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

2022

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

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

The data used in the Report and the analyses based on those have been prepared typically for the reference date of 31 December 2021, based on information received until 31 March 2022. Data of different frequency are updated differently. Accordingly, the horizon of the analyses may vary in certain cases.

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

Contents

Executive Summary

Economic recovery after the coronavirus continued in 2021. Recent developments in economic performance were determined by the waves of the coronavirus pandemic, the global semiconductor shortage and soaring energy and commodity prices. Recovery of the Hungarian economy was faster than seen after any of the previous crises. In 2021, the performance of the Hungarian economy exceeded the year-on-year level by 7.1 percent, which puts it to the front of the EU ranking. Domestic demand continued to recover, and household consumption accounted for almost half of the growth on an annual basis. Consumption of services rose to the largest degree (+15.1 percent), in line with the lifting of the measures taken to contain the pandemic. Hungary's investment ratio was 27.1 percent and remained high also by international standards. The outbreak of the war between Russia and Ukraine at the end February 2022 has fundamentally changed global economic outlooks. Due to geographical closeness and the larger weight of the external trade pursued with the countries involve, the impacts in Europe, and particularly in the Central and Eastern European region, are expected to be stronger. Gross assets (assets and stock of dwellings) of Hungarian households grew by 14.5 percent in 2021, and within that financial instruments registered a growth of almost the same degree. On the other hand, assets managed by institutional investors still falls short of the EU average as a percentage of GDP.

Last year **insurers'** gross written premium rose by 10.4 percent, with good performance of the life segment, and particularly of the pension and risk insurances. As a result of this, the size of the sector achieved the value determined in the MNB's vision, but in terms of its ratio to GDP it failed to set on the convergence path. The portfolio of regular premium policies also grew, while the volume of single and top-premium policies soared. Contrary to previous years, the main driver of growth in the non-life segment was not the compulsory motor third-party liability insurance (MTPL), but the corporate property insurances, casco and other segments. The profitability of MTPL mainly improved due to the favourable loss ratio resulting from the pandemic; however, inflation expectations may deteriorate its position.

The combined profit of the insurance market is still deemed outstanding in nominal terms, but in a sounder structure than before. Russian and Ukrainian exposures are not significant. However, the sector's level of capitalisation fell below 200 percent, mainly as a result of the rising yield curve and the depreciation of assets. Nevertheless, none of the individual institutions fell below the level expected by the MNB, increased by the volatility capital buffer.

Assets of the **voluntary** (pension, health, mutual aid) **funds** exceeded HUF 1,800 billion, while membership fee revenues reached nearly HUF 175 billion.

At the voluntary pension funds the rate of individual and employer member contributions both increased, to HUF 116 billion in total. Their net average yield of 2.6 percent, registered last year – which is relatively low compared to previous years – is mostly attributable to the depreciation of bonds, while average 10-15-year real yield of the sector is still in the band of 2-4 percent. The number of members stagnated, with a minor rise in the number of members paying membership fee within the total number of members.

Health and mutual aid funds registered an increase in both the number of members and the ratio of members paying membership fee. Member and employer contributions as well as benefit payments increased.

Both sub-segments realised an operating profit. Although it managed to maintain its stability in a volatile environment, the depreciation of assets generates challenges in asset management, and fostering the activity of members and reaching the younger generation remain a priority.

From a consumer protection perspective it should be noted that as a result of the ethical life insurance concept, introduced back in 2015, the cost level of unit-linked life insurances significantly declined, resulting in a higher customer value than before. The positive effects of this are reflected in the longer retention period and in the declining number of complaints lodged in respect of this product type. The pension fund version of the annual cost ratio (ACR), already used for insurances, helps customers in comparing the cost level of the individual funds easily and rapidly. Based on the number of members, the fund ACR, proposed by the MNB in a recommendation, is used by almost the entire market.

