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

2021

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

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

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Pursuant to Act CXXXIX of 2013 on the Magyar Nemzeti Bank, the MNB supervises the financial intermediary system in order to ensure, among others, 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 Executive Directorate for Prudential, Consumer Protection Supervision of Capital Markets and Insurers, Executive Directorate for Prudential and Consumer Protection Supervision of Money Market Institutions, the Sustainable Finance and Supervisory Coordination Directorate, the Prudential and Consumer Protection Supervision of Intermediaries Independent Division, 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 typically for the reference date of 31 December 2020, based on information received until mid-May 2021.

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, Capital Markets Risk Report and Consumer Protection Report annually. The purpose of the Report is to provide a comprehensive view on the most important changes in the insurance, funds, capital markets, intermediary sectors and financial enterprises not belonging to a banking group, presenting – in parallel with the prudential risks – also the consumer protection risks. In previous years, two separate reports were prepared, i.e. the Insurance, Funds and Capital Markets Report and the Financial Consumer Protection Report. From 2020 these are merged to create this Report.

2020 was an extraordinary year for Hungary, the European Union and for the world in many aspects. In this situation, the institutions, sectors, customers and the MNB as well had to adapt to the changes. The MNB has recently decided to introduce new supervisory approaches and methodologies in order to ensure the prudential operation of the sectors and institutions falling within its competence, the continuous protection of consumers and the maintenance of confidence in the financial market sector as a whole, despite the changed circumstances.

Economic performance was determined by the events of 2020, which was an exceptional year, and the related global measures, which of course also affected the insurance, funds and capital markets, intermediaries and non-banking group financial enterprises sectors. This year, Hungary's economic performance fell short of the year-on-year figure by 5.0 percent, based on raw data. Economic performance has exceeded expectations, indicating the Hungarian economy's capacity for rapid recovery. The labour market proved to be resilient, which was also supported by central bank and government measures (moratorium on loan instalments, wage subsidies). In the first months of the year, inflation was moderate in the euro area as a whole, while inflation in Hungary remained within the central bank's tolerance band, at 3.3 percent.

Due to the changed international financial market resulting from the global reflationary risks and to economic uncertainty, yields have recently risen significantly in the US and European bond markets. The Central and Eastern European region was also characterised by these trends, while yields in Poland rose more moderately with more moderate central bank involvement, which may have been partly attributable to the larger presence of institutional investors. The strengthening of the domestic institutional investor base has been previously proposed by the MNB in its Competitiveness Programme, which could bring similar benefits.

By the end of 2020, gross assets of households, comprising financial instruments and the stock of dwellings, exceeded HUF 110,000 billion, which represents a year-on-year growth of 8.5%. The most dynamic growth was observed in deposits, but cash and debt securities also grew significantly. The volume of these assets – as savings in safe-haven assets – may have increased as a result of the economic uncertainty.

In 2020, the premium income of the insurance sector was HUF 1,204 billion (and together with the branch offices HUF 1,285 billion), representing a growth of 4.7 percent year-on-year. This is positive compared to the change in GDP, and thus penetration has also increased; however, the 9 percent growth seen in previous years has faltered. The path projected in the MNB's previously outlined vision is achievable if growth returns to a range of at least 8-10 percent as soon as possible. The growth during the year was mainly due to the expansion of the non-life segment, with the largest contribution – similar to previous years – coming from the compulsory motor third-party liability (MTPL) segment; however, the mid-year premiums were still affected by the integration of the former insurance tax in the premiums. In September, the MNB issued an executive circular on motor liability insurance, drawing attention to the importance of statistically substantiated premium calculations and identifying the use of extremely high premiums and surcharges (excessive pricing) as an undesirable practice. Most products were affected by the restrictive measures moderately. A decrease in new acquisitions was observed in the life insurance segment, especially in pension insurances, while in the non-life segment major market shrinkage was observed at travel insurances. In the life segment, regular premiums increased at a similar rate as in previous years, while in single premium products, there was a significant decrease in traditional products and an increase in unit-linked products, as a combined result of which no significant change was registered overall. Life segment reserves rose, where *in addition to the low benefit payments it was a determinant factor that yields on unit-linked reserves, which follow capital market fluctuations, became positive overall by the end of 2020. The volume of claim payments has not increased either in the life or the non-life segment. Moreover, as a result of the decrease, the insurance sector was characterised by declining combined ratio and by similar high profitability as in previous years. In addition, the level of capitalisation has improved across the sector, due to – among other things – the MNB's Executive Circular of April 2020, as a result of which insurers postponed dividend payments. The protection of customer assets was also emphasised in an executive circular. This objective seems to be achieved by retaining the intra-year investments with temporary negative returns. Due to the persistent risks the MNB reiterated in its October 2020 circular its expectations published in spring to ensure that the sector's financial position remains strong and its shock-absorption capacity increases.*

Assets of the voluntary fund sector, counting a total of 2.1 million members, rose to HUF 1,700 billion in 2020. At sector level, membership fee revenues rose to HUF 153 billion. In the case of voluntary pension funds, both member contributions and employer contributions increased and reached nearly HUF 104 billion. For health and mutual aid funds, the increase in member contributions exceeded the slight decrease in employer contributions, further increasing the ratio of individual contributions, thereby reaching almost HUF 49 billion overall. In 2020, the voluntary pension funds realised an asset-weighted average net yield of 4.1 percent at sector level, showing a real yield of 1.4 percent when adjusted for inflation. Long-term figures are even more favourable (10-year real yield of 3.9 percent and 15-year real yield of 2.5 percent). Following the capital market fluctuations in March 2020, the MNB issued an executive circular to remind fund members that due to a predominantly negative valuation difference in the first quarter, it is worth keeping their savings in the fund to avoid realising a loss. This recommendation was justified by the positive net yields in the second and fourth quarters, which – on the other hand – greatly vary among the individual voluntary pension fund portfolios. The amount of benefit payments by health and mutual aid funds did not increase significantly, but the ratio of benefits related to children and housing continued to rise. The operation of the voluntary pension fund sector was loss-making, mainly due to the increase in certain cost factors (e.g. a steady rise in fees for IT services) and the fall in the deduction of non-paying members' costs from the yield amount. For the time being the reserves available for operating purposes provide adequate coverage at sector level. The health and mutual aid funds once again closed the year with negative operating result, but the trend has improved compared to last year.

In 2020, the life and non-life insurance segments developed differently in the insurance intermediary market. In the non-life segment, commission incomes increased compared to the previous year, while the amount of mediated premiums did not change significantly. In life insurance, the upward trend in commission income faltered in 2020; in addition to the decline in mediated insurance premiums, commission incomes also fell year-on-year, albeit to a smaller degree.

Similarly to insurance intermediaries, the financial intermediaries' market also showed a mixed picture. In 2020, the economic environment had a negative impact on car financing loans due to the exceptional circumstances and corporate loans also failed to grow. On the other hand, the intermediation of retail credits and loans rose dynamically.

In 2020, there was no significant change compared to the previous year in the portfolio managed by non-banking group financial enterprises, i.e. financial corporations not subject to consolidated supervision. Increase was observed only in the financial lease portfolio. Lending and lease activity shifted further towards financial services for enterprises. The loan and lease portfolios have improved, but the impacts of the moratorium on instalments should be taken into account. The profitability of the sector decreased significantly compared to 2019, which may be also attributable to the slightly restrained activity. The growth in the portfolio purchased for workout halted, under increasing number of contracts managed. As part of continuous oversight of non-banking group financial enterprises, the application of the transitional provisions of the moratorium on payments and the related feedback from customers received special attention.

The capital market turnover of HUF 341.1 billion realised by investment service providers in 2020 represents a total increase of 12 percent. The Budapest Stock Exchange's total turnover grew by 19.2 percent in 2020, with strong growth registered mainly in the prompt market. Despite the declining prices, the market value of customer securities managed by investment service providers also increased: the portfolio of HUF 39,077 billion rose by 2.1 percent year-on-year in total. Based on the significant growth in turnover, the profitability of investment firms continued to increase in 2020: profit after tax of HUF 12.8 billion in 2020 exceeds the 2019 profit by 29.5 percent and it is a historic high for the sector. At the end of 2020 all investment firms were adequately capitalised; the sector's capital adequacy ratio was 21.9 percent.

Despite the capital market turbulence in 2020, the volume of assets managed by investment fund managers continued to grow and reached a historic high: the volume of assets managed in the amount of HUF 10,668 billion at the end of 2020 exceeds the closing value at the end of previous year by 4 percent. The growth was mainly attributable to the HUF 193 billion increase in the net asset value of managed investment funds, as a result of which the net asset value of investment funds reached HUF 7,270 billion, while all other types of managed portfolios – pension funds, insurance funds and other portfolios – also registered a rise. As in the previous year, the growth in the assets of investment funds in 2020 was driven by the impact of yields realised on investments, which increased the net asset value of investment funds by HUF 181 billion. On the other hand, despite the capital market turbulences, investment funds still recorded positive net capital inflows overall on an annual basis. On the whole, the profitability of the investment fund management sector declined in 2020; the investment fund managers' after-tax profit fell from the historic high of 2019 by 1.3 percent to HUF 45.9 billion.

In the area of consumer protection in capital markets, the thematic inspection launched by the MNB in 2020 to examine MiFID suitability assessments has identified a number of good practices and also practices that pose consumer protection risks. In 2020, the MNB also inspected separately the provision of subsequent information on costs and, based on the experience gained from the continuous oversight, issued an executive circular to ensure that customers have access to timely and consistent information. As in recent years, the MNB has paid particular attention also in 2020 to further curbing the sale of CFDs, which carry a very high consumer protection risk, by extending the strict restrictions applicable to domestic CFD providers also to cross-border service providers and by banning the sale of binary options to retail customers.

The MNB takes measures against market manipulation, insider trading and activities that mislead investors to deter and prevent market abuse, and a top priority of its supervisory activity is to ensure that all practices of domestic issuers comply with the EU Market Abuse Regulation (MAR[1]). Accordingly, in 2020 the MNB paid special attention to monitoring whether public issuers fully comply with the obligations set out in MAR. In relation to the measures taken to curb unauthorised activities, it should be noted that in September 2020 the MNB launched an information campaign for households against suspected unauthorised service providers.

Due to the capital market turbulences in 2020, national supervisory authorities introduced temporary measures across Europe on short selling and the European Securities and Markets Authority (ESMA[2]) ordered on 16 March 2020 – as an emergency measure – the temporary, uniform lowering of the reporting threshold under the Short Selling Regulation (SSR) from 0.2 percent to 0.1 percent to obtain a more accurate picture of short positions, to monitor changes in short positions and to allow for the introduction of further restrictive measures, as necessary. After several extensions, the measure was in force until 19 March 2021. Unlike in many European countries, no further restrictive measures were needed in Hungary, since the deviations in the Hungarian capital market were more moderate.

Of the legal compliance risks the introduction of the European Single Electronic Format (ESEF) for issuers admitted to trading on a regulated market – aiming to increase the transparency of financial statements – bears special importance. While the introduction of ESEF brings many benefits, the preparation for implementation will absorb considerable capacity of issuers: the importance of the legal risks associated with the transition is also evidenced by the postponement of the mandatory domestic implementation until 2021.

[1] Regulation 596/2014/EU of the European Parliament and the Council on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC

[2] European Securities and Markets Authority (ESMA)

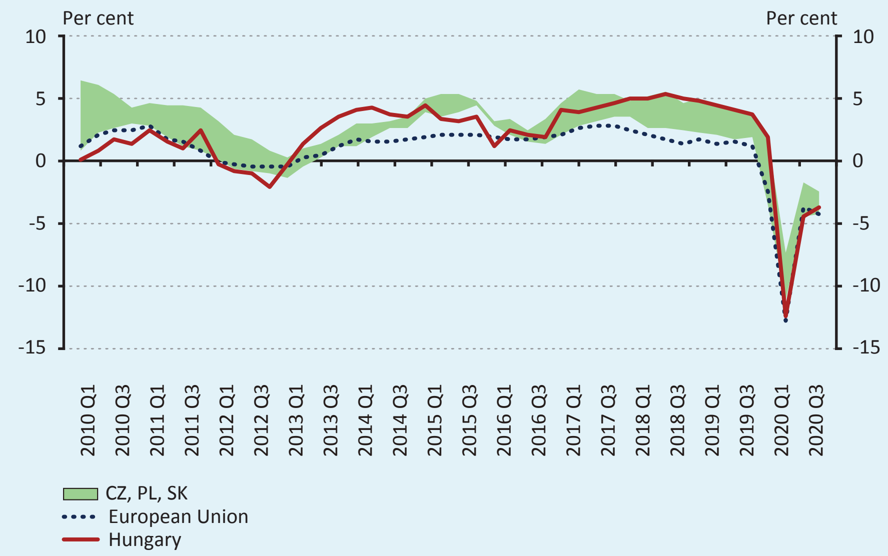
1 Macroeconomic environment and developments in household savings

1.1 INTERNATIONAL AND NATIONAL MACROECONOMIC TRENDS

1.1.1 Economic output declined all over the world

Economic performance in the recent period has been influenced by the coronavirus pandemic and the measures taken to contain it, as well as by the developments in vaccination coverage. Of the world's major economies, the United States registered a decline of 3.5 percent in 2020. In the fourth quarter, the Chinese economy grew at a significant rate, by 6.5 percent, and by 2.3 percent in 2020 as a whole. Based on seasonally and calendar adjusted data, the level of GDP in the European Union and in the euro area declined by 6.3 percent (Chart 1) and 6.8 percent, respectively, on an annual basis. The countries where the weight of tourism is greater within gross domestic product typically experienced sharper downturns. GDP of Portugal, Italy, Croatia and Spain declined by 7.6 percent, 8.9 percent, 8.1 percent and 11 percent, respectively. Mainly Baltic and northern countries lead the European ranking. In 2020, the economy of Germany, Hungary's main trading partner, shrank by 5.3 percent. Countries in the Central and Eastern European region performed better than the EU and euro area averages in 2020. In the region, the GDP of Poland (-2.7 percent), Romania (-3.7 percent), Slovakia (-5.2 percent) and the Czech Republic (-5.6 percent) also performed better than the EU and euro area averages.

Chart 1
Annual change of GDP



Note: Based on seasonally and calendar adjusted data.

Source: Eurostat

In 2020, the performance of the Hungarian economy fell short of the year-on-year figure by 5.0 percent, based on raw data. The level of GDP declined significantly in the second quarter of 2020. However, in the second half of the year it has been gradually rising already. In the context of the current situation, the value added of the services sector declined the most, and the performance of industry and construction also fell compared to 2019. However, the growth in the value added of information, communication and financial services mitigated the economic downturn. Hungary's investment ratio remained high also by international standards. Household consumption expenditures only declined slightly in a European comparison. The relatively favourable performance of consumption was attributable to the fact that the labour market adjustment was smaller compared to the 2009 global economic crisis, with contributions from the sustained functioning of loan markets, the loan repayment moratorium as well as the Government's job protection measures (wage subsidies).

The current account balance turned into surplus in 2020, while net lending of the economy was around 2 percent of GDP. The trade balance as well as favourable developments in the absorption of current transfers resulted in a better-than-expected current account surplus in 2020. Last year's budget deficit was slightly above average by regional and international standards. As a result of the measures to control the pandemic and the Economy Protection Action Plan, as well as declining tax revenues, in 2020 the budget deficit may rise to 8.1 percent of GDP. In parallel with this, government debt as a percentage of GDP temporarily rose to 80.4 percent last year.

The Hungarian economy was hit by the pandemic under stable fundamentals and strong growth, and the situation was managed while maintaining stability. Economic performance in 2020 outstripped expectations, indicating a capability of rapid recovery inherent in the Hungarian economy. The spread of new variants of the coronavirus and the third wave of the pandemic led to the extension of the restrictive measures. Based on preliminary data, in the first quarter of 2021 GDP contracted by 2.3 percent year-on-year. Depending on the population's vaccination and thus the timing of the restart of the economy, strong economic growth is expected from the second or third quarter. The potential for a rapid recovery in the Hungarian economy is also supported by structural and demand-related factors. Despite last year's recession, the investment rate has remained high partly due to the inflow of foreign capital, the unemployment rate has been low in international comparison and the healthy functioning of credit markets has been maintained.

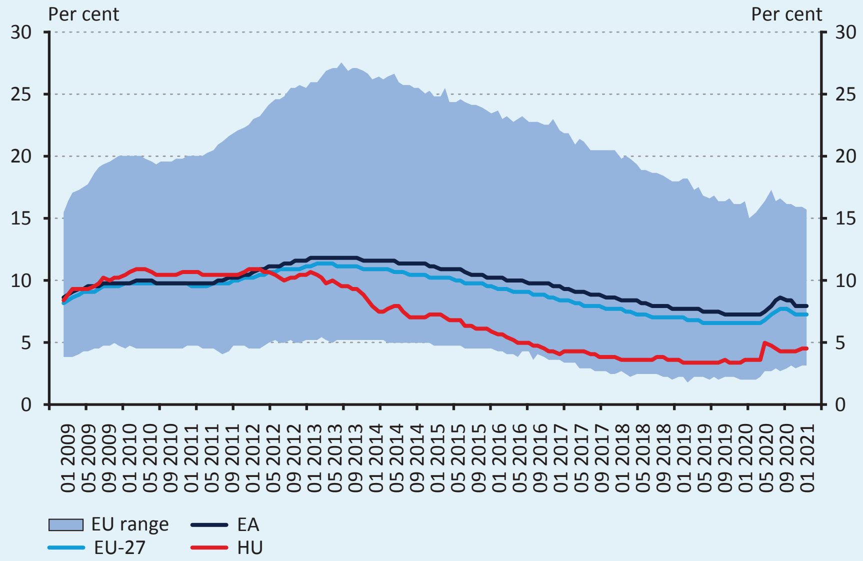
1.1.2 Labour market proved to be resilient

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 3.1 percent in December 2020. In January 2021, the unemployment rate of the euro area stood at 8.1 percent (Chart 2).

During 2020, the Hungarian labour market proved to be resilient, also supported by central bank and government measures (moratorium on loan instalments, wage subsidies). In Hungary, enterprises mainly responded to the changing circumstances experienced during the year by reducing the working hours of their employees. However, the sudden economic downturn has forced some companies to lay off workers, with the unemployment rate rising from a historic low of 3.4 percent of 2019 to 4.6 percent (based on seasonally adjusted data) in the second quarter of 2020. Thereafter, the adjustment considerably eased, with the unemployment rate falling to 4.3 percent by the third quarter.

In 2020, both national economy and private sector wage dynamics were substantial, albeit slightly lower compared to previous years. Falling short of previous years' figures, the minimum wage and the guaranteed wage minimum rose by 4 percent in February 2021, pointing to lower wage dynamics than in previous years.

Chart 2
Unemployment rates in the European Union



Note: Based on seasonally adjusted data.
Source: Eurostat

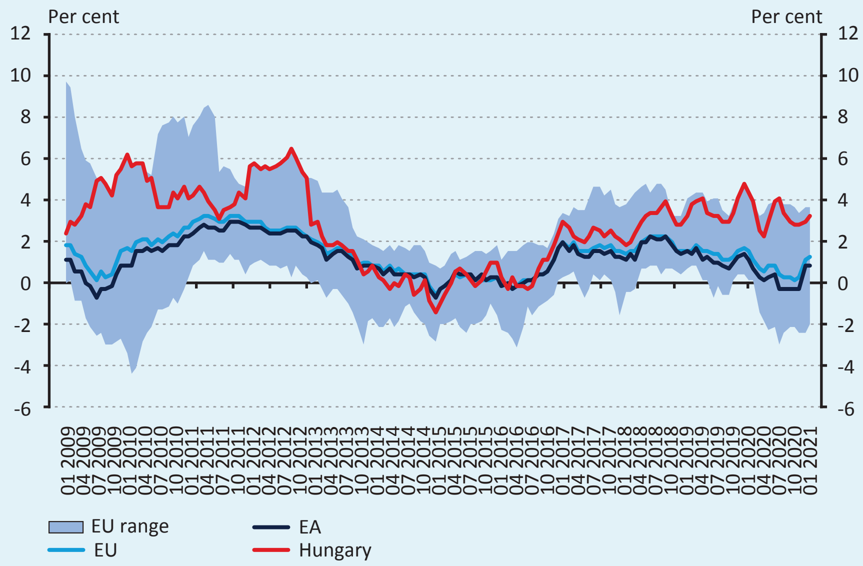
Labour market prospects remain uncertain in some sectors, most notably in the labour-intensive sectors affected by shutdowns (accommodation, catering, cultural services), where the decline in the number of people in employment was the largest. While central bank and government programmes contributed to mitigating the adverse employment effects, the protracted pandemic situation may increase labour market risks for companies in the service sector.

1.1.3 Inflation within the tolerance band

In the first months of the year, inflation was moderate in the euro area as a whole. The harmonised index of consumer prices was below the ECB's 2 percent target in most Member States. Over the year, inflation in the euro area gradually declined, once again falling to the negative range for the first time since May 2016 and stagnating at -0.3 percent from September 2020. This is attributable – in addition to the significant decrease in fuel and energy prices – to the impact of the German temporary VAT reduction, as Germany introduced a general and temporary VAT reduction between 1 July 2020 and 31 December 2020 as part of the measures related to the pandemic. However, from January 2021, with the exception of restaurant and catering services, it was reinstated to its previous level, and partly in connection with this, euro area inflation rose to 0.9 percent in January and remained at this level in February. In the quarters to come, the ECB expects significant volatility in inflation, but in the medium run underlying developments in the euro area may remain moderate due to slack domestic demand, followed by a gradual rise in parallel with economic recovery, as projected by the ECB.

Across the countries of the region, consumer price developments vary, with increased volatility in the regional price indices (Chart 3). Due to the major decrease in fuel prices – in line with the changes in world market oil prices – in the spring months of 2020 the inflation rates of the region countries returned or came close to the central bank tolerance bands. Overall, however, inflation in Poland averaged above the tolerance band during 2020, while in the Czech Republic price dynamics gradually declined, the Harmonised Index of Consumer Prices already standing at 2.1 percent in January 2021, down from 3.8 percent of January 2020.

Chart 3
Annual change of the Harmonised Index of Consumer Prices, HICP



Source: Eurostat

In 2020, inflation in Hungary remained within the central bank's tolerance band, at 3.3 percent. Pricing decisions have shown higher volatility and an unusual seasonal pattern. In the first months of last year, price rises were mainly related to food and fuel, and thus domestic inflation was 4.3 percent on average in the first quarter. Inflation fell to 2.2 percent in May as a result of the restrictive measures introduced and in line with world oil prices falling to a historic low. Following the reopening of the economy in the summer months, inflation rose to 3.9 percent by August. In parallel with strengthening disinflationary effects since September 2020, generally lower price dynamics were observed in the final months of the year, which also continued early 2021. Volatility of inflation may persist in the coming quarters as well. Supply- and cost-side effects, as well as tax measures are the factors playing a role in the increase in inflation in the second quarter, after which price dynamics are expected to moderate again in the second half of the year. In the first quarter, core inflation excluding indirect tax effect was 3.0 percent on average. In the past months, the 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. Looking ahead, core inflation excluding indirect tax effects will lag substantially behind inflation, indicating the temporary nature of the increase in inflation. Supply-side inflationary effects, stemming from repricing by enterprises and their efforts to restore profitability, may increase the price index.

The future path of inflation is subject to volatility due to the changed global economic environment and global oil market trends. The world market price of Brent crude oil rose from USD 50 per barrel of mid-December up to USD 70 per barrel by mid-March. The 40 percent rise in prices is the combined effect of several factors, such as the good economic performance of Asian countries, the appearance of the vaccines against the coronavirus in the market as well as the surge in fuel sales in China, which significantly influences global demand. In addition, OPEC+ member countries held another meeting, where they extended the prevailing production cut by one month and geopolitical tensions also contributed to the upward trend. Global food prices tended to rise in the past period. The increase was primarily related to the prices of oil crops, cereals and sugar, as well as dairy products. It should be emphasised that in Hungary the weight of articles susceptible to cost fluctuations – unprocessed food and fuel – is significant by EU standards (12.4 percent in total), and thus occasional food or fuel price shocks have a greater impact on the developments in the consumer price index.

1.2 OPPORTUNITIES INHERENT IN INSTITUTIONAL INVESTORS

1.2.1 Rising yields at the beginning of 2021

Due to the changed international financial market environment resulting from the global reflationary risks and to economic uncertainty, yields rose significantly in the US and European bond markets in the past period. The rise in developed country yields also impacts yields in the region and in Hungary, and thus the emerging region registered a major rise in yields. In the first quarter of 2021, German and US 10-year yields rose by 25-60 basis points and in parallel with this, regional yields moved up by 30-60 basis points. Within the region, the more moderate rise in yields in the Polish market occurred under lower purchases of government securities by the central bank than in Hungary. This is probably due to the different ownership structure, with a higher proportion of insurance and pension funds in the long-term segment of the Polish market, which results in a more stable market.

In line with the foregoing, the Hungarian yield curve also increased. The shorter – 5–10-year section – of the yield curve rose broadly in line with global and regional trends (the 10-year yield increased by 44 basis points), while the over 10-year segment of the yield curve registered a more pronounced increase, i.e. 50-60 basis points. This was due to the specific characteristics of the long-term series: low liquidity, large issuance by the Government Debt Management Agency in the first quarter (significant supply), concentrated ownership structure. On the demand side it should be noted that the MNB played a stabilising role by flexibly adjusting its purchases of government bonds, which resulted in the MNB's holdings in the over 10-year segment approaching the 50 percent limit. Both the latter and the announcement of the removal of the limit improved the market situation, but in order to avoid a counterproductive effect, central bank purchases should not continue to increase without limit.

1.2.2 Demand-side opportunities in institutional investors

The Hungarian insurance and funds sector manages substantial savings assets, totalling around HUF 4,000 billion. At the end of 2019, the MNB sent out an executive circular to insurers and funds, encouraging the use of the HMAX index and the purchase of long-term government securities to ensure the maturity match of their assets and liabilities. Also owing to this, the average remaining maturity of insurers' and funds' assets increased in the controversial last year, and they bought nearly 20 percent of long-term government securities (almost HUF 120 billion of government securities maturing in 2041 and 2038). However, the increasingly uncertain environment reduced the effectiveness of the circular's message. Demand may be further increased in the long-term segment significantly through a conceptual strengthening of the domestic institutional investor base.

Schemes based on voluntary stay or opt-out become increasingly widespread around the world, the primary purpose of which is to address demographic challenges. In the United Kingdom this scheme has already reversed the downward trend in pension savings and reduced gender and generation gaps with a penetration of 87 percent. In addition to their positive social effects, they can also generate demand for the economy in the capital markets, strengthening the economy's internal funding. The more moderate rise in the Polish yield curve in early 2021, relative to the region, highlighted the stabilising effects of strong funding.

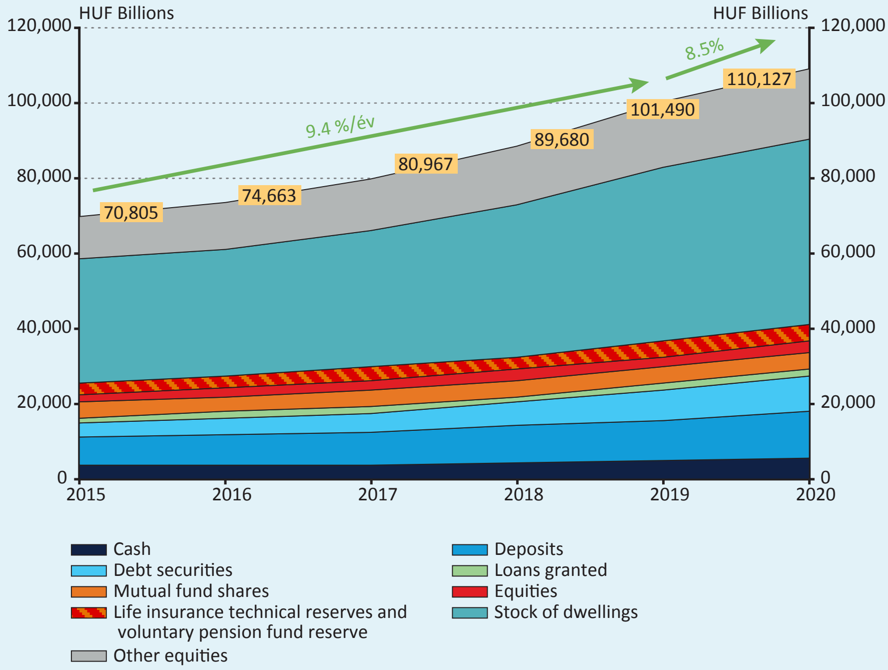
In addition to the establishment of a domestic scheme, the Pan-European Personal Pension Product (PEPP) is expected to be introduced from 2022. The PEPP will be a pension savings scheme portable between countries and providers, which can be offered by large European providers, even as a cross-border service. The domestic pension savings placed in these funds could be lost for the purposes of Hungary's macro balance if the (presumably) non-Hungarian investment-focused provider places the savers' assets in the instruments of other economies. A strong domestic institutional system capable of providing a wide range of services could significantly mitigate this threat.

1.3 DEVELOPMENTS IN HOUSEHOLDS' SAVINGS

1.3.1 Gross assets of households grew to HUF 110,000 billion

By the end of 2020, gross assets of households, comprising financial instruments and the stock of dwellings, exceeded HUF 110,000 billion, which represents a year-on-year growth of 8.5% (Chart 4). In the past one year, the biggest contribution to the growth in assets was made, in addition to the stock of dwellings – due to their weight in assets – by the rise in the value of deposits and debt securities (by HUF 6,206 billion in total, they accounted for 82 percent of the total growth). The most dynamic growth was registered in deposits (18.1 percent), but cash, debt securities and shares also increased considerably (by 12.9, 12.7 and 11.5 percent, respectively). The soar in certain asset components may be attributable to the extraordinary financial year. The volume of households' assets in cash, deposits and bonds – as savings in safe-haven assets – may have increased as a result of the economic uncertainty. On the other hand, economic performance weaker than in previous years could be the result of a slowdown in the appreciation of housing and other equity. The above-average annual growth in equities may have been due to a market adjustment following the capital market decline in the early phases of the spread of the coronavirus pandemic, which was followed by further growth in the last quarter.

Chart 4
Developments in the gross assets of households



2020	Cash	Deposits	Debt securities	Loans granted	Mutual fund shares	Equities	Life ins & VPF	Stock of dwellings	Other equities
Portfolio (HUF Bill.)	5,866	12,234	9,393	2,131	4,519	3,332	4,134	49,977	18,541
Ratio (%)	5.3	11.1	8.5	1.9	4.1	3.0	3.8	45.4	16.8
Δ2020 (%)	12.9	18.1	12.7	4.4	7.2	11.5	7.4	7.0	4.2

Note: The 2019 and 2020 data related to the stock of dwellings are MNB estimates.
Source: Hungarian Central Statistical Office, MNB

On the whole, the stock of assets available for liquidity in the short run (cash and deposits) increased at a rate above the average (by 16.4 percent), and thus their share within households' gross assets rose by 1.1 percent. Assets that can be liquidated in the medium term (debt securities, mutual fund shares and equities) essentially maintained their weight within assets, with an overall increase of 11 percent. The ratio of limited-liquidity assets (other equity, loans granted and stock of dwellings) with below-average growth fell by 1.4 percent in 2020.

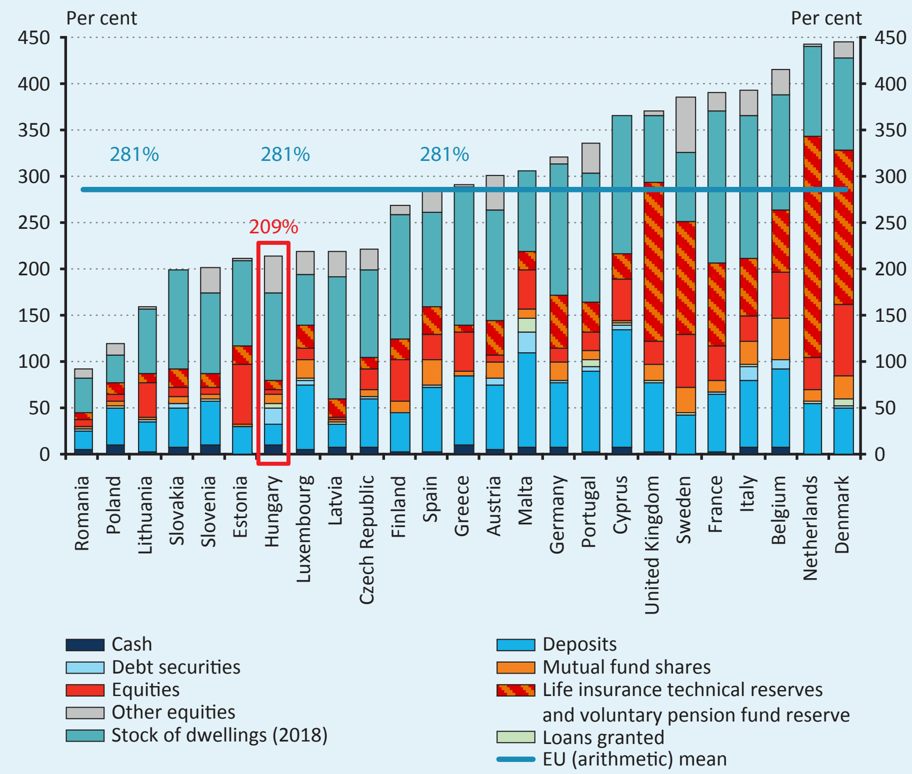
The life insurance and voluntary fund reserves, serving as means of long-term wealth accumulation, rose at a rate exceeding the average of previous years (by 7.4 percent). On the other hand, as a result of the growth rate lagging behind the average of total wealth of households, the share of the asset category remained 3.8 percent, while within the gross financial assets of households[3] if fell to 6.9 percent. The previous sustained favourable economic activity may have led households to a more extensive build-up of self-provision based on long-term products, which may have been somewhat curbed by the slowdown in economic growth.

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

1.3.2 Gross assets to GDP ratio exceeding the regional average

Gross assets of Hungarian households amounted to 209 percent of GDP in 2019 (Chart 5), which continued to 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 281 percent. The average for the countries of the region (the Czech Republic, Poland and Slovakia) is 177 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 Visegrád countries (these four countries have an average of 416% more).

Chart 5
Gross assets of EU households as a percentage of GDP, in 2019



Note: The stock of dwellings data related to 2018.
Source: Eurostat

According to individual categories as a percentage of GDP, Hungary ranks first in terms of cash holdings. In addition, it is among the leaders in debt securities, other equity and loans granted (ranked 2nd for the first two and 4th for the latter). By contrast, in terms of deposits, equities, and life insurance technical reserves and voluntary pension fund reserves Hungary was at the end of the ranking (ranked 24th for the first two and 23rd for the latter in 2019). Hungarian households are in the mid-range in terms of the proportion of their assets held in mutual fund shares (ranked 16th) and stock of dwellings (ranked 15th). Overall, it appears that the ratio of the most liquid assets (cash) and those of limited liquidity (other equity and loans granted) is outstanding by European standards, while the low ratio of long-term accumulation assets within the EU may reflect room for exploiting the financial intermediation system, which could be enhanced by improving financial awareness.

2 The insurance market and its risks

2.1 OVERALL PICTURE OF THE MARKET

In 2020 no change occurred in the ranking of institutions in the entire Hungarian insurance sector. There are still a total of 33 supervised insurance companies and insurance unions, 22 of which fall within S2. As regards the institutional form of the insurers 21 of them operate in the market as joint-stock company, 2 institutions as large insurance union and 10 as small insurance union. There are also 13 insurance branch offices operating in the Hungarian market. In respect of those the MNB has competence only in terms of consumer protection. 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. In 2020, premium income at sector level was HUF 1,204 billion, representing a year-on-year growth of 4.7 percent. The life segment and the non-life segment contributed to this in a proportion of 38-62.

The growth rate of non-life premiums decreased after the integration of insurance tax in the premium, and thus it increased by 5.2 percent compared to the previous year. Also taking into consideration the Hungarian branch offices of insurers with registered office abroad, the premium income of the insurance sector is HUF 1,285 billion. The share of branch offices within the total premium income (6.3 percent in 2020) rose by 0.1 percent compared to the previous year. In 2020, the rise in the number of policies (+0.5 percent) fell significantly short of the growth in premium incomes compared to the previous year. The number of life insurance policies decreased by 1.1 percent, while non-life insurance policies increased by 0.8 percent over the year. This may be attributable to restrictions imposed by government measures on the one hand, and to the economic downturn on the other. The sector-level return on equity of domestic insurers (ROE in 2020 24.3 percent) seems to have stabilised at a high level of around 20-24 percent over the last three years, which reflects a positive picture of the insurance sector from a stability perspective, but it is below the fair and competitive target set in FIS, while the S2 return on equity (S2 ROE) of 12.8 percent is within the target range.

Table 1
Key data of the insurance sector[4]

	2019	2020		
	Total	By institutions type		Total
Number of institutions*	32	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)*	1,150.5 *(1,229.5)*	*530.4* ↑ *(559.0)* ↑	*673.8* ↑ *(726.1)* ↑	1,204.1 ↑ *(1,285.1)* ↑
Number of contracts (thousand pcs) *(number of contracts per capita) ***	14 354 *(1.47)*	2,335 ↓	12,147 ↑	14,483 ↑ *(1.49)* –
Technical provisions (HUF billions)	2,194.3	2,004.4 ↑	315.3 ↑	2,319.7 ↑
Balance sheet total (HUF billions)	2,927.9			3,177.9 ↑
Eligible own funds (HUF billions)	572.2			655.9 ↑
Capitalisation level (per cent)	204			218 ↑
Profit before tax (HUF billions)	75.0			88.9 ↑
Return on equity (ROE)	22.8%			24.3% ↑
Return on solvency capital (S2-ROE) ***	12.2%			12.8 –
	Small insurance unions			
	2018	2019 ****		
Number of institutions	10	10 –		
Premium income (HUF millions)	459	530 ↑		
Number of contracts (pcs)	1,001	1,951***** ↓		
Return on equity (ROE)	11.7%	5.5% ↑		

Notes:
** The number of institutions does not contain one supervised joint-stock company falling outside S2 (state-owned export credit insurer).*
*** For the insurance policies per capita ratio we calculated with the total population indicated on the HCSO website.*
**** The S2-ROE index compares the profit after tax to the available capital under Solvency II.*
***** The 2020 data of the small insurance unions is not yet available. The number of policies include contracts with maturity within one year.*
Source: MNB

2.1.1 5 indicators started to approach the 10-year future vision

In February 2018, the MNB published its paper entitled "10-year future of the insurance sector in 7 points[5]" (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 previous years, we present developments in the FIS target figures in this publication as well, evaluating those by the 10-year target values and the projected paths (all this is summarised in Table 2)[6].

[4] The publication contains unaudited data for the end of 2020.
[5] 10-year future of the insurance sector in 7 points
[6] Upon backtesting considering the actual macroeconomic figures as necessary.

Table 2
Target values and actual data of the insurance sector

Objective to be achieved	Target variable	2019 actual data	2020 actual data	2026 target value
1. Wide-ranging self-provision *More savings, greater security*	life insurance and voluntary pension fund contracts/economically active persons	52.8%	**52.4%**	over **80%**
	ratio of reserves as a percentage of GDP (life technical reserve + voluntary pension fund individual accounts)	7.34%	**7.84%***	over **10%**
2. Market size convergence *Back to the forefront of the region*	Penetration (premium income/GDP)	2.42%	**2.53%***	over **3.0%**
3. Competitive market *Increasing competition*	Share of TOP5	59.6%	**60.4%**	below **55%**
4. Efficient sales *Half of sales over an innovative channel*	ratio of innovative channels	34% (2018)	**35% (2019)**	over **50%**
5. Economies of scale *Institutions operating more cost efficiently with dropping margins*	ACR values of UL contracts	0.90-5.52%	**0.92-5.39%**	**0.5-5.75%** steadily
	non-life combined ratio (net of tax)	81.4%	**78.8%**	**85-90%** steadily
	cost ratio	29.5%	**30.1%**	**20-30%** steadily
6. Fair and competitive profitability *Long-term confidence and stability*	ROE	22.8% S2 ROE 12.2%	**24.3% S2 ROE 12.8%**	**10-15%** steadily
7. Well-capitalised insurers *Safe and prudent operation*	capitalisation level	204%	**218%**	**>150%** steadily

*Note: The values marked with * were evaluated according to the trends projected in the publication.*
Source: MNB

The coverage of life insurance and voluntary pension fund contracts fell in 2020 by 0.4 percent (to 52.4 percent). The number of contracts decreased slightly during the year, while the number of economically active persons did not change significantly, resulting in a lower rate of penetration. For the time being no success was achieved in reaching the potential candidates for self-provision, and in addition to this declining GDP and the low yield environment did not support a rise in penetration either.

Despite the decrease in the number of contracts, life insurance reserves and voluntary pension fund reserves grew by 6.9 percent (by HUF 242 billion) in 2020. Despite the low yield environment and high volatility in capital markets, voluntary pension fund yields developed positively and contributed to the growth in savings. In the life insurance segment, the growth in premium income was fostered by the steady pickup in pension insurances, which may continue in the coming years as well 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 7.84 percent of GDP at the end of 2020. The growth during the year exceeded both the empirical trend and the annual increase expected under the international trend, but was below the level of previous years.

The growth in insurers' premium income was below that of the previous year, but exceeded the period-on-period growth of all three projected growth paths (inflation targeting, empirical and rising penetration trends). As a result, the penetration rate exceeded the inflation targeting trend in FIS by 0.5 percent and the empirical trend by 0.2 percent, but is still below the projected level of the rising penetration trend for 2020 by the same rate. To reach the latter penetration level, the sector would have needed an additional premium income of HUF 87 billion.

The top 5 market participants' share exceeded the projected path by 3 percent in 2020. The Herfindahl-Hirschman Index (HHI) increased slightly, which also moved away from the HHI level consistent with the projected path. The value of the indicators is the result of general trends and, unlike in previous years, it was not affected by institutional mergers.

The ratio of innovative channels[7] in the composition of insurers' sales channels was 35 percent in 2019, up 1 percent from a year earlier.[8] However, it is below the 2016 figure. 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[9], 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 lowest and highest ACR, i.e. from 0,90 to 0.92 percent and from 5.52 to 5.39 percent, respectively.

The sector-level combined ratio of non-life insurances decreased year-on-year. This may be mainly attributable to the fall in vehicle traffic in the second quarter of 2020, and as a result, the trend increase in claims halted. Accordingly, the value of the 2020 indicator for the sector as a whole was below the 2016 level. This may have been caused by insurers using data from previous years to calculate their premiums for a traditional period which, due to the exceptional year, exceeded the developments in claims and costs[10]

Cost ratios increased by 0.6 percent in 2020 compared to the previous year, which again reached 30 percent based on the sector average. The latter is the upper bound of the designated target range of 20-30 percent. However, in a breakdown by insurance segments the value still varies. 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 2020 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 three-quarters of the institutions exceeded 200 percent, and only one institution's capitalisation level was below 150 percent at the end of 2020. The persistently high level of the institutions' capital position serves as a good foundation for the sector's safe and prudent operation.

2.1.2 The sector continued to grow despite the COVID effect

In 2020, the premium income of the insurance sector was HUF 1,204 billion in total, which is a 4.7 percent increase compared to the previous year (Chart 6). The dynamic trend of recent years has faltered, with the growth falling short of the average of previous years, which may be attributable to the declining GDP data. Although as a result of this penetration increased, the MNB's vision for the future can only be achieved if growth returns to a range of at least 8-10 percent as soon as possible. In a breakdown by segments, the values rose by 5.2 percent in the non-life segment and by 4.0 percent in the life segment during the year.

The growth of the sector exceeded that of the entire economy; accordingly, following 2019, insurance penetration managed to increase further. After 2.42 percent in 2019, it reached 2.53 percent in 2020.

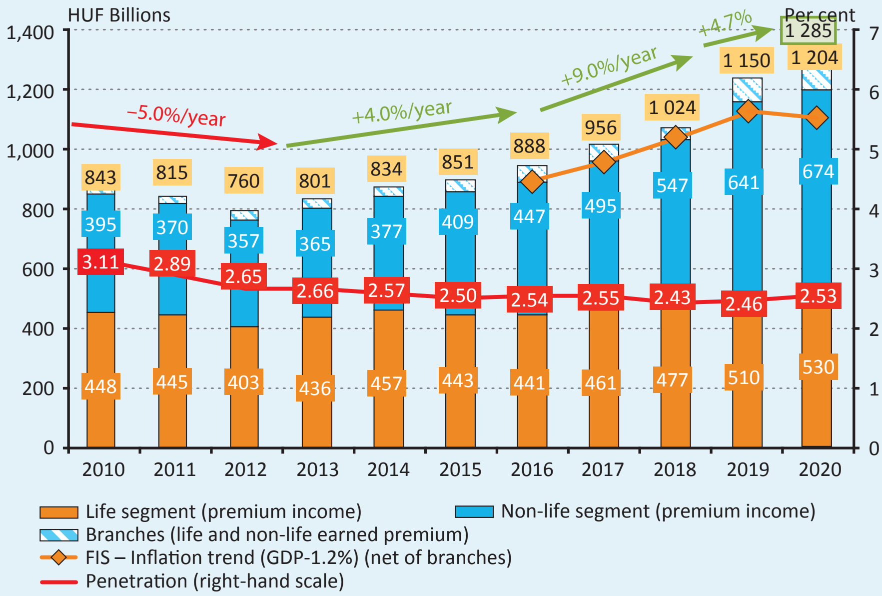
[7] Innovative channels: bank assurance, direct sales, online intermediation.

[8] 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.

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

[10] During the backtesting, the insurance tax – introduced in 2019 also for the MTPL products – was also taken into consideration indirectly, relying on insurers' regular data supplies in 2020.

Chart 6
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 are shown. 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.

