the distribution of the mutual fund shares of public, open-ended real estate funds[34].

Box 12
MNB recommendation on the issuing of the mutual fund shares of public, open-ended real estate funds

The MNB treats it as a priority to reduce the vulnerability of the Hungarian public open-ended real estate funds and keep their liquidity risks at the minimum level. Accordingly, to foster informed investment decision, it must be achieved that the product characteristics of mutual fund shares (liquidity profile) is in line with the possibility of liquidating the underlying assets. In the absence of any restriction imposed in respect by the regulatory environment, the former market practice of the distribution of the mutual fund shares of public, open-ended real estate funds failed to enforce due investor protection considerations, in view of the fact that in respect of the redemption period of mutual fund shares, investment fund managers defined an overly short period, typically merely three days. Accordingly, the purpose of issuing the recommendation was to formulate the MNB's expectation regarding the minimum redemption period in respect of the distribution of the mutual fund shares of public, open-ended real estate funds.

The addressees of the recommendation are the contributors to the issuance and distribution of the mutual fund shares of public, open-ended real estate funds, and the alternative investment fund managers managing the public, open-ended real estate funds.

The main content element of the recommendation is that, in order to manage the liquidity risk arising from the nature of the public, open-ended real estate fund, the MNB expects and regards it as proper practice that the market participants distributing the mutual fund shares (including also the distribution and sales in the form of continuous distribution) – investment service providers or investment fund managers – should primarily participate in the distribution of the mutual fund shares of only such public, open-ended real estate funds, in the case of the redemption of which the distribution settlement date exceeds the date of receiving the redemption order by at least 180 calendar days.

[34] Recommendation No. 5/2019 (IV.1.) of the Magyar Nemzeti Bank on issuing the shares of public, open-ended real estate funds. https://www.mnb.hu/letoltes/5-2019-ingatlanalapok.pdf

Furthermore, the recommendation formulates it as an expected behaviour that with a view to complying with the foregoing, the investment fund managers should define a trading limit specified in Section 110 of the Collective Investment Trust Act in respect of the already existing series of those mutual fund shares of the public, open-ended real estate funds managed by them, upon the redemption of which the trade settlement date does not exceed the date of the receipt of the redemption order by at least 180 calendar days. Furthermore, the recommendation formulates it as an expected behaviour that investment fund managers should regularly review the defined level of the trading limit, and reduce it with a view to achieving the objectives specified in the recommendation, thereby ensuring that that the number of the mutual fund shares of the series that already existed before the application of the recommendation, upon the redemption of which the trade settlement date does not exceed the date of the receipt of the redemption order by at least 180 calendar days, gradually decrease.

The MNB expects the addressees of the recommendation to apply the recommendation from 15 May 2019.

As a result of the MNB's recommendation, after 15 May 2019 the expansion of the public real estate funds halted and later, due to the emergence of Hungarian Government Securities Plus, a major outflow was observed. Furthermore, several investment fund managers – in accordance with the recommendation – developed mutual fund share series sold with redemption condition of T+180 days. In the period after the issuance of the recommendation, the MNB continuously monitored the liquidity situation of real estate funds and called upon the respective investment fund managers to improve the liquidity situation, as necessary.

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