Consolidation in the **insurance intermediary** market continued; the number of natural person intermediaries fell by 7.3 percent, while mediated premiums rose by 9 percent. Last year performance of the sector was mostly driven by revenues from the intermediation of life insurances under a more moderate growth in the non-life segment.

The volume of corporate and household loans and lease products distributed by**financial market intermediaries** rose to exceed HUF 1,100 billion, where around 30 percent of the retail mediated loans of almost HUF 840 billion were with state subsidy in 2021.

The portfolio managed by non-banking group **financial enterprises** grew dynamically last year after a halt for one year. Corporate lending and motor vehicle lease performed particularly well, while the workout portfolio declined. The sector achieved an outstanding ROE at 29 percent, the non-performing portfolio declined, while it relies on external debt for funding to an increasing degree compared to equity.

In the capital markets turnover of **investment service providers** rose significantly, by 30.5 percent (HUF 445,209 billion), which is mostly attributable to the strong growth in derivatives. Turnover of the Budapest Stock Exchange has been at a high level for the second year, primarily due to the good performance of the prompt market. The significant market concentration of the top three blue chips appears to remain steady. The growth in customer securities portfolio at 23 percent is also an acceleration compared to previous year. The after-tax profit of investment firms – characterised by excellent capital adequacy – over HUF 20 billion exceeds that of last year by more than one and a half times. In line with the global capital market trends, as a result of the war between Russia and Ukraine, the customer securities portfolio managed by investment service providers declined by 3.8 percent in the first quarter of 2022 compared to the end of 2021: the fall in the portfolio is essentially attributable to the declining prices, in addition to the stronger depreciation of investments related to Russia.

The volume of assets managed by **investment fund managers** in the amount of HUF 11,875 billion last year reflects an even higher growth rate than before. Net asset value of investment funds was almost HUF 8,300 billion, where the inflow of mixed fund registered an outstanding growth. The liquid assets to real estate ratio remains stable at the real estate funds. The after-tax profit of fund managers stabilised at a high level in 2021. Volatility, generated by the uncertain international economic environment, remains a risk also for the fund managers. The conflict between Russia and Ukraine did not trigger a panic redemption among investors: net withdrawal of capital from investment funds between January and May 2022 amounted to HUF 48 billion, i.e. merely 0.6 percent of the total portfolio. Although several investment funds had Russian exposure, the degree of those exposures is negligible compared to the entire sector.

In the capital market, last year the focus of consumer protection was on the practice of providing subsequent information, CFDs, the product governance requirements of MiFID II, the calculation of success fee by fund manager and the practice of suitability assessment. As regards the oversight of issuers, inspections continued to focus, among other things, on market abuses breaching MAR, market manipulation (at transaction and disclosure level) and on the adequacy of regular and extraordinary disclosures. In addition to the targeted inspections, the cooperative oversight activity was marked by a number of consultations, trade days and Xbond forum.

Last year, the number of market surveillance notifications received by the central bank has almost doubled and the number of market surveillance notices filed in connection with unauthorised activity also grew dynamically. As a result of the MNB's efforts, the law now provides for the possibility of blocking the website of unauthorised service providers. The MNB's keyword advertisements – launched against unauthorised service providers – appeared 1,500,000 times in 2021, as a result of which 115,000 customers visited the MNB's related warnings sub-site.