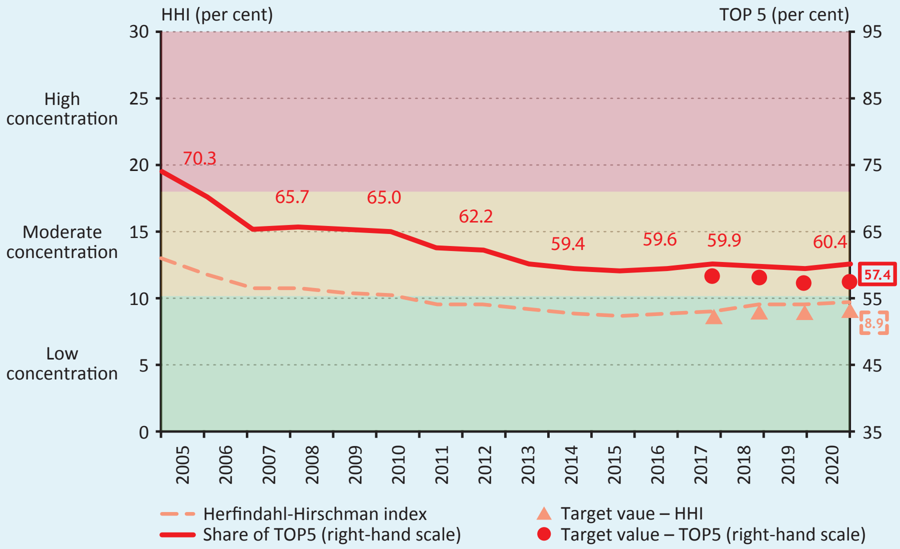
Source: Hungarian Central Statistical Office, MNB

The performance of the insurance branch offices operating in Hungary also forms part of that of the domestic sector, and thus the total premium income of the sector in 2020 is estimated at HUF 1,285 billion. Branch offices registered a growth of 2.3 percent.

2.1.3 Slight increase in the sector's concentration ratio

The share of the TOP5 market participants increased slightly, by roughly 0.9 percentage point, in 2020, and thus it reached 60.4 percent (Chart 7). The TOP5 institutions lost part of their market share in the life segment, while their share increased in the non-life segment. In line with this, the market share of medium-sized insurers decreased in the non-life and increased in the life segment. As the combined result of the foregoing, the HHI value also reflects a moderate rise in the concentration, with a change of 0.2 percentage point. Nevertheless, for the time being the value of the indicator still remained in the low concentration band (below 10 percent). The actual data considerably exceeded the concentration path projected in FIS, and the change in 2020 did not bring the sector closer to it either.

Chart 7
Share of the TOP 5 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

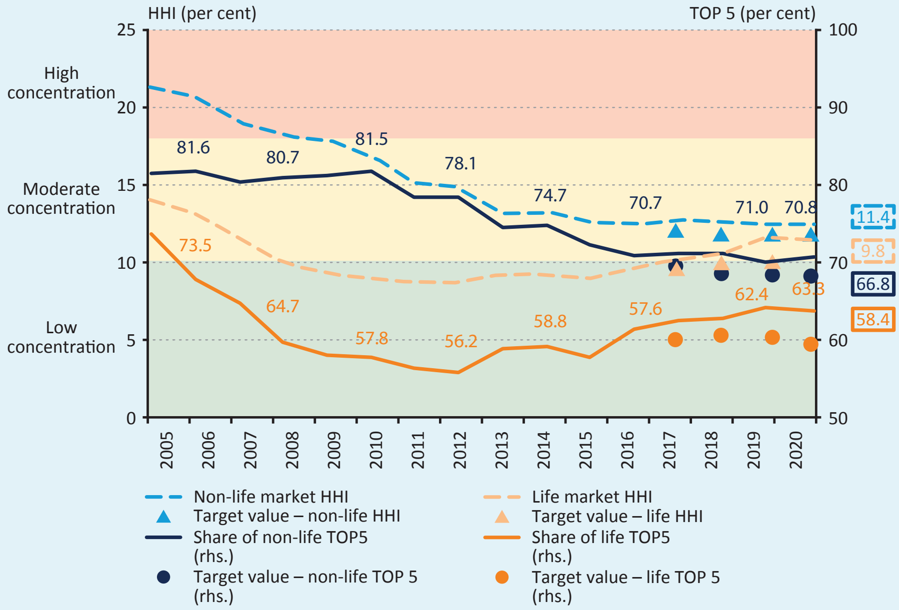
2.1.4 Convergence between the two segments has turned

In 2020, changes of opposite direction took place in the life and non-life segment (Chart 8). In the life segment the share of the TOP5 institutions decreased by 0.6 percent, with the HHI falling by 0.4 percent. A major contributor to the decline was the loss of a large player in the single-premium life insurance market. This may be due to the fact that larger, typically lump-sum savings and the placement of those have been adversely affected by the extraordinary economic situation and the curfew measures.

On the other hand, in the non-life segment, the market weight of the TOP5 insurers increased by 1.0 percent, while the HHI shows only a slightly, i.e. by 0.4 percent, higher concentration in 2020. The increase in the weight of market leader institutions was typical for all main product categories. There was a shift mainly in smaller non-life insurances within the group of the top 5 players and in the group of insurers outside those.

The actual figures exceeded the life and non-life segments' path projected in FIS. By now this may be mostly attributable to the cumulated effect of the actual figure having exceeded the values in the FIS path in previous years as well. On the other hand, the changes in 2020 in the non-life segment were of opposite direction, while in the life segment they almost corresponded to the changes presented in FIS for this year.

Chart 8
Share of the TOP 5 market participants and Herfindahl-Hirschman index (HHI) of the entire sector based on gross premium income by sector

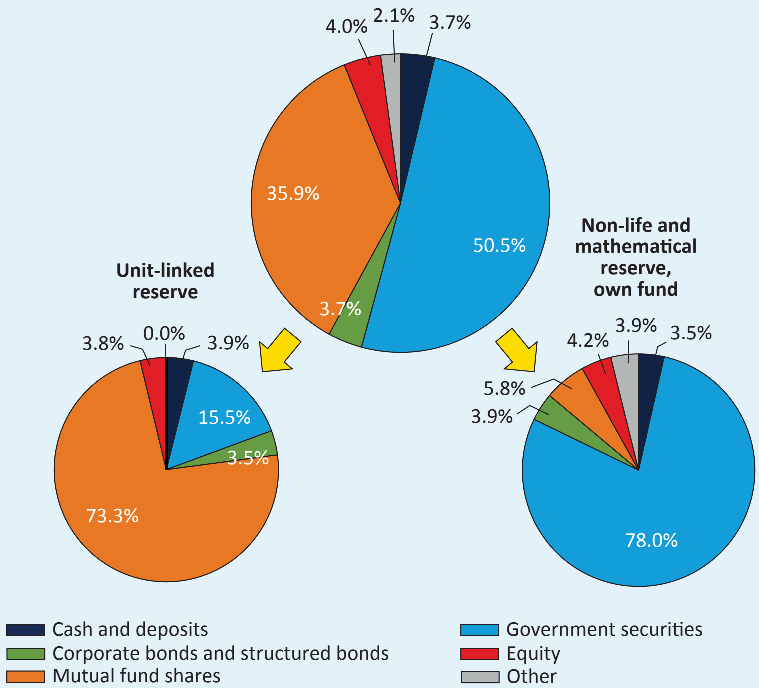


Note: The colour of the background illustrates the strength of concentration under HHI.
Source: MNB

2.1.5 Government securities have dominant weight in insurers' assets

The value of the Hungarian insurance companies' total assets repeatedly rose (by +8.5 percent) in 2020 following the growth in previous year. The value of total assets is HUF 3,149 billion, 45 percent of which cover 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 9). This ratio has not changed significantly compared to previous years. 54.2 percent of the insurers' total assets comprised low-risk, conservative instruments (government securities, cash and deposits), which represents a 0.9 percentage point increase compared to the previous year. The rest of the assets mostly consists of mutual fund shares, equities and corporate bonds (also structured bonds). In 2020, a reallocation of 1.1 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 lower risk instruments, thus the share of those rose to 19.4 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). 78.7 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.

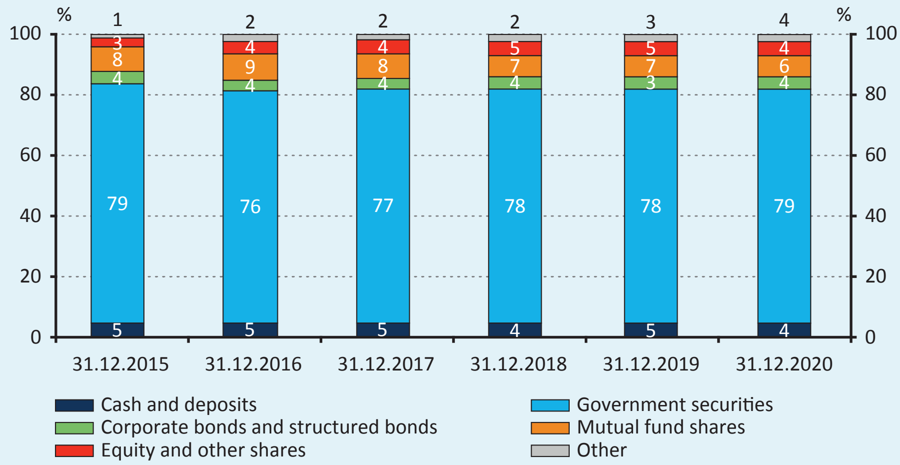
Chart 9
Asset composition of Hungarian insurers



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

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 10). The slow rise in the equity ratio observed until 2019 halted in 2020 and it fell by 0.5 percent. However, the decline is the combined effect of a fall both in volume and in value. However, following the peak of 8.8 percent of mutual fund shares registered in 2016, it fell by 0.9 percent in 2017, by 0.7 percent in 2018, by 0.6 percent in 2019 and by further 0.7 percent in 2020. There is still no major realignment in the category of assets underlying the reserves for policies other than unit-linked insurance.

Chart 10
Changes in the composition of assets underlying reserves other than unit-linked reserves



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

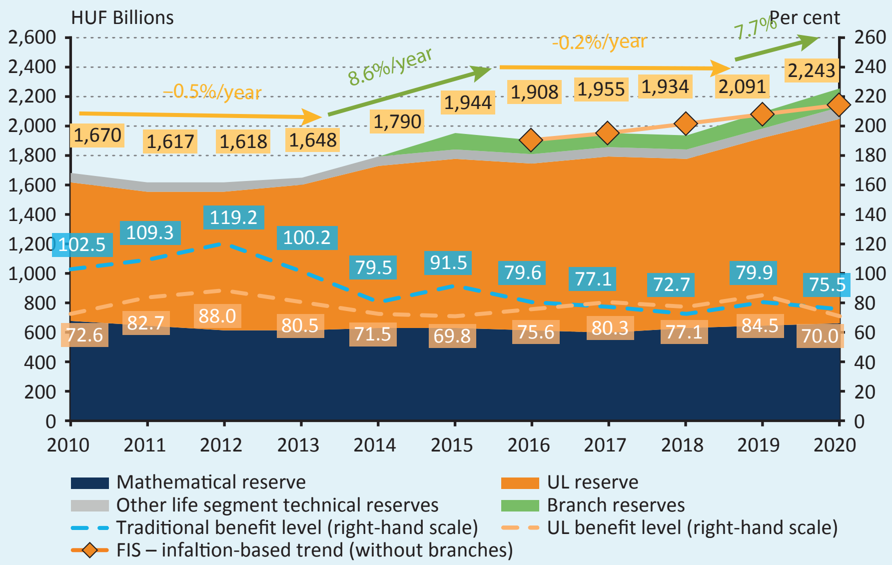
2.2 LIFE SEGMENT

2.2.1 Reserves have caught up with the increase in inflation in the last 4 years

At the end of 2020, the life insurance accounting technical reserves (hereinafter: life insurance technical reserve) amounted to HUF 2,125 (including the branch offices: HUF 2,243) billion, which represents a significant – 7.1 percent (including branch offices: 7.3 percent) – growth compared to the previous year (Chart 11). 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 (65.7 percent without branch offices and 62.3 percent with branch offices) is still linked to unit-linked products, and this ratio rose by 1.4 (together with the branch offices by 1.2) percent compared to the previous year. Actuarial reserves account for 30.6 percent (including the branch offices: 29.0 percent) of the life insurance reserves. The ratio of the life insurance reserves of the branch offices operating in Hungary is negligible (5.3 percent); the remaining 3.6 percent (3.4 percent together with the branch offices) of the reserves is linked to other life insurance reserves. The reserves of unit-linked products rose by 9.5 percent (+ HUF +120.7 billion), the actuarial reserve rose – below the rate of the entire of life segment reserve – by only 3.0 percent (+ HUF +19.0 billion), while the other life insurance reserve rose to an even smaller degree, by 2.4 percent (HUF 1.8 billion) compared to the previous year. More than half (56 percent) of the change in life insurance premium reserves in 2020 is linked to revaluations, i.e. the yields realised.

While the period of 2015-2018 was characterised by stagnation in life insurance reserves, in 2020 an increase similar to the previous year was observed. In FIS, three potential paths were projected with regard to developments in the self-provision reserves: inflation targeting, empirical and international trend. Of these, the development of reserves is currently in line with the inflation targeting trend: according to the path projected in FIS, the volume of reserves excluding branch offices would be close to HUF 2,147 billion by the end of 2020, and the level of life insurance reserves falls short of this only marginally (by 1 percent).

Chart 11
Developments in life insurance reserves and the related insurance benefit levels



Note: From 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. The total value of the life insurance reserve, shown on the chart shown in the yellow rectangle above the bars, does not include the value of the branch offices' reserves. Other life insurance reserves include the following reserve components: unearned premium reserve, outstanding claim reserve, reserve for premium refund depending on and independent of the profit, claim fluctuation reserve, extreme loss reserve, cancellation reserve and other insurance technical reserves.

Source: MNB

2.2.2 No significant outflow occurred in the life segment

Life insurance benefits paid by insurers in 2020 decreased compared to the previous year for both regular and single-premium products. This change was not followed by the premium incomes, where the ratio of single and top-up premiums, and regular premiums did not differ significantly from previous years (36 percent and 64 percent, respectively). As a result of the foregoing, the benefit level decreased for life insurance policies at all premium payment frequencies. For regular premium products, this was a continuation of a multi-year trend, while for single premium products it was due to a fall in unit-linked products, which may have been affected by the economic environment which was less favourable than in the past.

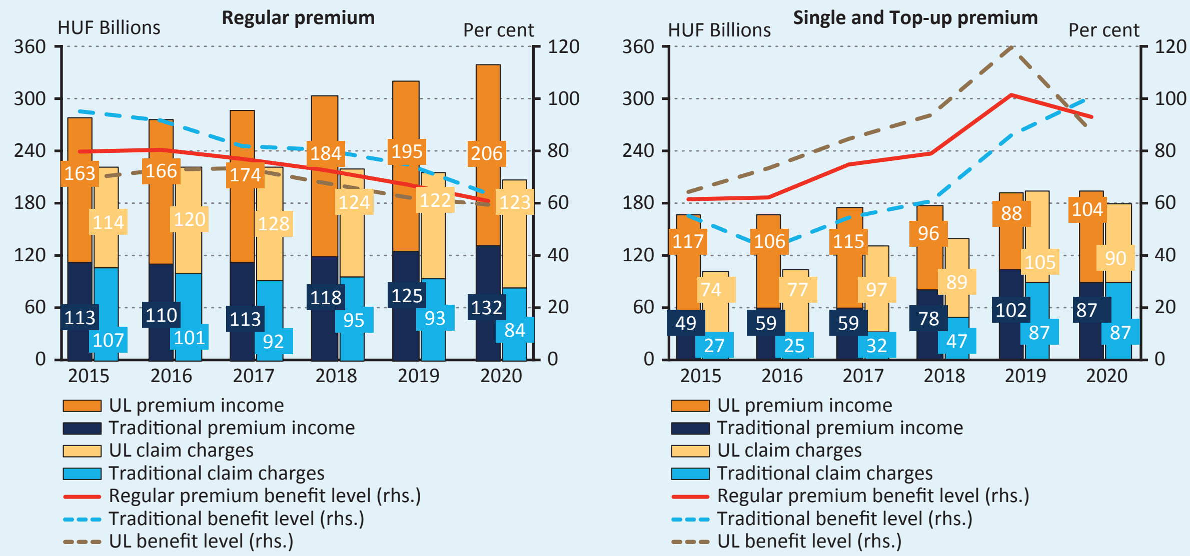
For regular premium products, premiums for both traditional and unit-linked life insurance increased by 6 percent. In terms of disbursements, unit-linked products registered an increase of 1.1 percent, while at traditional products a decrease of 10.2 percent could be observed. For unit-linked products, outflows increased as a result of payments due to expiry, which were mitigated by death, surrender and other payments. At the traditional products payments were primarily reduced by surrenders, which was mitigated only by the death benefits. As a result of the foregoing, the level of benefit payments under regular premium policies declined for both traditional and unit-linked products, by 6.2 percent in total.

Single and top-up premiums for unit-linked products rose by 18.2 percent and decreased by 14.6 percent for traditional products. By contrast, in 2020 benefit payments under single-premium products fell by 13.9 percent for unit-linked products, while for traditional products they essentially corresponded to the level registered in previous year. In the case of unit-linked products, a decrease was observed in all benefit types, while at the traditional products, the increase in death benefits and payments on expiry offset the decrease in other benefits.

As a result of the changes mentioned above, the ratio of surrenders in the composition of life insurance benefits fell to 61 percent, which falls short by 5 percent of the value registered a year earlier. Death benefits and payments on expiry accounted for 1 percent and 4 percent, respectively, of the lower ratio, and thus the ratio of these two benefit types in 2020 was 7 percent and 30 percent, respectively.

Last year, the distribution of life insurance premium incomes followed a similar trend at products with various premium payment frequency; in 2020 this has slightly changed. While the weight of the unit-linked products in the premium income from regular premium products remained 61 percent, the weight of unit-linked products increased by 7 percent (to 54 percent) in the premium income from single and top-up premiums. The ratio of unit-linked products in regular life insurance premiums remained stable at around 60 in the period under review. The same in the market of single and top-up premium products declined by an average of 6.1 percent per year over the period of 2014-2019, which was broken by the rise in 2020 (Chart 12).

Chart 12
Developments of premiums written, claim charges and benefit level* in the life segment, by premium payment frequency



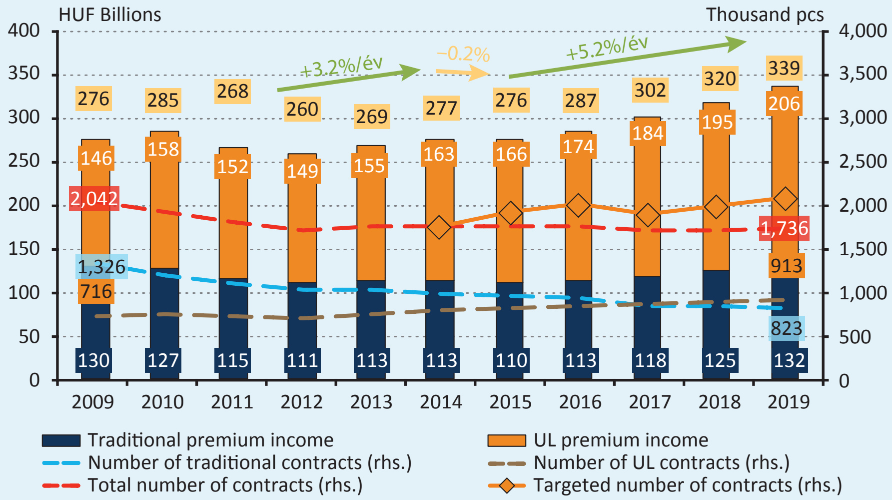
*Note: *The benefit level is the ratio of the claim charges compared to the gross premium income.*
Source: MNB

2.2.3 Rising regular premium income

The sector-level premium income of regular premium life insurance products was able in 2020 as well to continue its growth trend observed in previous years, amounting to HUF 339 billion, exceeding the amount registered at the end of last year by 6 percent. Due to the immediate response to the restriction on physical transactions (diverting the conclusion of contracts to the online space) and to the pickup in pension insurances, the sector successfully weathered the challenging market environment. According to the trend of the previous five years, the market of regular premium products grew by 4.2 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 prudential 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 13). At the end of 2020, the size of the portfolio comprising of roughly 1,736,000 contracts fell 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 2020 the growth was merely 0.9 percent, which represents roughly 15,000 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 2020, the premium income per contract in the market of traditional products is roughly HUF 161,000, while in the market of unit-linked contracts it exceeds HUF 226,000.

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 2.1 million contracts now.

Chart 13
Development of regular premium income and number of contracts in the life segment



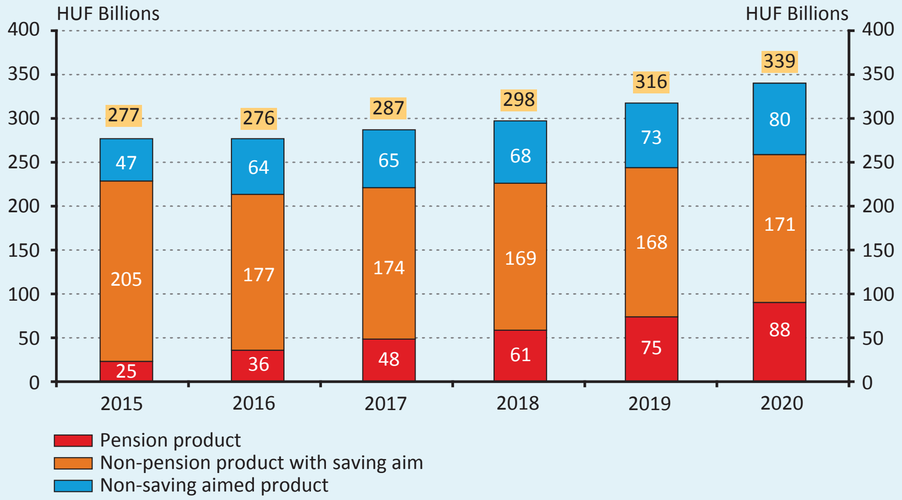
Source: MNB

2.2.4 More than a quarter of regular premiums are now for pensions

The introduction of pension insurance in the classical (and defined) sense, available from 1 January 2014, with a 20 percent tax credit, has started a long-lasting positive process in the market for pension insurance products. The guidelines serving the long-term sustainability of the pension product as well as the interests of customers, along with the tax allowance have created a stable environment and conditions for the penetration of this new product type. Following the introductory period of the pension insurance product, the premium income from regular premium pension products has been rising continuously, and in 2020 the annual growth rate of 17.1 percent may still be deemed high (Chart 14). The ratio of regular premium pension products is 26.0 percent, i.e. they have a share of almost one quarter in the total premium income from regular premium savings products, thereby exceeding the ratio of regular premium non-savings life insurance products (23.5 percent in 2020).

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, which ratio remained broadly unchanged since last year. 71 percent of the regular premium pension insurance portfolio comprises index-linked or unit-linked pension insurance products. Each of the 12 insurers active in the pension insurance market offer this type of product, while the number of insurers offering single premium products is still 6. The 5 market participants with the highest premium income (Top 5) currently possess 60.7 percent of total regular premium income, and thus there is room for further growth also for smaller players.

Chart 14
Breakdown of 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 2020 was not a good year for sales

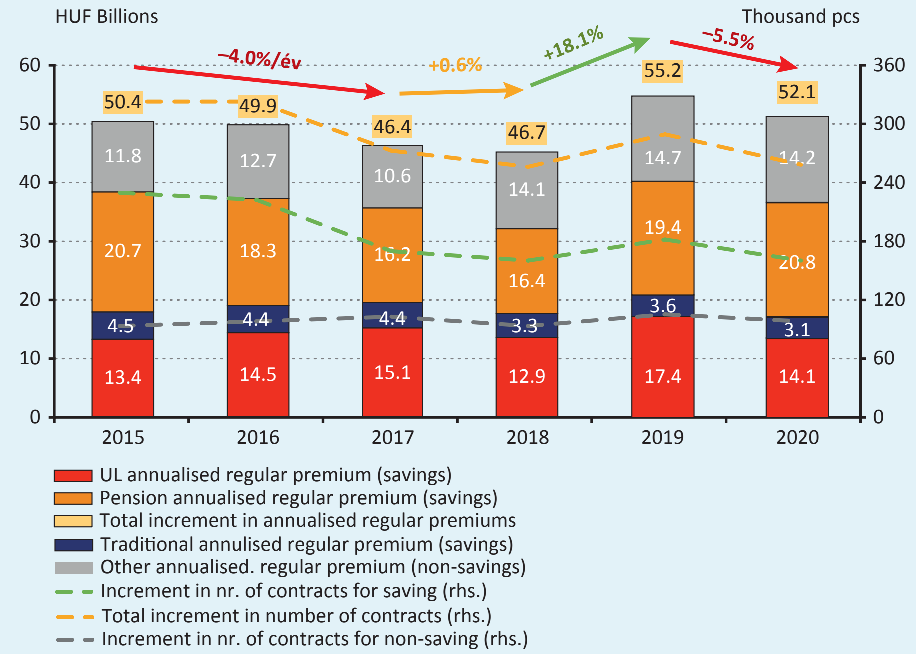
Trends in the sales of regular premium life insurances have been improving in recent years. On the other hand, as a result of the declining GDP the portfolio premium on the increment of regular premium life insurance policies were 5.5 percent lower in 2020 than a year earlier. This was essentially matched by a fall in portfolio premium due to the loss of portfolio (fell by 5.8 percent), and thus the net increment was almost the same as last year.

Until 2017, there was a steady decline in the portfolio premium increment, which was followed by a surge due to the introduction of the tax credit related to pension insurances in 2014. In parallel with the gradual rise of the portfolio, 2017 represented a turning point, as since then the portfolio premium growth surplus exceeded that of 2014.

The increment of regular premium life insurance contracts decreased by 10.0 percent in 2020. Three-quarters of the decline was connected partly to savings products, and particularly to pension products. Accordingly, in terms of its direction, it is in line with the direction of the change in the portfolio premium of the increment; however, it was almost twice as high as that. 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. which, based on the contract portfolio data in Chart 15, is in line with insurers' efforts to reduce their dependence on single premium life insurance contracts.

As regards the portfolio of the traditional regular premium products, there has been a steady decline in the increment of portfolio premiums over the last 5 years, which was exceeded in each year by the decline in portfolio premium due to loss of portfolio. 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 portfolio premium increment has been continuously increasing, even this was exceeded every year by the degree of the portfolio premium decrease resulting from the loss of portfolio until 2019. 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.[11] 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.

Chart 15
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
Source: MNB

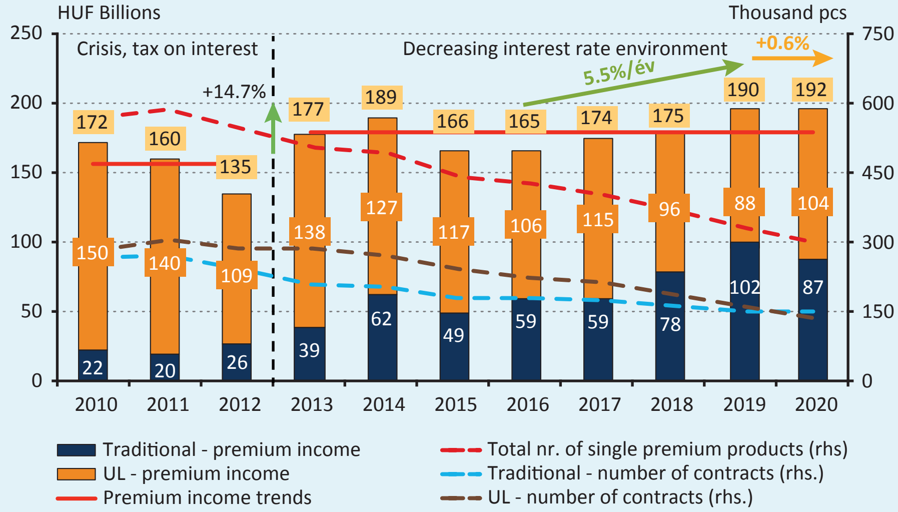
2.2.6 Single and top-up premium income close to the average

As regards the change in single and top-up premium income, there is no significant change compared to previous year. Its amount grew by 0.6 percent on an annual basis, reaching HUF 192 billion. Lower premium income than before was recorded for traditional products, with a 14.6 percent decrease in premium income, mitigated by an 18.2 percent increase in single and top-up premiums for unit-linked policies.

As regards the changes in and the composition of the premium income, a clear distinction can be made between the financial crisis and the period following the introduction of the tax on interest and the period afterwards (Chart 16). At the beginning of the decade the average periodic value of the single and top-up premium income in the life segment was lower than in the later period; the average value between 2010 and 2012 was around HUF 156 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 under 15 percent within the portfolio. In the years following the crisis, characterised by a declining interest rate environment, premium incomes started to rise, with an increasing share of traditional products. Between 2012 and 2013, there was a sharp increase of 14.7 percent to an average of HUF 178 billion. The fact that in the last 3 years of the period from 2013 to 2019 a persistent growth of 4.8 percent was registered implied a departure from the average level of premium income of the period. However, the downturn in economic growth has broken the growth trend.

[11] Pension aimed products were separated as pension products from traditional saving aimed and unit-linked products. The descriptions apply to the filtered categories.

Chart 16
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 Non-life sector growth has slowed down

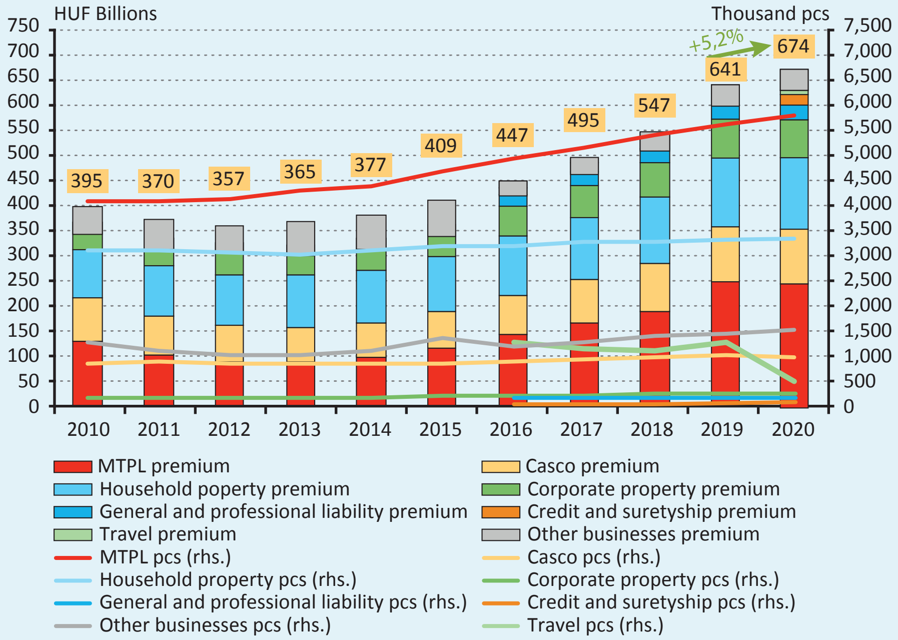
The growth of the non-life segment income, seen since 2012, continued in 2020 as well (Chart 17). On the other hand, the growth rate of premium income declined to 5.2 percent in 2020, which may be attributable to the decelerating economic environment. The increase of HUF 33 billion was mainly due to the compulsory motor third party liability insurance (MTPL) segment, with a contribution of HUF 17 billion. In 2020, the MTPL premium income accounted for 37 percent of the total premium income of the non-life segment, while its portfolio accounted for 48 percent of the non-life segment's total portfolio. The growth is partly attributable to the increase – also since 2012 – in the number of vehicles covered by MTPL and the average annual increase in the portfolio premium per policy of 9.8 percent, which may also reflect the technical effect of the integration of the insurance tax in the premiums. At the and 2020 the MTPL portfolio comprised of 5.8 million contracts.

As regards land vehicle casco, the policy portfolio growth rate was 1.9 percent in 2020, which lagged behind the 2.9 percent growth in MTPL. However, in terms of portfolio premium per contract, the 6.8 percent growth registered by casco substantially exceeded the growth of 2.7 percent for MTPL products. 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. Subsequently, the ratio started to decline, which may have been supported by favourable economic trends. However, due to the faltering of the economy, the decline stopped in 2020, and the ratio of second-hand cars put into service was 49 percent, which was almost the same as in previous year. In parallel with the improving economic trends and the recovery of the previous economic activity, the growth in the ratio of new cars may continue, which may support 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 2020 as a whole was 7.5 percent, which is a 10-year high. However, the number of contracts in this product category increased at a lesser rate than last year, i.e. by 0.2 percent (6,000 contracts), which falls short of the average of previous years. Under stagnating contract portfolio, due to the rise in the stock of dwellings at a similar rate as in previous years, the coverage of the housing market decreased, but at 73.6 percent, it is considered high compared to most insurance products.

In the area of corporate property insurances, accounting for 11 percent of the non-life segment's premium income, in 2020 the premium income of the product category rose at almost the same rate as in 2019, i.e by 9.1 Within the products with smaller share, payment protection insurances grew to the largest degree, by 9.1 percent, which may have been supported by the pickup in lending On the other hand, premium income from general and professional liability insurances increased moderately, by 3.6 percent Measures taken by both domestic and foreign governments included the introduction of curfews and travel restrictions, resulting in a 58.6 percent drop in travel insurance premium incomes The remaining other products accounted for 6.6 percent of the non-life market in 2020, and with a 2.8 percent decrease, they impacted the insurance segment's premium income negatively.

Chart 17
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.

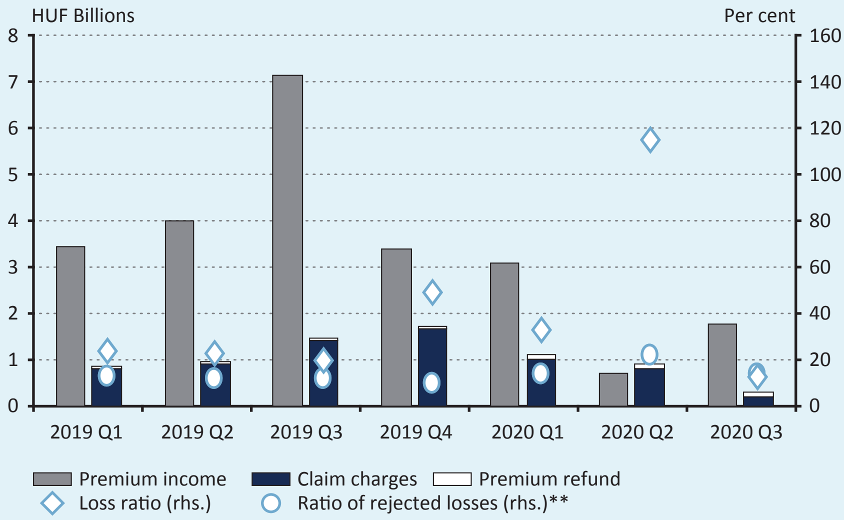
Source: MNB

Box 1
The travel insurance market has shrunk

The introduction of travel restrictions had the greatest impact on the tourism sector, which of course has also affected the travel insurance market. The MNB, in cooperation with the insurers, has thoroughly surveyed recent market developments.

According to this, in the case of travel insurances – representing the largest segment within travel-related insurances (passenger, cancellation, surety) – in the first half of 2020 the number of contracts fell by 22 percent compared to 2019, representing 1.3 million policies and a decline of 67 percent in premium income. The diverging change in the number of policies and premium income may be partly attributable to the continuous nature and low premiums of travel insurances linked to bankcards, and partly to the slight increase in the number of policies in the second quarter, driven by the easing of travel restrictions within the EU. The spectacular soar in the loss ratio in the second quarter is attributable to the premium income falling to a fraction of the usual amount, since the forint equivalent is smaller than the data registered in the same period of last year. The third quarter, which is usually the high season, was a fraction of that of last year; accordingly, the total annual premium income fell short of the figures registered in 2019 by almost 60 percent (Chart 18).

Chart 18
Indicators related to changes in losses of travel insurances



Note:
** Q3 2020 = 01.07.2020 - 31.08.2020*
*** Ratio of rejected losses = number of losses rejected/submitted*
Source: MNB

However, it should be noted that – irrespective of the current situation – this business line has marginal impact on the profitability of the insurance sector, as it accounts for merely 2.5 percent of the sector's premium income. Due to its product structure, the decline in travel insurance could be a problem for one insurer. However, the risks of this insurer are addressed adequately due to its capitalisation level being over 280 percent and to the supplementary coverage agreement concluded with its main reinsurance partner. Accordingly, it may be stated that there is no capital risk, as after the lifting of the restrictions premium incomes may also set on upward path in 2021. On the other hand, from a consumer protection perspective, the MNB issued several warnings to institutions regarding claims settlement practices (see Section 4.1 entitled Expectations for efficient, customer-friendly claims settlement).

2.3.2 Steady concentration in the non-life segment

In the past 10-15 years concentration decreased in the MTPL business (Chart 19), which is due to the higher price sensitivity of the product compared to other products. In the case of MTPL, the primary concern for customers is the price of the service, which, combined with the flexible capacity limits of insurers and active sales by brokers provides an opportunity for fierce price competition. The steeply 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[12], while other institutions were able to sell at a lower price. In 2020, no significant change occurred in concentration within the business line, either based on HHI or on the weight of the TOP5 market participants.

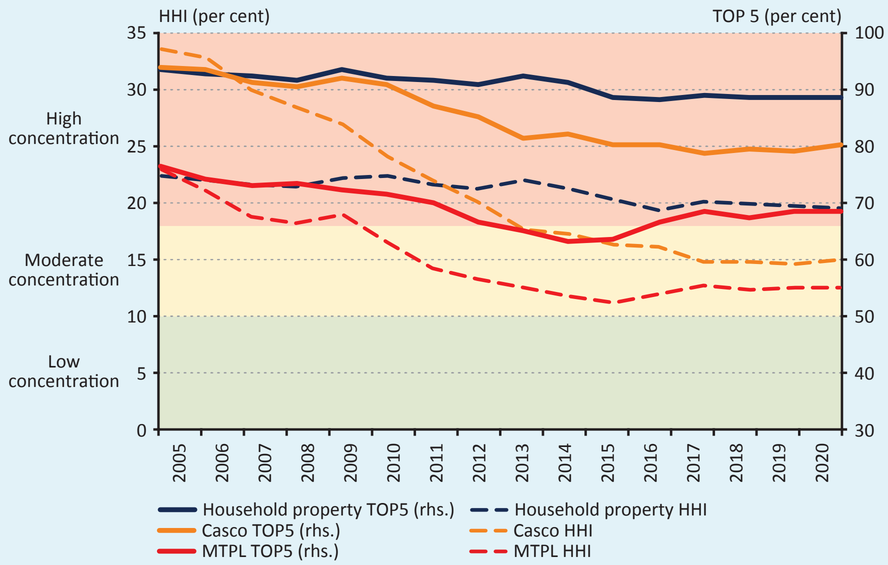
In the case of casco insurances, which also have a declining concentration path, the prospective quality of the service and the brand are important factors, since customers take out the insurance for their own property. The declining trend of the two concentration ratios substantially decelerated in recent years. HHI and the TOP5 market share indices rose only marginally in 2020 compared to previous year (by 0.3 and 0.2 percent, respectively). The 3.2 percent decrease in the casco claims ratio does not imply increased competition either. However, this data – similarly to the MTPL – may have been affected by lower than average vehicle use in 2020 compared to previous years. The price comparison applications

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

of online brokers could foster competition. However, the ratio of direct channels in the insurers' sales mix of the casco product category was not outstanding, ranging between 5-9 percent in previous years, and the ratio of electronic sales at independent insurance intermediaries, fluctuating around 7-9 percent (Chart 47), shows the underutilisation of the technological potential.

As regards the household property insurance segment, the index remains in the band signalling a high concentration ratio – over 18 percent when considering HHI. As in previous years, in 2020 both the HHI and the ratio of the top 5 market participants decreased only slightly, by 0.2 percent, each. Overall, the amount of claims payments was the highest in 2020 in the period since 2010, which contributed to the gross claims ratio rising to 33.7 percent. However, this level is below the average of the previous 10 years. 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 order to boost competition, the MNB announced its new home insurance concept at the end of 2019. Following successful applications, Certified Consumer Friendly Home Insurance (CCHI) were made available from 2021. Through these insurers may become interested in obtaining the CCHI certification, which helps them prove to their consumers the high quality of their products, also acknowledged by the MNB. 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 can contribute to reducing market concentration.

Chart 19
Share of the TOP 5 market participants and Herfindahl-Hirschman index of the non-life segment based on gross premium income by main businesses



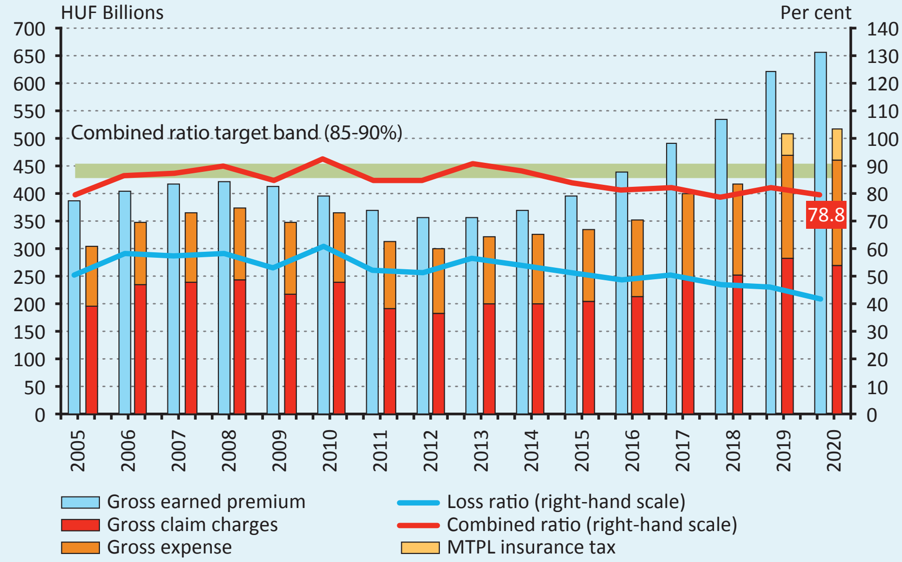
Note: The colour of the background illustrates the strength of concentration under HHI.
Source: MNB

2.3.3 The non-life combined ratio moved away from the target band

The combined indicator of the non-life segment at sector level fell to 70.5 percent in 2020, mainly due to the government's extraordinary restrictive measures introduced during the year. During the year, the personal administration of most activities insured in the non-life segment was suspended or it was presumably of lower intensity, which may have contributed to the lower loss ratio across a wide range of the business lines. Claims declined by 4.6 percent, while costs increased by 3.9 percent (in aggregate fell by 1.2 percent), accompanied by a further growth of 5.3 percent in earned premiums. Adjusted for the insurance tax, introduced in 2019 and levied on MTPL products, based on expert estimate, the combined ratio was 78.8 percent in 2020 (Chart 20). This level may be deemed low even after accounting for the adjustment compared to previous years, with 78.2 percent in 2018 being the historical low.

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. 2020 resulted in a move away from the lower end of the target range (85 percent).

Chart 20
Changes in non-life combined ratio



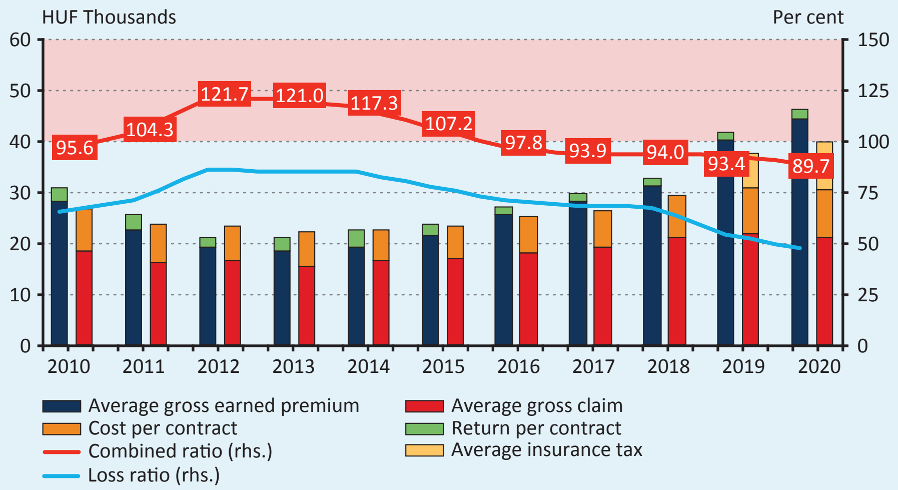
Note: The MTPL insurance tax is calculated from the expenditure data in the profit and loss accounts of insurers.
Source: MNB

2.3.4 Fewer vehicles, fewer claims

The loss ration per contract fell by 3.2 percent in 2020, which may have been driven by the decline in vehicle traffic in the second quarter during the curfew period. This broke the trend of steady, on average 5.8 percent, annual growth lasting since 2014 (Chart 21). However, the earned premium per contract increased by 10.4 percent, i.e. at a rate similar to that before the introduction of the MTPL insurance tax. 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). After this, the business segment was able to consolidate by 2016 and remained stable thereafter. Part of the impact of the insurance tax introduced in 2019 was carried over to 2020 due to policies with different anniversaries within the year, which may have supported the increase in premiums. Since neither the dynamics of determining new premiums charges nor the rate of passing on the tax are known, the direct change in aggregate data does not reflect the actual change in the level of premiums.[13] In the combined ratio for 2019 and 2020 the insurance tax is approximated based on the insurers’ supervisory reporting. On the other hand, the ordinary profit of the MTPL sector rose by 42.5 percent compared to the previous year, due to the successful integration of the insurance tax in premiums and a temporary decline in loss ratios. Similar positive developments are not expected in the future, due to a return of loss ratios to the levels before the restrictions and claim inflation effects (spare part prices, exchange rate effects, labour cost increases) well exceeding the underlying inflation rate.

[13] The listed items cannot be defined precisely from the supervisory data reporting related to the period of 2019-2020.

Chart 21
Changes in combined ratio of motor third-party liability insurance in Hungary

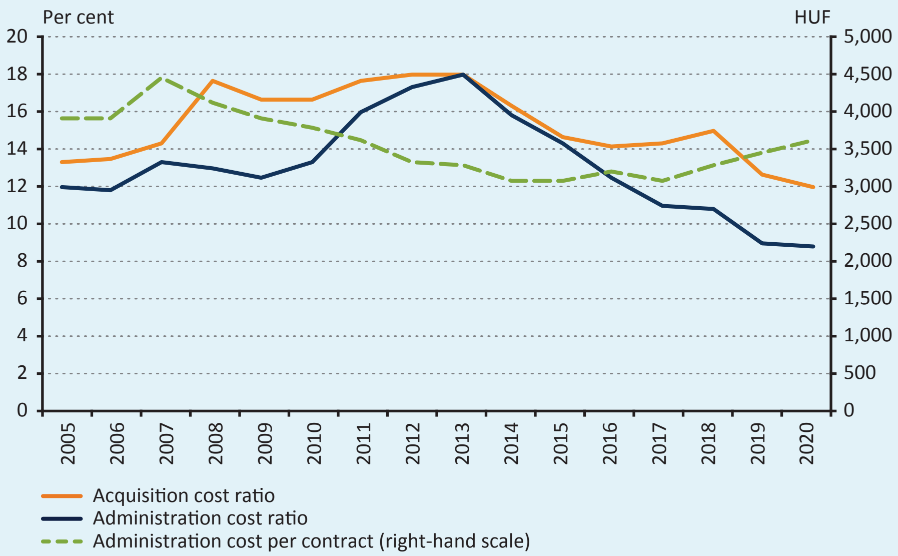


Note: The loss ratio values were adjusted for the change in outstanding loss reserves. The pink area in the chart denotes the band of combined ratio exceeding 100 percent. The MTPL insurance tax was calculated from the expenditure data in the profit and loss accounts of insurers.
Source: MNB

2.3.5 The cost level is close to target, but this is partly attributable to the premium increase

In 2020, the administrative cost per contract exceeded the 2019 value by 4.6 percent, which thus came close to its level registered 10 years ago. In recent years the segment's cost ratio has followed a declining trend and it is in line with the ideal target of below 30 percent for non-life insurance set in FIS. In 2020, the value of the indicator fell to almost 21 percent, of which 11.9 percent related to acquisition costs and 8.8 percent to administration expenses. The major fall in the 2019 cost ratios is primarily attributable to the comparison with the premium increased by the insurance tax, which effect, albeit to a small degree, may have been carried over to 2020 due to the policies with mid-year anniversary (Chart 22).

Chart 22
Changes in the cost ratios of motor third-party liability insurance in Hungary



Source: MNB

Box 2
New supervisory index for the transparency of the MTPL market

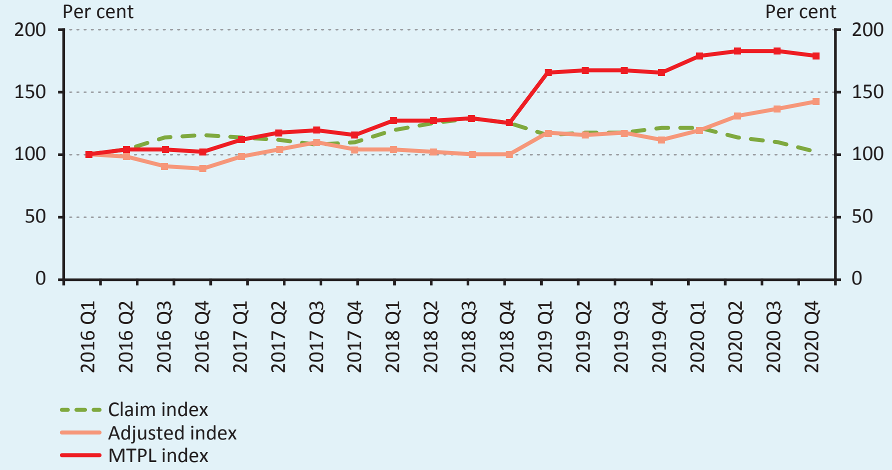
According to the amendment to Act LXII of 2009 on compulsory motor third party liability insurance (MTPL) adopted in autumn 2018, the Itemised Compulsory Motor Third Party Liability Insurance policy and claim Batch Compulsory Motor Insurance Contract and Claims Database (MTPL policy and claim database) established and operated by the Magyar Nemzeti Bank supports all actors in the MTPL market. In addition to supervisory use, insurers supplying data to the MTPL policy and claim database may request aggregated data. In addition, the availability of data also helps satisfy demand for wider information.

The information available to the MNB in the MTPL policy and claim database has enabled the MNB to create and publish on its website a comprehensive MTPL index on a quarterly basis from February 2021, which provides a comprehensive and up-to-date picture of the changes in average premiums in the market. The MTPL index for passenger cars expresses the average increase in the premium level calculated based on the current portfolio composition (bonus/malus classification and vehicle type). Thus, the method provides a comprehensive picture of the change in premiums, as it uses the data in the MTPL policy and claim database to cover not only the portfolio that changes insurer, but also the remaining policies and new entrants. In addition, it can also illustrate how the average premium has changed due to reasons other than claims and tax, taking into account the estimated average change in claims and taxes.

The MTPL index calculated for passenger cars takes into account individual and normal-use vehicles, with the benchmark being the first quarter 2016 data (Chart 23). Compared to these, it shows the change in average premiums nationally and in Budapest/outside Budapest breakdown. The adjusted index derived from the index shows the premiums adjusted for the claim charges calculated for the individual segments (i.e. the sum of claim payments and the change in the recognised reserves) and for the insurance tax, extended to MTPL in 2019 and integrated in the premiums. For other vehicles, due to the heterogeneous nature of the contracts (anything from mopeds through buses to agricultural vehicles are included in this category), the change in premiums is calculated only for certain priority categories.

The average portfolio premium was HUF 45,000 in the last quarter of 2020, which represents an annual increase of 9 percent. Until the fourth quarter of 2018, the adjusted index was around 100 percent, i.e. the change in premiums was in line with the developments of claims. After this a slow rise commenced, which accelerated in 2020: the average premium increase in excess of the claim and tax effects was 40 percent, which is connected with the changed driving habits during the pandemic and the fewer accidents resulting from this.

Chart 23
MTPL index of passenger car



Source: MNB

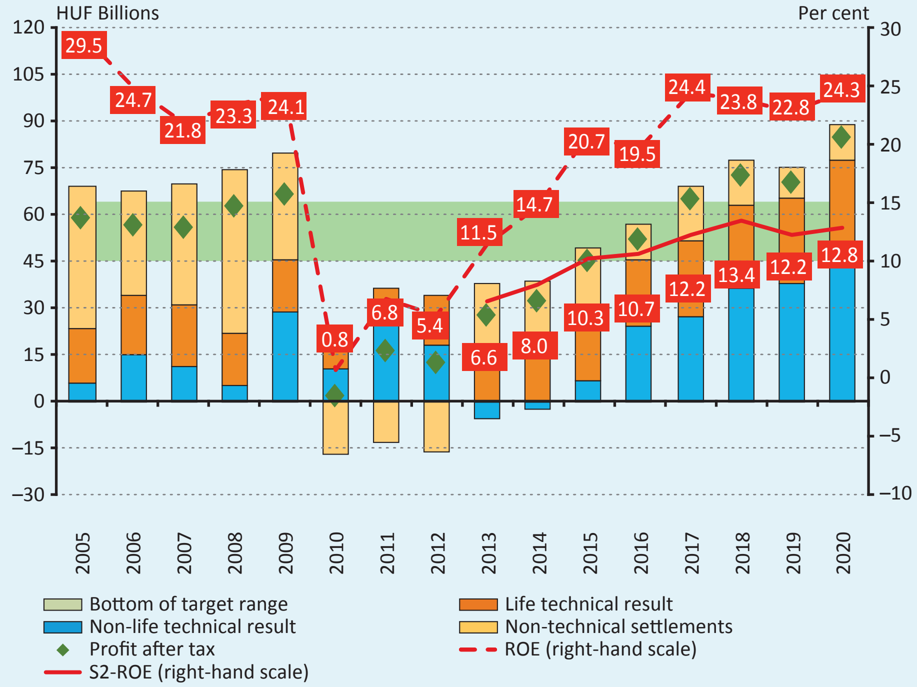
The MNB determines and publishes the MTPL index quarterly, in line with the frequency of the data supply to the MTPL policy and claim database, which is expected to contribute to increasing market transparency and to boost competition.

2.4 PROFITABILITY AND CAPITAL POSITION

2.4.1 One-off effects improved profitability in both segments

The insurance sector's return on equity (ROE) has been increasing dynamically from the year following the 2008-2009 global economic crisis until 2017. In the last three years, this dynamic seems to have lost momentum and profitability seems to have stabilised at pre-crisis levels of around 24 percent (24.3 percent in 2020). While the magnitude of the index is similar, the underlying processes follow opposite trends. The current low yield environment resulted in lean years in terms of non-technical results (investments) for insurers, unprecedented before 2009. On the other hand, the profitability of products has improved spectacularly (mainly MTPL), due to which the insurance technical result of the non-life segment is soaring. Moreover, profit on life products – contributing more and more to the total value year by year – should not be ignored either. In 2020, 65 percent of the technical result of HUF 77.4 billion (HUF 50.4 billion) was attributable to the non-life segment, which is higher by one third than a year earlier. However, there was a slight decrease in the life segment's technical result in 2020 (currently HUF 26.1 billion) compared to the base period. Taken together, the sector's after-tax profit reached a new high in 2020, at HUF 84.2 billion, exceeding the previous high registered in 2018 by HUF 11.9 billion (Chart 24). In 2020, the indicator fell short of the record high 7.1 percent registered in 2018 only by 0.1 percent. The underlying reason for this trend is that the insurance sector's premium income has grown faster than its profit after tax; in the case of the MTPL products the integration of the insurance tax in the premiums had substantial effect on the latter both in 2019 and in 2020. Similar trends can be observed in recent years also in respect of the return on available solvency capital (S2-ROE[14]), since the profit dynamics exceeds the rate of the solvency capital growth.

Chart 24
Profitability of the Hungarian insurance sector and its composition



Note: The sector level ROE values (with the exception of 2020) 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 indicator the profit after tax it is compared to the eligible own funds under Solvency II (2013–14 are estimated values).

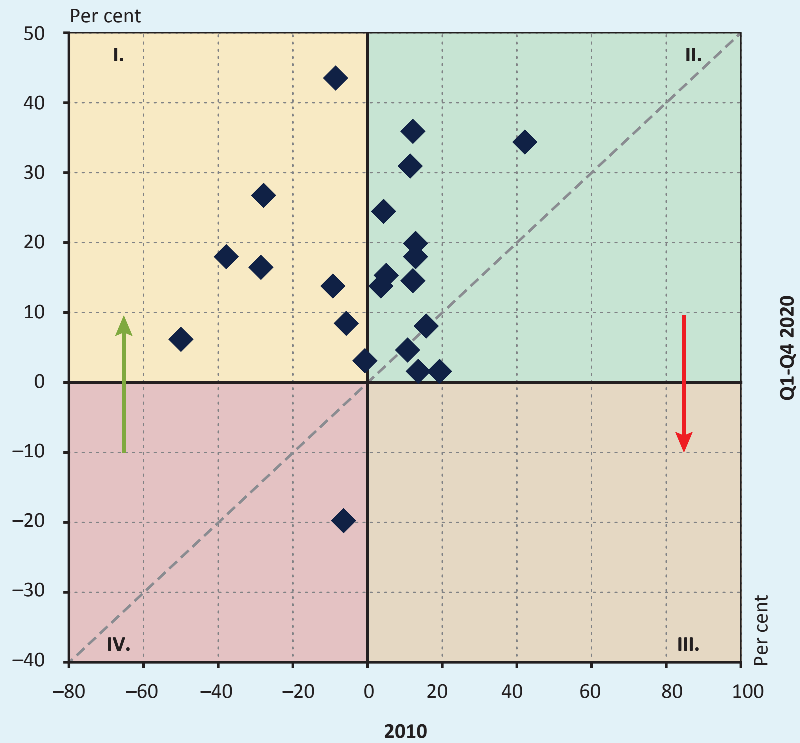
Source: MNB

[14] 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.

2.4.2 Almost without exception, insurers remained profitable under the one-off effects

At the level of institutions, the individual insurers' return on equity varies. In 2020, only one of the 22 insurers operated with a loss. In addition, 8 market participants managed to turn their negative return on equity registered at the end of 2010 into positive by Q4 2020 (Chart 25). No shift in the opposite direction was identified for any of the insurers. The curfew measures introduced in 2020 have hit hard the profitability of insurers offering travel insurance, while the declining traffic in the second quarter of the year may have had a positive impact on insurers whose profitability comes from motor insurance. 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 25
ROE value of Hungarian insurers



Source: MNB

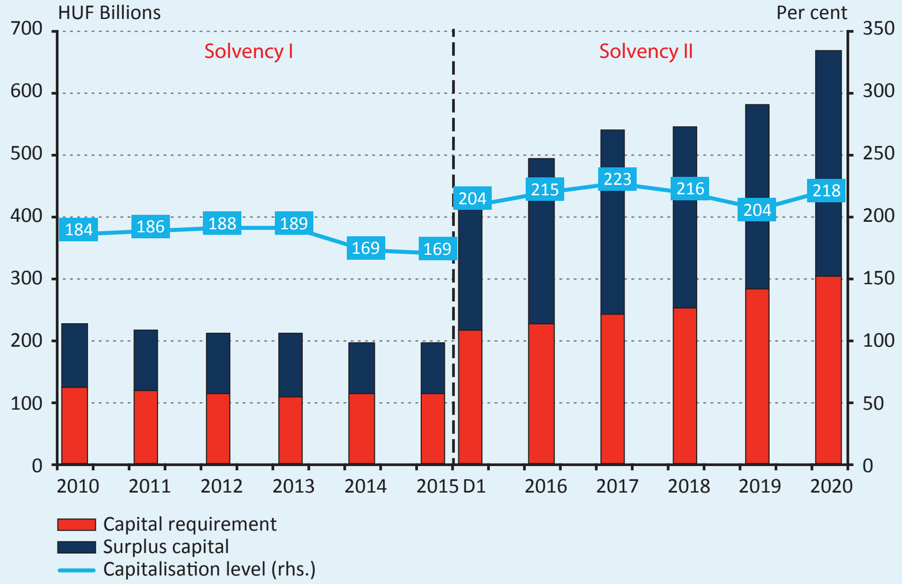
2.4.3 Restriction on dividend payments strengthened capital position

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 204 percent, registered on 1 January 2016, the difference is merely 14 percent at the end of 2020 (218 percent). In recent years both the solvency capital requirement and the solvency capital increased constantly, i.e., the sector's capital holding is in line with the increasing risks (Chart 26).

In response to the pandemic situation, the MNB issued several executive circulars. Of these, in a letter dated 2 October 2020, it indicated its expectation to insurers that dividends should only be paid if the institution's capital adequacy after payout reaches or exceeds the usual average of international and domestic capital adequacy, which has been in the range of 205-243 percent in recent years. As a result of the executive circular, dividend payments previously planned for 2020 have been largely postponed, and the expected dividend under Solvency II is much lower than in previous years (74 percent of last year's value), thereby further strengthening the insurance sector's capital position.

The capitalisation level of the Hungarian insurance sector complies with MNB Recommendation 6/2016 related to the holding of volatility capital buffer, and also 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.

Chart 26
Development of capitalisation rate at sector level

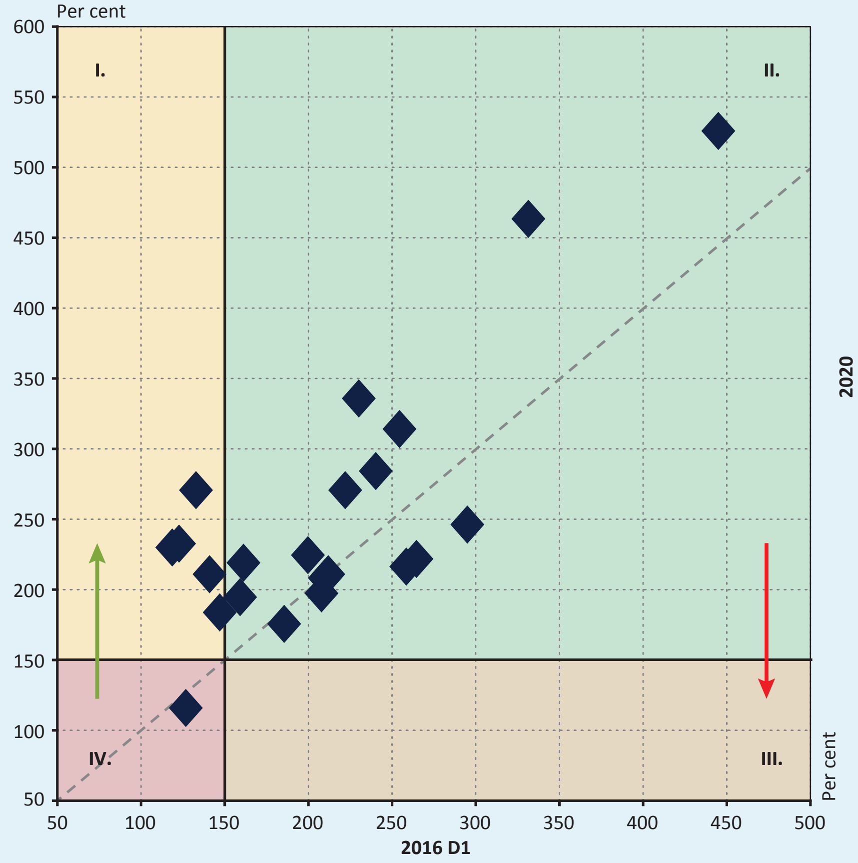


Source: MNB

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 27). At the end of 2020, all insurers outperformed the statutory level of 100 percent. Only one insurer failed to reach the 150 percent capitalisation level recommended by the MNB. In the case of this market participant, the MNB identified significant additional risks that are not covered by the standard formula and therefore prescribed additional capital requirement for it. Based on premium income the insurer's market share is less than 1 percent, and thus it has no significant impact on the sector as a whole. In the case of three-quarters of the institutions, the capitalisation rate was over 200 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. Chart 27 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 2020 already exceeded 150 percent. It is clear that the capital adequacy of the majority of institutions has improved in recent years, partly as a result of the MNB's measures.

Chart 27
Individual capitalisation rates of insurers (2016 D1 and 2020)



Source: MNB

Box 3
New protection elements added to the MNB's set of instruments

The MNB will continue to monitor closely the developments in the economic and financial system and their impact on the operation of domestic insurers. Fine-tuning the response to emerging new risks not seen in previous years, will continue to require continued focus by the central bank. The first experiences of customer service through electronic and telephone channels are positive, and insurers are seeking to exploit this effectively through ever newer digital developments, thereby shortening the time horizon of the learning curve. It should be noted though that without the openness of customers this would be a futile effort.

2020 was also a successful year in terms of the preservation of client assets, regarded as another priority area and previously identified as a key objective in the MNB's executive circular. This can be identified not only in the positive yields achieved by insurers and funds despite the volatility in the capital markets, but also in the financial awareness of customers, as evidenced by outflow statistics. Namely, they did not immediately withdrew their investments seeing the temporary negative returns in early 2020, but waited for yields to recover, taking a long-term investment approach. The communication strategy prescribed by the MNB probably also played a major role in this.

As regards the investments, it is worth highlighting the technical interest rate reduction for traditional life insurance products taken out newly, effective from 1 January 2021. Due to the fall in the yields on long-term government securities, the central bank decided to reduce the technical interest rate on forint denominated schemes from 2.3 percent to 1.8 percent, and that on euro denominated products from 1.1 to 0.8 percent. The aim of the amendment is to prevent insurers from promising excessive returns to their customers, thereby also jeopardising their own financial situation.

In its October 2020 circular, the MNB confirmed its expectations published in the spring, in line with the European Insurance and Occupational Pensions Authority (EIOPA)'s statement on dividends distribution and variable remuneration policies issued on 2 April 2020. The central bank continues to expect domestic insurers to remain cautious about dividend payments due to the long-term economic risks of the pandemic, and asked them to postpone their dividend, share buyback and large-amount variable remuneration payments planned for 2020 to 2021. These payments can only be made in 2021 if the respective insurer's capital adequacy after the payment reaches or exceeds the usual average international and domestic capital adequacy (range of 205-243 percent). The MNB believes that this will ensure the financial stability of the whole sector and increase its shock absorbing capacity.

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			2020 was characterised by falling GDP, low yield environment and high volatility. The dynamics of the business segments' response varied. Positive profitability at sector level remained stable. *Although the uncertainty has not ceased, the MNB does not anticipate further increase in risks.*
Corporate governance	Exercise of owner's rights Internal governance Risk management system and ORSA Internal control system			Adequate owner's control and internal governance system. The changeover to working from home is a challenge for the governance and control system. Significant control capacity due to the effects of the protracted pandemic situation. *For the time being, the functioning of the organisation and management is stable. When the pandemic is over, control risks are expected to decrease.*
Financial and operational risks	Insurance risk Market risk Credit risk Operational risk Other relevant risks			There was no significant outflow in the life segment. Claims development was favourable in the non-life segment. Government bond-heavy own portfolios were less exposed to capital market volatility. Accelerated digitalisation developments due to environmental impacts, still significant IT and portfolio management risk. *In the short term, environmental uncertainties continue to pose a significant insurance and operational risk in 2021.*
Capital and reserve risk	Capital Reserves			Higher than usual capital must be held due to larger volatility. The current level of capital, also supported by the dividend cap, may offset the risks. Generally adequate reserve policy. *No change is expected in the level of risks.*
Market entry risk	Products Customers			Deficiencies in IDD[15] requirements (suitability assessment/declaration, customer information) and PRIIPs[15], KIDs[17] and complaints handling. *Enhanced supervisory focus and consumer-friendly products may reduce the risk rating in the longer run.*

Legend:

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 2020 the Hungarian economy shrank by 5.0 percent on average. Based on the forecast included in the MNB's March Inflation Report, the MNB expects 4-6 percent growth in the coming years. The extent of growth may be significantly influenced by the effectiveness of the vaccination against the coronavirus pandemic and the timing of the opening of the economy.

[15] Directive 2016/97/EU of the European Parliament and of the Council on insurance distribution

[16] PRIIPs (packaged retail and insurance-based investment products): Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 2016 November 31 on key information documents for packaged retail and insurance-based investment products (PRIIPs), applicable from 31 December 2016

[17] KID: key information document - PRIIPs Regulation requires the use of a key information document (KID) for the packaged products indicated above

Inflation averaged 3.3 percent on an annual basis, with higher mid-year volatility than last year, while core inflation rose slightly, to 4.1 percent, also under higher volatility. The varying rise in the consumer price index was caused by different rates of price increases for different product groups.

Based on the thorough examination and assessment of the strategies adopted by institutions active in the insurance market shows that institutions placed strong emphasis on countering the negative economic impact of the measures taken to contain the coronavirus epidemic pandemic in 2020. Government measures affected the individual insurance segments, and the institutions, differently. However, the majority of insurers were able to operate profitably according to the plans they had developed, with no significant services disruption during the year. After the opening of the economy and achieving the required vaccination coverage, the insurance sector can return to the usual course of business observed in previous years.

The profitability of insurers remained strong even in the unfavourable economic environment. FIS, 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 unaudited data, the insurance sector's total after-tax profit in 2020 was HUF 84 billion, exceeding that of previous years as well as the target band set in FIS. The negative result of the only loss-making institution was due to problems stemming from corporate governance and control shortcomings in previous year.

The institutions' ownership control and internal governance systems are adequate, but the events in 2020 posed serious challenges for those. The MNB maintained intensive communication with the institutions and the experiences were positive: the management of the insurers identified and monitored continuously the effects of the external environment on their operations and responded to those adequately. However, the on-site inspections continued to reveal weaknesses in internal regulation and in the independence of certain control functions, but overall market participants have adapted well to the extraordinary situation. Within the framework of this both the management bodies and the operation of the control functions were revised and reorganised through working from home and in line with requirements of communication without personal contact. Based on the foregoing, the MNB expects that the level of risk may also decline as environmental risks diminish.

Of the financial and operational risks, insurance risks developed better than expected in 2020. The change in travel patterns due to the restrictions resulted in fewer traffic accidents, which led to lower claims in the MTPL segment than in previous years, and thus to an increased technical result. At sector level, this effect more than offset the negative impact of the decline in the sales of travel insurance. In life insurance, the portfolio premium on new acquisitions fell by 5.5 percent compared to 2019, but it is still 11 percent higher than in 2018, and the growth in premiums has not faltered either. During the year, there was a risk that the level of life insurance benefit payments would rise in parallel with the economic downturn, but this risk did not materialise. However, the potential increase in surrenders remains a risk, just like the considerable uncertainty surrounding the developments in life insurance sales.

In the persistently low yield environment, the global decline in equity prices and, as a result of this, the global fall in mutual fund share prices due to environmental effects, appeared as a significant risk. Although this effect proved to be temporary, policyholders of certain unit-linked life insurance contracts may have suffered a significant fall in prices during this period. This was subsequently offset to a significant extent by the adjustment of the equity market, but the combined potential impact of the low yield environment and the change in equity prices ("double hit") still results in a significant level of market risk. This risk mainly jeopardises the yield realisable by or payable to policyholders in the life insurance segment, but it also affects the return realisable on assets with shorter maturities than life insurance, being the coverage for non-life insurance liabilities. The investment policy of Hungarian insurers remains very conservative, which keeps the associated credit risk at a moderate level. The significant level of operational risks is supported by the risks arising from the operation of the identified record-keeping and IT systems, as well as by the supervisory findings and experiences related to IT security. The additional development and implementation risks arising from digital developments prompted partly by customer expectations and partly by environmental effects, also contribute to these risks. Liquidity risk, assessed among other material risks, is also moderate at the sector level. The liquidity of market participants is adequate. Given the environmental impacts, the MNB does not expect the level of insurance, market and operational risks to decline in the short to medium term.

Since the introduction of Solvency II in 2016, the sector level capital adequacy ratio has consistently exceeded twice the regulatory requirement. The MNB's measure also significantly contributed to the figure registered at the end of 2020 (225 percent). In addition to the 150 percent capitalisation guideline included in the 2016 recommendation related to maintenance of capital buffer, the MNB has asked insurers to postpone or limit dividend payments in 2020, in line with the recommendations of international supervisory bodies. Namely, the increased volatility in capital markets and the significant uncertainties justify keeping a higher surplus capital than usual. In terms of reserve risk, the MNB has not identified any significant shortcomings. Insurers' reserve holdings are generally adequate. Looking ahead, no change in the classification of capital and reserve risk as moderate is expected on the basis of current information.

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 trend change compared to the previous risk level; no significant improvement can be identified either.

The implementation of regulatory changes, which also entered into force in Hungary in 2018, and designed to enhance the protection of customers' interests (PRIIPS, IDD), in the internal processes and practices of institutions – even despite the major efforts to ensure compliance and the continuous consulting – have not reduced customer risk materially for the time being. In 2020 as well most of the findings in the investigations related to the incorrect application of the new provisions introduced in parallel with the implementation of the IDD and the rules on KID documents. Within this there is major room for improvement particularly in the area of sales with advisory services. We also continue to identify a number of weaknesses and inadequacies in complaints handling. In this area – also due to the MNB's increasingly stringent and consistently enforced requirements – the number of infringements has already decreased in terms of the number of responses sent within the deadline, and the focus has increasingly shifted to the quality of the complaint responses and the qualitative analysis of consumer-friendly solutions that have an impact on the merits of the customer's complaint.

Regulatory changes extending the needs assessment and information obligations to be applied by insurers at the time of contracting and thereafter – throughout the entire term of the contract – if they are integrated into business processes in the future, are factors that strengthen the position of customers (and, in the event of possible future disputes, make constructability and thus regulatory supervision even more efficient) and may therefore reduce customer risk in the period ahead. In addition to the foregoing, the MNB's expectations, communicated through executive circulars or recommendations, and the development and penetration of a certified consumer-friendly product range, could also lead to a more consumer-focused approach in the market.

3 Funds market and its risks

3.1 OVERALL PICTURE OF THE MARKET

By the end of 2020, the aggregated balance of voluntary pension funds individual accounts exceeded HUF 1,600 billion, and the assets per contract rose by 7 percent, reaching HUF 1,453,000. In 2020, the membership fee contributions credited to individual accounts (coverage reserve) of voluntary pension funds reached almost HUF 99 billion, which represents a slight increase compared to the 2019 figure of HUF 96.6 billion. In 2020, the voluntary pension funds realised an asset-weighted average net yield of 4.1 percent at sector level, showing a real yield of 1.4 percent when adjusted for inflation, and the return on the individual accounts (coverage reserve) was HUF 62.6 billion.

Contributions credited to health and mutual aid funds' coverage reserves increased by 5.5 percent in 2020. It may be regarded as a positive trend, reflecting the strengthening of self-provision, that individual contributions have increased by 7.3 percent, more than three times the amount paid a decade ago at sector level.

At the end of 2020, 51 funds operated in the voluntary fund sector, fewer by four compared to the 55 institutions registered at the end of the previous year. In 2020, 4 institutions decided to merge into another fund and 1 institution opted for winding-up through dissolution without legal successor. During the year, 1 fund received an activity licence.

Table 3
Key data of the voluntary funds sector

	Pension funds				Health and mutual aid funds			
	2019		2020		2019		2020	
Number of institutions	36		33 ↓		19		18 ↓	
Number of members (thousand persons)	1,111		1,106 ↓		1,022		1,025 ↑	
Number of members paying membership fee (thousand persons | %)	567	51.1%	564	51.0%	344	33.7%	328	32.0%
Total funds portfolio (HUF billions)	1,527		1,625 ↑		65		69 ↑	
Of this: Coverage reserve (HUF billions)	*1,507*		*1,606* ↑		*61*		*65* ↑	
Asset value per contract (HUF thousands)	1,357		1,453 ↑		59		63 ↑	
Membership fee payments (HUF billions)	101		104 ↑		46		49 ↑	
Of this: Annual membership fee payments allocable to coverage reserve (HUF billions)	*97*		*99* ↑		*43*		*46* ↑	
Claimed tax credit (HUF billions)	12		17 ↑		7		10 ↑	
Payments against the coverage reserve (HUF billions)	127		89 ↓		53		54 ↑	
Operating profit/loss (HUF billions)	0.62		-0.22 ↓		-0.55		-0.07 ↑	
Operating reserve (HUF billions)	16.6		16.4 ↓		4.4		4.2 ↓	

Note: In 2020, of the 18 health and mutual aid funds, 3 operated in the form of health fund, 3 in the form of mutual aid fund and 12 in the form of health and mutual aid fund.
Source: MNB

In the voluntary pension fund sector, the payments affecting the coverage reserve decreased significantly. Only HUF 89 billion was paid out in 2020, compared to HUF 127 billion in 2019. The major decrease in payments against the coverage reserves was attributable to the drop in benefit payment expenses. In 2020, members received HUF 51 billion as benefit payments, representing a decrease of 27 percent compared to the HUF 70 billion paid in 2019. The outlier 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. In the voluntary pension fund sector the number of members declined by more than 5,000 compared to previous year. The number of entrants was not able to offset the number of those excluded due to non-payment of the membership fee, who died or received benefit payment, and thus the number of the – anyway ageing – members declined further, which represents major risk in terms of the future sustainability of funds.

Following the decline of almost 22,000 in the number of members in health and mutual aid funds last year, the number of members rose by 2,700. The more than 50,000 entrant fund members exceeded the number of those who left the funds (16,500), died (1,800) and excluded for non-payment of membership fees (28,700). Almost 70percent of new entrants joined the funds through recruiters. Due to the high ratio of non-paying members, in the coming years further exclusions, and thereby the cleansing of the membership may be expected.

3.1.1 Membership fee incomes rose in both sectors in 2020

In 2020, in the voluntary pension fund sector the amount of both the individual contributions and the employer's membership fee contribution increased. The growth in employer contributions exceeded the growth in member contributions, which is a positive development after a significant decline in 2019 due to changes in the tax rules applicable to the fringe benefit system. By contrast, employer contributions to voluntary health and mutual aid funds declined on an annual basis, while individual membership fee contributions continued to increase. 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, which, based on the data supply, may be deemed successful. While in the voluntary pension fund sector membership fee payments allocable to the individual accounts (coverage reserve) already approximated HUF 108 billion in 2018, in 2020 individual and employer's contributions were credited to the institutions' individual accounts (coverage reserve) in the amount of HUF 98.8 billion, which represents a minor growth compared to the contributions in 2019.

Voluntary pension fund benefit payments fell to HUF 51 billion in 2020 from a record high of HUF 70 billion in 2019 (HUF 45 billion in 2018 and HUF 30 billion in 2017). The amount paid as lump sum benefit declined not only due to the decline in the number of members using the benefit, but also because these members – presumably after a longer accumulation period – claimed a lower pension benefit. The use of annuity benefits is still not popular among the members, and their ratio is negligible within the benefit expenditures.

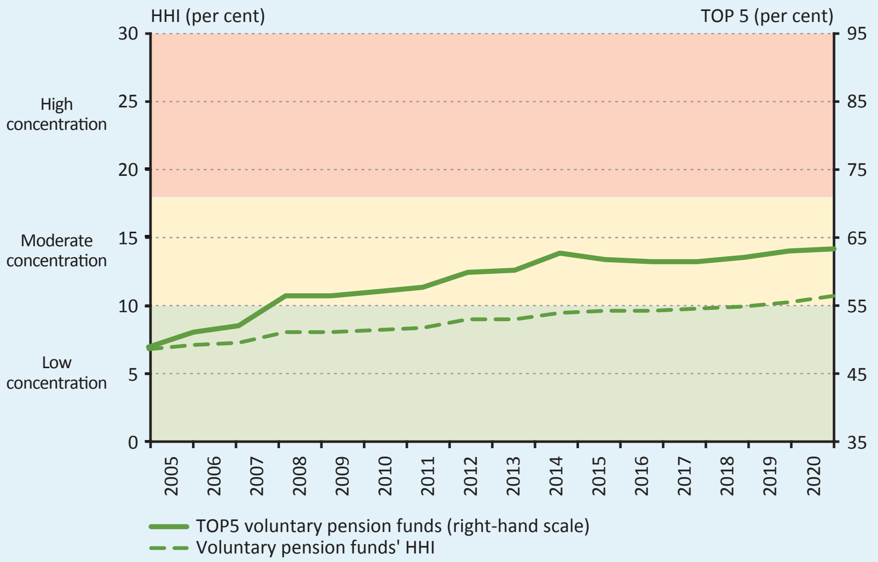
Following an increase of HUF 4.1 million, the assets of health and mutual aid funds amounted to HUF 69 billion the end of 2020, of which the assets allocable to the individual accounts (coverage reserve) amount to HUF 64.7 billion. The amount of benefit payments exceeded the sum of the members' and employers' contributions. The latter slightly increased in the health and mutual aid funds sector in 2020 compared to previous years.

3.2 VOLUNTARY PENSION FUNDS

3.2.1 Since 2014, voluntary pension fund concentration has slowed down

In the voluntary pension fund sector the number of funds declined by three in 2020 as a result of the merger of institutions. The decision to terminate independent operation was primarily attributable to economies of scale and efficiency issues.

Chart 28
Developments in voluntary pension 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 was used only in respect of 2020. The figures of previous years were updated with the annual audited data. Due to this, the chart may differ from that published last year.

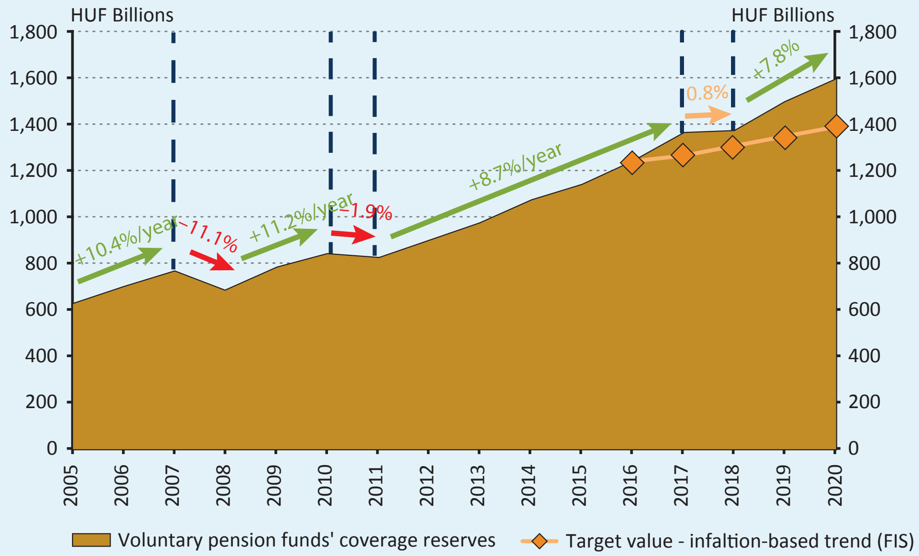
Source: MNB

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 2020 (Chart 28), which is attributable to the merger mentioned above. The market share of the TOP5 funds, based on membership fee income, also increased compared to 2019. When analysing the concentration of membership fee payments we found that 68 percent of the membership fee payments and 54 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 Favourable yields supported expansion

At the end of 2020, the balance of the voluntary pension funds' individual accounts (coverage reserve) was HUF 1,606 billion, exceeding the value registered at the end of last year by 6.6 percent (HUF 1,507 billion). In 2020 this level outperformed each of the growth paths presented in FIS, based on the annualised change. On the other hand the level of the coverage reserve has so far only exceeded the inflation targeting trend, due to the growth in previous years. At the end of 2020, 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 1,397 billion. The latter corresponds to 87 percent of the coverage reserve, exceeding previous year's ratio by 2 percent. 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 29
Developments in the voluntary pension funds' coverage reserves



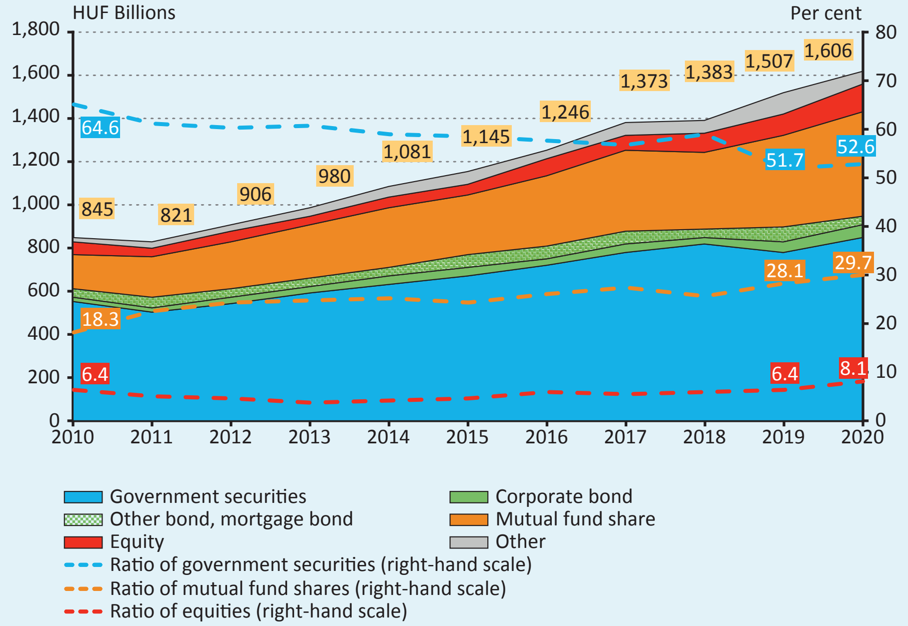
Source: MNB

3.2.3 Ratio of main instrument categories increased

Investments in Hungarian government securities still account for the largest part of the voluntary pension funds' individual accounts (Chart 30). Compared to the 51.7 percent registered at the end of 2019, direct government securities exposure rose by 0.9 percent in 2020, and thus at the end of the year it stood at 52.6 percent. Funds shifted towards less risky government securities investments, presumably in order to compensate for the capital market uncertainties emerged in several waves in 2020. In 2020, within the funds' portfolio the share of direct equity investments – owing to the further increase in the ratio of Hungarian equity investments – rose from 6.4 percent registered at the end of 2019 by 1.7 percentage point, and thus at the end of the year it stood at 8.1 percent. Of this 5.4 percent were Hungarian equities at the end of 2020, which represents a 1 percentage point growth from 4.4 percent registered at the end of 2019.

The indirect equity exposure of funds, through investment funds, is of similar magnitude as the direct equity exposure; at the end of 2020 it was 7.1 percent, dominant part of which (5.8 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 28.1 percent to 29.7 percent, of which the ratio of domestic and foreign mutual fund shares was 19.5 percent and 10.2 percent, respectively. The ratio of corporate bond investments rose from 2.8 percent to 3.7 percent. By the end of 2020 the share of real estate investment funds within the funds' portfolio rose from 1.8 registered at the end of 2019 to 1.9 percent, while the ratio of direct real estate investments fell, albeit to a small degree, from 0.7 to 0.6 percent. Total real estate exposure (direct and indirect together) amounted to 2.5 percent at the end of 2020. The share of mortgage bonds in the funds' portfolio is negligible; it was 1.6 percent in 2019, while in 2020 it decreased by 0.7 percentage point to 0.9 percent.

Chart 30
Distribution of the voluntary pension funds' investments by asset groups

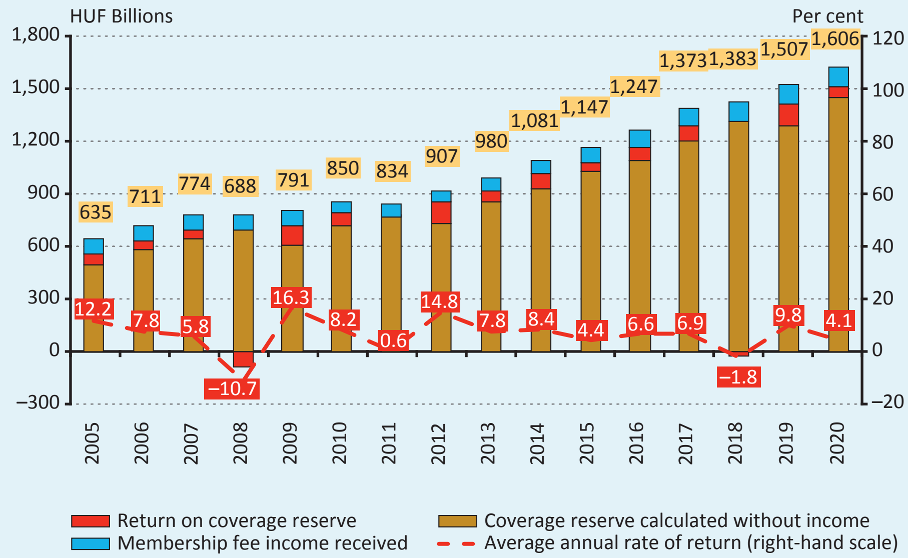


Source: MNB

3.2.4 Positive yields despite capital market volatility

In 2020, the voluntary pension funds realised an asset-weighted average net yield of 4.1 percent at sector level, showing a real yield of 1.4 percent when adjusted for inflation (Chart 31). However, there are major differences between the yields of funds. In 2020, net yields on the voluntary pension funds' portfolios varied between -0.9 and 26.1 percent. It can be generally stated about funds that portfolios with higher equity ratio and risk profile performed better and realised higher yield in 2020, while portfolios of lower risk exposure, mostly containing government securities investments, realised lower yield. In 2020, funds achieved lower yields at sector level compared to the previous year, but they fluctuated in the positive range despite the volatility in capital markets that characterised the year.

Chart 31
Developments in voluntary pension funds' coverage reserve, membership fee income, volume of yields and net annual average rate of return



Source: MNB

The purpose of pension savings is to supplement the state old-age pension materially. Following the negative yields realised in 2018 by voluntary funds, in 2019 and 2020 funds realised high yields the rate of which exceeded inflation, which also evidences that the trends in voluntary fund savings should be assessed on a longer horizon. Based on past experience, the weaker investment performance in some years has been not only corrected but exceeded by the positive performance in subsequent years, increasing the level of long-term savings in real terms.

Box 4
Confidence in the pension fund system paid off by the end of the year

Under the circumstances developed in 2020, the MNB regarded it as its key duty to monitor the processes that take place in the economic and financial system on an ongoing basis, assessing and identifying, as soon as possible, the risks appearing as a result of the spread of the pandemic, and to call upon the institutions supervised by it to take intensive risk identification and risk control measures expected in the extraordinary situation.

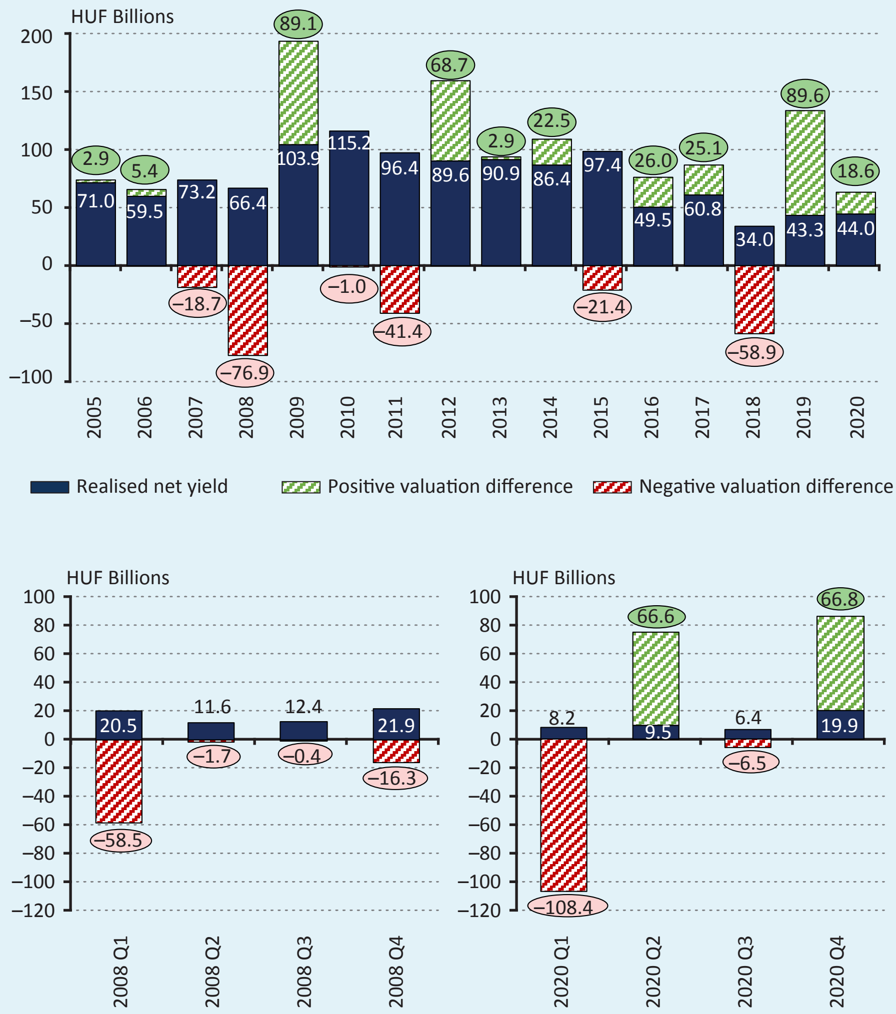
Within the framework of this, at the end of March 2020, the MNB issued an executive circular[18], in which it reminded fund managers to pay special attention to safeguarding the assets of their members and ensuring the continuity of their business in view of the turbulence and increased volatility in the capital markets. To this end, the MNB proposed to draw the attention of fund members to the fact that, based on decades of experience in the funds sector, withdrawing their pension savings from the fund is not necessarily the best solution in the event of low yields or investment losses, as through that they realise the loss. Pension fund saving is a long-term product, an investment that is worth keeping in the fund even in a negative yield environment, because the positive results expected after a bad period will offset what can be considered temporary investment losses.

By now it is known that the facts justified the MNB's proposal, as the available data show that of the -6.6 percentage point yield loss in the first quarter of 2020 comprised a negative valuation difference of -7.1 percentage points and a realised yield of 0.5 percentage points. This means that members did not start to withdraw their pension savings in a panic, and thus they did not realise the losses. Owing to this they had the opportunity to compensate for their losses when market prices rose in the second and fourth quarters and even achieve positive returns on an annual basis.

The graphs below show that in the last 15 years it was possible to realise positive yields every year and in those two years (2008, 2018) when the annual net yield was negative, it was due to a negative balance of the valuation difference. It should be noted that if we compare 2020 with 2008 (when the effects of the last economic crisis appeared), we see that although the rate and intensity of the devaluation at the beginning of 2020 was almost double that at the beginning of 2008, there was a significant recovery already in the second quarter of 2020 and the decline was fully worked off by the end of the year, while in 2008 the decline reversed only by the second half of 2009.

[18] https://www.mnb.hu/letoltes/vezetoi-korlevel-a-penztari-szektor-szamara-a-koronavirus-terjedese-altal-okozott-helyzetben-elvart-kockazatmerseklo-lepesekrol.pdf

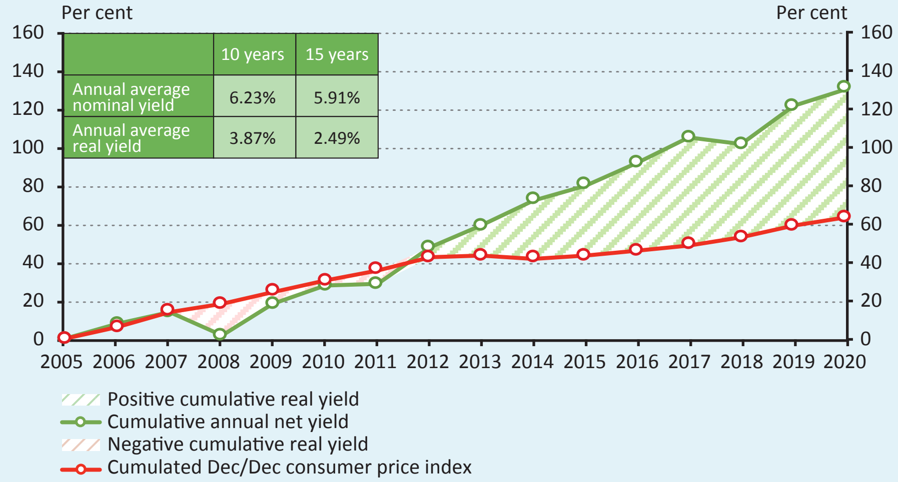
Chart 32
Breakdown of the investment result of the voluntary pension funds' coverage reserve



Source: MNB

Based on data supplied by the funds, the MNB has published the pension funds' 15-year average rates of return for six years now. Based on the yields of 2006-2020, the average asset-weighted net rate of return at sector level, calculated from the average 15-year yield rates, is 5.91%, which – considering the 15-year average December/December inflation rate of 3.34 percent – represents a real yield of 2.49 percent.

Chart 33
Long-term cumulated net yield of the voluntary pension fund sector



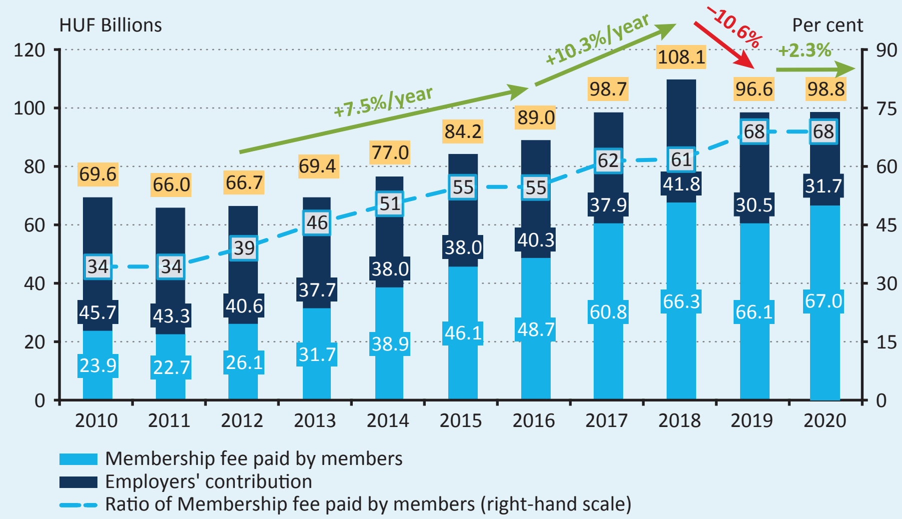
Source: MNB

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 Membership fees increased again in 2020

In 2020, the membership fee contributions credited to individual accounts (coverage reserve) of voluntary pension funds reached almost HUF 99 billion, which is a slight increase from the HUF 96.6 billion credited in 2019, but still below the record of HUF 108 billion in 2018. Receipts were still dominated by individual contributions; individual membership fee incomes account for 67.9 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 (Chart 34). Since 2009, the smallest increase in individual contributions (1.5 percent) was registered in 2020. Employers' contributions increased by 4 percent following the decrease in previous year. Increasing employers' contributions and individual contributions will continue to be a key issue in the future as well. On the whole, the membership fee income credited to coverage reserves decreased by 8.7 percent compared to 2018 peak.

Chart 34
Membership fee income credited to the voluntary pension funds' coverage reserves, broken down by payers



Source: MNB

Box 5
Membership fee incomes on the rise again

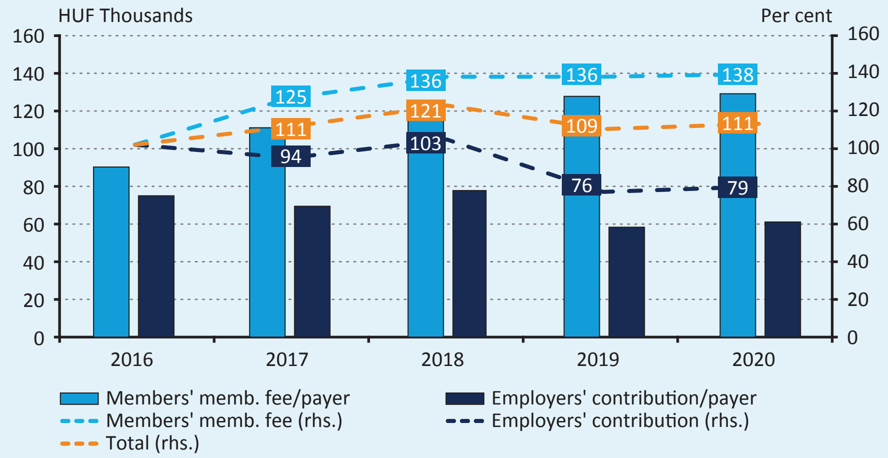
The coronavirus pandemic and the measures taken to contain the pandemic had and continue to have a significant impact on economies worldwide. The pandemic hit certain sectors abruptly and significantly (e.g. tourism, catering), while its impact may appear in other sectors with some delay.

Owing to the measures taken during the first wave of the pandemic, the MNB closely monitored the financial situation of the funds and analysed income and expenditure trends. As regards the pension funds, the risks included the direction in which the economic impact of the pandemic would affect the willingness and ability of members to pay contributions and, on the employers' side, the changes in the degree of employers' contribution. However, as regards the situation of voluntary pension funds, despite the extraordinary, income from membership fees increased. It should be noted that after a significant decrease in employers' contributions in 2019, affecting all but one fund, employers' contributions increased in 2020 at 21 of the 33 pension funds operating at the end of the year. In 2020, the impact of the pandemic was not perceivable in the number of members duly paying the membership fee. The number of members who qualify as members paying membership fee in accordance with the statute decreased by 668 during 2020, which is not a significant change compared to previous years.

Naturally, at the level of institutions, there may be significant differences between the extent of the impact of the pandemic has affected the funds. There were some workplace funds whose operations were significantly affected by the fact that the associated employer was active in a sector negatively affected by the pandemic.

Chart 35 shows the changes in the individual membership fee incomes and in the amount of employers' contributions in percentages, compared to the amounts in 2016, and the average annual amount of the individual membership fee and employers' contributions per payers of membership fee.

Chart 35
Changes in membership fee per paying member



Note: The right-hand scale shows the values as a percentage of 2016 (2016 = 100 percent).
Source: MNB

Chart 35 shows that membership fee incomes in 2020 have not yet reached the record of 2018, after the decline in 2019 they are on the rise again. On the other hand, individual contributions reached their high in 2020. The amount of the total contribution does not exceed the figure recorded in 2018 because the increase in 2020 has not yet been able to compensate the loss of employers' contributions.

The composition of membership fee incomes has changed significantly in recent years. Due to the fringe benefit rules effective from 1 January 2019, individual contributions have become increasingly important, in parallel with the major fall in employers' contributions. In 2010, employers' contributions accounted for two-thirds of membership income and individual contributions for one-third, but this breakdown reversed by 2020. Individual contributions have grown steadily over the past 5 years, both overall and per membership fee paying member. This growth continued in 2020 as well, which implies that voluntary pension fund members were less affected by the economic impact of the extraordinary year.

Employers deemed it important to pay employers' contributions in 2020 as well, but the growth in the amount of contributions was negligible. The remaining and hopefully growing role of employers can be an effective way to foster self-provision for pension in the younger generations.

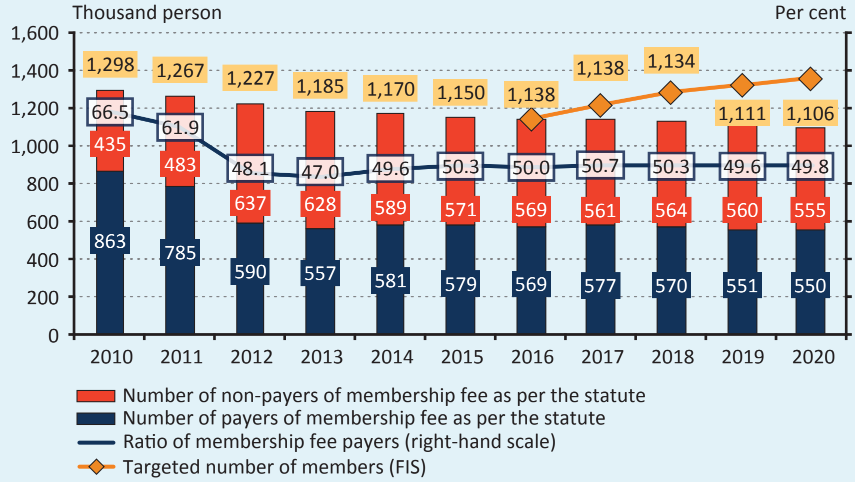
3.2.6 Stagnating number of members, moving away from target

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 2020 roughly half of the members (49.8 percent) paid membership fees. The proportion of members classified as non-payers based on the statute increased to a small degree compared to the previous year (49.6 percent) (Chart 36). The number of members has been steadily declining, moving further away from the ideal path presented in FIS with a self-provision outlook. Approaching non-payer members and fostering their activity remain a priority.

The number of members in the voluntary pension fund sector decreased to a lesser degree in 2020 than in previous year, by 5,200. The decline is mainly due to the fact that the decrease in the number of leaving members and of those who cancelled their membership due to using the pension benefit fell short of the number of new entrants. In 2019, there were nearly 32,000 new pension fund members, while in 2020, despite the extraordinary year, nearly 30,000 people joined the funds as members. In 2020, of the new entrants 19,000 members joined through recruiters. The number of new entrants alone is a positive development; nevertheless, the voluntary pension fund sector was unable to halt the increase in the average age of members and the decline in the number of members. The average age of the members was 47.5 years in 2019 and 47.1 years in 2018. An analysis of data from previous years shows that the average age of the sector's member increased by 4.1 years by 2019 compared to 2010. Based on this it can be stated that the members of voluntary pension funds are ageing and there is no sufficient replacement from younger generations. Reaching the generation below the age of 30 is extremely important for institutions in order to halt the rising trend that characterise the age pyramid of member and maintain it at a steady level.

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.

Chart 36
Ratio of payers of the voluntary pension fund



Source: MNB

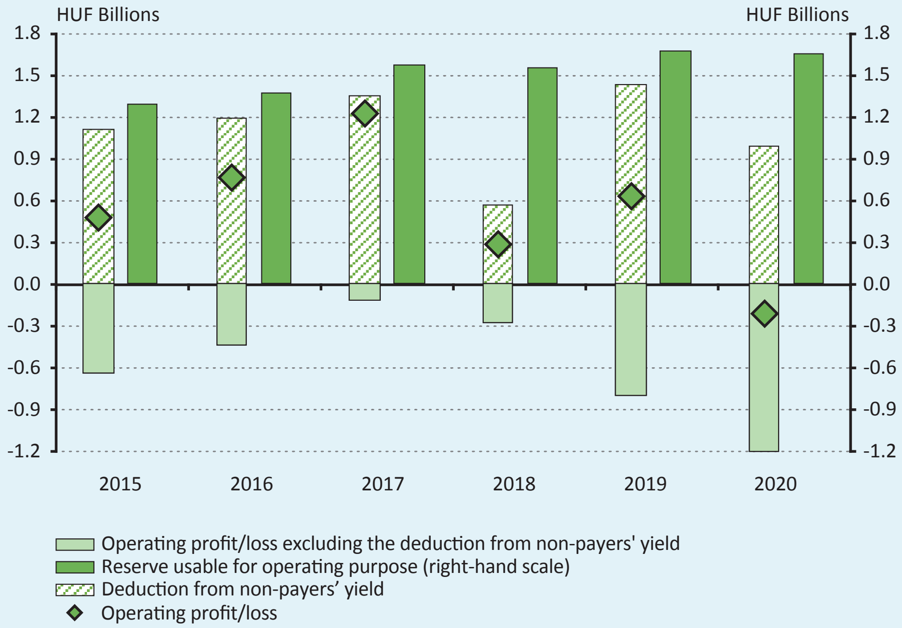
The ratio of the non-payment of membership fees has fluctuated around 50 percent in the past 7 years, which may still be deemed high and represents a risk in terms of fund long-term operation. According to the business model of the voluntary funds, the operating expenses must be covered by the amount deducted from the members' payments or from donations for operations. 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 paying members.

3.2.7 Reserves stabilise deteriorating operating profit/loss

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. However, in 2020, 23 out of 36 voluntary pension funds realised an operating loss due to an increase in certain cost factors (e.g. a steady rise in fees related to IT services) and the enforceability of lower yield deductions as well as to the dynamics of costs exceeding membership fee payments. However, the reserves available for operating purposes provide sufficient coverage for the sector. The funds that realise negative operating result in the longer run should reconsider their operating characteristics (more actively approaching non-payers, restructuring of the operating cost model).

At the end of 2020, the operating reserves of the voluntary pension fund sector registered a year-on-year decrease of 1.3 percent at sector level.

Chart 37
Changes in operating profit/loss of voluntary pension funds



Source: MNB

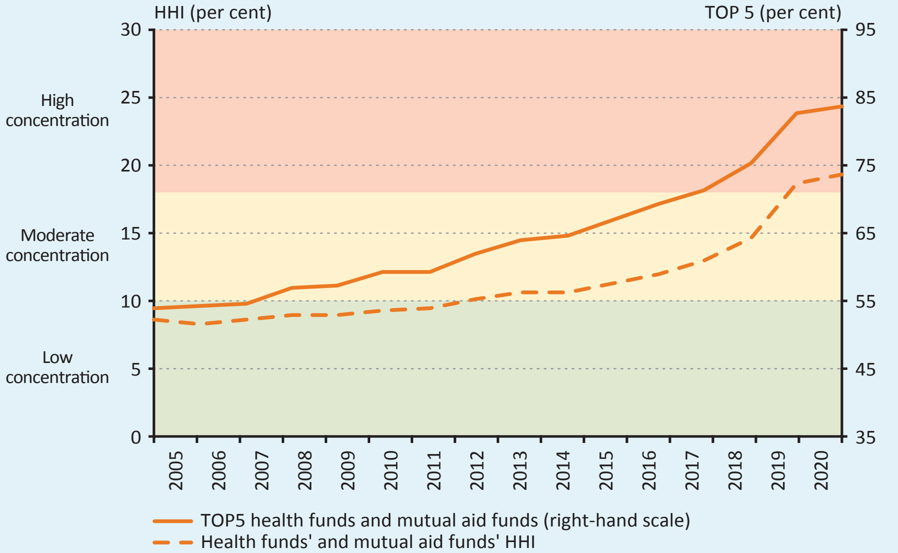
3.3 HEALTH AND MUTUAL AID FUNDS

3.3.1 Concentration decelerated after mergers of mutual aid and health fund activities

The concentration ratio increased further both in the health and mutual aid fund sectors, albeit at a more moderate rate compared to previous years (Chart 38). The increase is due to the dissolution of one institution and to the merger resulting from the economic changes that characterised 2020. When analysing the concentration of membership fee payments we found that 82 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 payments.

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 38
Developments in the health and mutual aid funds' concentration

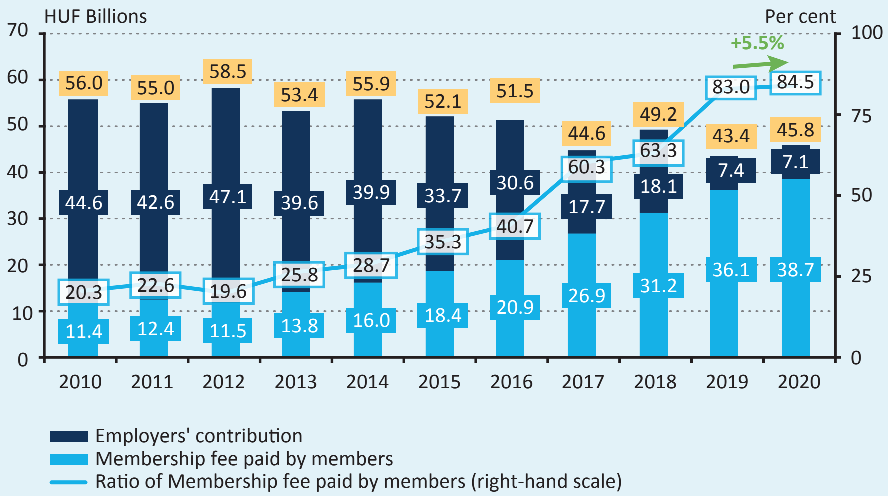


Note: The colour of the background illustrates the strength of concentration under HHI. Contrary to the practice of previous years, this year quarterly data was used only in respect of 2020. The figures of previous years were updated with the annual audited data. Due to this, the chart may differ from that published last year.
Source: MNB

3.3.2 A shift in contribution can be observed

Contributions credited to health and mutual aid funds' coverage reserves increased by 5.5 percent in 2020 (Chart 39). It may be regarded as a positive trend, reflecting the strengthening of self-provision, that individual contributions have increased by 7.3 percent, more than three times the amount paid a decade ago at sector level. Employers' contributions decreased by 3.3 percent compared to the previous year. Compared to 2010 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 payments are still distributed unevenly (seasonality) during the year between the individual quarters, since a significant part of the membership fee payments are concentrated in the last quarter due to the fund campaigns. 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.

Chart 39
Membership fee income credited to the health and mutual aid funds' coverage reserves, broken down by payers



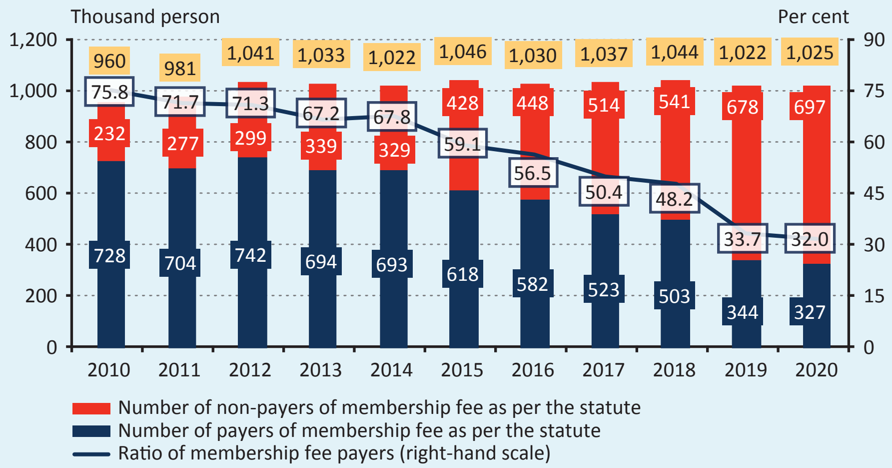
Source: MNB

3.3.3 No significant change in the number of membership fee payers

The number health and mutual aid fund members increased by 2,700 in 2020, despite the exclusions for non-payment of the membership fee (28,700 persons) and the number of members leaving the funds (16,500 persons). Reaching more than 50,000 new entrants was therefore enough to achieve a growth in the number of members. Roughly 34,000 of the entrants joined the funds through recruiters. The ratio of membership fee payers decreased by 1.7 percent by the end of 2020 (Chart 40). Nevertheless the amount of membership fee payments increased at the sector level, which may have been attributable to the surplus contributions received from the membership fee payers.

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. Accordingly, if their statutes permit it, they 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, 78 percent of the membership qualified as payers according to the statute, while in 2020 only 32 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 these members 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 40
Developments in the number of members paying health and mutual aid fund membership fee



Source: MNB

3.3.4 Benefit payments related to children and housing continued to grow

Benefit payments rose by almost HUF 1 billion (HUF 52 billion) compared to last year (HUF 52 billion), which substantially exceeded the membership fee income allocable to the coverage reserve (HUF 45.8 billion).

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 1994. 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 42 percent after a decrease in the ratio by 1.5 percent, followed by healthcare services at 29 percent (e.g. dentist, diagnostic medical imaging) and financial support for the purchase of therapeutic equipment at 15.5 percent after a decline in the ratio by 0.9 percent.

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 2020 as well (Chart 41). In 2019, the share of the financing of healthcare services rose to 29 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 58 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 5.3 to 7.2 percent, while the share of amounts paid as assistance for the repayment of home mortgage loans increased from 1.4 percent to 1.6 percent in 2020.

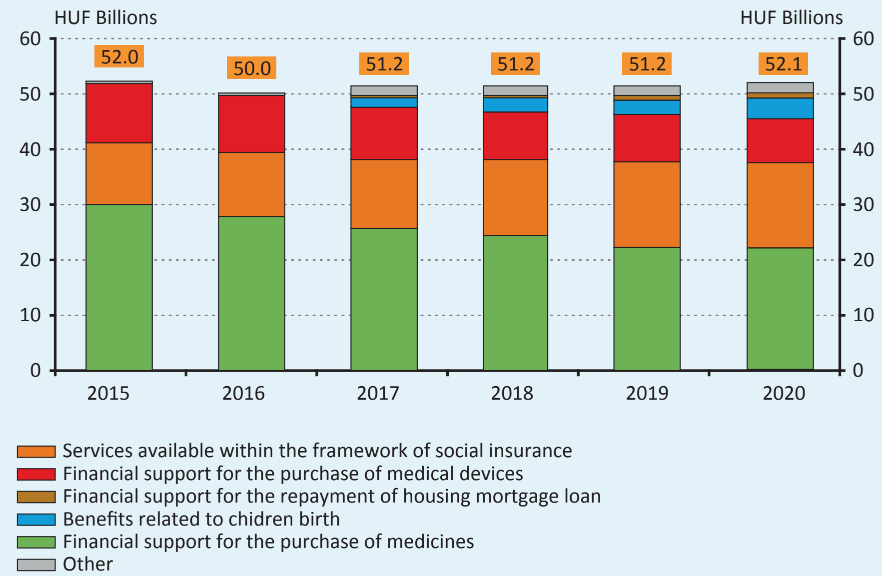
During the pandemic state of emergency, the supervised institutions had to adapt in a short time and rapidly to market needs and expectations. The health fund sector was also significantly affected by the change, as members tried to avoid post offices and personal administration when claiming the benefits, which increased the demand for digitalisation and electronic administration.

In 2020, at the MNB's recommendation – and the support of the Association of Voluntary Funds – significant progress was achieved in the digitisation of health funds, due to the fact that after a legislative amendment it became possible for health and mutual aid fund members to claim the support for medicines and therapeutic equipment also by submitting a simple electronic copy of the original purchase document in the absence of a health fund card.

According to the position issued by the MNB in 2020, IT equipment can be considered as teaching aids, in particular with regard to the digital education ordered in the context of the state of emergency; and that, as a consequence, such IT equipment may be taken into account as teaching aids for the purposes of the settlement of the start of the school year (school enrolment) aid. According to the opinion formulated after consulting the Ministry of Human Capacities, such equipment qualifies as teaching aids only in periods when public education is implemented in digital form. Even during this period, only if those are used for illustration serving the implementation of the teaching programme and, in the context of digital education outside the classroom, for communication between the school and the pupils, for supporting the learning process, and for transferring and verifying the curriculum digitally.

These benefit payments are expected to grow further in 2021. 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 41
Developments in the health and mutual aid funds' benefit payments



Source: MNB

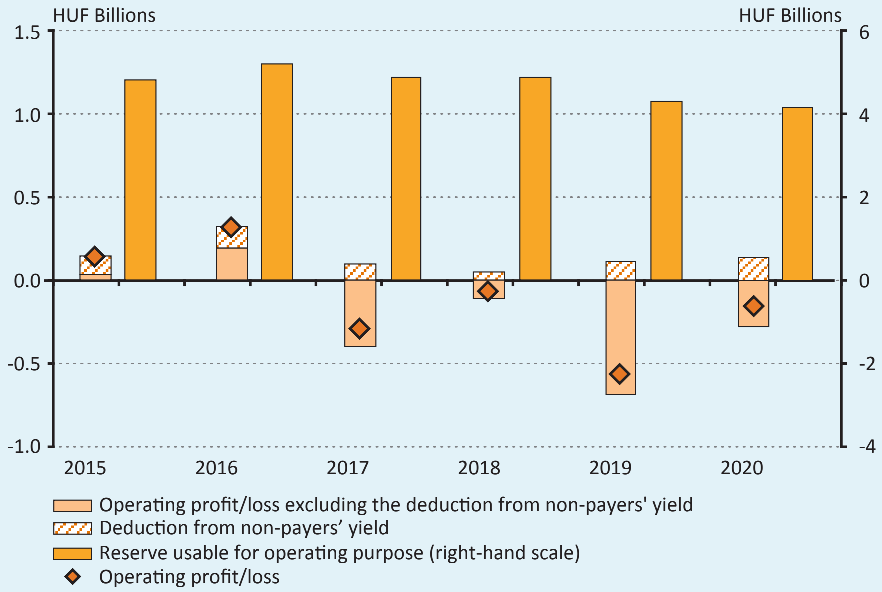
3.3.5 Improving but still negative result at the health and mutual aid funds

The operating result of health and mutual aid funds at sector level has been a loss since 2017, also taking into consideration the amounts deducted from the return on non-paying members for operating purposes. Although in 2020 the operating position of the health and mutual aid fund market improved compared to the operating loss in realised in 2019, the improvement was still not enough for the sector to close the year in the positive range. In 2019, at 11 out of the 18 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 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 2020, the operating reserves of the health and mutual aid fund sector registered a year-on-year decrease of 2.6 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 (Chart 42).

Chart 42
Changes in operating profit/loss of health and mutual aid funds



Source: MNB

3.4 RISKS OF THE FUNDS MARKET

Risk category	Risk groups	Risk rating	Risk prospects	Evaluation in words
Business model	Environment Strategy, business plans Sustainability of operation	significant	stagnant	Positive yield at sector level under capital market volatility. Operating loss at voluntary funds. Repeatedly increasing contributions, which have not yet reached the 2018 levels. *Unchanged outlook due to existing uncertain environmental impacts.*
Corporate governance	Exercise of owner's rights Internal governance Risk management system Internal control system	moderate	stagnant	Limited functioning of decision-making bodies during the state of emergency. The documentation of the activities of audit committees is incomplete in some cases. Non-comprehensive control of outsourced activities. The risk can be mitigated by measures in the medium term, but no decrease is expected in the short term.
Financial and operational risks	Insurance risk Investment risk of operational and liquidity reserve Operational risk	significant	stagnant	Increasing contributions despite the extraordinary year. The use of services declined significantly at pension funds. Risks arising from shortcomings in IT systems and from data supply problems. Risks related to the coverage of operations. *Due to the increasing IT development requirements, the risk is not expected to decrease.*
Sustainability and reserve risk	Coverage reserve (individual account) investment risk Capital Operating and liquidity reserve	significant	stagnant	Investment results of quarterly varying sign. Portfolio management aligned with the extraordinary situation, including closer monitoring of investment portfolios also by asset managers and custodians. Possibility to implement yield deductions in view of the positive investment result. *Persisting risk of volatility.*
Market entry risk	Products Customers	low	increasing	The number of complaints is low. Restrictions related to personal customer service. Favourable ACR_{PF} values. Acceptance of e-invoices. *Meeting the challenges of digitalisation may put small funds in a difficult position, and thus their risks may increase.*

Legend:

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

In the voluntary fund sector, despite the extraordinary year, contributions increased compared to the previous year, but have not yet reached the level of 2018. With higher than usual volatility in the capital markets, voluntary pension funds achieved positive returns also in real terms at sector level. In 2020, the voluntary fund sector was loss-making, and even the yield deduction enforced vis-à-vis the non-paying members was unable to push tip it into the positive range.

The age of the voluntary pension funds' members shows a steadily rising trend. There are still potentials in the recruitment of members; reaching of the young generation is extremely important to ensure that the rising trend of the members' age pyramid can be halted and maintained at the same level.

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

In 2020, voluntary pension funds were characterised by portfolio management aligned with the increased volatility. The investment portfolios were more closely monitored also by the asset managers and custodians.

The use of services declined significantly at pension funds. Despite the exceptional situation, there was no outflow from the voluntary pension fund sector, due to the awareness of members and effective communication by the funds.

The supervisory inspections revealed major weaknesses in connection with the IT systems. At some of the funds access right management is inadequate, part of the IT systems is obsolete with no manufacturer's support or the necessary security updates have not be installed. Problems with the quality of data supply and the coverage of operations persist at some of/the funds. At these institutions special measures have been or are implemented (e.g.: background institution support; prescribing liquidity reporting requirements; supervisory letter, targeted audit, appointment of a supervisory commissioner).

The MNB introduced the annual cost ratio for pension fund products ($ACRP_{PF}$) through a recommendation. The ACR_{PF} is comparable with the same indicator of the life and pension insurances, which strengthens transparency and competition within and between sectors. The average 30-year cost ratio of voluntary pension funds – calculated for the first time in 2020 – was 0.84 percent, while their adjusted fee burden ratio was 0.78 percent. The fund $ACRP_{PF}$ values show that the annual cost ratios of the voluntary pension fund sector are extremely favourable in the area of supplementary pension savings.

Among the product and benefit types provided by health and mutual aid funds, the purchase of medicines and therapeutic equipment, and services available within the framework of social insurance continue to account for the largest share, and there was an increase in the ratio of amounts spent on benefits related to children.

In the extraordinary situation, the operation of personal customer services of the funds was usually limited. Nevertheless, the number of complaints remained low and the institutions were able to deal with customer enquiries effectively.

4 Consumer protection risks in the insurance and funds market

In accordance with the core values of stability and trust, the MNB designated consumer protection in its strategic objectives allocated to its new 6-year cycle starting in 2020 as an even more stressed, key priority than before. Prudential and consumer protection supervision are implemented as equal and mutually reinforcing functions in terms of their organisation, audit methodology and effectiveness, and thus the two areas are also integrated in terms of organisation. In addition to the ongoing supervisory activities and the inspections carried out in 2020, the integrated structure has also performed well in its cooperation with EU and domestic professional organisations over the past year, reflecting the conviction that the prosperity of market institutions can only be sustained in the long term through prudent operation and a combination of a consumer-centric and customer-friendly approach, while new challenges require the development of new solutions and the introduction of more proactive, flexible and effective processes.

4.1 EFFICIENT AND CUSTOMER-FRIENDLY CLAIMS SETTLEMENT IS A MINIMUM REQUIREMENT

In 2020, the changes lifestyle changes and market influences also affected consumer expectations and behaviour, and accordingly, different trends in certain insurance product types were identified. While the broadening of risk insurances and supplementary health insurance product types, the general increase in requirement and willingness to save, the lower-than-expected number of surrenders, or even the lower claims payments under MTPL and casco insurance (based on a decreasing number of accidents) may be regarded as positive developments, the travel insurance market shrank significantly due to travel restrictions, as described in Box 1. The direct and indirect consumer protection effects of all this were constantly monitored and assessed by the MNB.

The recurring surveys carried out during the year identified as a consumer protection risk the delays in claims settlement procedures and claim payments. The reasons for this bad trend included the failure to provide information during the claims settlement process and prior to that, i.e. when concluding the contract. The majority of the respondent insurers reported as a general experience that in the case of trip cancellation insurance and flight cancellation covers, possible delays in claim payments were usually attributable to the delays in responses to calls for supplementation. In response to the identified risk, the MNB formulated its supervisory expectations and communicated them to the relevant market participants in the form of an executive circular[19]. Providing customers with proper information is of utmost importance in cases when damages occur. Accordingly, the focus of the formulated expectations was on providing consumers with more effective and practical information, at the same time taking advantage of the benefits of the on-line space. In the case of trip cancellation insurances and flight cancellation cover, the MNB expects insurers to provided assistance to consumers in the claims settlement process by e-mail messages with specific content and targeted practical information on the claim settlement process.

As a result of complying with the supervisory expectations, the need for supplementation and the lead time for the assessment of claims may be significantly shortened, which may also lead to a significant fall in the number of complaints due to the lengthy claim assessment procedures. In order to implement the foregoing in the market in the most efficient way, there are continuous consultations with the Association of Hungarian Insurance Companies.

[19] Executive circular on the expected information to be provided in connection with the travel insurance claims settlement process

4.2 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[20] 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, despite the positive changes, there are still areas that need attention and intervention, and the MNB will continue to play an active role in these areas: 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.

4.2.1 MNB certifications for quality

In order to implement the approach presented in the foregoing, at the end of 2019 the MNB developed and finalised the application scheme for the Certified Consumer Friendly Home Insurance, which is part of its Certified product family. As the first step of elaborating the framework, the MNB summarised its audit findings, market analyses and performed consumer surveys. 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 Certified Consumer-friendly Housing Loan certification scheme – created the Certified Consumer-friendly Home Insurance (CCHI) concept. The MNB specified the certification criteria also considering family-friendly, green and digital aspects. The consumer-friendly home insurances provide customers with higher quality service compared to the products available on the market so far, without unnecessary covers and surplus expenses, in easily comparable manner, guaranteeing customer-friendly service. The CCHI certification prescribed minimum requirements for the insurers, departure from which is permitted only to the benefit of the customer, and 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.

2020 was a significant year in terms of CCHI: although the challenges faced during the year prompted institutions to reschedule their product development plans and the related IT and other systems developments, internal training processes and marketing activities, in the second half of the year they submitted an increasingly large number of applications. By spring 2021, 7 institutions have already obtained CCHI certification, and thus already a determinant part of the housing insurance market offers consumer-friendly products. These products represent a new grade in the home insurance market in terms of risks covered, speed of benefit payments, customer-friendly processes and premium/benefit ratio. The CCHI applications also provided an opportunity for insurers to integrate good practices into their other products: it was found in comprehensive inspection conducted in 2020 that the respective institution enforced certified consumer-friendly standards (proactively improving the conditions) in other products as well.

The free calculator on the MNB's website also helps consumers to review the offers and navigate between products. The comparative calculator facilitates the viewing of a table of personalised offers based on the pricing formulas provided by insurers. The platform, which was created in order to strengthen competition in the market, provides an objective view of each offer. The selected insurance, deemed the most favourable, can be taken out by contacting the insurer online or through other channels.

[20] MNB Decree No 55/2015 (XII. 22.) on the definition, calculation and publication of the total cost indicator

4.3 STRENGTHENING CROSS-BORDER CHALLENGES

The MNB has a limited range of instruments at its disposal to supervise institutions rendering cross-border services. On the other hand, in terms of consumer protection, they are subject to the same rules and thus, the MNB has indirect means – such as cooperation with other national supervisory authorities or European authorities – to act in the interest of protecting consumer rights. Accordingly, the supervision and inspection of institutions rendering cross-border services was a key duty in 2020 as well, with special regard to contractual terms and conditions departing from the standard practice or sensitive target groups in need of special protection. In the case of NOVIS Insurance, a company with registered office in Slovakia, the MNB, in order to protect the interests of Hungarian customers, exercising its powers related to public good and consumer protection in the host countries, banned the distribution of company's all domestic life insurance policies in several steps in recent years because the terms and conditions of the schemes concerning the capital and yield guarantee and the actual payments to customers were non-transparent. Owing to the MNB's previous measures, NOVIS' Hungarian contract portfolio has not increased for two years, but the Insurer's domestic exposure remains significant, with some HUF 20 billion in premiums collected from its customers. In the past year, the National Bank of Slovakia (NBS), supervising the Insurer, has taken several actions against the Insurer. Most recently in a decision issued on 19 April 2021, it obliged NOVIS to invest the full premium of unit-linked contracts prudently, in accordance with the contractual terms and conditions. Prior to this, the NBS took a temporary measure on 5 November 2020, in which it significantly restricted the Insurer's free disposal over its assets, and from 11 September 2020, it also applied a conditional interim measure, in which, among other things, it prohibited the sale of all products until such time as the Insurer's reserves for its unit-linked policies reached the required level. The prohibition of the sale of new contracts, included in the latter measure, was repealed by the NBS' appeal body from 12 February 2021. In addition to the foregoing, the April 2021 decision also imposes additional obligations on the Insurer, which will only be disclosed once they have been fulfilled.

The MNB continuously monitored the negotiations on the United Kingdom's exit from the European Union and took proactive measures in the market under its supervision to ensure that it has the most accurate picture possible of the size of the contract portfolio concerned and the potential impact on Hungarian consumers. During the year, the MNB approached insurers established in the United Kingdom active in the Hungarian market in the form of rendering cross-border services, when it also stipulated its expectations for a controlled run-off of the relevant portfolios, including:

- ban on new contracts and on extending the duration and scope of existing contracts, but with maximum enforcement of consumer rights under existing contracts;
- termination of the contract immediately when the terms and conditions permit it;
- native language customer service and complaint handling functions maintained throughout the duration of the contract;
- regular data supply to the MNB from the beginning of 2021.

The MNB has repeatedly published press releases on these issues, encouraging the relevant consumer groups to keep themselves informed. Owing to the steps taken by the MNB, the impact of Brexit on Hungarian consumers is limited.

4.4 STABLE COST LEVELS AT INSURERS, INCREASING TRANSPARENCY AT FUNDS

The annual cost ratio (ACR), which expresses the cost of savings products as a percentage, has been present in the insurance market for 10 years, since 2010, the purpose of which is to compare the cost level of individual products and to increase transparency. In order to achieve this objective, the calculation of ACR, which originally appeared in the market through self-regulation, has been regulated by the MNB in a decree as part of the Ethical Concept since 1 January 2016[21]. The provisions cover all savings life insurance products, including mixed and unit-linked life insurance and

[21] MNB Decree No 55/2015 (XII. 22.) on the definition, calculation and publication of the total cost indicator

pension insurance. For the latter two product groups, the MNB formulated requirements with regard to the maximum ACR depending on the maturity[22],[23]. Compliance with these ACR limits has a key role in the cost regulation of savings type life insurance products, since as result of those the products offered in the market with extremely high ACR before the ethical regulation disappeared from the market. In addition to the ceasing of these extremely expensive products, the standard deviation and the average of the ACRs also decreased. At the end of 2015, the ACRs still fluctuated in the band of 0.5 and 13 percent, while by 2020 the bounds of the ranges changed to 0.9 percent and 5.4 percent, with the average falling from 4.3 percent to 3.4 percent. The process mostly took place in 2017 and since then the cost level has been stable. The application of the ACR increased transparency, which, together with the MNB recommendations, has led to a significant fall in the cost of life insurance products.

The cost level of saving life insurances is in the focus of attention not only in Hungary but also in Europe. The report entitled "Cost and Past Performance", published by EIOPA for the third time in 2021, compares the yields realised by life insurances with the costs charged to customers. The report examines, among other things, the trends in effective yields available to customers in the current low yield environment. The results show that, taking into account both costs and inflation, achieving positive real yields and thereby providing adequate customer value may pose significant challenge. The limited yield potential resulting from the low yield environment may prompt institutions and customers to take higher risk.

Voluntary pension funds submitted the ACR values calculated in accordance with Recommendation 20/2019 (IX.20.) of the Magyar Nemzeti Bank for the first time at the end of February 2020, i.e. one year ago. The application of the recommendation in the sector may be deemed successful. Despite the fact that the MNB has introduced the calculation of the ACR for funds by a non-mandatory regulatory instrument, almost all but three institutions with negligible market weight (33 out of 36) submitted the calculated ACR values. Based on the number of members, the institutions that submitted the ACR data supply covered 99.9 percent of the sector at the beginning of 2020. One of the funds that did not provide data was terminated through merger in 2020, and thus – based on the number of members – the funds that report ACR value cover almost 100 percent of the sector in 2021.

According to the recommendation, the MNB expects funds to review their ACR values on a regular basis, annually, and to submit the revised values to the MNB by 28 February. The recommendation also expects funds to revise the ACR values mid-year, if significant changes occur in the cost parameters. For the 2021 review, 29 out of 33 active institutions submitted revised ACR values.

The submitted revised values cover 70 portfolios of 29 institutions. The revised values of the 70 portfolios differ only slightly from the previous year's value, by 2 basis points at the most, for 31 portfolios for all three-time horizons of the ACR. According to the recommendation, when calculating the ACR values, the funds use the forint yield curve published by EIOPA for the end of the previous year. A small deviation (1-2 basis points) may also be attributable to a change in the applied yield curve. (The size and direction of the deviation caused by changes in the yield curve at each time horizon also depends on the cost structure of the fund.) For most of the funds, neither the ratio deducted from the membership fees for operation nor the amount of the asset management fee changed.

The revised ACR values at sector level practically have not changed compared to the previous year. While there was no significant change in the cost ratio at the majority of funds, the ACR of certain portfolios increased, while that of other decreased. At four funds the revised ACR decreased by at least 10 basis points at certain portfolios (over one or several more time periods), while at three funds the ACR increased by at least 10 basis points for seven portfolios. The reason for an increase in ACR may as well be beneficial for the fund members. In the investment environment characterised by rather volatile capital market price movements in 2020, certain portfolios of some funds achieved outstanding yields in 2020, significantly exceeding the benchmark yield. In the case of success fee schemes, these funds paid a higher success fee than in previous years. The success fee is recommended to be taken into account by the funds in the calculation of the ACR, which may have increased the ACR of these portfolios. At one institution, the increase in ACR was also affected by

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

[23] Recommendation No 1/2017 (I. 12.) of the Magyar Nemzeti Bank on pension insurances

a change in the ratio of the membership fee deducted for operations. At some funds, the decrease in ACR may be due to a small decrease in asset management fees, changes in the success fee payments or changes in indirect investment costs.

When examining ACR values other characteristics of the funds and portfolios should be also taken into consideration. For example, in the case of particularly low-risk portfolios with assets held in money market instruments or short-term bonds, the cost related to investing, and hence the ACR, can be expected to be lower than the cost of a portfolio comprising a variety of riskier assets.

When examining ACRs we found that observed that for funds operating an optional portfolio scheme, the ACR of lower risk portfolios is lower, in line with the preliminary expectations, than the ACR value of portfolios with a higher ratio of equity investments. The funds apply the provisions of Recommendation 12/2016 (XII.1.) on the setting up and operation of the optional 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". In practice, portfolios with higher equity content have higher asset management costs. In respect of portfolios of higher risk, members may rightly expect that to realise higher yields in the long run in return for taking risks and paying higher costs.

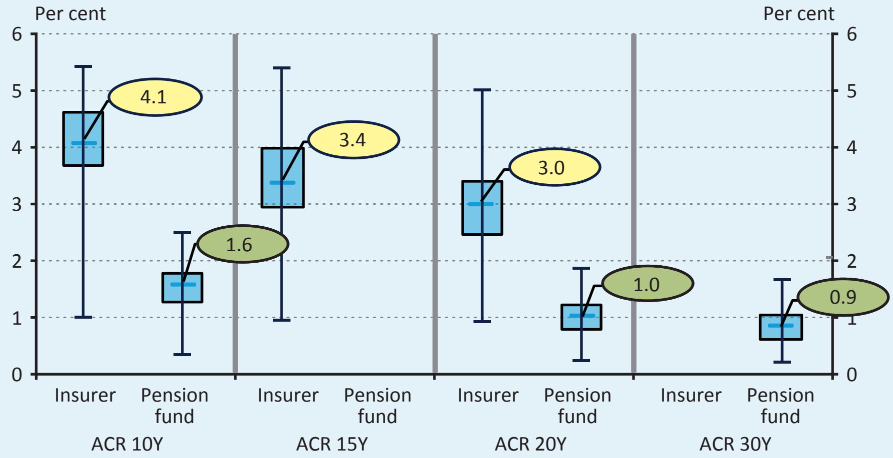
The MNB recommendation proposes that closed, workplace-type funds should also calculate the ACR values. These funds do not wish to compete in the sector, but the publication of ACR values facilitates providing the members of these funds with information.

One of the principles for the development of the calculation methodology for the fund ACR was to ensure that the calculation of the fund ACR is as close as possible to the calculation methodology for the ACR calculated for life insurance. This makes it possible to compare the costs of different types of long-term savings products with essentially similar objectives. The ACR values of life insurances and voluntary pension funds are shown in Chart 43.

Obviously, when comparing the ACR values of life insurances and voluntary pension funds, the special features and differences of the products in question should be taken into consideration. In addition to the long-term savings objective, pension insurance also provides protection against certain risks and can therefore offer more complex benefit to the customer. The ACRs for pension insurance also include the risk insurance premium component. Even in the case of an optional portfolio scheme, pension funds can generally operate 3-5, or maximum 6 optional portfolios. In the case of life insurances, the number of optional asset funds at some products may be as high as 10-20, with significantly different risk profiles. These different risks are also accompanied by different investment costs.

When assessing the magnitude of ACRs, it should also be taken into account that insurers and pension funds operate under different legal frameworks. The costs that voluntary pension funds may charge (both the amount that can be deducted from the membership fee for operations and the cost of asset management) are capped by the legislation applicable to the sector.

Chart 43
ACR values of life insurers and voluntary pension funds



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

Source: MNB

4.5 CONSUMER PROTECTION TASKS AT INTERNATIONAL LEVEL

4.5.1 The MNB's activity in European Union's joint consumer protection platforms

In 2020, the insurance consumer protection function supported, with its export cooperation, the development of a new chapter on supervisory practices in the EIOPA Supervisory Handbook on business conduct. The relevant chapter of the Handbook, expected to be finalised in 2021, will provide methodological support and guidance to Member States for the oversight of the key information documents (KIDs) of PRIIPs as well as for the identification and mitigation of specific conduct risks through the examination of KIDs and for the prevention damages that consumers may suffer.

4.5.2 International cooperation outside the European Union (IAIS[24], ICP, PRP)

As a founding member of the organisation, the Hungarian Financial Supervisory Authority has been a member of the International Association of Insurance Supervisors (IAIS), an organisation of insurance regulators and supervisors from nearly 140 countries and more than 200 jurisdictions worldwide, since 1994. In 2020, compliance with the expectations of insurance core principles (ICP[25]), developed by IAS, related to business conduct affecting consumers (peer review process - PRP[26]) was assessed. The expert group carrying out this review also included insurance consumer protection experts from the MNB. In the survey, 70 IAIS members (including the MNB) undertook a comprehensive assessment, covering supervisory powers and mandates, legal provisions, other supervisory instruments as well as practice and actual experience over the previous three years. Publication of the results is expected in 2021.

4.5.3 Inspection of the implementation of EU legislation in Hungary

The EU Regulation setting out common standards for information and sales processes for packaged retail investment and investment-based products (PRIIPs) and the EU Insurance Distribution Directive (IDD), which requires the development of standardised prospectuses and the disclosure of intermediaries' commissions, entered into force in 2018. The purpose of the fixed format written information is to help consumers make informed savings decisions. In addition, the new

[24] IAIS: International Association of Insurance Supervisors
[25] ICP: Insurance Core Principles
[26] PRP: Peer Review Process

regulation provides EIOPA and the Member States' supervisory authorities with the opportunity to restrict or prohibit (even in advance) the distribution of insurance-based investment products that raise investor protection or financial stability concerns. The MNB has been monitoring compliance with the IDD and the PRIIPs regulation since their entry into force and has identified them as a priority target area for 2020 and has verified compliance in individual submissions and during the comprehensive inspections.

The MNB also found during its 2020 inspections – despite the improving trend – that in certain case the KIDs exceeded the size limits, and thus they did not ease overview and comparability. In addition, the use of difficult-to-understand legal language remains a problem. It is still the case that as the consumer is provided with the KID right before signing the offer, consumers have no sufficient time to get acquainted with the document and make an informed decision.

Box 6
EIOPA's 2020 Thematic Overview

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 the BoS, the focus of the 2020 thematic review, in cooperation with the Member States' supervisory authorities, was on the challenges posed by the COVID situation, and in particular on the impacts and risks of the pandemic for the European insurance and funds market and as well as for the consumers of the sector.

EIOPA's Consumer Trends Report identified the following main risks related to the pandemic, impacting customers:

1. Business continuity and operational risks: Owing to the stability of the European insurance market, institutions were able to maintain business continuity despite the pandemic and to adapt flexibly to changes in the organisation of work, customer management and service delivery. They were able to isolate potential systemic disruption and use the set of digitalisation and financial innovation instruments to ensure smooth customer service.

2. Lack of forbearance measures and flexibility vis-à-vis customers who have failed to meet their contractual obligations: Unfortunately, due to travel and curfew restrictions and limited administrative possibilities, it was difficult for customers to meet, for example, the deadlines specified in the insurance contract for filing claims and submitting the necessary documents for claims handling in time.

3. Risks related to the business model and poor quality of certain travel insurance products: EIOPA has already identified concerns earlier as well about the sales and business models and service quality of some travel insurance products. Unfortunately, the pandemic situation brought to the surface problems in the contractual conditions related to exclusions and coverage. The strategies of the institutions varied, not all insurance companies excluded pandemic risk in their products and even took equitable measures for the benefit of customers. However, some institutions responded by suspending the sale of products or terminating contracts (mainly in the case of products with health cover).

4. Changes in risks and consumer needs have not been followed by appropriate insurers' measures: The change in consumer habits due to the pandemic also changed the risk exposure of certain insurance products, prompting some insurers to take action to ensure that their products continue to meet the needs, objectives and characteristics of their target group. These measures were not widespread and supervisory authorities should therefore keep a close eye on the appropriateness of insurance products for the target group.

5. Complicated language of the exclusions in the contracts and lack of clear communication: The exceptional situation highlighted the diversity of exclusions, markets, products and institutions. While for some products certain risks were excluded – legitimately – due to the pandemic, at other products the risk of unfair treatment of consumer emerged. The situation was exacerbated by the complicated language of contract terms and conditions and the lack of clear communication from insurers to their customers. However, several institutions took a positive stand and implemented customer-friendly measures to reduce uncertainty, which is likely to continue to be necessary in the future as well.

6. Complex and expensive unit-linked products and structural problems in the unit-linked market: The potential early surrenders brought structural problems to the surface in some unit-linked products (riskiness of underlying investments, high fee deductions, complex cost structure). Volatility and low expected returns may further exacerbate the impact of high-cost deductions on investments.

As the pandemic, and in parallel with that its impact on the financial sectors, will extend into 2021, the MNB will continue to monitor the issue closely, taking into account the specificities of Hungary.

5 Intermediaries and their risks

5.1 CONCENTRATION IN THE INSURANCE INTERMEDIARY MARKET CONTINUES[27]

In the insurance market, the number of licensed intermediaries decreased further in 2020, continuing the downward trend that started in 2019 after stagnation, thereby increasing the concentration of the market. One of the reasons for the decrease is the increased administrative burden caused by the more stringent regulatory environment resulting from the transposition of the European Union's Insurance Distribution Directive (IDD) into Hungarian law, which increased the focus on consumer protection. As a result, in 2020, several insurance intermediaries decided to return their licence or transfer their portfolio to another broker. Another reason for the decrease is the institutional difficulties in meeting the regular data supply obligations also expected of insurance intermediaries – essential for the sound functioning of the market and effective supervision – and the application of sanctions, complying with the principle of progressivity, for failure to supply data.

Table 4
Key data of insurance intermediaries

	Insurance intermediary	
	2019	2020
Number of institutions*	431	**410**
Broker	*391*	*369*
Multiple agent	*40*	*41*
Number of natural persons (persons)	13,926	**13,362**
Commission income (HUF billions)	87.5	**91.1**

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

Source: MNB

5.1.1 Mixed overall picture, declining life insurance commission incomes

In 2020, the life and non-life insurance segments shows a different picture in the insurance intermediary market. Non-life insurance commission incomes rose to HUF 71.5 billion, up 11.5 percent year-on-year, while mediated premiums registered a negligible, 0.2 percent growth. Growth was observed at MTPL and corporate and institutional property insurances. For the first premiums on the mediated portfolio increased by 4.7 percent to HUF 96.2 billion, while the number of policies decreased by 0.2 percent. The number of mediated casco motor liability insurance policies decreased, which may be attributable to a decrease in the number of vehicles put into services. In 2020, the volume of mediated premiums and contract fell by 5.5 percent and 9.8 percent, respectively, year-on-year. The distribution of travel insurance sales was hit the hardest by the restrictions in 2020. Here mediated premiums and contracts fell be 65.1 percent and 67.3 percent, respectively.

[27] 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.

The rising trend in life insurances faltered in 2020; the commission income of HUF 22.2 billion down by 5.1 percent year-on-year, while mediated premiums fell to an even larger extent, by 10.5 percent. The decline is attributable to the 5.2 percent fall in unit-linked insurances on the one hand and the 67.5 percent decline in other life insurances, on the other. The latter may be due to the decline in group life insurance policies for entrepreneurs as a result of the difficult economic situation.

Table 5
Sales data of insurance intermediaries

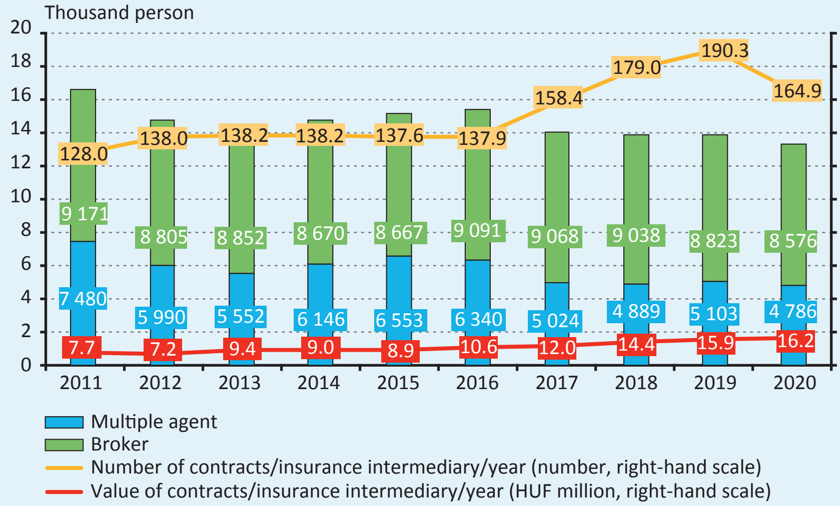
	Value of contracts HUF Billions		Number of contracts Pcs		Commission income HUF Billions	
	2019	2020	2019	2020	2019	2020
Non-life segment	**175,7**	**176,0**	**2,511,624**	**2,071,296**	**64,1**	**71,5**
Compulsory motor third-party liability insurance	91,9	96,2	1,460,159	1,457,817		
Home insurance	4,6	4,9	112,773	109,926		
Casco motor liability insurance	31,2	29,5	216,900	196,926		
Corporate and institutional property insurance	26,1	28,2	56,076	53,627		
Travel insurance	4,5	1,6	450,308	147,184		
Other non-life insurance	17,5	15,6	215,408	105,816		
Life segment	**45,5**	**40,7**	**138,965**	**127,441**	**23,4**	**22,2**
Traditional life insurance	4,2	4,0	65,826	69,771		
Unit-linked life insurance	37,5	35,5	70,119	55,628		
Other life insurance	3,7	1,2	3,020	2,042		

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

5.1.2 Larger scale decline in the number of multiple agents

After the stagnation observed in 2018-19, the total number of natural persons acting as insurance intermediaries has changed in 2020. The total number of intermediaries declined marginally, by 4 percent compared to previous years. The decline in the number of brokers continued at a similar rate as in the previous year, while the decrease in the number of multiple agents was proportionately larger (Chart 44). The decline of larger ratio is also partly due to the fact that multiple agents, typically active in the distribution of life insurance, were hit harder by the difficulties posed by 2020 with regard to sales in person. Accordingly, the premium amount of mediated life insurances also fell by more than 10 percent. In the entire intermediary market, the temporary halt in official examinations also complicated the replacement of staff. In addition to the reduce number of intermediaries, the number of contracts also fell significantly. The latter is mostly attributable to the drastic fall in the number of travel insurances, being one of the most striking consequences of the restrictions triggered by the pandemic. Despite the foregoing, the value of non-life insurance contracts shows a slight increase, which implies a more concentrated and professional intermediary market.

Chart 44
Changes in number of natural person insurance intermediaries

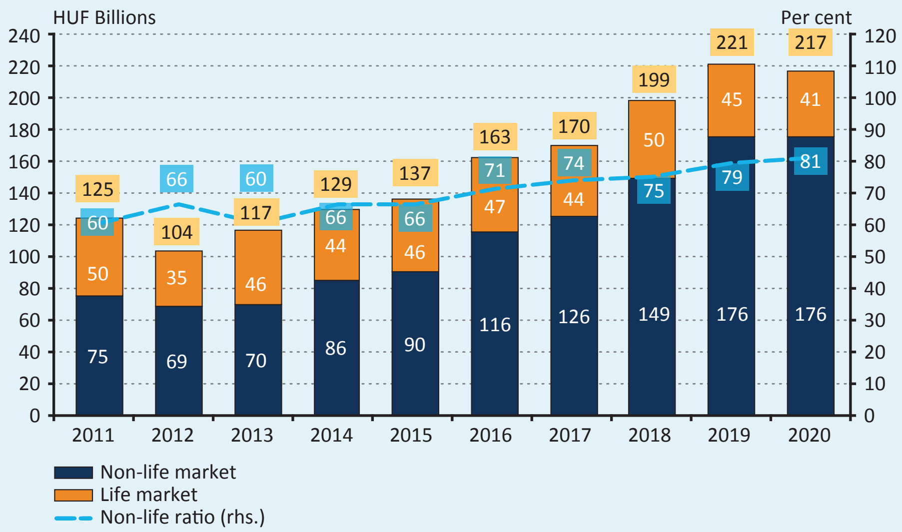


Source: MNB

5.1.3 Further decline in the life segment; faltering growth in the non-life segment

The eight-year upward trend in mediated insurance premiums has been broken, with life insurances showing a decline already for two years, offset by dynamic growth in non-life insurance; however, growth decelerated in 2020. On the whole, the total amount of mediated premiums is HUF 217 billion, which fall short of the amount registered in 2019 by 2 percent (Chart 45). As regard the mediated premiums, non-life insurances account for a dominant part, and their ratio is steadily increasing. By now it reached 81.2 percent, the highest ratio in the last decade. The unprecedented difference is attributable to continued decline in the life segment. The moderate growth in mediated non-life insurance premiums is due to the fact that rising MTPL premiums and a marginal increase in the distribution of home insurances were unable to offset the decline in casco, driven by the fall in new car sales, and the fall in the sales of travel insurance sales – representing a low ratio at market level before as well – resulting from the travel restrictions. The unfavourable economic environment and soaring credit demand continue to weigh on insurance-based investments, which also fell by 5.5 percent in 2020, similarly to 2019. A proportionately similar, 5.8 percent, decline can be observed also in traditional life insurances.

Chart 45
Changes in insurance premiums mediated by brokers and multiple agents



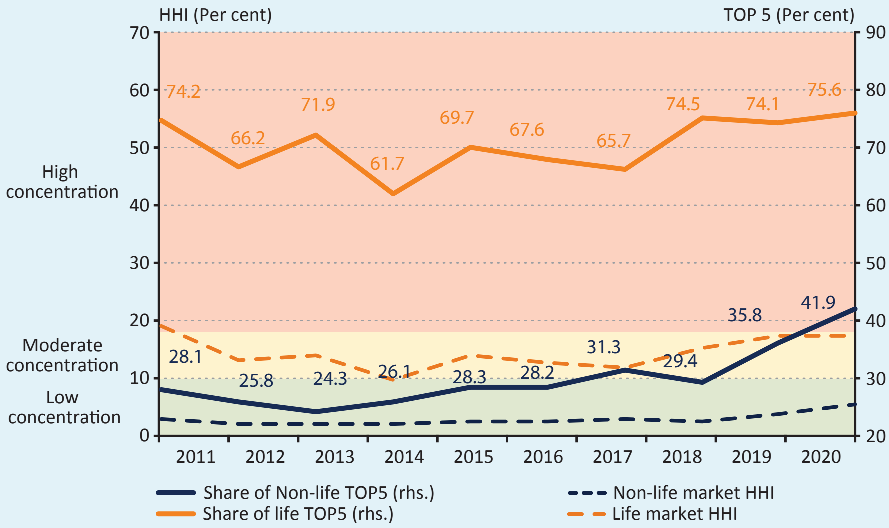
Source: MNB

5.1.4 Steady concentration in the non-life segment

In 2020, the market concentration of independent insurance intermediaries, calculated on the basis of gross premium income and portfolio premium rose further both in the life and non-life segments (Chart 46). In the non-life segment the value of the Herfindahl-Hirschman index (HHI) rose further in 2020 as a result of additional market acquisition by the larger market participants (5.7 percent). At the upper 10 percent of the intermediaries[28] the rise in mediated premium exceeded that of the entire market on the whole in 2020, which continues to imply substantial restructuring. The share of the 5 largest market participants (TOP 5) – similarly to the HHI – rose to a historic high (41.9 percent). However, based on its HHI, the non-life market is still considered to have a low level of concentration.

In the life segment the two concentration ratios also show a change of identical direction, but it was less dynamic in 2020. The share of the top 5 players, after a slight correction in the previous year, has increased again, and the HHI also increased further (to 17.4 percent), but it is still below the upper bound of the moderate concentration level (18 percent). Merely 15.4 percent of the decrease in mediated premiums occurred at the top 10 percent of the life segment market participants[29], which was primarily suffered in the unit-linked product category, but eve there only to a degree below the market average. In the case of the traditional products the largest actors improved their market position with increasing sales despite the falling market, which caused the HHI value to strengthen.

Chart 46
Share and Herfindahl-Hirschman index of the TOP5 independent insurance intermediaries based on gross premium income and regular premium, by segments



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

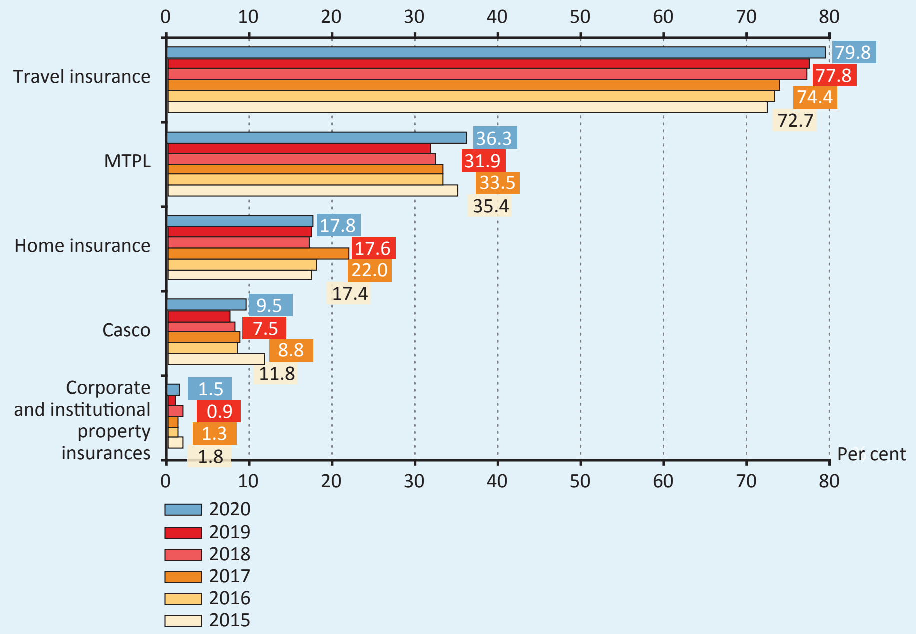
5.1.5 Increasing ratio of electronic sales

Despite the decline in the sales of travel insurances, this is still the only product group that is distributed mainly electronically, without the personal involvement of intermediaries. The ratio is increasing year by year; in 2020, insurance intermediaries sold four out of five contracts through this channel. The impact of the restrictive measures linked to the situation developed as a result of the pandemic can be also traced in the share of electronic sales. All non-life product categories surveyed show an increase in the share of electronic intermediation. In the case of motor insurances the declining trend of several years seems to have stopped (Chart 47). However, there is still no breakthrough in the electronic distribution of life and corporate insurances. The innovations linked to the restrictive measures and changing customer

[28] Based on the mediated non-life premiums, this included the 39 largest insurance intermediary undertakings.
[29] Based on the mediated premiums in the life segment, this included the 26 largest insurance intermediary undertakings.

needs could may give an impetus to electronic intermediation of retail non-life insurances and trigger positive change in life insurances.

Chart 47
Ratio of electronically mediated non-life insurance contracts (by number of policies, ratio within the mediated contracts)



Source: MNB

5.2 INCREASING RETAIL LENDING, DECREASING COMMISSIONS[30]

In 2020, the troubled economic environment had a negative impact on car financing loans and corporate loans also failed to grow. On the other hand, the intermediation of retail credits and loans rose dynamically. As a consequence of the fall in car sales in 2020, the value of mediated car leasing contracts fell by 25.4 percent, and the mediated car loan category, which has been unpopular with lenders before already, has almost fully ceased. Due to the sales difficulties and the presumably competitive personal loan offers, credit card intermediation by independent financial market intermediaries also almost fully disappeared, which is in line with the downward trend in the number of credit cards in circulation in Hungary. The restrictive measures taken to deal with the exceptional situation had negative effect on several sectors of the economy; nevertheless the intermediation of corporate loans decline only by 1.6 percent. On the other hand, contrary to the foregoing, retail mortgage and personal loan intermediation trends developed positively. Average net income in 2020 increased by 9.7 percent year-on-year, providing a good basis for increased appetite to borrow. Contrary to expectations of a downturn in the housing market and a decline in purchases, propensity to buy property did not wane, strengthened by significant state subsidies and favourable credit conditions. Accordingly the amount of intermediated mortgage loans rose by 14.1 percent. Personal loans show a much larger increase than that, 30.2 percent, which is mainly attributable to subsidised loans not backed by mortgage (this category also includes part of the prenatal baby support loans) and favourable market offers. On the whole, the value of mediated credits and loans, and financial lease contracts increased by 10.2 percent; nevertheless the related commission income decreased by 35.1 percent. One reason for this is that mortgage loans in the low commission category made the greatest contribution to the increase in mediated contracted amounts (HUF 52.6 billion). Another key element is that commissions on personal loans shrank from an average of 3.0 percent to 1.3 percent, due to the low interest rates and caps on commission linked to state subsidies.

[30] 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.

Table 6
Sales data of independent financial market intermediaries

	Value of contracts HUF Billions		Number of contracts Pcs		Commission income HUF Billions	
	2019	2020	2019	2020	2019	2020
Corporate credits, loans and financial lease	202.9	199.6	28,683	18,010	2.5	2.4
Total household credits and loans	519.3	620.7	192,815	126,863	13.1	10.9
of this: Mortgage	372.9	425.5	33,273	36,008	6.5	7.6
Motor vehicle	2.6	0.2	912	77	0.60	0.01
Personal loans	95.4	124.3	19,404	18,068	2.9	1.7
Credit card	2.8	0.5	17,880	606	0.3	0.01
Other	45.6	70.3	121,346	72,104	2.8	1.7
Total household financial lease	72.1	54.9	25,541	15,413	1.8	1.1
of this: Real property	4.9	5.8	309	369	0.08	0.09
Motor vehicle	65.8	49.1	25,053	14,916	1.7	1.0
Other	1.4	0.1	179	128	0.009	0.017

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

5.2.1 Further decline in intermediary headcount, increasing efficiency

The slight decline in the number of institutions in the previous period was followed by significant concentration in 2020, with the number of financial market intermediaries decreasing by 9.8 percent and the number of natural person intermediaries by 11.2 percent. Commission income of financial market intermediaries also continued to decline in the increasingly concentrated market, down by 12.5 percent year-on-year.

The decline in the number of institutions was caused, among other things, by the withdrawal of licences for non-compliance with the regular supervisory data supply requirements, given that, similarly to the insurance intermediary market, fulfilment of the data supply of key importance also in the financial market and is a fundamental instrument for the MNB to carry out its supervisory activities.

Table 7
Key data of independent financial market intermediaries

	Financial market intermediary	
	2019	2020
Number of institutions*	553	499
Broker	12	12
Multiple agent	384	344
Multiple special intermediary	6	6
Hire purchase intermediary	151	137
Number of natural persons (persons)	13,426	11,965
Commission income (HUF billions)	18.4	16.1

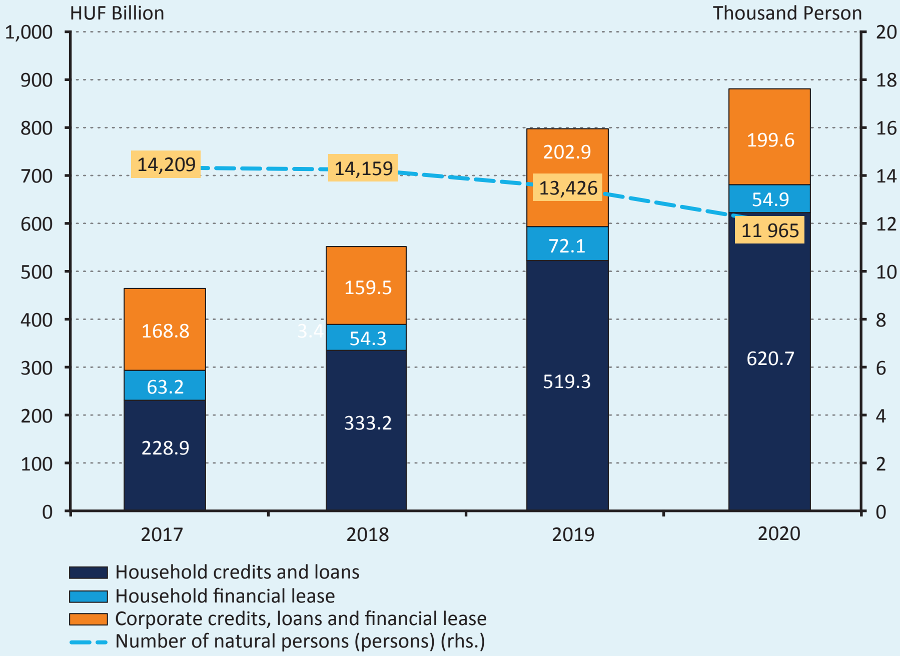
**The number of independent financial market intermediaries includes institutions registered as financial market intermediaries and carrying out financial market intermediation activities as their core activity, as well as institutions registered based on other core activity and also carrying out financial market intermediation activities.*

Note: Hire purchase financial market intermediaries are not obliged to supply data. An overlap between the financial market and insurance intermediary natural persons is possible.

Source: MNB

The intermediary market, being increasingly concentrated due to a fall in the number of institutions and headcount, became more efficient, under declining commission income, owing to the significant increase in retail lending. The contract value per capita shows an increase of almost 20 percent compared to the previous period, which is outstanding given the economic impact of the pandemic.

Chart 48
Number of financial market intermediaries and amount of mediated credits and leases



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

5.3 CONSUMER PROTECTION RISKS

In the course of its supervisory activity, the MNB pays special attention to the control of intermediary markets, the prudent operation of market participants and the identification of risks. The size and role of intermediary sectors is shown by the fact that 64.9 percent of insurance contracts in the insurance sector in 2019 – based on the number of policies – were sold through an intermediary (broker, multiple agent or agent). In view of the intermediaries' role in establishing the contact between the contracting parties and contacting the customer first, their consumer protection inspection can be efficient when combined with prudential supervision. It follows from the foregoing that compliance with and enforcement of prudential rules, in particular the rules on operating in accordance with the activity licence, significantly reduces the consumer protection risks of the intermediary activity.

Intermediaries may act as tied or independent agents, depending on whether they are acting on behalf of the client or the insurance/financial institution. In the case of insurance intermediaries, the independent intermediary is the broker, whose task is – acting on behalf of the customer – is to find the product best suited to the customer's needs by surveying almost the entire market, or at least a sufficient number of competing products[31]. By contrast, an agent who mainly acts on behalf of the insurer, intermediating the products of one insurer or the non-competing products of several insurers and a multiple agent who is authorised to intermediate the products of several insurers qualify as tied agents.

[31] Pursuant to point 111 of Section 4(1) of the Insurance Act, insurance products which are suitable substitutes for each other for the customer with regard to the purpose of use, the scope of the risks covered and the related insurance benefits are considered to be competing products.

Accordingly, one of the biggest risks in the intermediary market is inherent in the customer relationship, as it is not possible to verify every single liaison with a customer, given their high number. For that very reason, from a prudential point of view, it is important to establish an appropriate internal control system for institutions, which can help prevent or at least reduce consumer protection risks. Both from a consumer protection and a prudential point of view, the “welcome-call”, as described in the unit-linked recommendation[32], could be an appropriate instrument, whereby the insurer or insurance intermediary makes a phone call within the 30-day cancellation period from the conclusion of the contract to check that the customer is aware of his long-term – which may as well be regular – obligations, and to make sure that the contract has been concluded on terms that are in line with the customer’s transactional intent. On the one hand, this protects the customer in terms of consumer protection, since if during the telephone conversation the customer earns of facts that would lead him to withdraw from the contract, he still has the possibility to do so, and on the other hand, both the insurer and the insurance intermediary exercise control over the intermediaries and the quality of the intermediation.

Furthermore, in the context of consumer protection risks, it is of key importance and a most determinant element of prudential operation that insurance intermediaries operate in accordance with their licence, i.e. the respective insurance intermediary – considering the material differences inherent in the forms of activity described before – should always comply with the insurance professional rules applicable specifically to the form of activity for the performance of which it holds a licence. In the case of a broker operation contrary to the activity licence includes when it offers a product in a way that significantly narrows the market supply, leaving almost no choice for the customer. The lack of opportunity to choose a product, which makes it clearly questionable whether the product offered is indeed the most suitable one for the customer, immediately results in another breach of customer rights.

Either operating contrary to the activity license or the lack of internal control systems entails a breach of customer rights, such as the right to information, to recommend sufficient number of products and recommend the product best suited to the needs, which in all cases entail a significant consumer protection risk.

In view of the foregoing, the MNB repeatedly and firmly calls the attention of market participants to choose the appropriate form of activity and, if necessary, to change the form of activity.

5.4 RISKS OF INTERMEDIARIES

According to data at the end of 2020, there are 909 institutions supervised by the MNB and subject to an independent licence, including 410 insurance intermediaries and 499 financial market intermediaries. The introduction in 2020 of an independent intermediary risk assessment methodology and risk map, supervisory inspections and close monitoring resulted in positive changes in the prudent functioning of the intermediary market. The experiences of the intermediary-specific risk assessment and the prospects resulting therefrom are summarised in the table below.

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

Risk category	Risk groups	Risk rating	Risk prospects	Textual evaluation
Business model	Environment Strategy, business plans Sustainability of operation	●	↑	In 2020 no significant changes occurred in the legal and regulatory environment. However, the introduction of restrictions related to the extraordinary situation may delay the recovery of the economy. *Significant changes could result from the amendment of the itemised small business tax (KATA) at the beginning of 2021 and the new EU sustainable finance disclosure regulation (SFDR[33]), which entered into force on 10 March 2021.*
Corporate governance	Owner's control Internal governance Conflicts of interest Compliance	●	→	Similarly to 2019, the functioning of internal governance systems is still problematic. The inspections revealed that several intermediaries lack adequate control points, in addition absence of proper regulation. However, the follow-up of previous inspections identified positive direction. In terms of ownership structure, significant changes occurred at three large market participants. *The MNB will conduct a thematic review in this matter in 2021, the conclusion of which is expected to lead to improvements across the market.*
Financial and operational risks	Material conditions Registration requirements Qualification requirements Registers Trainings, courses Data supply	●	→	There was no significant outflow in the life segment, while claim developments are favourable in the non-life segment. Government bond-heavy own portfolios were less exposed to capital market volatility. Accelerated digitalisation developments due to environmental impacts, still significant IT and portfolio management risk. *Insurance and operational risk in the short term remains significant in 2021 due to environmental uncertainties.*
Market entry risk	Service delivery Marketing, customer acquisition Complaints management	●	↑	The completeness of information provided to customers and the quality and thoroughness of the needs assessment showed serious shortcomings in 2020, with strong deviation. According to the completed data supplies intermediaries received 1,376 complaints, of which 367 were deemed justified by the service providers. On a market scale the number of complaints is not significant, but the inspections revealed that the handling of complaints is inadequate in some cases, and thus it will remain in the focus of the MNB. *In terms of service delivery, marketing and customer acquisition, the situation is expected to have an impact on the functioning of intermediaries.*
Partner (product owner) risks	Portfolio quality risk Dependency risk	●	→	In terms of portfolio quality and dependency risk, the MNB has not experienced any significant market-wide problems in 2020. *It remains unlikely that any tight dependency or major product owner risk develops at sector level.*

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

[33] Regulation (EU) 2019/2088 of the European Parliament and of the Council on sustainability-related disclosures in the financial services sector

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

6.4.1 Market presence

The analysis of financial enterprises, operating in Hungary, not belonging to a banking group, i.e. not subject to consolidated supervision, is based on unaudited data for the end of 2020. For the purpose of the analysis, with a view to eliminating the distorting effect, the MNB ignored the data of two financial enterprises pursuing special activity, not related to the usual course of business of financial enterprises.

Table 8
Key data of financial enterprises not belonging to a banking group

	2016	2017	2018	2019	2020
Number of financial enterprises not belonging to a banking group*	217	217	223	225	229 ↑
Total assets of financial enterprises not belonging to a banking group (HUF billions)*	1,094	1,107	1,139	1,519	1,588 ↑

*Note: *Based on the data reported by financial enterprises for the reference period and the data in the MNB's Central Data Repository*
Source: MNB

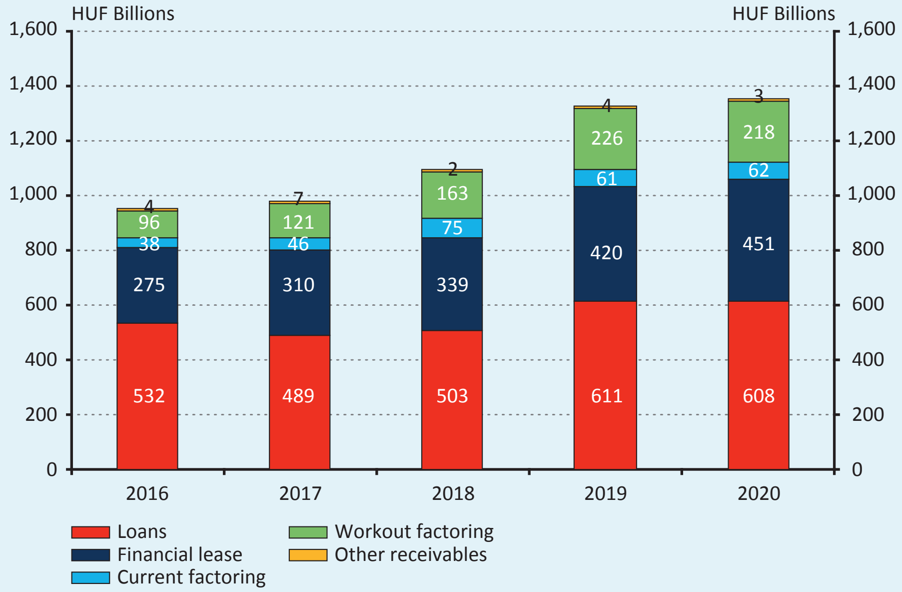
The regulation on the initial capital of financial enterprises, effective since 2001, which uniformly prescribed an initial capital of HUF 50 million for institutions, changed from 2020, and thus not the amount required for establishing a financial enterprise is higher. The financial enterprises already holding a licence must increase it in two steps by 2026, first to HUF 75 million and then to HUF 100 million. Those holding a licence for lending activity, the statutory amount of the start-up capital is HUF 100 million and later HUF 150 million. In 2020, the subscribed capital was raised by 30 institutions. Despite the higher capital requirements, the impetus to establish new enterprises did not break. In 2020, the MNB's firm action against institutions that failed to comply with the legislative requirements resulted in the withdrawal of the institution's activity and operational licence in 7 cases. There was no significant change in the number of institutions in 2020 compared to previous years.

6.4.2 Increase in the financial lease portfolio

Despite the small overall increase, the receivables of the institutions under review from financial services activities, significantly falls short of the volume of the last 2 years. In 2018 and 2019, the total receivables of institutions increased by 11 percent and 22 percent respectively, compared to the previous year's base (Chart 49). Similarly to the previous period, the receivables of financial enterprises not belonging to any banking group remain highly concentrated. 15 percent of institutions hold 82.6 percent of the total receivables.

The most common financial market activity of financial enterprises remains the granting of credits and loans. The purchase of receivables is the second most popular activity, while in terms of frequency leasing is only in third place. In 2020, in the portfolio of financial enterprises only the placement of financial leases grew significantly, exceeding the closing balance of previous year by 7.4 percent, which is also partly attributable to the conservation effect of the moratorium on loan instalments. By contrast, the stock of loans in 2020 fell short of the significant increase registered in previous year, thereby breaking the positive trend in this area lasting for several years. Current factoring and workout stocks showed a minimal positive shift compared to the previous period. Overall, in the exceptional year of 2020, only the leasing area was able to grow further, while lending and workout stagnated.

Chart 49
Developments in the outstanding receivables of financial enterprises not belonging to a banking group



Source: MNB

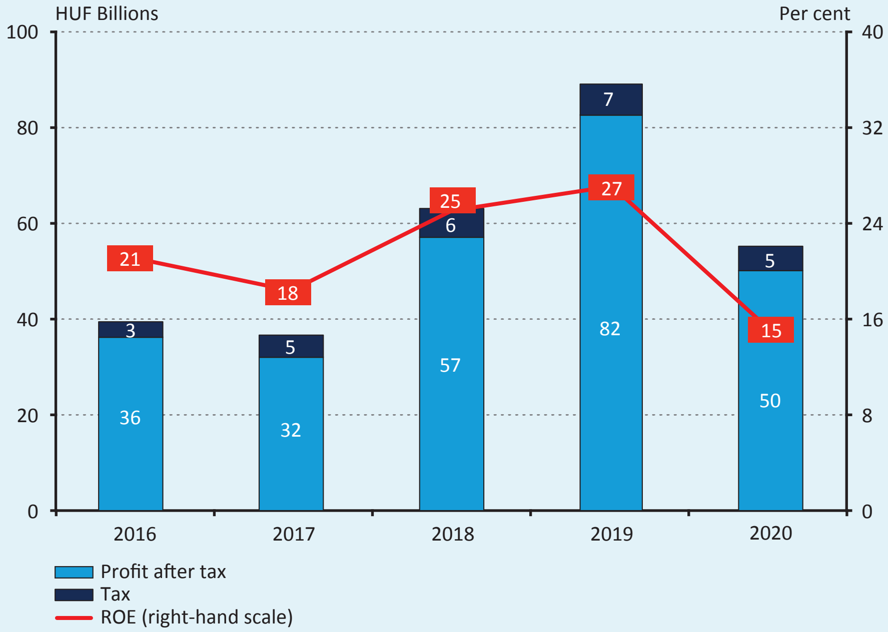
6.4.3 Significantly decreasing profitability

Compared to previous years, profitability declined significantly, i.e. below the profitability level of 2018 (Chart 50). The decline is attributable to the more cautious lending behaviour in certain institutions, in addition to the fall in lending and the lower APR[34] applied during the period of the moratorium on payments. The deterioration in profitability thus affected the most the sectors engaged in lending and factoring; however, the profit of workout companies also declined. Nevertheless, there is no difference in the ratio of institutions that realised a profit after tax. Both in 2019 and 2020, 82 percent of the surveyed institutions reported a profit. However, while in 2019 profit after tax over HUF 1 billion was realised by 9 non-banking group financial enterprises, in 2020 only 4 of them managed to achieve this result, 3 of which pursue factoring and 1 pursues lending activity. Based on the after-tax profit of 2020, non-banking group financial enterprises are still characterised by heavily concentrated market, albeit the concentration ratio declined compared to 2019. The 10 companies with the highest after-tax profit accounted for only 69 percent of the sector’s profit/loss in 2020, compared to 84 percent in previous year.

The number of loss-making institutions increased marginally, while the amount of realised loss declined by roughly 47 percent. A major part of the after-tax profit was still realised by financial enterprises pursuing factoring and lending activity, and in 2020 there were companies achieving high profitability also among the leasing institutions. The largest losses were mostly suffered by financial enterprises engaged in lending and workout activities. 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 pertaining to the increased initial capital by 2023, and then in the transitional period lasting until 2026.

[34] APR: annual percentage rate of charge

Chart 50
Profit/loss of financial enterprises not belonging to a banking group



Source: MNB

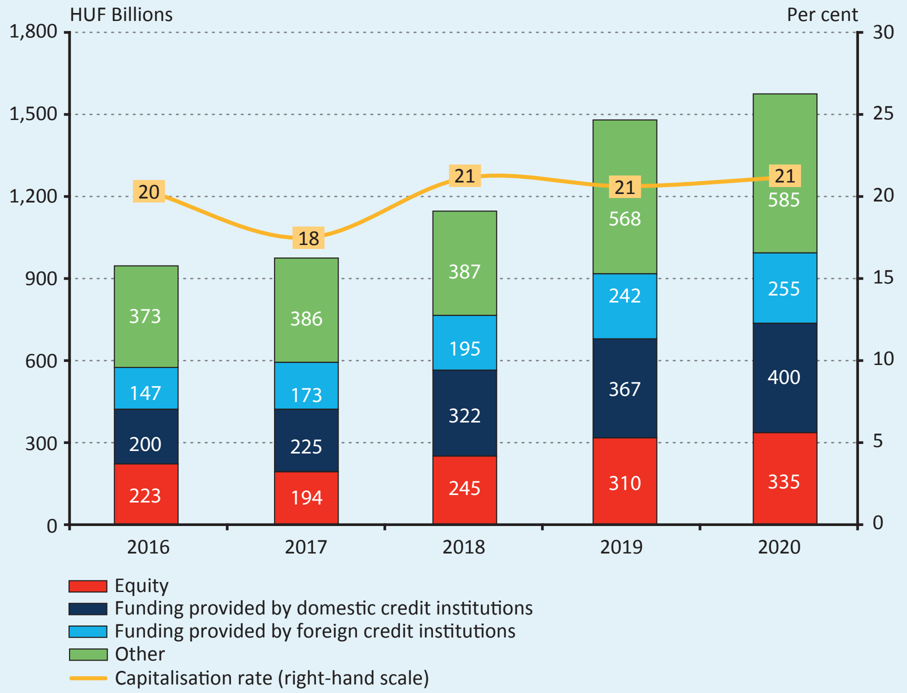
According to the MNB's expectations, the decline in ROE will be a transitory phenomenon, due to a temporary decline in the willingness to lend and a technical decline in profit from workout activities, unrelated to the usual course of business. The moratorium on loan instalment may have caused primarily temporary liquidity problems for financial enterprises, which were further exacerbated in the first half of 2021, as the moratorium was not extended for the loans of financial enterprises, while their customers may continue to benefit from the moratorium. The MNB examined the management of liquidity risks and identified no systemic problems. On the positive side, although profitability has declined, there are still no extreme losses and the share of loss-making institutions has not changed either.

6.4.4 Decelerating growth in equity

In 2020, minor growth was observed in the volume of credit institution refinancing funds, 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 slowly (Chart 51). The MNB examined refinancing risks also in the light of the moratorium provisions of 2020 and 2021, and found that non-banking group financial enterprises were able to manage risks with sufficient flexibility, where necessary by reaching a compromise with the financing credit institution.

In addition to the increase in funding provided by credit institutions and in other liabilities, the equity of non-banking group financial enterprises has been also increasing steadily since 2017. The equity growth rate slowed down in 2020 compared to the upward trend in previous years, which is attributable to the decline in profitability figures; nevertheless the sector's liability structure continues to be stable. Growth in equity is mainly based on the successful operation of certain financial enterprises pursuing workout, lending and financial lease activities. The equity growth rate typically exceeds growth in credit institution and other liabilities, and thus the sector's capitalisation level increased overall since 2017. For 2020 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. The MNB monitors the capital position in the light of the feasibility of complying with the statutory initial capital ratio, taking into account profitability.

Chart 51
Capitalisation level of financial enterprises not belonging to a banking group



Source: MNB

6.4.5 Stagnating credit portfolio; shift towards the corporate sector continued

By 2020, the range of financial enterprises engaged in lending activities essentially has not changed. While in 2019, the sector's lending activity showed a strong increase due to the growth in outstanding lending to corporations, by 2020 the growth in outstanding corporate loans was no longer able to offset the decline in household and other lending (Chart 52). Growth in the volume of outstanding lending faltered.

The changes in the volume of outstanding lending were assessed taking into consideration and eliminating the distorting effects, such as the new financial enterprises added to the range of the institutions under review and the soar in the outstanding lending of newly established institutions. As regards the changes in the volume of outstanding lending during the year, 2020 was characterised by a year-on-year decrease in items that cause outstanding lending to increase disbursements, purchases and other transaction-based growth), which mainly concentrated within the corporate loan portfolio. The lower increment was somewhat offset by the decline in the items that reduce the volume of outstanding lending (repayments, sales and other reducing criteria) – presumably also due to the effect of the moratorium on payments – and thus the total outstanding lending of the institutional sector under review shows no major shift compared to the previous period.

When examining the outstanding borrowing of households, we found that concentration continues to be strong, as the vast part of the stocks are concentrated in the portfolio of merely a few financial enterprises. In 2020, a total of 4 financial enterprises managed household loan portfolios over HUF 10 billion, accounting for 75 percent of the portfolio of the sector under review. The institutions are typically specialised, with 3 of the 4 largest lending institutions specialising in quick loans, pawnbroking and hire purchase. The decline in outstanding borrowing of household in 2020 is mainly due to a decrease in the portfolio of three financial enterprises, attributable to the changeover to IFRS for accounting and to the sale of a larger volume of terminated loans in the case of 2 financial enterprises on the other.

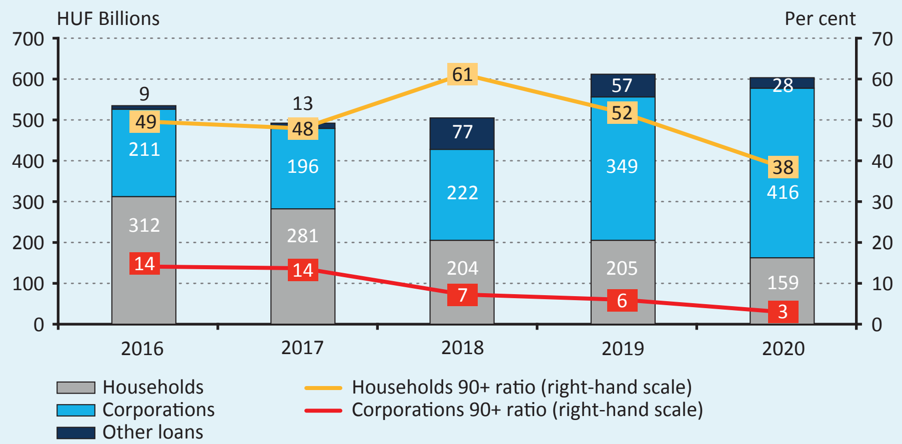
The range of financial enterprises engaged in pawnbroking remained unchanged, and the volume of loans managed by them started to grow again after 2 years of decline. In 2020, the increment was around HUF 1.2 billion, and thus the portfolio managed at the end of 2020 reached the level registered in 2017. There was no increase in turnover during 2020;

the increase in the stock was attributable to the outstanding loans connected to pawned articles not redeemed due to the moratorium and not subjected to forced sale either. The vast majority of institutions engaged in pawnbroking were able to realise a profit after tax also in 2020, but the profit after tax decreased compared to the previous year.

In 2020, the previous year's growth in outstanding corporate loans continued, albeit at a slower pace, which is also reflected in the number of financial enterprises pursuing this activity. 94 non-banking group financial enterprises companies granted corporate loans, 2 of which commenced their activities in 2020, while 5 financial enterprises expanded the range of their financial services rendered to customer compared to 2019 by granting corporate loans. It should be noted that the growth is also attributable to the increase in the intermediation of the Hungarian Development Bank's refinancing funds to the SME sector through financial enterprises, representing an increasing ratio.

Due to the sales of non-performing portfolios and the change in the accounting treatment at an institution managing a large portfolio, and to the moratorium on loan instalments, the ratio of severely overdue (90+) outstanding receivables from households significantly declined. There was no deterioration in the quality of the corporate loan portfolio. The improvement in the 90+ past due portfolio was significantly influenced by the improvement in the portfolio quality of 1 financial enterprise. It should also be taken into consideration that a large part of corporate customers struggling with payment difficulties opted for the moratorium of loan instalments, which may have resulted in improved portfolios.

Chart 52
Composition of the credit portfolio of financial enterprises not belonging to a banking group



Source: MNB

6.4.6 Continuing growth in high-quality leasing portfolio under declining profit

In 2020, continuing the trend of the previous years, outstanding receivables from financial leasing activities of the sector under review continued to grow (Chart 53). In 2020, the corporate lease portfolio continues to dominate the institutional sector, with 89 percent of the portfolio coming from finance leases to corporation; on the other hand, the retail lease portfolio rose by 2 percent, year-on-year, in 2020. While the overall growth dynamics decreased compared to the previous year, it should be noted that the increase in the portfolio in 2019 was due to the transformation of an institution – previously operating as a bank – with a significant motor vehicle lease portfolio, into a financial enterprise. When this distorting effect is eliminated, we see the highest growth in receivables in the past 5 years; however, the portfolio increasing effect of missed instalments due to the moratorium on loan instalments.

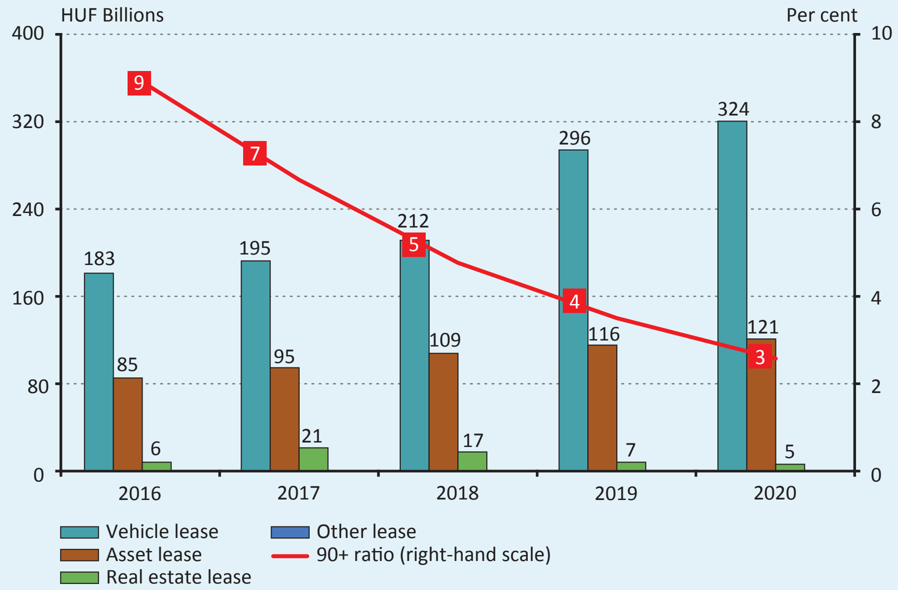
We found that in the category of non-banking group financial enterprises, the number of institutions engaged in financial leasing activities is relatively stable; in 2020 (similarly to the data registered in 2019) 29 financial enterprises pursued this activity. Concentration is particularly typical for leasing activity; the customer receivables of 9 financial enterprises in total exceeded HUF 10 billion in 2020 and 95 percent of the financial lease portfolio of the sector under review is concentrated at these institutions. These institutions are predominantly engaged in motor vehicle lease activities for corporations.

When examining the after-tax profit/loss we found that most of these financial enterprises realised a loss in 2020, and their after-tax profit/loss fell to its half by 2020.

The growth in the motor vehicle lease portfolio is mainly attributable to 5 financial enterprises and the rise in the corporate portfolio was determinant at all 5 institutions in 2020. Asset lease also increased, albeit the growth rate follows a decreasing trend. Institutions are highly specialised and 86 percent of the portfolio is concentrated at 5 financial enterprises.

Financial lease continues to be characterised by a high-quality portfolio. Portfolio cleaning continued in 2020, and the growing portfolio of previous years did not lead to deterioration in the portfolio quality. The impact of the moratorium on loan instalments is also reflected in the financial lease portfolio. In 2020, the increase in the portfolio due to disbursements fell short of that of previous year – only 1 of the largest institutions managed to reach the 2019 level – which was offset by the fall in the portfolio reducing items, which – however – was also affected by missed instalments by customers opting for the moratorium.

Chart 53
Composition of the financial lease portfolio of financial enterprises not belonging to a banking group



Source: MNB

6.4.7 Growth in workout portfolio halted

After five years of dynamic growth, the growth in the workout portfolio faltered in 2020 (Chart 54). While the receivables purchased from financial institutions shows a slight, 5 percent, increase compared to the previous year, the portfolio purchased from non-financial institutions decreased by 18 percent and the total portfolio managed by financial enterprises after the purchase of receivables for workout decreased by 3.5 percent compared to 2019. The decline observed in the market may be attributable to the lower number of receivable packages offered for sale due to the moratorium on loan instalments, while the savings on loan instalments may help consumers to exercise greater payment discipline towards utility and telecom providers.

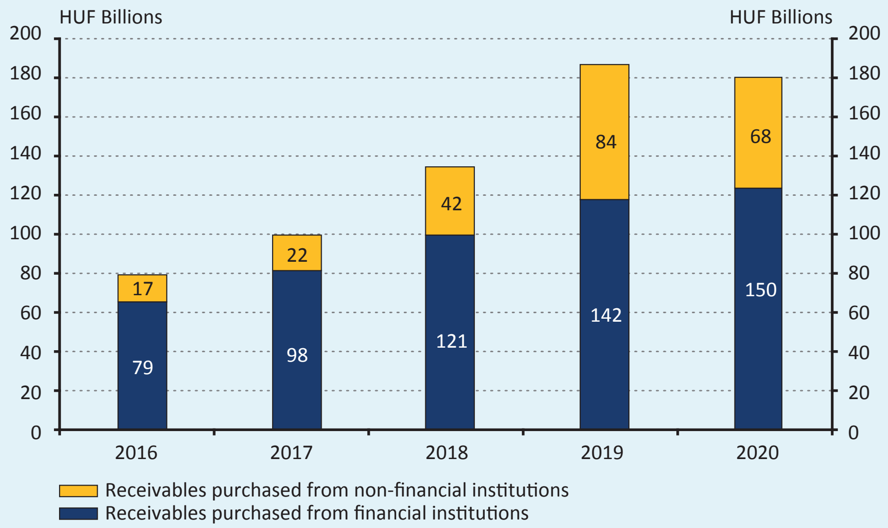
In 2020, 11 percent of the decline due to transactions resulting from repayments may be stated as a fall in total receivables, taking into consideration other reduction factors and transaction-based increments during the year. On the one hand, this reflects the improved efficiency of the workout activity of financial enterprises engaged in workout, and on the other hand, it may be the result of certain debtors participating in the moratorium on loan instalments using the released funds for repayment. In 2020, once again 7 non-banking group financial enterprises achieved a portfolio growth in excess of HUF 1 billion. However, among them there are also new entrants as well as companies that until now typically had a small market share.

When examining the composition of the managed portfolio we found that while the volume of receivables decreased, the number of contracts increased by 10 percent compared to the previous year. This increase is mainly due to a 20 percent increase in the number of receivables from financial institutions, in addition to a 2 percent rise in the number of receivables from non-financial institutions. Receivables purchased from financial institutions are typically larger in size, and in 2020 their dominance increased further. Based on the number of contracts and the portfolio value they account for 44 percent and 69 percent of total receivables, respectively. The value of receivable from household mortgage loans secured by real estate fell by 9 percent compared to 2019, while the number of these contracts increased by 13 percent, indicating a decline in the concentration of transactions.

Financial enterprises that are predominantly engaged in workout tend to rely on credit institution funding to a lesser degree. Financing from own or owner's funds is used more frequently, which is not affected directly by the moratorium on loan instalments. Furthermore, taking into consideration that the portfolio managed by workout companies includes transaction that already expired and were overdue before 18 March 2020, they are outside the scope of the moratorium.

The profitability of financial enterprises engaged in workout fell by more than a quarter in 2020 compared to 2019. However, the decline in profitability of the major players in the workout sector is not a trend decline, and is mostly due to exchange rate fluctuations and or changes in accounting treatment. In addition, several institutions voluntarily provided their customers with longer or shorter grace periods, similar to the moratorium, which also reduced profitability. On the other hand, the equity of workout companies increased by around 20 percent. The capital formation, while fostering prudent operations and adequate liquidity, may signal the preparation of the workout market for the post-moratorium period.

Chart 54
Portfolio of non-banking group financial enterprises purchased for workout



Source: MNB

6.4.8 Consumer protection – special attention to transitional provisions

Continuing the practice of previous periods, the MNB, in addition to prudent operation, paid special attention to the enforcement of consumer protection legislation and the MNB recommendations in 2020, and monitored domestic developments and the effects of legislative changes.

To this end – in addition to the review of the policies submitted during the authorisation procedures and the inspections – the MNB also examined the advertisements, website and other press releases of the supervised institutions as part of the continuous oversight, and took the necessary measures based on the signals and requests received and the information available during the supervision. In addition to the communication channels, the MNB monitored the institutions' administration and complaint handling solutions. A shift towards digital solutions under the special circumstances characterised this sector as well.

In 2020, in order to protect consumers, in addition to the provisions on the moratorium on loan instalments, a number of regulations entered into force, the practical application of which required guidance from the MNB. The MNB received a number of enquiries related to pawnbroking with regard to the moratorium. In the case of financial enterprises engaged in lending activities, in addition to monitoring compliance with the provisions of the moratorium and the provision of information to customers, the MNB had to take measures – typically through continuous oversight, with special view to proportionality and speed – to terminate the infringements in commercial communication.

The MNB also paid special attention to the compliance with the maximum APR for the loan and financial lease products introduced on a temporary basis. To this end, it verified institutions' data supply with special care and took immediate action where necessary if it identified any infringement. It also regularly issued consumer protection warnings to non-banking group financial enterprises when it identified practices that potentially breached consumers' interests or the MNB's recommendations. In the workout sector – continuing the practice of previous years – the MNB continued to focus on consumer applications concerning the behaviour of financial enterprises engaged in workout, in particular the handling of complaints, and on the licensing procedures of companies planning to start their activity in this sector. MNB Recommendation 2/2019 (II.13.) on the workout activity performed vis-á-vis consumers, which entered into force on 1 May 2019, was also in the focus of continuous oversight. In addition to the foregoing, the verification of the adequacy of the information published on the institutions' websites also received special attention.

In 2020, the MNB continued the examination of compliance with the provisions of the PTI[35] and ACR regulations, started in previous years, extending it to the monitoring of commercial communications both as part of the prudential inspections and the ex officio targeted audits. In 2020, on request inspections were typically launched in relation to financial enterprises' complaints handling practices, breach of confidentiality and customer information. In addition, the MNB examined during the individual licensing procedures, on a preventive basis, the rules relating to consumer protection laws.

[35] PTI: Payment-to-income ratio limit

7 Capital market and its risks

At the end of 2020, 34 investment service providers were active on the Hungarian capital market. In 2020, the HUF 39,077 billion volume of customer securities managed by investment service providers – HUF 34,293 billion by credit institutions and HUF 4,784 billion by investment firms – exceeded the HUF 38,269 billion value of customer securities registered in 2019, by 2.1 percent. The number of securities accounts increased by 0.5 percent in 2020. The HUF 341.1 billion capital market turnover realised by supervised institutions in 2020 represents a 12.1 percent increase compared to the previous year.

Table 9
Key data of investment service providers

Investment service sector	2019			2020		
	Credit institutions	Investment firms	Total	Credit institutions	Investment firms	Total
Number of institutions (pcs)*	20	13	33	20	14	34
Customer securities portfolio (HUF billions)	34,674	3,595	38,269	34,293	4,784	39,077
Number of securities accounts managed (thousand pcs)	1,467	242	1,709	1,465	252	1,717
Capital market turnover (HUF billions)	274,256	30,172	304,428	306,069	35,076	341,145
Profit after tax (HUF millions)		9,895			12,815	
Capital adequacy ratio (percent)		22.5%			21.9%	

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

The managed assets in the amount of HUF 10,668 managed by the 41 investment fund managers exceeds the amount registered previous year by 4 percent and reached a historic high at the end of 2020. The growth is mainly attributable to the increase in assets managed in mutual funds and pension funds. Similarly to previous year, the pension fund sector was the main driver of relative growth in 2020: the pension fund assets managed by investment fund managers at the end of 2020 in the amount of HUF 1,853 billion exceeded the amount a year ago by 6.9 percent. In absolute terms, in 2020 the largest growth was realised in the net asset value of mutual funds (HUF 193 billion).

Table 10
Key data of investment fund managers

Investment fund management sector	2019	2020
Number of institutions (pcs)	46	41
Number of funds managed (pcs)	646	661
Volume of assets managed (HUF billions)	10,262	10,668
Profit after tax (HUF millions)	46,498	45,872

Source: MNB

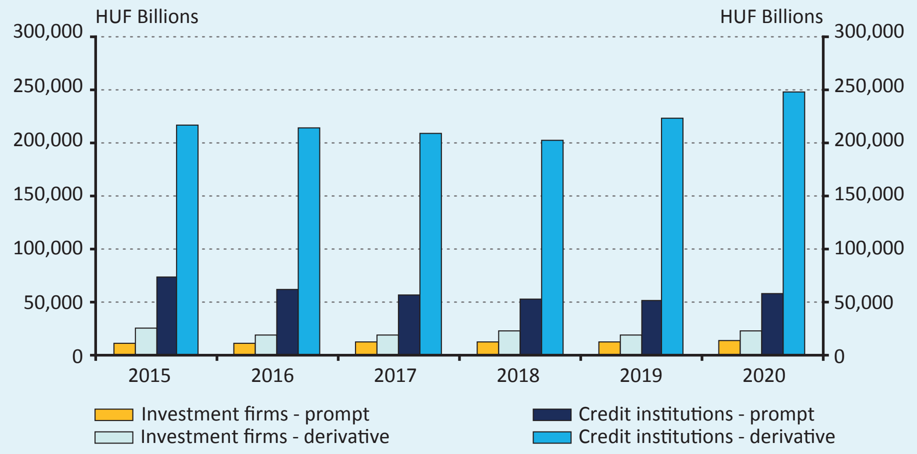
7.1 INVESTMENT SERVICES MARKET: TURNOVER AND BALANCES

7.1.1 Capital market turnover was characterised by vigorous growth in 2020

Investment service providers – credit institutions providing investment services and investment firms – realised a total capital market turnover of HUF 341,100 billion in 2020, which exceeds the turnover of HUF 304,400 billion realised in 2019 by 12.1 percent. In 2020, the capital market turnover of both types of market participants – i.e. credit institutions providing investment services and investment firms – increased: the capital market turnover of credit institutions of HUF 306,000 billion in 2020 exceeded the level of HUF 274,300 billion registered in 2019 by 11.6 percent, while the capital market turnover of investment firms increased by 16.2 percent from HUF 30,200 billion in 2019 to HUF 35,100 billion in 2020 (Chart 57). At credit institutions, capital market turnover grew in all market segments in 2020: there was a sharp increase in the stock exchange prompt turnover of credit institutions, which grew by 57.1percent from HUF 1,379 billion in 2019 to HUF 2,167 billion in 2020, followed by a 16.3 percent increase in the turnover of stock exchange derivatives (stock exchange derivatives turnover amounted to HUF 3,331 billion in 2019 and reached HUF 3,873 billion in 2020). The OTC prompt capital market turnover of credit institutions increased from HUF 49,800 billion in 2019 to HUF 55,600 billion in 2020 (+11.6 percent), and the OTC derivatives turnover of credit institutions of HUF 244,200 billion in 2020 was 11.1 percent higher than the HUF 219,800 billion in 2019.

The increase in the turnover of investment firms in the capital markets is mainly explained by the increase in the stock exchange prompt turnover: the HUF 6,710 billion prompt turnover of investment firms in 2020 exceeded the HUF 4,585 billion prompt turnover of 2019 by 46.3 percent. There was also a strong increase in the derivatives turnover of investment firms at the stock exchange and over the counter: in 2020, stock exchange derivatives turnover increased by 20 percent to HUF 2,946 billion. A similar increase (+19.4 percent) was recorded for OTC derivatives. By contrast, the OTC prompt turnover of investment firms fell by 19.7 percent from HUF 7,356 billion in 2019 to HUF 5,905 billion in 2020.

Chart 55
Developments in the capital market turnover

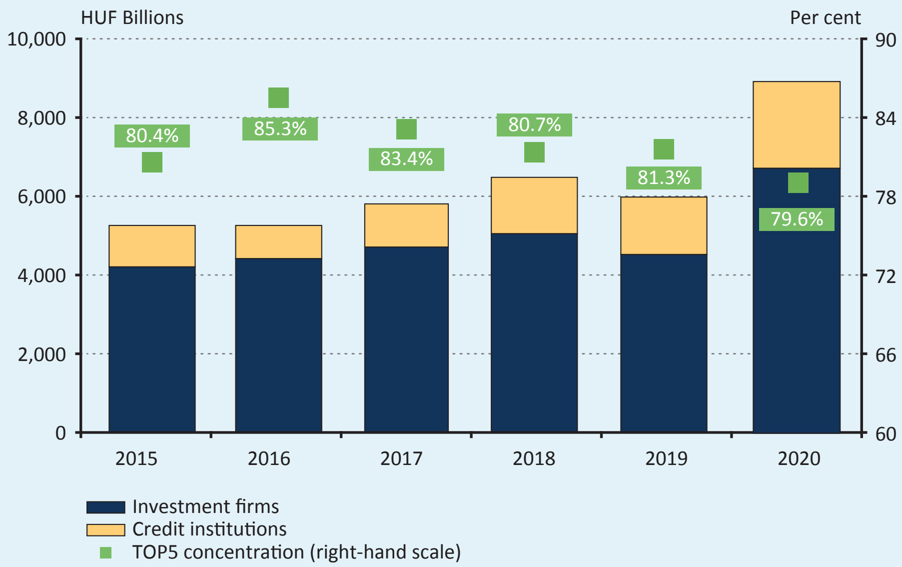


Source: MNB

7.1.2 Stock exchange prompt turnover soared

In 2020, stock exchange turnover increased significantly. The prompt stock exchange turnover rose by HUF 2,912 billion to HUF 8,876 billion in 2020, which corresponds to an annual growth of 48.8 percent. The increase in prompt stock exchange turnover is mainly explained by the rise in brokerage trading: the prompt stock exchange turnover of credit institutions rendering investment services realised through brokerage trading soared by 76.8 percent at an annual level and reached HUF 967 billion in 2020. Investment firms also registered a dynamic growth in the volume of prompt stock exchange turnover through brokerage trading: in 2020, the brokerage part of investment firms' prompt stock exchange turnover was by almost 53 percent higher than in 2019, reaching HUF 5,850 billion. By contrast, the growth in proprietary prompt stock exchange turnover fell short of the rise in brokerage turnover: the credit institutions' proprietary prompt stock exchange turnover increased by 44.1 percent from HUF 832 billion in 2019 to HUF 1,199 billion in 2020, while the investment firms' proprietary prompt stock exchange turnover grew only by 13.7 percent (2019: HUF 756 billion; 2020: HUF 859 billion). The trend of previous years continued in 2020: the share of investment firms in the stock exchange prompt turnover fell from 76.9 percent registered in 2019 to 75.6 percent by 2020 – in 2016, 2017 and 2018 it amounted to 84.3, 81.1 and 78.1 percent, respectively. Similarly to 2019, the composition of the top 5 investment service providers with the highest prompt stock exchange turnover changed in 2020 as well. 1 investment firm was removed and it was replaced by 1 credit institution, leaving 3 investment firms and 2 credit institutions in the top 5 in 2020. The concentration of prompt stock exchange turnover decreased: the share of the top five investment service providers realising the highest stock exchange prompt turnover decreased from 81.3 percent of 2019 to 79.6 percent by 2020. (Chart 56)

Chart 56
Stock exchange prompt capital market turnover and concentration



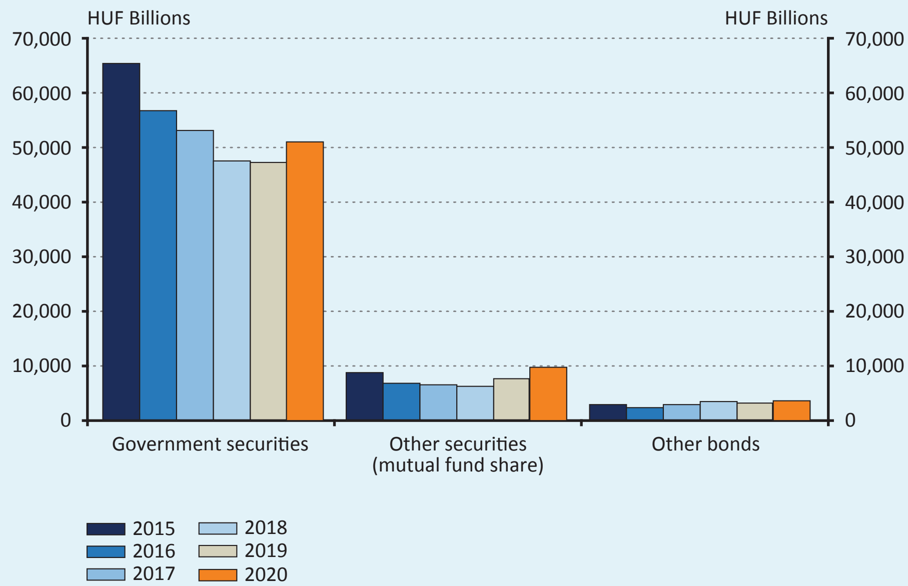
Source: MNB

The concentration of stock exchange derivative turnover decreased further: the share of the top five investment service providers realising the highest stock exchange derivatives turnover decreased from 75 percent of 2019 to 73 percent by 2020 (it was 78 percent in 2018). The stock exchange derivative turnover rose by HUF 1,033 billion to HUF 6,819 billion in 2020, which corresponds to an annual growth of 17.8 percent. The increase in stock exchange derivatives turnover is mainly explained by the rise in brokerage trading. In 2020, the stock exchange derivatives turnover of credit institutions providing investment services realised from brokerage trading increased by 36.6 percent in annual terms to HUF 1,774 billion. The increase is mainly related to one institution. The stock exchange derivatives turnover of investment firms realised from brokerage trading rose by 19.6 percent year-on-year to HUF 2,296 billion. On the whole, the stock exchange proprietary turnover of derivative products rose by 7.1 percent at an annual level to HUF 2,749 billion. While at investment firms, the 21.6 percent growth in the turnover of stock exchange derivative proprietary trading (corresponding to HUF 650 billion) in 2020 exceeded the growth in the turnover of stock exchange derivative brokerage trading (+19.6 percent), at credit institutions the growth in the turnover of stock exchange derivative proprietary trading in 2020 (+3.3 percent, annual turnover HUF 2,099 billion) substantially lagged behind the growth in the turnover of stock exchange derivative brokerage trading (+36.6 percent). The growth in the turnover of investment firms' proprietary stock exchange derivative trading in 2020 can be essentially linked to one institution.

7.1.3 Vigorous growth in over-the-counter prompt capital market turnover

The dominance of credit institutions in the OTC prompt capital market strengthened in 2020: the turnover realised by credit institutions in the OTC prompt capital market covered 90.4 percent of total OTC prompt turnover, which is a relatively significant increase compared to the 87.1 percent share in 2019 (88.8 percent in 2017). The OTC prompt capital market turnover of HUF 61,547 billion, realised by domestic investment service providers in 2020 was 7.8 percent higher than in 2019. The increase is the combined result of two opposite effects: while the turnover of credit institutions in OTC prompt capital markets increased by 11.9 percent, the turnover of investment firms in OTC prompt capital markets decreased by 19.7 percent. The growth observed at credit institutions is mainly linked to three institutions; nevertheless, the growth was also present at sector level overall. The decrease observed at investment firms is essentially attributable to the developments in the OTC prompt capital market turnover of 2 investment firms. In 2020, 9 investment firms were active in the OTC prompt capital market segment, fewer by one compared to 2019, in view of the fact that at the end of 2019 Magyar Posta Befektetési Zrt. – which was typically active in the OTC prompt capital market – returned its operating licence. Breaking the downward trend of recent years, the concentration of OTC prompt capital market turnover increased in 2020, with the top 5 market participants covering 66 percent of the prompt OTC turnover, up from 64.7 percent in the previous year (70 percent in 2017 and 68.7 percent in 2018). In 2020, the composition of the top 5 investment service providers with the highest prompt OTC turnover changed by 1 market participant: 1 investment firm was replaced by 1 credit institution, and thus there is no investment firms in top 5 market participants with the highest prompt OTC turnover. The OTC prompt capital market turnover, similarly to previous years, was dominated by government securities in 2020 as well, with a share of 79 percent, followed by mutual fund shares with a ratio of 15 percent. It should be noted that contrary to the trend decline in previous years, the turnover of government securities on the OTC capital market increased by 8.5 percent to HUF 51,377 billion in 2020. (Chart 57)

Chart 57
OTC prompt turnover by types of securities

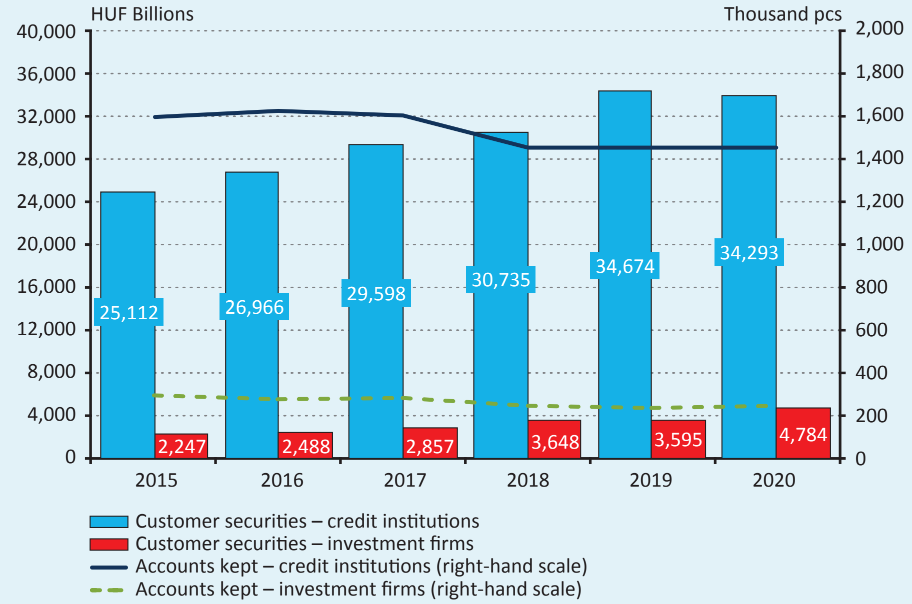


Note: due to their negligible OTC turnover equities are not included in the chart
Source: MNB

7.1.4 Customer securities portfolio at a historic high despite capital market turbulences in 2020

The impact of the extraordinary year 2020 was also felt in capital markets. However, despite the fall in prices, the total market value of customer securities managed by investment service providers increased by 2.1 percent from HUF 38,269 billion in 2019 to HUF 39,077 billion by the end of 2020. However, the growth rate lagged behind dynamic rates registered in previous years (customer securities portfolio grew by 10.2 percent in 2017, 5.9 percent in 2018 and 11.3 percent in 2019). The customer securities portfolio of HUF 34,293 billion, managed by credit institutions at the end of 2020, was by 1.1 percent lower than the HUF 34,674 billion portfolio in 2019. By contrast, the customer securities portfolio managed by investment firms increased by 33.1 percent in 2020: the portfolio of HUF 4,784 billion in December 2020 was by HUF 1,189 billion higher than in 2019 – the soar is attributable to several high-value transfers and securities originations. Accordingly, the ratio of customer securities portfolio managed by investment firms within the total customer securities portfolio soared to 14 percent in 2020 – a historic high – from the previous levels of 8-10 percent. In a breakdown by asset class – in line with the capital market developments – equity portfolio of credit institutions rendering investments services declined in 2020: the equity portfolio of HUF 11,640 billion at the end of 2020 fell short of the 2019 portfolio by 7.4 percent, which corresponds to a decline of HUF 934 billion. By contrast, the government securities portfolio increased by HUF 248 billion to HUF 13,021 billion (a rise of 1.9 percent), while the mutual fund share portfolio rose by HUF 673 billion to HUF 7,807 billion (up 9.4 percent). In 2020, investment firms' customer securities portfolio increased in all asset classes: of the HUF 1,189 billion increase, HUF 526 billion is linked to equities (+40 percent), HUF 261 billion to mutual fund shares (+19.1 percent), HUF 80 billion to government securities (+10.8 percent), HUF 302 billion to corporate bonds (+242.8 percent) and HUF 20 billion (+37.8 percent) to other securities. The soar in the corporate bond portfolio is essentially attributable to the increase in the portfolio of one institution. In 2020, the number of customer securities accounts held by investment service providers increased by 0.5 percent. The number of customer securities accounts kept by credit institutions fell minimally, by 0.1 percent, to 1,465,000 (corresponding to 2,000 accounts) by the end of 2020, while investment firms registered an increase of 11,000 accounts and thus the closing stock of 252,000 at the end of 2020 corresponds to a year-on-year increase of 4.4 percent. (Chart 58)

Chart 58
Customer securities portfolio



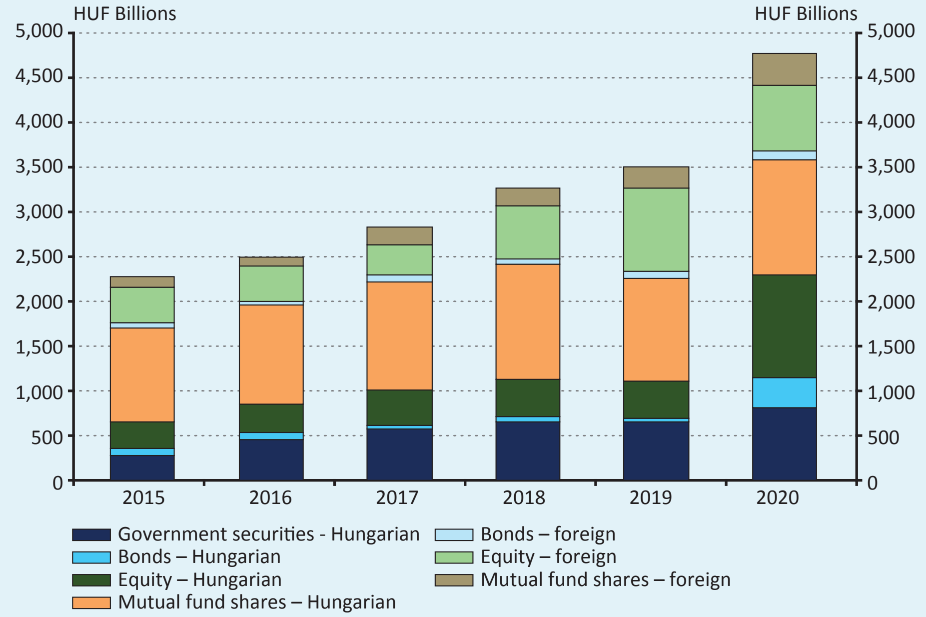
Source: MNB

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

The breakdown of investment firms' customer securities portfolio by asset classes shows that the equity asset class has moved up from its previous usual second place to first place in the ranking based on share, with a ratio of 38.5 percent in 2020 (2019: 36.6 percent), followed by the mutual fund asset class in the second place with 34 percent (2019: 38 percent), the government securities asset class in the third place with 17 percent (2018: 20.4 percent) and the corporate bond asset class in the fourth place with 8.9 percent (2018: 3.5 percent).

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. In the mutual fund asset class the ratio of Hungarian mutual funds decreased further among investment firms: the ratio of 78.2 percent at end of 2020 fell short of the value registered in 2019 by 4.4 percent. (Chart 59)

Chart 59
Customer securities portfolio by asset classes



Source: MNB

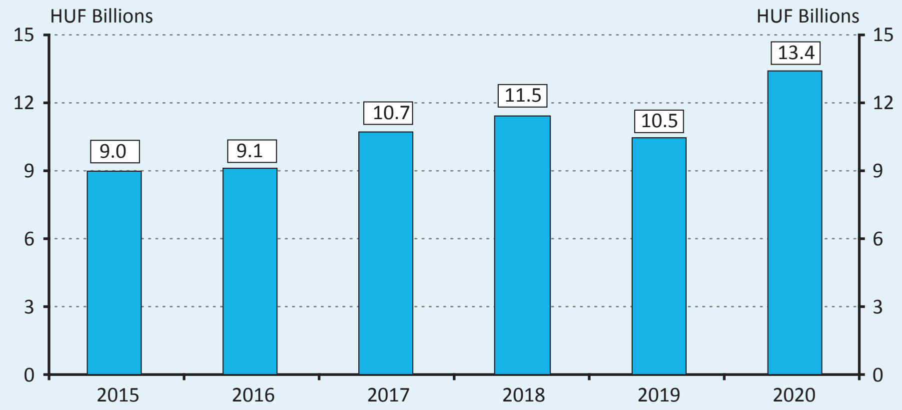
7.2 REGULATED MARKET

7.2.1 Outstanding increase in the turnover of the Budapest Stock Exchange

The total turnover of the Budapest Stock Exchange in 2020 increased by 19.2 percent at an annual level, while in 2019 it decreased by 6.1 percent year-on-year and in previous years it was also characterised only by single-digit growth (2018: +2.8%, 2017: +3.1%). Essentially the growth was strong in the prompt market: the 2020 prompt turnover of HUF 3,526 billion showed an increase of 32.7 percent compared to 2019, while turnover in the derivatives market rose only by 3.6 percent. The increase of HUF 870 billion in turnover on the prompt market is attributable to the growth of HUF 787 billion (30.6 percent) in the turnover of Hungarian equities, the rise of HUF 49 billion (67.9 percent) in the turnover of certificates and the soar 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 to HUF 648 million in 2019 followed by a rise to HUF 28 billion in 2020. Under a significant increase in the prompt turnover, the share of domestic equities in the total prompt turnover decreased by 1.5 percentage points from 96.9 percent in 2019 to 95.4 percent in 2020 (2017: 94.6 percent, 2018: 96.8 percent). The concentration of the turnover of the members of the prompt section increased further in 2020: the turnover generated by the top five stock exchange members covered 83.5 percent of the entire prompt market, which exceeds the value of 81.5 percent registered in 2019 by roughly 2 percentage points, while this ratio in 2017 and 2018 was 76.9 percent and 80.9 percent, respectively. Four of the top five stock exchange members were also in the top five in 2019.

The growth in the derivatives market turnover in 2020 broke the downward trend of several years: the total derivatives turnover of HUF 2,401 billion in 2020 exceeds the total turnover of HUF 2,318 billion in 2019 by 3.6 percent. The increase in the derivatives market total turnover was driven by a 96.2 percent surge in index-based futures (2019: HUF 140 billion; 2020: HUF 274 billion), and this significant increase offset the 7.2 percent decline in equity futures (2019: HUF 270 billion; 2020: HUF 251 billion) and the 0.7 percent decline in currency futures (2019: HUF 1,884 billion; 2020: HUF 1,871 billion). Derivatives market concentration declined in 2020, although it remains strong: the turnover generated by the top 5 stock exchange members covered 86.6 percent of total derivatives market turnover, up by around 1.3 percent from 87.9 percent in 2019. (Chart 60)

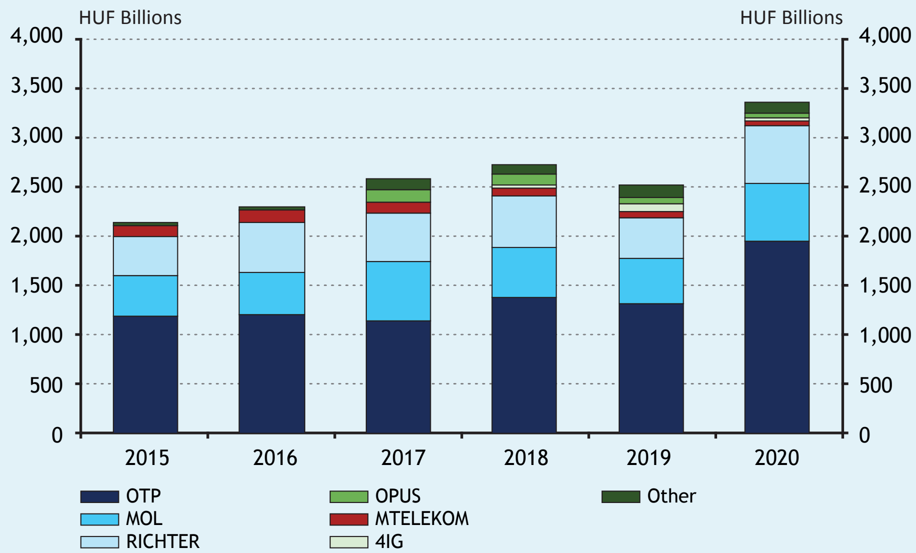
Chart 60
Average daily equity market turnover of the Budapest Stock Exchange



Source: MNB

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 2020, but their order has changed: OTP is still on the first place, while MOL – ranked second in 2019 – slipped to the third place in 2020 and it was replaced by Richter, ranked third in 2019. Equity market concentration continued to rise in 2020 from its previous high level: the share of the top three issuers with the largest turnover in the total equity market turnover increased from 83.4 percent in 2019 to 92.8 percent in 2020. An increase was observed at all three issuers, but it was particularly large in OTP, the annual turnover of which increased by 49.7 percent (it was HUF 1,305 billion in 2019, and HUF 1,954 billion in 2020), followed by Richter, the turnover of which in 2020 in the amount of HUF 591 billion exceeded previous year's turnover of HUF 424 billion by 39.5 percent and finally by MOL, which registered a growth of 24.4 percent (2019: HUF 464 billion; 2020: HUF 577 billion). The turnover of the other major issuers decreased in 2020: accordingly, the turnover of Mtelekom decreased by 7.4 percent (2019: HUF 61 billion; 2020: HUF 56 billion), the turnover of 4IG by 61.9 percent (2019: HUF 82 billion; 2020: HUF 31 billion) and the turnover of Opus by 36.6 percent (2019: HUF 54 billion; 2020: HUF 34 billion). (Chart 61)

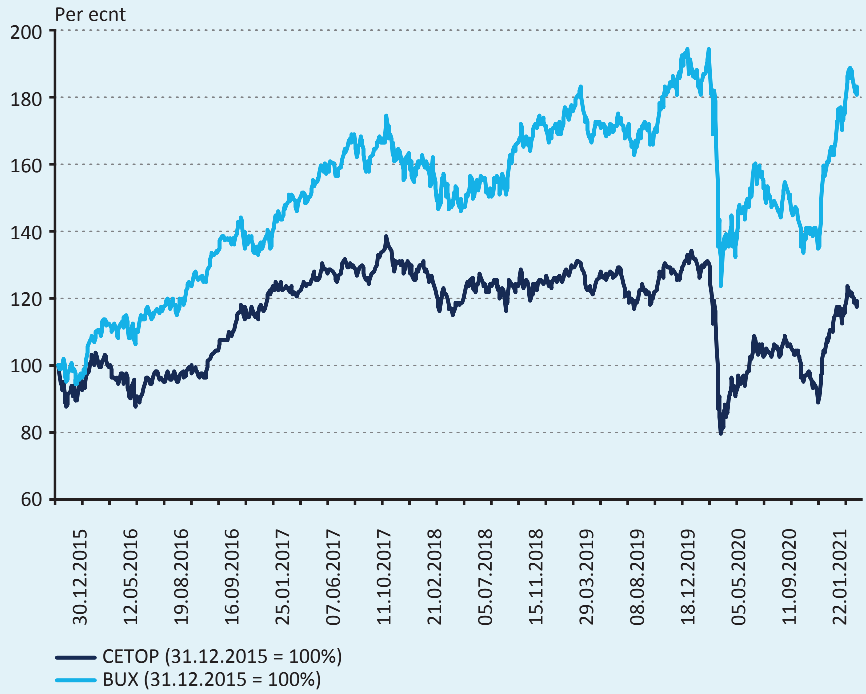
Chart 61
Annual stock exchange turnover of issuers



Source: MNB

In 2020 the BUX index decreased by 8.8 percent from the closing value of 46,083 registered at the end of December 2019 to the closing value of 42,048 points at the end of December 2020. As a result of the events in 2020, the BUX index was highly volatile, falling 36.2 percent from its 2020 peak in the first quarter of 2020 to reach its annual low, before recovering in the second half of 2020. (Chart 62)

Chart 62
Changes in the BUX and CETOP indices



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

7.2.2 In 2020 five new issuers' equity was listed on BSE's trading venues

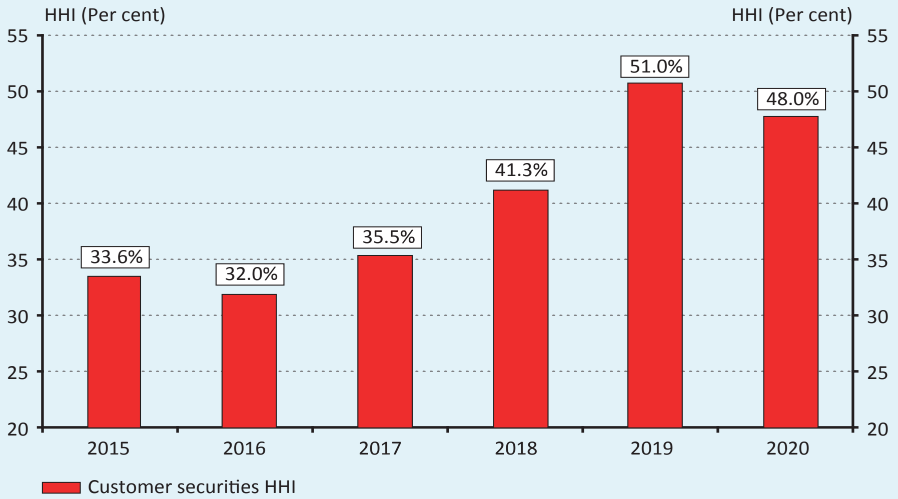
In 2020, the shares of Pensum Group Plc and SunDell Estate Plc were admitted to the primary market of the Budapest Stock Exchange (i.e. Xbud), while 4 shares were delisted from this market: 2 issuers were automatically delisted (ELMŰ Plc, ÉMÁSZ Plc), 1 issuer was delisted due to liquidation (Csepel Holding Plc) and 1 issuer was delisted due to failure to meet the conditions for the commencement of trading (BILK Logisztikai Plc). In 2020, the shares of two issuers (DM-KER Nyrt., Gloster Infokommunikációs Nyrt.) were admitted to the Xtend multilateral trading facility for small and medium-sized companies of the Budapest Stock Exchange, while the shares of Wizz Air Holdings PLC were admitted to the market of BETa multilateral trading facility, which allows trading in foreign equities.

7.3 RISKS AFFECTING INVESTMENT FIRMS

7.3.1 The decreasing trend in the market share of small investment firms continued in 2020

The concentration of investment firms' customer securities portfolio, calculated in accordance with the Herfindahl-Hirschman Index (HHI), fell by 3 percent to 48 percent by end-2020 compared to 2019, but remains at a high level. The decrease is attributable to market entry of 2 new investment firms. The trend increase in market concentration in previous years is attributable to the significant consolidation following the broker scandals of 2015: by 2020 9 of the 15 former non-bank investment service providers remained in the market (Chart 63).

Chart 63
Market concentration of customer securities portfolio

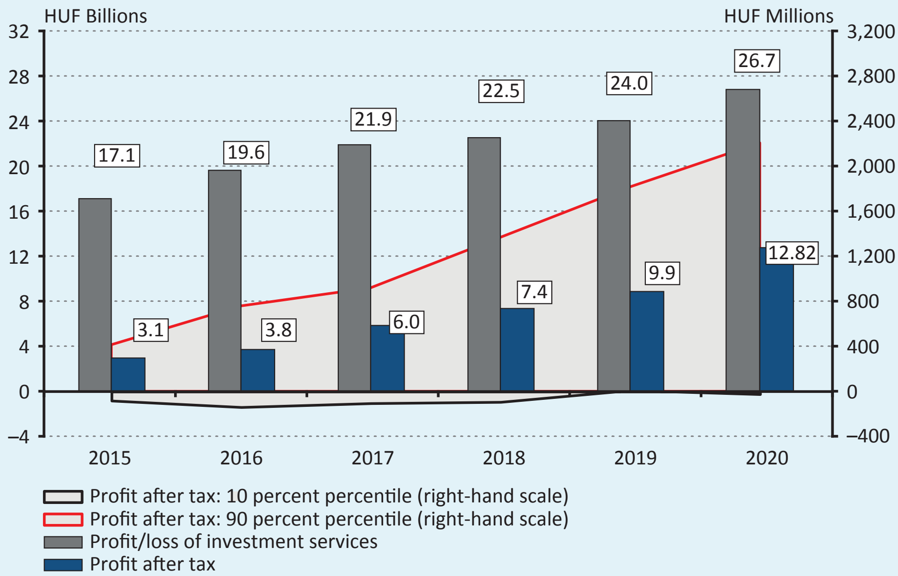


Source: MNB

7.3.2 Sector profitability at a historic high

In 2020, the investment firm sector's – including branch offices – profitability continued to rise: the after-tax profit of HUF 12.8 billion in 2020 exceeds the after-tax profit of HUF 9.9 billion registered in 2019 by 29.5 percent (the annual growth rate in 2019, 2018, 2017 and 2016 was 33.6 percent, 24.1 percent, 55.8 percent and 25.6 percent, respectively) and reached a historic high at sector level. The significant increase in the after-tax profit of investment firms is attributable to the growth in the capital market turnover realised by them: the capital market turbulences in the first half of 2020 activated investors, which led to a surge in investment firms' revenues due to transactions. The after-tax profit of 9 of the 15 investment firms that operated at the end of 2020 increased, that of 4 investment firms decreased, while 2 investment firms entered the market in 2020. The income concentration of the sector declined further in 2020, albeit marginally: the share of the combined after-tax profit of HUF 10.5 billion of the top 3 market participants based on after-tax profit decreased to 82.2 percent of the entire sector's after-tax profit, from 82.8 percent recorded in 2019, and the combined after-tax profit of HUF 12 billion of the top 5 market participants with the highest after-tax profit declined to 93.5 percent of the entire sector's after-tax profit from 96.6 percent registered in 2019 (Chart 64).

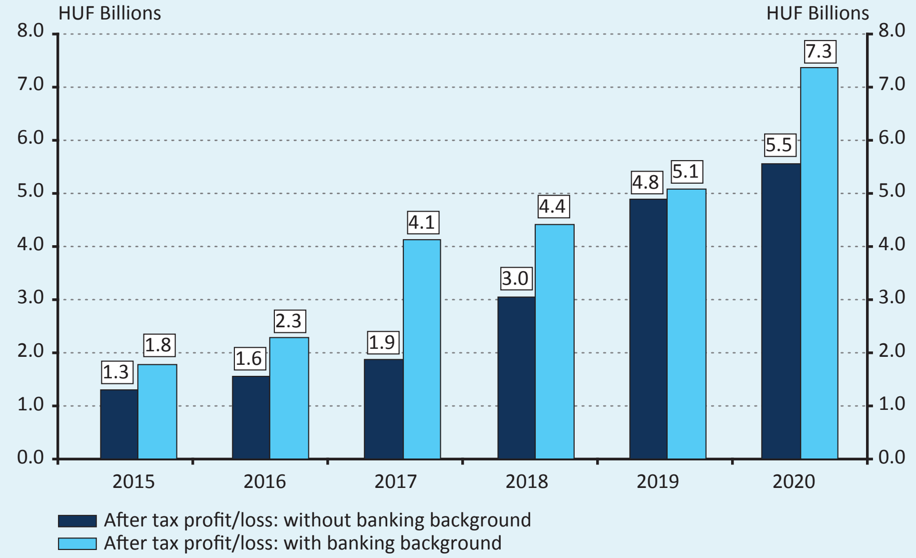
Chart 64
Profitability of investment firms



Source: MNB

Last year's experience shows that the consolidation process that previously characterised the investment firm sector has come to an end, with no investment firm having returned its operating licence in 2020. Both of 2 investment firms that entered the market in 2020 have strong and committed ownership background. Improved profitability at sector level is also evidenced by the fact that the profitability of independent investment firms not belonging to the banking group continued to increase in 2020: their profit after tax increased by HUF 0.7 billion from HUF 4.8 billion in 2019 to HUF 5.5 billion in 2020 (+14 percent). The growth was comprehensive across the sector: the 2020 after-tax profit of 7 of the 11 non-bank investment firms holding an activity licence already in 2019 exceeded previous year's after-tax profit (Chart 65).

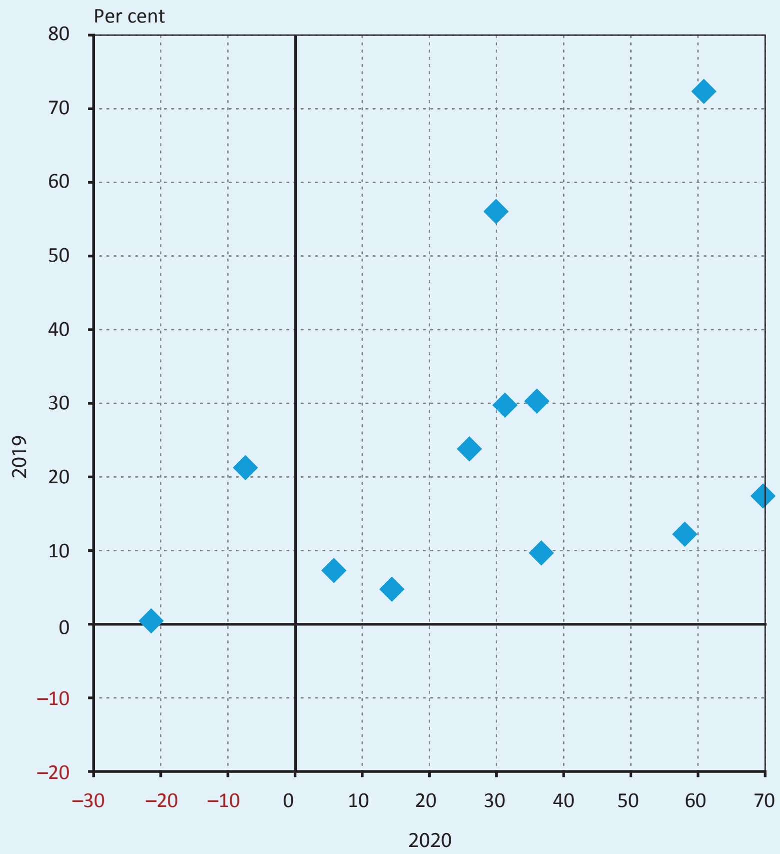
Chart 65
After-tax profit/loss of investment firms with and without a banking background



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

While in 2019 only 1 investment firm realised a loss, by 2020 this number rose to 3. The investment firm that realised a loss in 2019 continued to be loss-making: this investment firm, which received its activity licence in 2017, has no customer portfolio and keeps no customer accounts. One of the other 2 loss-making investment firms received its activity licence in 2020, and thus the initial start-up costs explain the loss-making operation. In the case of the other loss-making investment firm, the profitability problems are attributable to the applied business model. The improvement in the sector-level profitability is also evidenced by the after-tax return on equity (ROE): Chart 66 shows that investment firms cluster to the right from the vertical zero axis.

Chart 66
ROE value of investment firms (percent)



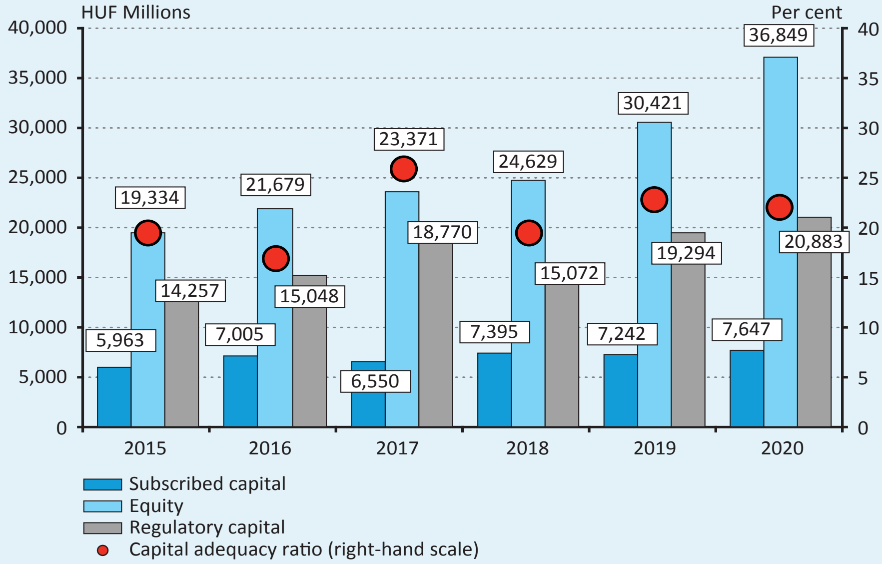
Source: MNB

7.3.3 Adequate capital adequacy at sector level

The subscribed capital of investment firms rose from HUF 7.2 billion of 2019 to HUF 7.7 billion in 2020: the growth is primarily attributable to the market entry of investment firms. Similarly to 2019, the equity of investment firms strongly increased also in 2020, by around HUF 6.4 billion (+21.1 percent). The increase is essentially attributable to 3 institutions, but it should be noted that of the 11 of the 15 investment firms holding an activity licence at the end of 2020 registered a growth in equity compared to the previous year, 2 of them registered a decrease, while the remaining 2 investment firms entered the market in 2020. The capital adequacy ratio of the investment firms sector decreased, albeit marginally, in 2020, by 0.6 percentagepoint from 22.5 percent at the end of 2019 to 21.9 percent by the end of 2020. The decrease in the capital adequacy ratio at sector level is mainly attributable to the increase in capital requirements. This is also evidenced by the fact that only 2 investment firms experienced a decrease in solvency capital in 2020, while the indicator increased at the rest of them.

All of the 13 investment firms with a registered office in Hungary had an adequate capitalisation level at the end of 2020. In 2020, 10 of the 13 investment firms with registered office in Hungary, have to comply with the capital requirement calculated on the basis of risk exposure, while in the remaining 3 cases the capital requirement comprises the statutory initial capital requirement, as a higher limit (Chart 67).

Chart 67
Capital and capital adequacy ratio of investment firms



Source: MNB

7.3.4 Sector level risk map of the investment firms

Risk category	Risk groups	Risk rating	Risk prospects	Textual evaluation
Market risk	Risky investment products may come to the fore in the hope of higher yields	significant	increasing	In 2020, investors' risk appetite increased compared to the past. *The persistently low yield environment in capital markets, the inconsistency between equity market valuations and the macroeconomic situation, and the market uncertainty caused by the market turbulences in 2020 could push investment firms and investors towards riskier products.*
Corporate governance	Exercise of owner's rights Internal governance Risk management system Internal control system	significant	increasing	The investment firms managed the turbulent effects of 2020 efficiently in terms of organisation, and the provision of investment services, the related control and back-office functions were uninterrupted and continuous, even during the period of remote work and the suspension of customer service in person. *In 2021-2022, investment firms will need to comply with several EU regulatory regimes, which are expected to place a significant burden on firms' organisational and financial resources (IFR/IFD, SFDR, CSDR).*
Profitability	Competition between service providers	moderate	stagnant	Despite the capital market turbulences, investment firms overall were highly profitable in 2020. In particular, the volatile capital market environment in the first half of the year prompted investor to be more active, as a result of which revenues on transactions and the customer base grew significantly. *Risk to profitability may be represented by the continuously tightening regulatory requirements related to product distribution/marketing. Competition between service providers may have a negative impact on the profitability of certain firms.*
Capital adequacy	Changeover to IFR/ IFD regime	moderate	stagnant	The regulatory capital adequacy of investment firms was stable in 2020. *The changeover to the IFR/IFD regime – which will fundamentally change the capital calculation rules – carries moderate uncertainty, which could be clarified in the second half of 2021.*

Legend:

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

The turbulence in capital markets in the first half of 2020 stimulated investors' activity, with considerable positive impact on the profitability of investment firms through a significant increase in the turnover of institutions. In 2020, the sector's capital adequacy remained stable and investment firms' risk management practices adequately managed the risk entailed by the increased volatility. It is still the case that ongoing compliance with and preparation for the application of international regulatory requirements, such as the MiFIDII[36]/MiFIR regulatory framework, the IFR/IFD prudential framework and the SFDR sustainability framework, continue to tie up significant organisational resources in investment firms, and this trend will continue in the future as well. The range of institutions operating in the sector has stabilised: of the investment firms entering the market in 2020, one large investment firm with international background should be highlighted, the activity of which may entail a significant growth in the volume of customer assets managed by the sector in 2021, and competition between service providers may also increase.

7.4 FUND MANAGEMENT MARKET AND RISKS AFFECTING INVESTMENT FUND MANAGERS

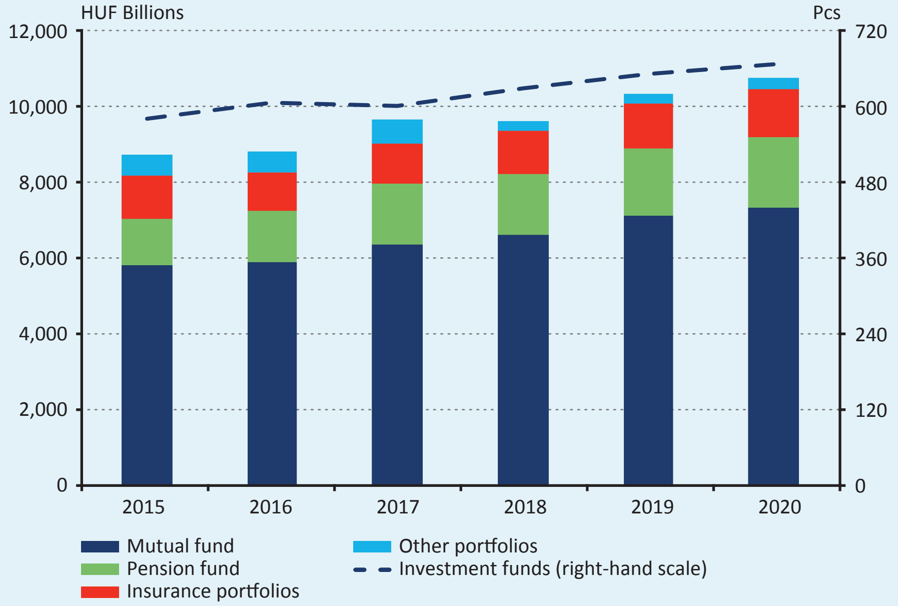
7.4.1 Assets managed by investment fund managers continued to grow despite capital market turbulence in 2020

The number of investment funds rose from 646 registered at the end of 2019 to 661 by the end of 2020. The previous increasing trend of real estate funds continued in 2020 as well and accordingly, the number of real estate fund rose from 137 in 2019 to 154 by the end of 2020. The number of securities fund at the end of 2020 was 507, the same as at the end of 2019. The number of public real estate funds – also available to retail investors – did not change in 2020.

Despite the turbulence in the capital markets in 2020, the volume of assets managed by the domestic investment fund managers continued to grow and reached a historic high: the volume of assets managed in the amount of HUF 10,668 billion at the end of 2020 exceeded the amount of HUF 10,262 billion at the end of 2019 by 4 percent (the volume of assets managed by investment fund managers rose by 7.5 percent in 2019, decreased by 0.2 percent in 2018 and increased by 9.7 percent in 2017). As in the previous year, the growth in 2020 was mainly driven by the pension fund sector: the voluntary and private pension fund assets in the amount of HUF 1,853 billion managed by investment fund managers at the end of 2020 exceeded the assets managed in 2019 in the amount of HUF 1,733 billion by 6.9 percent (by HUF 120 billion) – growth in the assets of pension funds was significant also in 2019 (+ 8.8 percent). In absolute terms, the net asset value of investment funds continued to grow to the largest degree in 2020: the HUF 7,270 billion net asset value of investment funds in December 2020 exceeds the HUF 7,077 billion net asset value registered in 2019 by HUF 193 billion (2.7 percent). The assets managed by investment fund managers in insurance portfolios – similarly to the previous years – continued to increase also in 2020: the portfolio of HUF 1,253 billion exceeds the value registered in 2019 by 4.6 percent. The growth is practically related to three investment fund managers with insurance background, while one investment fund manager registered a decline. Despite the declining trend in previous years, assets managed in other portfolios grew by 14.7 percent in 2020 and reached HUF 292 billion: the growth in assets managed in other portfolios was typical across the sector. (Chart 68).

[36] Directive 2014/65/EU of the European Parliament and the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU

Chart 68
Assets managed by investment fund managers and the number of investment funds



Source: MNB

Box 7
MNB recommendation on liquidity stress testing for investment funds

Liquidity stress testing is an instrument that forms part of the general liquidity risk management framework. It simulates a variety of circumstances, including – among other things – normal and "stressed" (i.e. extreme, unlikely or adverse) conditions, to assess their potential impact on funding, assets, overall liquidity of the fund and to identify any additional measures that may be necessary to ensure that the institution is capable of preserving its solvency even under such circumstances.

Given that the topic is key to the long-term, safe functioning of the individual institutions, it has been a priority in the past as well and has become even more so in the turbulent times of last year. In the spirit of this, the MNB issued Recommendation 6/2021 (IV. 29.) on liquidity stress testing for UCITS[37] and AIFMs[38] to improve the quality and consistency of liquidity stress testing and, in certain cases, to increase its frequency and to specify the detailed rules for liquidity stress testing. The recommendation is the domestic implementation of Guideline No ESMA34-39-897 issued by the European Securities and Markets Authority (ESMA) with the same title.

The recommendation sets out guidelines for investment fund managers and custodians on the criteria that investment fund managers should consider when carrying out liquidity stress testing of the investment funds they manage and on the obligations of investment funds' custodians in relation to this activity. The recommendation also touches upon those factors that investment fund managers must identify when developing the liquidity stress test model. Fund managers should also ensure that the liquidity stress test ultimately provides information that facilitates the accomplishment of any additional necessary measures. Namely, liquidity stress testing should help the investment fund manager prepare the fund for a crisis and for a broader emergency planning. To this end, the recommendation stipulates the specific purposes that the outcome of the liquidity stress test should serve to facilitate this.

[37] UCITS: Undertakings for the Collective Investment in Transferable Securities
[38] AIFM: alternative investment fund managers

The recommendation also sets out the expectations that an investment fund manager should comply with in relation to the liquidity stress testing in terms of meeting the requirements applicable to appropriate governance, supervisory structure and practices, independence and conflict of interests. The recommendation also states that investment fund managers should draw up a policy for conducting liquidity stress tests, also determining the mandatory content elements of it.

The recommendation lays down that investment fund managers should develop a liquidity stress test that takes into consideration and is consistent with the liquidity risks arising from both the assets and liabilities of the investment fund and also complies with the criteria that are appropriate to achieve balance. The liquidity stress test should apply past scenarios based on assumptions and, in some cases, reverse stress tests. The recommendation sets out expectations for the development of scenarios and for the asset and liability stress testing of investment funds, with a particular focus on investment funds investing in less liquid assets. After stress testing the asset and liability sides of the investment fund's balance sheet separately, the investment fund manager should combine the results of the liquidity stress test to determine the overall impact on the fund's liquidity and also aggregate the liquidity stress test for the multiple investment funds managed by it. The recommendation also sets out the criteria based on which the stress test can be tailored to the characteristics of each investment fund.

The recommendation requires investment fund managers to carry out the stress tests described above at least annually; however, more frequent stress tests may be justified under certain conditions. The recommendation also provides examples of factors that may increase or decrease the frequency of conducting the liquidity stress tests.

The recommendation lays down the monitoring obligation of custodians with regard to the conduct of liquidity stress tests by the investment fund managers. However, custodians are not expected either to assess the adequacy of the liquidity stress test or to perform stress test on their own with regard to the investment fund subjected to custody management.

The MNB's guideline also set out the data supply obligations of investment fund managers to the MNB.

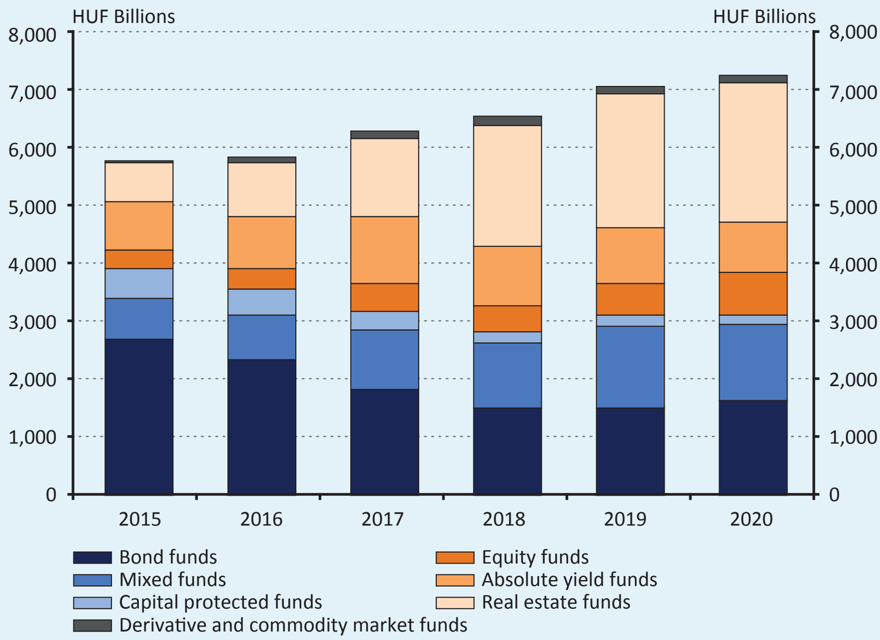
The MNB expects market participants to comply with the recommendation from 1 June 2021.

7.4.2 Net asset value of investment funds reaches new historic high as a result of yields realised on investments

Despite the capital market turbulence in 2020, the net asset value of investment funds increased by 2.7 percent to HUF 7,270 billion in 2020. Similarly to previous years, in 2020 as well the growth in the assets of investment funds is attributable to the positive yields realised on the investments: accordingly, the growth of HUF 193 billion in net asset value is attributable to the positive yield effect of HUF 181 billion and the positive net capital inflow of HUF 12 billion.

Breaking the downward trend of several years, in 2020 the assets managed in fixed income investment funds, i.e. liquidity, money market, short-term bonds, long-term bonds, and bonds without duration target, increased by 7.4 percent to HUF 1,636 billion. However, restructuring within fixed income investment funds continued: the assets managed in liquidity and money market funds fell in 2020 by 69 percent, corresponding to a decrease of HUF 63 billion and HUF 57 billion, respectively, while the net asset value of short-term bond funds rose by HUF 193 billion (20.5 percent) to HUF 1.139 billion. This is attributable to the EU regulation applicable to liquidity and money market funds from 21 January 2019, which imposes extra compliance requirements on liquidity and money market funds, thereby encouraging investment fund managers to alter the investment policy of the liquidity and money market funds managed by them and to reclassify them to the short-term bond fund investment class. Overall, assets managed in mixed funds decreased by HUF 55 billion to HUF 1,333 billion (- 4 percent). The decline in mixed funds was attributable to the contraction in the assets of balanced mixed funds: in 2020, the assets managed in balanced mixed funds decreased by 20.8 percent (HUF 162 billion), while the assets managed in bond-heavy mixed funds and dynamic mixed funds increased by 8.2 percent (HUF 39 billion) and 53.9 percent (HUF 68 billion), respectively. Following the growth of 23.5 percent in 2019, the net asset value of equity funds rose in 2020 by 32.9 percent – the closing balance of HUF 739 billion exceeds the volume of assets managed in 2019 in the amount of HUF 556 billion by HUF 183 billion: most of the growth is essentially attributable to the net capital inflow. The decline in the assets of capital protected funds over the past five years continued and even accelerated in 2020: the net asset value of capital protected funds of HUF 147 billion in 2020 is lower by 28.7 percent compared to 2019 (a contraction of 2.6 percent in 2019, 33 percent in 2018 and 28.6 percent in 2017). In line with market trends in the previous year, the growth in assets managed by real estate funds – funds investing directly and indirectly in real estate – continued in 2020: At the end of 2020, the assets managed in real estate funds in the amount of HUF 2,429 billion exceeded the 2019 closing value of HUF 2,309 billion by 5.2 percent. The 5.2 percent growth in net asset value in 2020 is well below the growth rates experienced in recent years (2015: +16.7 percent, 2016: +40.1 percent, 2017: +47.4 percent, 2018: +55.3 percent, 2019: +10.4 percent), which is explained by events in 2020 (Chart 69)

Chart 69
Breakdown of the investment funds by investment policy

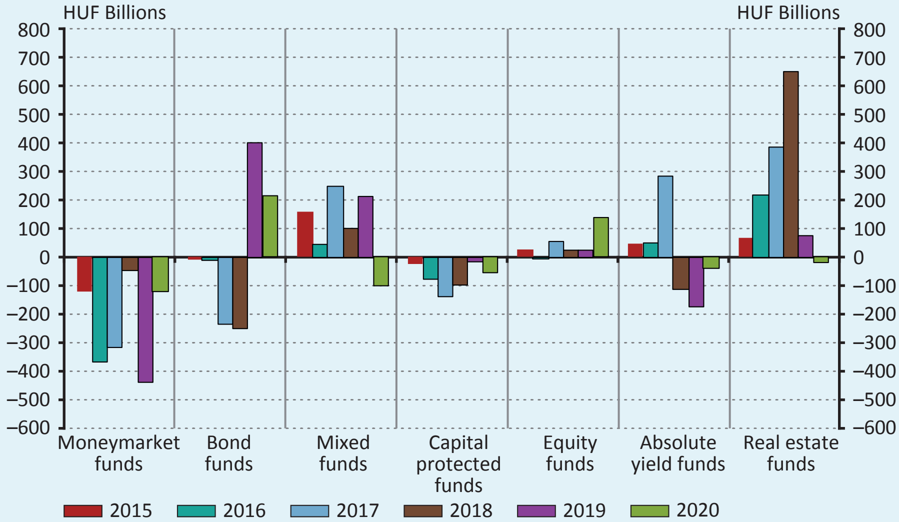


Source: MNB

7.4.3 Under capital market turbulence, investment funds were characterised by positive net capital inflows overall

Investment funds were characterised by positive capital inflow at sector level in 2020 as well, but it significantly fell short of the values registered in previous years: the + HUF 12 billion net capital inflow of 2020 is only a fraction of the values of registered in 2019, 2018 and 2017 in the amount of + HUF 67 billion, + HUF 260 billion and + HUF 270 billion, respectively. The significant decline in net capital inflows in 2020 is explained by the capital market turbulence in 2020 and the investors' reaction to it. The capital market turbulence led to significant withdrawal of capital from investment funds in the first half of 2020, followed by a correction in the second half of 2020, resulting in positive net capital inflows into investment funds overall during the year. The capital market turbulence led to a shift in investors' interest: on the whole mixed funds, capital protected funds, absolute yield funds and real estate funds were characterised by divestiture, while there has been a relatively strong investor interest in equity funds. Fixed income investment funds, i.e. liquidity, money market, short-term bonds, long-term bonds and without duration target, experienced positive capital inflows (+ HUF 94 billion) in 2020, contrary to the divestiture experienced in previous years (2017: HUF -545 billion, 2018: HUF -298 billion, 2019: HUF -41 billion). Divestiture from absolute return funds continued, albeit at a declining rate: in 2020 net divestiture amounted to almost HUF 41 billion, which substantially falls short of the net divestiture of HUF 112 billion in 2018 and HUF 174 billion in 2019. As a result of the capital market turbulence in 2020, investors' interest in equity funds surged, which was also evidenced by the net capital flows of equity funds: the net capital inflows of HUF 136 billion in 2020 is almost five times higher than the capital inflows of HUF 26 billion and HUF 23 billion in 2018 and 2019, respectively (Chart 70).

Chart 70
Net capital flows of investment funds

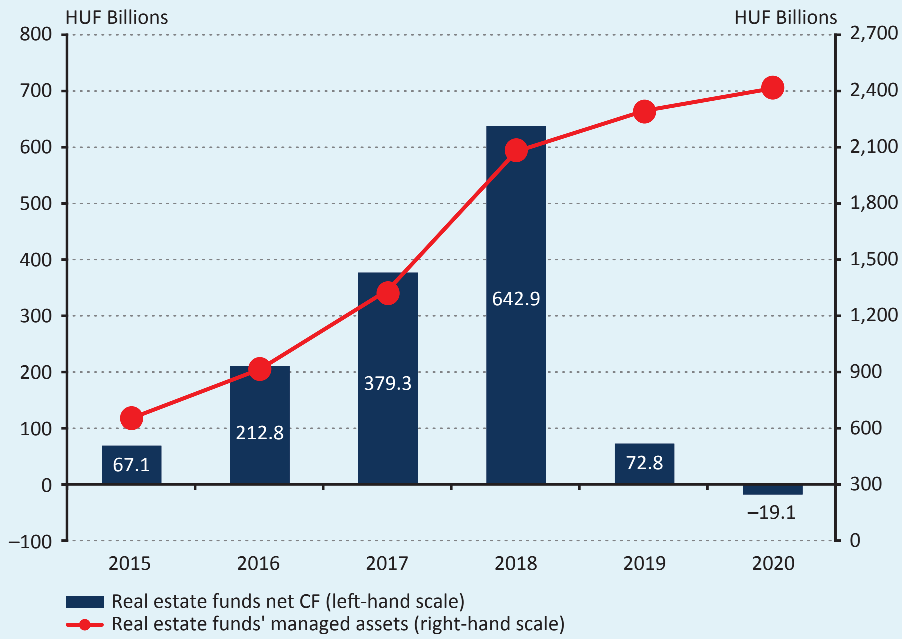


Source: MNB

7.4.4 Real estate funds were characterised by divestiture in 2020

Following several years of strong net capital inflows, due to the turbulence in the capital markets in 2020, real estate funds – funds investing in direct and indirect real estate – were characterised by net divestiture of HUF 19 billion in 2020 (2016: HUF +213 billion, 2017: HUF +379 billion, 2018: HUF +643 billion, 2019: HUF +63 billion). Despite the net divestiture, the net asset value of funds investing in direct real estate increased from HUF 2,092 billion in 2019 to HUF 2,181 billion in 2020: of the increase of HUF 89 billion, the investment yield realised on the managed portfolio amounted to HUF 126 billion, while net divestiture was HUF 37 billion. The net asset value of funds investing into indirect real estate rose by HUF 30 billion in 2020, from HUF 217 billion of 2019 to HUF 248 billion. Of the HUF 30 billion increase in net asset value, HUF 18 billion is attributable to net capital inflows and HUF 12 billion to yields realised on investments. The net capital inflow of HUF 18 billion in 2020 in funds investing in indirect real estate should be highlighted in view of the market trends developed as a result of the capital market turbulence in 2020 and the fact that in 2019, funds investing in indirect real estate were characterised by net divestiture (HUF -57 billion) (Chart 71).

Chart 71
Portfolio and net capital inflows of real estate funds

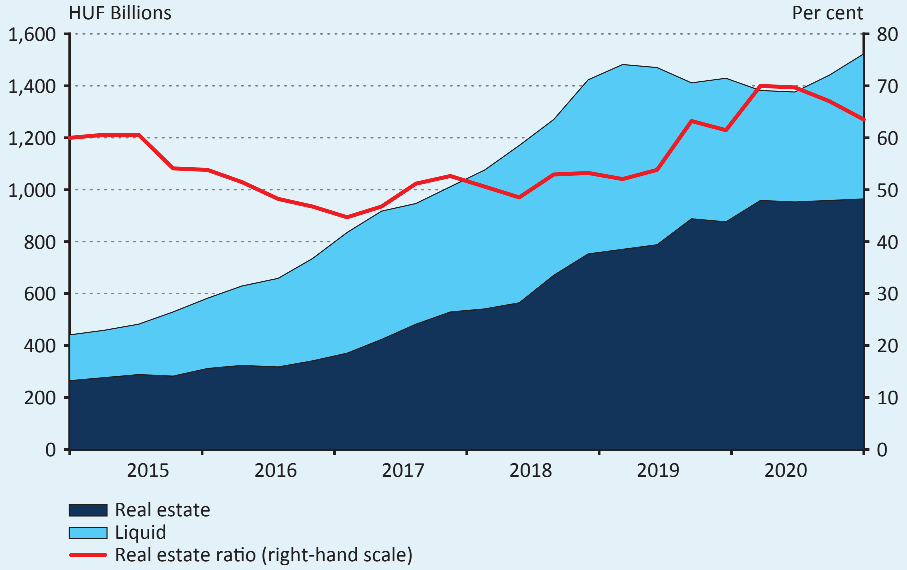


Source: MNB

7.4.5 Despite the capital market turbulence, assets managed by public real estate funds increased

Despite the capital market turbulence in 2020, the portfolio of public real estate funds grew: the HUF 1,520 billion net asset value of public real estate funds in 2020 exceeded the net asset value registered in 2019 in the amount of HUF 1,422 by 6.9 percent. The growth registered in 2017, 2018 and 2019 was 36.9 percent, 41.6 percent and 0.4 percent in 2019, respectively. The low dynamics in 2019 is partly attributable to the MNB recommendation on public open-ended real estate funds issued by the MNB in spring 2019 and partly to the launch of the Hungarian Government Securities Plus retail government securities. The growth in assets managed in public real estate funds was practically experienced across the sector: 9 out of 10 public real estate funds recorded an increase in managed assets in 2020. Of the HUF 98 billion increase in the net asset value of public real estate funds in 2020, HUF 50 billion is linked to net capital inflows, while the remaining HUF 48 billion is the yield realised on investments. As a result of the capital market turbulence in 2020, the capital flows of public real estate funds were characterised by diversity: while in the first half of 2020, in net terms HUF 74 billion was withdrawn from public real estate funds, in the second half of 2020 the net capital flows turned positive and net capital inflows reached HUF 124 billion. As a result, the ratio of real estate investments in the net asset value of public real estate funds approached 70 percent in the first half of 2020, but by the end of 2020 this ratio declined to 63 percent, which is roughly the same as the closing value of 61 percent in 2019 (Chart 72). After the downward trend observed in previous years, the share of public real estate funds in the portfolio of funds investing in direct real estate stabilised in 2020: the 68 percent share of public real estate funds in 2020 is practically the same as in 2019, compared to 83.6 percent in 2017 and 77.3 percent in 2018 (the decrease in the share in previous years was due to the strong growth of closed-end real estate funds). Public real estate funds continued to be characterised by strong concentration in 2020 as well: the top three public real estate funds with the highest net asset value accounted for 77.4 percent of the public real estate funds' total net asset value, which exceeds the level registered in 2019 by 0.7 percent.

Chart 72
Real estate investment portfolio of public real estate funds and the ratio thereof compared to net asset value



Source: MNB

Box 8
Information for investors in publicly available real estate funds

Owing to the historically low bank interest rates and a spectacular boom in the real estate market, until 2019 more and more retail investors turned to investment funds with focus on real estate, promising higher yields. Domestic real estate funds achieved significant progress in recent years, but as with all investments, it is worth acting and making decisions after weighing up the risks here as well. In order to address the systemic risks posed by the increased portfolios, the MNB has recently issued several recommendations and executive circulars with regard to real estate funds.

The domestic real estate fund market experienced strong asset growth prior to 2019. The increase in the managed assets of publicly available open-ended real estate funds was mainly attributable to net inflows. The demand for real estate funds is driven by several factors. On the one hand, demand for investment funds with real estate exposure appeared as an alternative to buying property directly; on the other hand, the persistently low interest rate environment increased demand for alternative investment opportunities offering higher returns than bank interest rates.

These processes carry risks if, for example, there changes occur in the value of the properties in the funds, which could be triggered by a downturn in the real estate market, a possible turbulent environment or the devaluation of properties. However, there is also a risk of a sudden change in interest in real estate, which could result in concentrated divestiture from real estate funds in a short period of time. In exceptional cases, despite the very high level of liquid assets required by the MNB, a real estate fund manager may find that it is unable to redeem the mutual fund shares at the expected pace because the properties are sold with a longer lead time or not at the expected price. As is well known, the financial crisis that broke out in 2007-2008 left a deep mark on the Hungarian investment fund market well, and in particular on the Hungarian real estate fund market. The then very popular real estate distribution funds experienced a sudden surge in divestitures, and as a result, net asset value halved in a matter of days, destroying funds’ underlying liquidity. In such cases, the supervisory authorities should intervene using instruments such as temporary suspension of distribution and modification of the settlement period for redeemed mutual fund shares. Based on the experience of recent years and the legislative changes that meanwhile have come into force, real estate funds are now better prepared, their liquidity is under tighter control, they are maintaining a much higher level of liquidity and their risk management instruments are also more advanced than in 2007-2008. This is evidenced by the fact that this sector as well managed efficiently the turbulent effects of 2020.

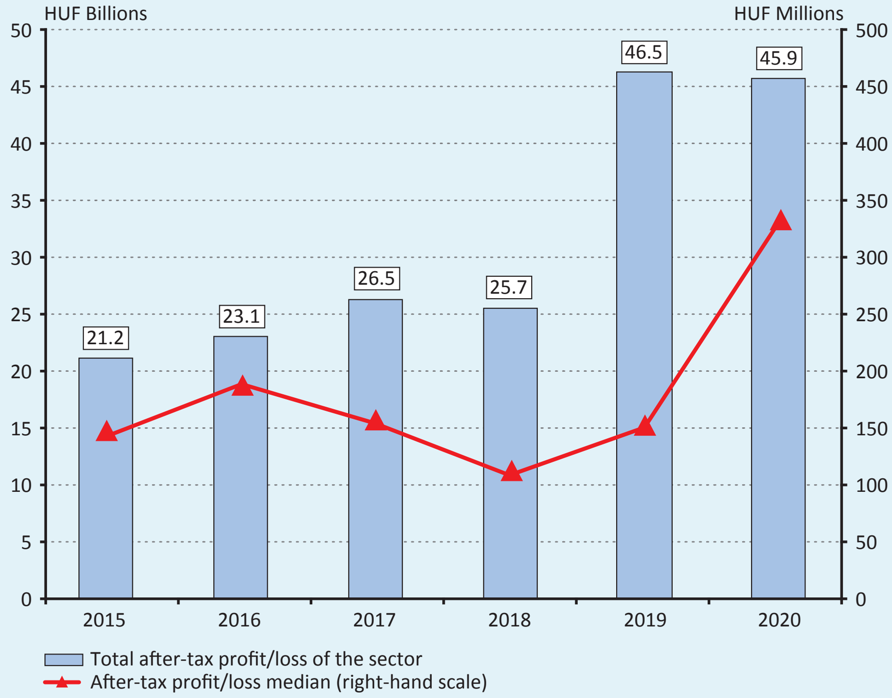
When investing in a real estate fund, it is advisable to check the redemption conditions stipulated in the fund's management regulations and the timeframe recommended for investment in its information document. This will help to clarify the costs and lead times for investors to get their money and whether this fits in with their investment plans. Special attention should be paid to examining which funds invest in residential real estate and which funds include a higher proportion of commercial real estate, as these two segments of the real estate market react very differently to market shocks. The commercial property market can react more quickly and with greater volatility to changes in economic indicators, such as a fall in production, while residential property tends to have a higher velocity, which may be more favourable in terms of meeting the liquidation criteria.

The MNB treats it as a priority to reduce the vulnerability of the Hungarian publicly available open-ended real estate funds and keep their liquidity risks at the minimum level. To this end, in order 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. Based on the MNB's recommendation issued on 1 April 2019, market participants marketing mutual fund shares are expected to participate primarily only in the marketing of mutual fund shares of publicly available open-ended real estate funds registered after the application of the recommendation, where the redemption settlement date is at least 180 calendar days later than the date of receiving the redemption order. In order to comply with this, the MNB expects the relevant fund managers to define a regularly revised distribution limit for the mutual fund shares of publicly available open-ended real estate funds with a redemption period shorter than 180 days. This means that for such funds, the number of units issued at any given time must not exceed the stock as at 15 May 2019, or as subsequently revised and determined. The size of the maximum stock must be reviewed periodically by the issuer of the fund.

7.4.6 Profitability in the fund management sector remains high

The after-tax profit of investment fund managers decreased from HUF 46.5 billion of 2019 by 1.3 percent to HUF 45.9 billion in 2020. The decrease is mainly due to the significant (46 percent) decrease in the market leader's after-tax profit compared to 2019, which was an outlier due to one-off effects, but it still exceeds the 2017 and 2018 figures (by 13 percent and 127 percent, respectively), which was offset by the overall increase in the sector's after-tax profit (Chart 73).

Chart 73
Profitability of investment fund managers

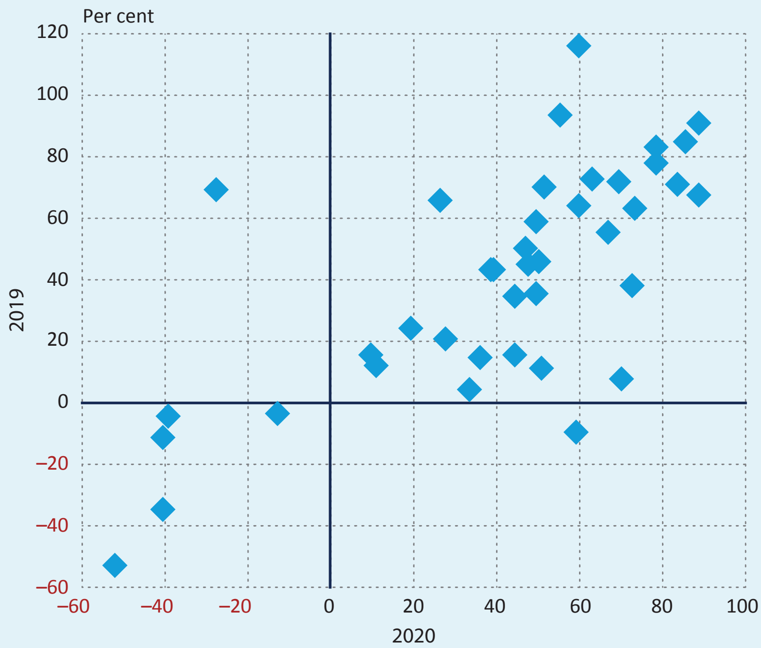


Source: MNB

As a result of the foregoing, the income concentration in the investment fund management sector decreased significantly in 2020: the after-tax profit/loss of the 5 top market participants with the highest after-tax profit accounted for 59.8 percent of the entire sector's after-tax profit in 2020, which falls short of the 2019 figure by 8.9 percentage points.

In 2020, the number of loss-making fund managers was 9, the same as in 2019. The total after-tax result of the loss-making fund managers in 2020 amount HUF -280 million, which is lower by 29 percent compared to 2019. Seven of the 9 loss-making investment fund managers started operations in the last two years. The business model of the investment fund managers was characterised by outstanding profitability in 2020 as well, also evidenced by the high level of the ROE indicator, i.e., after-tax profit to equity ratio: Chart 19 only shows the investment fund managers that were active in both 2019 and 2020 and whose activity licence was not withdrawn in 2020 (Chart 74).

Chart 74
ROE value of investment fund managers (percent)



Source: MNB

7.4.7 Sector level risks of investment fund managers

Risk category	Risk groups	Risk rating	Risk prospects	Textual evaluation
Market risk	Liquidity, operation of real estate funds in a stress environment	significant	increasing	The persistently low capital market yield environment and the general market uncertainty caused by capital market turbulence support the significant level and increasing trend of market risk. Capital market turbulence led to significant capital outflows in spring 2020, followed by a correction in the second half of 2020. *The low interest rate environment and the outstanding yield of household government securities also influenced the investment fund market: the negligible yield on government securities and deposit products available to funds, encourages fund managers to assume risks.*
Corporate governance	Sustainability aspects, tightening international expectations	moderate	stagnant	Compliance with EU sustainability legislation is a challenge for fund managers. *Compliance with the tightened international requirements may represent further challenges also for the money market funds.*
Profitability	Market yield environment	moderate	stagnant	In 2020, the profitability of the fund management sector was affected by uncertainty arising from the general economic and capital market situation. *The competition generated by the yields realisable on household government securities remains a challenge. A potential change in the market environment may represent a risk for the price of securities and the real estate sector.*
Operational risk	Risk management systems	moderate	stagnant	At some of the fund managers, the risk management, liquidity management and back-office processes call for enhancement
Capital adequacy	Profitability	low	stagnant	The fund management sector closed a positive year in 2020, as a result of which the capital position also improved on the whole. *At present – at the vast majority of the fund managers – there are major reserves.*

Legend:

Degree of risk — *high*, *significant*, *moderate*, *low*

Direction of risk — *increasing*, *stagnant*, *decreasing*

The impact of the capital market turbulence in 2020 affected the investment fund management sector more significantly primarily in the area of market risks, as a result of which the assessment of the sector's risk changed to significant in 2020 and the sector is expected to continue to face high levels of risk in the period ahead. Due to the turbulence significant outflow from investment funds was observed in the first half of 2020, and thus the continuous maintenance of liquidity was a top priority for fund managers. In the second half of the year, as a result of the improved market environment and the central bank bailouts investors repeatedly turned to investment funds, which improved the liquidity situation of the funds. The position of fund managers remained unchanged for the year as a whole in terms of profitability, capital adequacy, corporate governance and operational risk. In the area of corporate governance risks, fund managers face the challenge of complying with the EU sustainability legislation and, for money market funds, the challenge of meeting the tightened international standards.

7.5 CAPITAL MARKET CONSUMER PROTECTION

7.5.1 Circular on annual subsequent cost reporting

Based on statutory requirements, investment service providers are also required to provide their customers, at least annually, with subsequent information on the costs of all services provided and the financial instruments sold. In 2020, the MNB assessed, within the framework of continuous oversight, how investment service providers comply with this obligation. Based on this it found that different market practices emerged in terms of the content, format and timing of the information sent to customers. To ensure that customers receive more consistent and timely subsequent information on costs, the MNB issued an executive circular to service providers to remind them of the practices it expects them to follow. In addition to the expected timing of the sending of the cost information, the executive circular also formulates content and format requirements, the purpose of which is to reduce the information asymmetry between the service provider and the customer by deepening the information and, in certain cases, to make the cost information more informative. The MNB plans to backtest the fulfilment of the provisions of the circular about the cost information sent out for 2020 in 2021 and will assess the need for further measures based on that.

7.5.2 Suitability assessment thematic inspection

In addition to reinforcing consumer protection issues in its comprehensive inspections, following 2019 the MNB launched a thematic inspection affecting several investment service providers in 2020 as well, at the initiative of the European Securities and Markets Authority's (ESMA) to strengthen convergence between national supervisory authorities. The 2020 thematic inspection aimed to assess compliance with investor protection obligations involving the provision of investment advice. Within the framework of the inspection it was verified, among other things, in the case of service providers holding a licence for investment advisory services, to what extent the content and evaluation logic of the MiFID test assessing the customer's knowledge, experience, income position, risk appetite and investment objectives, the content of the suitability reports underlying and supporting the advice, and the content of the cost-benefit analyses to be produced by the service provided when switching between investments, comply with the regulatory requirements. 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 for a service provider to use other elements supporting objective assessment (such as questions that actually test the customer's knowledge) in addition to the customer's self-assessment, or to keep records of cases and the reasons for them, where the more expensive or complex product was recommended out of several possible products. However, the MNB identified it as risky practices from a consumer protection perspective if the service provider relies exclusively or excessively on customer declarations and self-assessments when evaluating the test, if it does not have a detailed methodology for assessing the risks of individual financial instruments, or if the content of the suitability report is not sufficiently informative or does not fully cover regulatory requirements.

In order to support ESMA's efforts, in 2021 the MNB, similarly to other Member States, will conduct yet another inspection with consumer protection focus, this time focusing on the product governance obligations of capital market participants, both as distributors and as product developers.

Box 9
Suitability test in practice

The suitability test to be completed by customers prior to portfolio management and investment advice is not only an administrative formality required by the Investment Firms Act[39], but also an essential consumer protection instrument. If an investment service provider asks inaccurate questions or the customer fails to provide honest answers, the customer may ultimately be offered or purchase a service or instrument that is not in line with the customer's financial knowledge, experience, risk tolerance and risk appetite.

The completion of the test by the customer and its evaluation by the service provider serves the purpose of investor protection, as it provides the service provider with information on, among other things, the customer's previous knowledge of the investment and financial instrument, trading experience, risk appetite and risk tolerance, and investment objective. The detailed rules of taking and assessing the suitability test are included in the Investment Firms Act and in Commission Regulation 2017/565.

A suitability test must be taken when the customer uses portfolio management, investment advice or investment services. The reason for this is that investment advice and portfolio management are services where the customer concludes transactions or authorises the service provider to conclude transactions trusting in the service provider's professional competence and relying on the service provider. Thus, the service provider's value added, and therefore its liability, is the most decisive factor for these services. It is therefore necessary to ensure that the customer is aware of the characteristics of the service and that the service provider's customer service framework is defined as precisely as possible. For all other investment services, the service provider will take an appropriateness test on the customer, as in these cases the trust element referred to above is no longer present to the same extent.

In this respect, it should be emphasised that a negative result in the suitability test has a different consequence for the investor compared to the appropriateness test. In the event of a failed suitability test, the investment service provider must refuse the execution of the customer order. On the other hand, if the appropriateness test shows that the given transaction or financial instrument is not suitable for the customer, the investment service provider only has a duty to warn the client, but may not prevent the conclusion of the specific transaction. The different consequences are justified by the differences in the investment services related to the tests, as explained above.

In practice, the investor protection function of the suitability test can be compromised by the behaviour of both the service provider and the customer. The service provider can realise the objective of the legislator to be achieved by the test by compiling relevant questions and developing an appropriate methodology for the assessment of the customer's answers, while the customer can do so by providing honest answers. Profit-oriented investment service providers are mainly interested in maximising the fee or commission income from the investment services they provide to their customers. Since the protection of customers' interests must not be prejudiced by the economic interests of investment service providers, service providers must ensure that the investor protection function of the suitability test is not compromised through pressure to sell. The profit target of investment service providers and the volume of their fee and commission income should not be more important than protecting the interests of their customers.

The suitability test is therefore a key investor protection instrument. However, this protection system can only work effectively if customers are honest and attentive when filling it in. Even the most carefully designed tests of service providers will be useless if customers do not answer them according to their real knowledge and experience.

[39] Act CXXXVIII of 2007 on Investment Firms and Commodity Dealers, and on the Regulations Governing their Activities

7.5.3 Cross-border CFD services

A significant part of institutions providing cross-border services in Hungary from other EU Member States offer high-risk contracts for differences (CFD) products to Hungarian customers. MiFIDII provided both the national supervisory authorities and ESMA with the possibility to impose restrictions or prohibitions on the design and marketing practices of certain products in order to mitigate consumer protection risks. Due to the high risk and speculative nature of CFDs, first ESMA and then the supervisory authorities of the individual Member States, including the MNB, resorted to this instrument and imposed strict restrictions on the sale of CFDs. In 2020, the MNB, in line with other Member States, extended its measure applicable to domestic CFD providers to cross-border providers and banned the sale of binary options to retail customers. In 2020, the MNB has continuously monitored the popular cross-border service providers that also advertise in Hungarian, primarily in relation to the information elements prescribed by the MNB, such as mandatory risk warnings. The MNB did not identify any serious infringement but identified consumer protection risks in the information provided in several cases, due to which in several cases it contacted the foreign supervisory authorities supervising these institutions. Given the high risk of CFDs, the MNB will continue to monitor their sales closely in 2021 as well.

It should be noted that the scope of the MNB's product intervention decision on CFDs (and binary options) covers CFD trading for retail clients in Hungary by investment firms domiciled in Hungary, as well as by branches and cross-border service providers, i.e. the restrictions set out in the decisions apply not only to domestic service providers involved in the sale of the product in question, but also to all domestic and cross-border market participants potentially authorised to trade in it. Extending the scope of product intervention as described above will ensure a consistent level of investor protection across the European Union.

Box 10
What is a CFD trading risk warning?

The annex to the product intervention decision, which applies to both domestic and foreign service providers and aims to restrict the sale of CFDs to retail clients, sets out specific content and format requirements with regard to the content of risk warnings that providers must include in their websites, advertisements and marketing materials promoting CFD trading, following the expectations previously established by ESMA:

– the risk warning should include up-to-date, provider-specific data on the proportion of loss-making CFD trading accounts held by the CFD provider for retail clients. The calculation must be performed every three months and it should cover the 12 months preceding the day of the calculation;

– the warning must be published in a form that makes it prominent, in a font size at least equal to the most typical font size, and in the same language as that used in the communication or information disclosed.

According to the MNB's product intervention decision, CFD providers are required to display a risk warning on their websites with the following wording:

"CFDs are complex instruments and come with a high risk of losing money rapidly due to leverage. At this provider, [...] percent of retail investor accounts incur losses on CFD trading. You should consider whether you understand how CFDs work and whether you can afford to take the high risk of losing your money."

CFD providers must also include information on the percentage of loss-making accounts in their internet advertising. However, as a concession, they may choose to present this in an abbreviated form, as set out below, but in this case, they must also include a direct link to their website with the full risk warning.

"Losses are incurred on [...] percent of retail CFD accounts."

The formal and content requirements for risk warnings are designed to help potential clients obtain information in a simpler and comparable way on the quantified risk of trading CFDs with a given provider. Due to the introduction of a uniform risk warning requirement, potential investors will be able to know the average degree of the risk of trading in CFDs with a specific provider from the moment they first encounter the provider's offer, typically in the form of an internet banner.

The introduction of risk warning requirements will therefore increase the ability of customers to obtain information on the real risk of CFD trading and will provide an opportunity to compare service providers operating within the EEA.

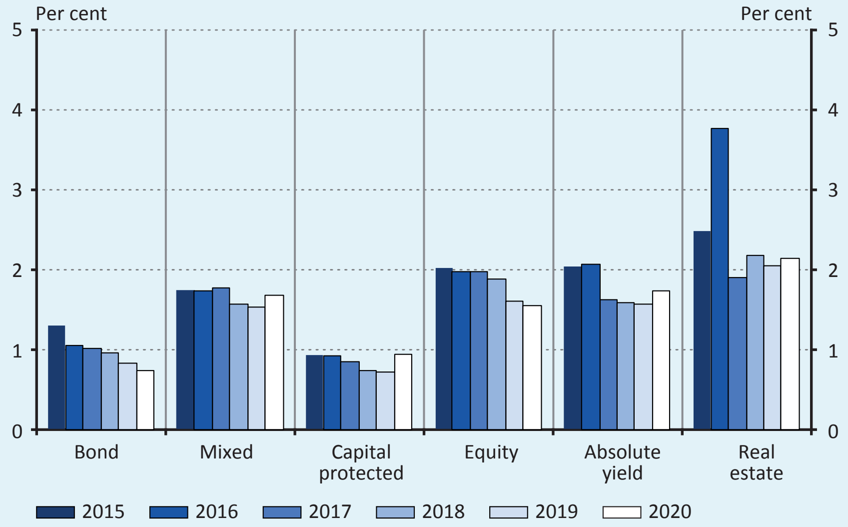
In the course of its capital market consumer protection monitoring activities, the MNB pays special attention to the content of the websites and internet advertisements of the most active foreign CFD providers – typically based in Cyprus – in reaching domestic and Hungarian investors, in order to verify compliance with the basic legal requirements on customer information and the formal and content requirements on risk warnings, as described above.

7.5.4 Costs of public investment funds in 2020

When examining Total Expense Ratio (TER)[40] in the preliminary unaudited individual data supply, MNB found that the funds with low average expense ratios are fixed income (such as liquidity, money market, short-term, long-term bond and without duration target). In the case of capital protected funds, the low TER is justified by the fund's investment strategy and business model, as they incur higher costs in the year of launch. In the case of funds with a higher risk profile, such as equity funds and absolute return funds, the higher average TER is justified by the investment activity requiring additional expertise. The average TERs for fixed income and equity funds registered a trend decline over the past five years, while it moderately rose at mixed and absolute return funds in 2020. When examining the same period, while real estate funds registered an increase a few years ago, costs moderately declined in recent years and in 2020 they once again increased slightly. After receiving the audited data, the MNB publishes TERs in line with previous practice (Chart 75).

[40] TER (Total Expense Ratio) shows the total expenses of an investment fund as a percentage, making it possible to compare different investment funds from a cost perspectivel.

Chart 75
Changes in the TER of domestic public investment funds



Source: MNB

Ensuring the greatest possible convergence in Europe also in costs is key to improving investor confidence in financial markets and reducing the costs associated with the acquisition of financial products. To this end, the national supervisory authorities and the European Securities and Markets Authority (ESMA) have agreed to launch a common supervisory action (CSA) to assess whether market participants comply with the applicable rules in practice.

ESMA announced in 2020 that it will launch a common supervisory action in 2021 on the supervision of costs and charges of UCITS funds. The purpose of the CSA on costs and charges is to assess whether supervised institutions comply with the relevant provisions of the UCITS legislation on costs and to ensure that investors are not burdened with unjustified costs. During the CSA the cost data used in TER are analysed more deeply, particularly considering the fact that the TER does not include any success fee that may be deducted from the performance of the funds above the benchmark yield.

Box 11
Draft MNB recommendation on performance fees applied by investment fund managers

Performance fee is one type of the costs that potentially may occur at investment funds. An investment fund manager using such fee may charge a performance fee if the investment fund managed by it is able to outperform the reference yield during the specified period.

In the Hungarian investment fund management market, this element exists at more than a quarter of the roughly 400 public investment funds, and a large majority of these actually charged a performance fee during 2020. In most cases, they used short-term government indices (ZMAX[41], RMAX[42]) or other money market indices as benchmarks, and thus fund managers were entitled to receive performance fees even when they realised very low yields.

[41] The ZMAX index is an index of the average change in the market price of government securities with a maturity of less than six months
[42] The RMAX index is an index of the average change in the market price of government securities maturing within one year

This phenomenon is normal for investment funds with characteristics aligned with these benchmark indices. However, these are also commonly used as benchmarks by investment funds that differ significantly in terms of risk, geographical exposure, volatility, recommended investment horizon and other characteristics, in particular the absolute return funds that most often use performance fees. The MNB, in close cooperation with ESMA, has therefore formulated recommendations to ensure that the performance fee models used by investment fund managers comply with the principles of honest and fair conduct when pursuing their business activity, and of acting with the expected skill, due care and diligence in the best interests of the fund they manage, thereby preventing the charging of unjustified costs to the fund and its investors. The recommendation based on ESMA's guidelines published in 2020 is expected to be issued in summer 2021.

Perhaps the most important objective of the draft recommendation is to ensure that the performance fee model used by investment fund managers is at all times consistent with the fund's investment objectives, strategy and policies, in order to prevent such practices. Accordingly, the draft recommendation contains a separate chapter on the consistency of the performance fee model with the specific characteristics of the fund. It defines the process for verifying and reviewing the objective, the criteria to be taken into consideration in this process as well as the consistency indicators.

The draft recommendation also stipulates requirements for the method of calculating the performance fee, emphasising that it must be verifiable and there should be no room for manipulation. The draft recommendation also sets out the mandatory elements of the performance fee calculation method and establishes it as a principle that it should be in line with the interests of investors and ensure that performance fees are always proportionate to the fund's actual investment performance.

As regards the frequency of the settlement of the performance fee, the draft recommendation stipulates it as a principle that it should ensure the harmonisation of the interests of the fund manager and the investors and fair treatment between investors. The performance fee may, as a general rule, be calculated and determined maximum once a year, on the same date for each mutual fund share series in the fund.

Based on the draft recommendation, in the future the performance fee will only be payable if the fund achieves a positive performance in the reference period applicable to performance. In the spirit of reasonable incentives, an important expectation of the draft recommendation is that the performance fees should not encourage fund managers to take excessive risks.

Finally, the draft recommendation sets out the transparency requirements for the performance fee. To this end, it stipulates as a priority that investors must be properly informed about the charges in question and their potential impacts on the return on their investment. The annual and semi-annual reports of each investment fund should clearly indicate the amount of performance fees actually charged, as well as the percentage rate of the fees charged, in the key investor information, the information necessary to justify the performance fee charged, the basis on which the fees are calculated and when the fee applies. The prior information and marketing material should include a description of the method of calculating the performance fee, in particular the conditions and the date of paying of the performance fee, and specific examples of the performance fee calculation.

7.6 ISSUER SUPERVISION AND MARKET SURVEILLANCE

7.6.1 The MNB has paid particular attention to monitoring compliance with the obligations stipulated in MAR

The MNB takes resolute measures against market manipulation, insider trading and other activities suitable to mislead investors, in order to curb and prevent market abuse. A key priority of the oversight activity is to ensure that domestic issuers are aware of and voluntarily comply with the EU Market Abuse Regulation (MAR[43]) in their practices at all times. The MNB has already indicated this in an executive circular to listed issuers in 2016, and it has also revised the former concept of issuer oversight. The MNB has specified it as an objective that issuers should fulfil their obligation to provide information and comply with MAR on a voluntary basis, the efficient verification of this by the central bank and the prevention of infringements instead of imposing subsequent sanctions. It should be emphasised that in ensuring compliance with MAR rules, the MNB acts as an educating and supporting supervisory authority, and through regular issuer forums, professional articles and executive circulars, it strives to ensure that issuers voluntarily develop the "good practices" expected by MAR and strive to comply with the rules.

In 2020, as part of its continuous oversight of issuers, the MNB monitored more closely than in previous years whether the relevant capital market participants complied fully with the obligations under MAR. Within the framework of this, last year the MNB issued resolutions in 3 cases due to breaching the provisions on the maintenance of a list of insiders and in 1 case due to breaching the rules on the delayed disclosure of insider information, while in 4 cases the MNB sanctioned senior managers of issuers due to breaching the provisions applicable to the closed period stipulated in MAR or exceeding the EUR 5,000 threshold.

Box 12
Transfer of insider information legally

The EU Regulation on Market Abuse (MAR) introduced the concept of market sounding, i.e. a public opinion poll of market participants. Market sounding occurs when, prior to the announcement of a transaction to be executed by a public issuer of securities, potential investor(s) are approached by the sellers of the financial instruments concerned or even by the public issuer itself, in order to gauge their interest in the planned transaction. Inside information may be disclosed during these discussions, but the procedure, if carried out in accordance with the MAR rules, it may not be regarded as market abuse. However, this requires that the market participant carrying out the market sounding fully complies with the relevant provisions of the EU regulation.

Prior to the start of the process, the capital market participant conducting the market sounding should establish internal procedures that define how it will be carried out and should also define a standard set of information that it intends to provide to or obtain from the subjects of the market sounding. In developing the standard scope of information, the disclosing market participant should consider whether the market sounding entails the disclosure of inside information and should record its related conclusions in its reasoned notes. This obligation applies even if the information to be provided is not classified as inside information.

[43] Regulation 596/2014/EU of the European Parliament and the Council on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC

The standard scope of information and the order in which it is disclosed are subject to detailed regulations, depending on whether or not inside information is ultimately disclosed in the course of market sounding. Without being exhaustive, the most important of steps of this process include that the disclosing market participant must first of all clearly inform the person subject to market sounding about the purpose of the communication between them and request confirmation that it is communicating with the person mandated by the potential investor to receive market sounding information and that he agrees to receive it.

The disclosing party must also clearly state whether or not the information to be disclosed constitutes inside information. If yes, it must obtain specific approval to receive inside information from the subject of the market sounding. The latter must also be informed of his obligations to keep this information confidential and not to use or attempt to use it. Following this information, the disclosing party will seek the express consent of the negotiating party to conduct the poll in the light of the foregoing. Only after this is received may information be provided for the purpose of market sounding, explicitly identifying those that are considered to be insider information.

Another MAR requirement is that the disclosing market participant must also comply with strict registration requirements. It must keep these – together with the related correspondence, minutes and records of the disclosed information – for 5 years and hand them over to the competent authority upon request.

The aim of the regulation on market sounding requirements for public issuers of securities is to ensure that potential investors have the same information by standardising the transfer of information, and that the flow of information can be properly traced by recording the information transferred in a traceable manner and that the confidentiality of inside information is guaranteed at all times. The foregoing will contribute to building lasting investor confidence in the capital markets and will also support the activity of supervisory authorities.

Registration obligations related to market sounding can undoubtedly represent major administrative burden for the disclosing market participants. However, accurate and precise documentation during the investigation of a potential market abuse will help the capital market participant provide evidence to the competent authorities of the adequacy of the conducted process. This is in the best interest of all stakeholders concerned, as the MNB pays special attention to cases of this kind to examine whether the unauthorised disclosure of inside information can be established as a breach of the provisions on market sounding.

7.6.2 Emphasis on the education of issuers

In 2020, 7 issuers’ workshops and 5 other educational forums gave companies seeking to be listed on the stock exchange the opportunity to get prior detailed information from the MNB on the relevant legislation before the formal regulatory process. They were also informed about the legislation on information requirements and the prohibition of market abuse as well as the MNB’s practice in this area. These informal, interactive workshops are tailored to the specific issuer. The MNB also seeks to pay due attention to investor protection and prevention considerations through the publication of the results of market surveillance procedures and through press releases.

Box 13
Authorisation of prospectuses of public issuers

In the case of the public offering of securities or admission of securities to trading on a regulated market, the law prescribes the publication of a prospectus. Similarly to the previous regulation, the governing EU regulation also provides for exceptions where the publication of a prospectus is not mandatory, allowing issuers in this case to prepare a prospectus on a voluntary basis.

The procedure for the approval of the prospectus is carried out by the competent authority of the home Member State of the issuer, which verifies the completeness, clarity and consistency of the information contained in the prospectus. The regulations contain a number of criteria against, based on which the three requirements mentioned above are verified.

Issuers are not necessarily institutions subject to prudential supervision by the competent financial supervisory authority or central bank, and thus the authority usually has no in-depth knowledge of their economic operation. It can only incorporate in the prospectus review process the information that has come within its knowledge, most of which is public. This includes, in addition to the prospectus, mainly the review and evaluation of the annexes attached during the procedure and the documents incorporated by reference in the prospectus, such as the issuer's historical, interim or preliminary financial information, according to specific criteria. In addition, the competent authorities may become aware, for example, of the issuer's oral or written advertisements or other disclosures not meant for advertising. These must be consistent with the content of the prospectus and may therefore also be taken into account when verifying it.

In line with its new supervisory strategy for the period ending in 2025, entitled Stability and Confidence 2.0, the MNB will act in a fundamentally supportive manner during the authorisation procedures, but will also consider whether a company seeking to enter the capital market is considered to be eligible for listing, in line with its 'gatekeeper' approach. In order to protect investors, the MNB takes measures to ensure that issuers operate in a compliant and transparent manner whenever necessary. For example, during the authorisation procedure, the MNB may request additional information from the issuer if it deems it necessary for the verification of the prospectus.

It should be noted, however, that the procedure for approving a prospectus alone is not intended to examine and assess the economic activity of the issuer. The EU legislator has still not established an objective regulatory framework for this. The lack of regulation in this respect, the potential information asymmetry between the issuer and the competent authority, and the short procedural deadlines set by the regulations do not allow competent authorities to carry out a more in-depth due diligence of the issuer. The responsibility for the content of the prospectus, base prospectus or any of their elements therefore remains with the person specified in the prospectus, typically the issuer.

7.6.3 Information campaign against unauthorised service providers

With a view to further supporting investor protection objectives, the MNB launched an information campaign against unauthorised service providers in September 2020. The aim is to prevent the increasing number of illegal online fraud attempts, raise financial awareness and protect investments. "Investment opportunities" behind click bait and aggressive advertising offering fast, extreme and risk-free returns, passive income or even "stock exchange secrets" can cause serious harm to unwary investors.

It is obvious for a financially literate consumer that there is no lawful investment that can double their savings every year, guaranteed and risk-free. Of the "risk-free, lawful, high yield" criteria only maximum two may be true simultaneously. However, the scam behind the tempting slogans is not obvious to everyone. While the internet is now the main source of information for customers, many have not yet developed a sound scepticism about the reliability of online financial content. The current low yield environment, increased internet usage during the pandemic and a growing sense of uncertainty have led many people to try to earn money in ways other than they used to. As a result of this interest in various investment opportunities on internet search portals significantly increased.

Demand creates its own supply, and this is also the case with investment opportunities advertised online. As in any other area of life, alongside the lawful and honest market participants, there are also fraudulent actors fishing in troubled water, this also applies in the area of investments. In Hungary, the majority of financial, investment and other activities are, for reasons of business prudence and investor protection, subject to an explicit MNB licence or may be performed after registering it with the central bank. Accordingly, in the absence of these, the performance of such activities is unauthorised and prohibited. Unauthorised activity is particularly dangerous because the service providers do not meet the strict requirements related to personnel, equipment, IT or even capital that are a prerequisite for obtaining a licence. Service providers engaged in unauthorised financial activities can undermine confidence in the financial intermediary system and in legitimate market participants.

Customers of unauthorised providers are not covered by the investor protection scheme. Some of the unauthorised market participants offer their products and services as "marketing gurus", business development or stock trading advisors - i.e. disguising their illegal investment services as education. It is also worth acting with special care when, in advertisements – especially in social media – a service provider offers a recipe for getting rich quick, for passive income that can be achieved without risk for anyone without work, or promises to reveal the "secrets of the stock market", Wall Street or the stock market in general. The MNB monitors suspected fraudulent content on the internet as part of its investor protection mission.

If the investors of an unauthorised "service provider" do not get their money back, the suspicion of property crime may arise and depending on the extent of the damage caused, the maximum prison sentence at the end of the criminal proceedings may be 10 years, in addition to the MNB's market surveillance fine.

The MNB not only informs the public when it suspects unauthorised financial activity strictly falling within its competence, but also when it detects the spread of financial fraud that poses a risk to unsuspecting, imprudent investors. The most effective prevention is for investors to be aware, before they hand over their money, that there may be fraudulent service providers behind online advertising and content, and to be able to identify whether a market participant is operating legally or illegally. The MNB is therefore running an internet information campaign to enhance investors' financial literacy. The aim is that those who want to invest their savings and are looking for information online should check the MNB website for the company of their choice on the MNB Warnings subpage[44], so that they can make investment decisions with the necessary caution.

As a result of consumer searches, the MNB's keyword advertisements have already appeared 170,000 times in 5 months, and as a result, nearly 11,000 more people have visited the MNB's Warnings subpage in that period. Each visit and click reduces the chances of someone becoming a victim of a breach. A special result of the MNB's above-mentioned activities is that the analytics obtained in this way – as a new source of information – will expand the range of instruments used to detect unauthorised activities, in addition to the monitoring tools used so far, which may even form the basis for new market surveillance procedures. Based on the experience of recent years, unauthorised service providers tried to make schemes that seem "too obvious" attractive to unsuspecting investors by novel repackaging. They were keen on the concepts and trends that have characterised recent years. Based on this, there may be a connection with crypto-assets in the "classic" categories of unauthorised activity detailed below, which are characterised by extreme interest, mainly because of the hope of getting rich quick without any basis in reality.

- Deposit-taking: deposit-taking and other acceptance of repayable funds from the public, as defined in Act on Credit Institutions and Financial Undertakings (Credit Institutions Act[45]), is an activity that involves the collection of funds in transactions not specified individually and in advance – usually through public advertisements, personal recommendations – over which the deposit-taker may dispose as owner, but is obliged to repay, with or without

[44] https://www.mnb.hu/figyelmeztetesek
[45] Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises

interest or other benefits. Such activities may be pursued on a commercial basis only with the prior authorisation of the MNB.

- Lending: according to the Credit Institutions Act, granting a credit or loan (including, for example, factoring activities) carried out on a commercial basis in Hungarian forint or in foreign currency is considered a financial service, which may only be pursued with the prior authorisation of the MNB.

- Tied agent: according to the Investment Firms Act, an investment firm and a commodity exchange service provider may use an intermediary, which may also be a tied agent, for the provision of investment services or commodity exchange services. A tied agent is a natural or legal person who facilitates the provision of investment services or ancillary services to a customer or prospective customer under the full and unconditional responsibility of the investment firm he represents. According to the Act, an investment firm may enter into such an agreement with a tied agent having its registered office or residence (domicile) in Hungary and registered with the MNB. Tied agent activity may only be carried out after conducting the necessary registration procedure.

- Portfolio management: portfolio management activity as defined in the Investment Firms Act is the activity of investing and managing customer assets in financial instruments for the benefit of the customer under predetermined conditions, on the basis of an order given by the customer, with the customer bearing directly the risks and yields, i.e. losses and gains, arising from the financial instruments acquired. The portfolio manager is legally entitled to represent the customer as a proxy under the contract concluded with the customer in all current and future transactions conducted with the investment service provider, in particular in respect of all deposits held on accounts with the investment service provider, and to give orders to buy and sell financial instruments or spot and/or forward trading on the accounts of investors. Such activities may also only be pursued with the prior authorisation of the MNB.

7.6.4 Market surveillance penalty of HUF 1.8 billion in 2020

In 2020, the MNB launched 30 market surveillance proceedings, 16 for unauthorised activity, 4 for insider trading, 9 for market manipulation and 1 for suspected breach of short selling regulations, and closed 27 market surveillance proceedings, imposing a total market surveillance penalty of HUF 1,864 million.

Market abuse investigations accounted for an increasing ratio of the market surveillance proceedings launched and ongoing in 2020. In addition to insider trading, the number of market manipulation cases may be deemed significant, highlighting a case where a capital market participant failed to demonstrate that the issue price of new shares to be issued in the course of a capital increase was determined in a professionally sound manner. Accordingly, it published unsubstantiated information in connection with the transaction, thereby ultimately giving a false or misleading indication as to the demand for or price of its equities, thereby breaching the MAR's provisions on the prohibition of market manipulation.

From a legal perspective, the cornerstone for the oversight of capital market abuse is the MAR, in force since July 2016, which has implemented a directly applicable legislative framework with the dual objectives of better protecting investors, combating market abuse and ensuring the integrity of markets through the creation of integrated, efficient and transparent financial markets. The smooth functioning of the securities market and public confidence in markets are prerequisites for economic growth and prosperity. Market abuse damages the integrity of financial markets and undermines public confidence in financial instruments.

In order to eliminate significant distortions of competition resulting from differences in national legal systems and to prevent other barriers to trade and subsequent significant distortions of competition, a regulation was needed to determine a more homogenous framework for market abuse in the EU, setting out more clearly the rules applicable in all Member States. The definition of the requirements related to market abuse in a regulation ensures that such requirements are directly applicable. In this way, by eliminating differences in national rules resulting from the transposition of a directive, equal conditions can be created. The definitions of the types of market abuse used by MAR are important reference points for the oversight activity. Insider trading, unauthorised disclosure of inside information and market manipulation are the main types of capital market abuse:

- Insider trading is when a person with inside information uses the inside information for acquiring or disposing of financial assets linked to that information, directly or indirectly, for his own benefit or for the benefit of a third party.

- An unauthorised disclosure of inside information occurs when a person possesses inside information and discloses it to any other person, unless the information is disclosed within the framework of employment, occupation or in the normal course of performing specified duties.

- Market manipulation includes entering into a transaction, placing an order to buy or sell, or other conduct that gives, or is likely to give, false or misleading signals about the supply of, demand for, or price of a financial instrument. Under the broader interpretation of MAR, market manipulation may also be accomplished by the creation of obviously false information, the intentional concealing of material facts, or by knowingly communicating false information.

7.6.5 Temporary measures were taken in respect of short selling due to capital market turbulence in 2020

There was no single EU framework for the regulation and supervision of short selling before the financial crisis. During the most difficult months of 2008, the supervisory authorities of various countries, both within the EU and overseas, took emergency measures of varying effectiveness, in different ways and within their own areas of competence, to restrict or ban short selling in the case of certain or all equities. The emergency measures were necessary because, in times of significant financial instability, short selling can amplify the downward movement of equity price, which can ultimately threaten – as a result of the negative spiral – the viability of financial institutions and public issuers, thereby entailing systemic risks.

The way in which the crisis was handled at the level of Member States to curb short selling showed that there can be no regulatory arbitrage in the supervision and regulation of short selling in the EU, which aims to create a capital market union, and that the interdependence of capital markets means that crisis situations cannot be dealt with separately. In order to ensure the proper functioning and improve the operating conditions of the internal market, in particular financial markets, and to ensure a high level of consumer and investor protection, it is appropriate to establish a common regulatory framework as regards the rules and powers relating to short selling and to ensure greater consistency and uniformity between Member States as regards the measures to be taken in exceptional circumstances. It should be noted that, due to their speculative nature, they can have adverse effects in certain situations, but under normal market conditions short selling plays an important role in ensuring the proper functioning of financial markets, especially in the context of market liquidity and efficient development of prices.

The single legal framework to regulate short selling and to meet the transparency requirements associated with it materialised in a regulation, i.e. EU Regulation 236/2012 on short selling and certain aspects of credit default swaps (SSR). An essential element of the regulation is that, in addition to defining the concepts related to short selling and the supervisory powers, it also lays the foundations for emergency measures and, more generally, for transparency requirements related to investors' behaviour in the capital markets. Increased transparency of significant net short positions in financial instruments is in the interest of both national supervisory authorities and market participants. For equities admitted to trading in an EU trading venue, the Regulation prescribes a two-step reporting model to enhance transparency and ensure an appropriate level of transparency for significant net short positions in equities.

The current reporting threshold is set at a lower limit of 0.2 percent of the subscribed capital of the issuer of the securities traded in the trading venue, which, once reached, is only reported to the relevant supervisory authorities, in order to allow them to monitor and, if necessary, investigate short positions that may pose systemic risks, abusive or irregular market conditions. When the upper threshold corresponding to 0.5 percent of the subscribed capital is reached, the positions should be disclosed to the market in order to provide useful information to other market participants on significant individual short positions in equities. The notification and disclosure thresholds apply to both natural and legal persons. The transparency requirements for the disclosure of information are provided by the MNB's officially approved disclosure platform (www.kozzetetelek.mnb.hu), where data on published net short positions are available retrospectively since to the SSR's entry into force.

The general uncertainty caused by the first wave of the coronavirus pandemic also affected capital markets across Europe. As an exceptional measure to address the crisis, ESMA ordered a temporary, uniform reduction of the reporting threshold under SSR from 0.2 percent to 0.1 percent on 16 March 2020 to achieve a higher level of transparency and to give supervisors greater field of vision to monitor changes in short positions and to take further restrictive measures if the downturn in capital markets were to intensify. This measure was extended several times and finally it was in force until 19 March 2021.

Additional temporary restrictions on short selling were also introduced at international level. Six countries temporarily banned short selling, i.e. Spain from 17 March 2020, while Italy, Greece, France, Belgium and Austria from 18 March 2020 until 18 May 2020. A similar measure was not necessary in Hungary, as the volatility observed in the capital market was less severe and the continuous monitoring of the size and volatility of short positions allowed by the SSR did not justify the imposition of further restrictions.

Based on the data collected by the supervisory authorities over the past year, there is also a possibility that a lower reporting threshold could be permanently included in the SSR, as a more detailed picture of the developments in short positions under normal circumstances would support the work of supervisory authorities in detecting anomalies. In order to preserve stability in the long term – when sadly, due to the pandemic, feedback from the live application of SSR is already available – it is worth redefining the framework on the basis of recent experience and incorporating lessons learnt from the backtesting of the methodology for reporting emergency measures between Member States.

Based on the experience of the past year, the legitimacy of SSR is unquestionable when Member States, building a capital market union together, wish to give uniform and rapid response to emergencies. However, it is also clear that, in addition to speed and uniform action, attention must also be paid to the effectiveness of measures. This will require updating the current regulation on the basis of real-life examples, as since its entry into force there was no capital market depression of the same magnitude as observed in the first quarter of 2020, which is the real test for EU regulations equivalent to SSR.

7.6.6 Public issuers – Preventive measures applied within the framework of continuous oversight

At the end of 2020, the securities issued by 46, 5 and 18 companies were traded on the regulated market operated by BSE (Xbud), on the Xtend multilateral trading facility and[46] on the Xbond multilateral trading facility, respectively, both also operated by BSE. In its "gatekeeper" role, the MNB monitors compliance with the obligation to provide regular and extraordinary information of issuers of securities admitted to trading on a regulated market, in accordance with the legal requirements in force, and it increasingly focuses its supervisory activities on the examination of issuers' compliance with the MAR requirements applicable to issuers of securities registered on Xtend and Xbond. In 2020, in line with the previous trend, the MNB mainly used preventive or rapid follow-up measures within the framework of continuous oversight. Accordingly, in 2020, the MNB launched a total of 3 targeted inspections, closed 4 inspection and made 125 requests for information and data. During the year, the MNB issued 23 resolutions in total, 8 of which included fines.

[46] This figure does not include issuers whose securities are also listed on a regulated market as they are subject to the stricter requirements of the regulated market.

Box 14
Close monitoring of issuers' disclosure practices

The MNB supervises the issuers of securities admitted to trading on a regulated market in relation to the fulfilment of their disclosure obligations. In order to emphasise the good practice expected in this area, the MNB repeatedly issued an executive circular in 2020, which contained additions to and clarifications on the topics of the 2018 executive circular.

The 2020 executive circular details out five topics: disclosure of voting rights, extraordinary information, splitting of nominal value of shares, preparation of pro forma financial information and the transition to the single electronic reporting format. This latter topic is also covered in a separate box.

According to the revised circular, the MNB expects issuers to publish information within the framework of their regular and extraordinary disclosures in a clearly legible format, accessible to the public without discrimination. The circular also stated that issuers are obliged to submit inside information electronically to the officially designated information storage system operated by the MNB (https://kozzetetelek.mnb.hu/)– belonging to the scope of regular and extraordinary reporting according to the Hungarian Capital Markets Act – based on the regulation related to the acquisition of control, and the EU regulation on insider trading and market manipulation,. Issuers must clearly indicate any changes to disclosures and link them to the original disclosures. The MNB considers it to be acceptable practice for issuers to fulfil their obligation to provide information to the media by publishing it on the official website of the Budapest Stock Exchange.

The MNB found that the practice of issuers remains inconsistent as regards the determination of the number of shares conferring voting rights, and therefore drew their attention to the fact that the number of shares conferring voting rights is determined on the basis of all shares to which voting rights are attached by virtue of the articles of association (i.e. treasury shares held by legal entities under the majority control of issuers must be also taken into account). Issuers must publish the disclosure of voting rights, the treasury stock holding and the amount of share capital for the last day of each calendar month, not later than on the first working day following the last day of the month, even if the first working day of a month falls on a Saturday.

The MNB repeatedly emphasised its expectation that issuers should disclose information falling within the scope of extraordinary disclosure requirement separately (e.g. information on the change of auditor separately and not only embedded in the extraordinary information on the resolutions of the general meeting).

In recent years, the general meetings of several issuers decided to split the nominal value of their listed shares, leaving the share capital unchanged, and to make available to shareholders an appropriate number of new shares in exchange for the old ones. In connection with this, the MNB has drawn the attention of issuers in a circular to the fact that it considers a good practice for issuers to publish – in addition to the publication of the decision of the general meeting on the nominal value of the share – special information on the technical conduct and timing of the general meeting, and on any changes in these matters compared to the previous publication. In addition to the foregoing, the MNB recommended that issuers should check on ESMA's website in which markets their shares are listed or registered, and inform the market operators of these markets in advance of the technical settlement and the scheduling thereof.

The MNB also reminded issuers that pro forma financial information is also required when a prospectus is prepared in connection with the public offering of securities and one or more indicators indicating the size of the issuer concerned change by more than 25 percent as a result of the transaction. The value of total assets and the sum of sales revenue and profit or loss essentially belong to these indicators. Issuers can also choose to include pro forma information in the prospectus even if no indicator changes by more than 25 percent as a result of a transaction, or they can choose to include pro forma financial information as part of the annual report or half-yearly report published as part of the regular information.

7.6.7 Postponement of the mandatory application of ESEF

Risks related to legal compliance and regulatory transition include the introduction of the European Single Electronic Format (ESEF) for issuers admitted to trading on a regulated market. ESEF aims to increase the transparency of financial statements. The use of a standardised format allows the collection and organisation of structured, machine-readable business information, making it easier to compare, analyse and verify data.

Although the introduction of ESEF has many benefits, preparing for its application and implementing changes to the method of annual reporting takes up considerable capacity of issuers. The difficulty of the task and the legal risks involved in the transition are also reflected in the postponement of the mandatory application. The Government of Hungary has postponed the introduction of ESEF by one year due to the difficulties in preparation caused by the pandemic, and thus its application will be mandatory for annual reports for financial years commencing on 1 January 2021 and thereafter.

Box 15
The ESEF Regulation

Securities issuers should provide investors with adequate transparency through a regular flow of information, since the disclosure of accurate, comprehensive and timely information on them enhances long-term investor confidence and enables investors to make an informed assessment of their business performance and assets. This will also improve investor protection and market efficiency.

The legal framework at EU level for disclosure requirements for issuers is provided by Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (Transparency Directive). The disclosure requirements for the implementation of the Transparency Directive in Hungary are set out in Act CXX of 2001 on the Capital Markets (Capital Market Act) and MoF Decree 24/2008 (VIII.15.) on the detailed rules of the disclosure obligation in relation to publicly traded securities issued on the basis of the Act.

Under the regulation, issuers must publish their annual report within four months of the end of the financial year, which includes the audited financial statements (annual accounts and consolidated accounts), the management report, the responsibility statements of the persons responsible within the issuer and the independent auditor's report on the financial statement(s).

In order to increase the transparency and comparability of financial statements at European (and global) level, from 2005, companies whose securities are admitted to trading on a regulated market in a Member State are required to prepare their consolidated accounts in accordance with International Financial Reporting Standards (IFRS) adopted by the EU, under Regulation (EC) No 1606/2002 on the application of international accounting standards. According to a report published by ESMA in April 2020, at the end of 2020 in the EU 4,294 issuers were required to prepare their financial statements in accordance with IFRS.

Considering that the flow of information and investment decisions have accelerated considerably in recent years and decades – also due to the technological improvements – EU investors have a very large number of potential "targets" in their horizon. In addition to the application of the single reporting framework, it has become necessary to increase the accessibility of financial statements to investors, to improve their comparability and to simplify and accelerate the processing and analysis of financial data by investors. To this end, the Transparency Directive stipulated already in 2013 that from 2020, annual reports should be published in a European Single Electronic Format (ESEF), replacing the publication of annual reports and financial statements in pdf format.

Following the preparation by ESMA, Commission Delegated Regulation (EU) 2019/815 of 17 December 2018 supplementing the Transparency Directive with regard to regulatory technical standards on the specification of a single electronic reporting format (ESEF Regulation), was promulgated in 2019, which specified the format to be used and clarified that the ESEF must be applied for financial years starting on or after 1 January 2020.

However, during 2020, due to the challenges and difficulties posed by the COVID-19 pandemic, it was decided that each Member State may decide on the postponement of the application of the ESEF by 1 year, as set out in the Transparency Directive. The Government of Hungary decided by Government Resolution 1078/2021 (II. 27.) that Hungary would resort to this opportunity and that domestic issuers will only be required to apply the ESEF requirements – on a mandatory basis – for the financial year starting on or after 1 January 2021.

Under the ESEF Regulation, issuers must prepare their annual report entirely in the extensible hypertext markup language (XHTML). The XHTML format does not require any special mechanism to be human-readable, any web browser is applied to support it. XHTML is a non-proprietary, free-to-use electronic reporting format.

The MNB draws attention to the fact that the official Hungarian translation of the ESEF Regulation is inaccurate in places, as where the Hungarian text refers to “annual financial statements”, the original text refers to annual financial reports in several places. Accordingly, not only the annual financial statements, but the entire annual report must be prepared in XHTML format.

Where the issuer is also a parent company and is required to consolidate its subsidiaries, the consolidated financial statements prepared in accordance with IFRS that form part of the annual report must be identified using the extensible business reporting language (XBRL). XBRL is a machine-readable markup language that allows automated use and processing of large amounts of information. XBRL is a well-known markup language used in many countries and is currently the only one that is suitable for the proper markup of financial statements.

XBRL markups should be embedded into XHTML documents using InLine XBRL technology, which is already successfully used in the US, Japan, the UK and elsewhere. Owing to the selected formats, the annual report will be suitable for viewing in a web browser, human readable, and – through the XBRL tags – the transparency and comparability of the consolidated financial statements data will be enhanced and it will be also possible to subject it to machine (automated) processing.

The taxonomy used for marking is contained in the ESEF Regulation (ESEF Taxonomy) and can be downloaded from the ESMA website in a format readable by the marking and verification software. The ESEF taxonomy is based on the IFRS Taxonomy, with only minor changes made by ESMA and the possibility for issuers to add to it as provided for in the ESEF Regulation. Given that the IFRS Taxonomy tracks changes in IFRS every year, the ESEF Taxonomy based on it is also expected to be updated every year. Taking into consideration that the latest taxonomies basically reflect the amendments to IFRS entering into force in the future, issuers can choose to apply the latest taxonomy (e.g. this year’s update of the IFRS Taxonomy was published on 24 March 2021, on the basis of which ESMA prepared the ESEF Taxonomy 2021. This is the basis for the ESEF Taxonomy 2021 update, which is expected to be promulgated in autumn 2021 with the amendment of the ESEF Regulation – therefore, taking into account that issuers could already work with the ESEF Taxonomy 2020 version during 2021, they can use both the ESEF Taxonomy 2020 and the ESEF Taxonomy 2021 when preparing their annual report in ESEF format for 2021).

In order to ease the implementation of ESEF, in the first two years of application only the primary financial statements (statement of financial position, statement of profit or loss and other comprehensive income, statement of changes in equity, statement of cash flows) and some basic information (e.g. name of the issuer, other identification data, registered office, legal form, nature of activity, etc.) are to be marked up. Subsequently, in the consolidated financial statements, forming part of the annual report, the notes to financial statements must also be marked with XBRL, in the mandatory form of “block tagging”, which means that it is not necessary to tag the specific data or information, but it is sufficient to mark the block of text or table containing the information.

Based on the negative experiences of third countries concerning the quality of mark-ups, particularly during the implementation period, the EU has from the outset aimed to ensure that auditors of issuers also check XBRL mark-ups and compliance with the ESEF Regulation when auditing consolidated financial statements. In a Q&A published upon the promulgation of the ESEF Regulation and in a Communication in November 2020, the European Commission also stated that, under Directive 2006/43/EC of the European Parliament and of the Council on statutory audit of annual accounts and consolidated accounts, the statutory auditors of issuers will in future also be responsible for expressing an opinion on the compliance of consolidated accounts with the ESEF Regulation. The verification of the mark-ups by the auditor – prior to publication – significantly increases the reliability of the published data, which is a prerequisite for efficient automated, machine processing.

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