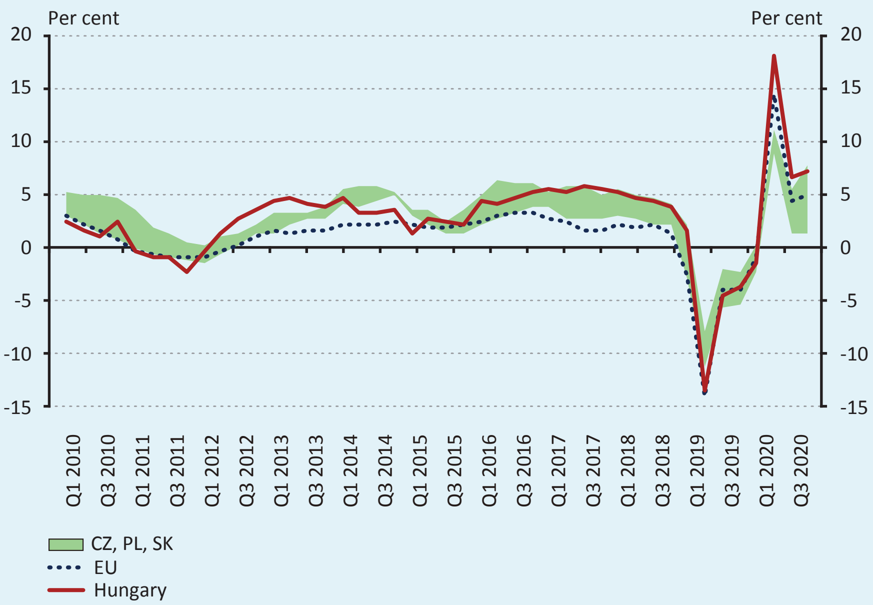
1 Macroeconomic environment and developments in household savings

1.1 INTERNATIONAL AND NATIONAL MACROECONOMIC TRENDS

1.1.1 Hungary's economic recovery has continued, the risks strengthened

Economic recovery after the coronavirus continued in 2021. Recently developments in economic performance were determined by the waves of the coronavirus pandemic, the global semiconductor shortage and soaring energy and commodity prices. After the decline seen in 2020, trends in GDP improved in most countries. Of the world's major economies, the United States and China registered a growth of 5.7 percent and 8.1 percent respectively in 2021. Based on seasonally and calendar adjusted data, in 2021, the level of GDP rose in both the European Union and the euro are by 5.3 percent on an annual basis. The level of GDP also rose in the large economies of the EU. The economy of Germany, Hungary's main trading partner, grew by 2.9 percent in total. In 2021, of the countries in the region, GDP in Romania rose by 5.9 percent, in Poland by 5.7 percent, in Slovakia by 3.0 percent and in the Czech Republic by 3.3 percent, year-on-year. The outbreak of the war between Russia and Ukraine at the end February this year has fundamentally changed global economic outlooks. Due to geographical closeness and the larger weight of the external trade pursued with the countries involved, the impacts in Europe, and particularly in the Central and Eastern European region, are expected to be stronger.

Chart 1.1
Annual change of GDP



Note: Based on seasonally and calendar adjusted data.

Source: Eurostat

Recovery of the Hungarian economy was faster than seen after any of the previous crises. In 2021, the performance of the Hungarian economy exceeded the year-on-year level by 7.1 percent (Chart 1.1), which puts it to the forefront of the EU ranking. Domestic demand continued to recover, and household consumption accounted for almost half of the growth on an annual basis. Consumption of services rose to the largest degree (+15.1 percent), in line with the lifting of the measures taken to contain the pandemic. Hungary's investment ratio was 27.1 percent and remained high also by international standards. Recovery in industrial production is characterised by duality. Performance of the automotive industry, representing a significant share and hit by the global semiconductor shortage was moderate, while domestic battery production has gradually recovered.

The current account balance deteriorated further, while the accrual-based budget deficit developed more favourably than expected. In the third quarter of 2021, the four-quarter current account deficit rose to 2 percent of GDP, while Hungary's external balance position turned into net borrowing. The underlying reasons for the economy's external balance developments included the decline in trade surplus: the global semiconductor shortage and the weakening external demand were reflected in falling exports, while the pick-up in domestic demand and soaring energy prices appeared in rising imports. As a result of dynamically growing tax revenues due to the rapid, strong economic recovery and the investments postponed by the government in December, the budget deficit developed more favourably in 2021 than previously expected, i.e. it stood at 7.3 percent. In parallel with this, government debt as a percentage of GDP temporarily declined to 77.3 percent last year.

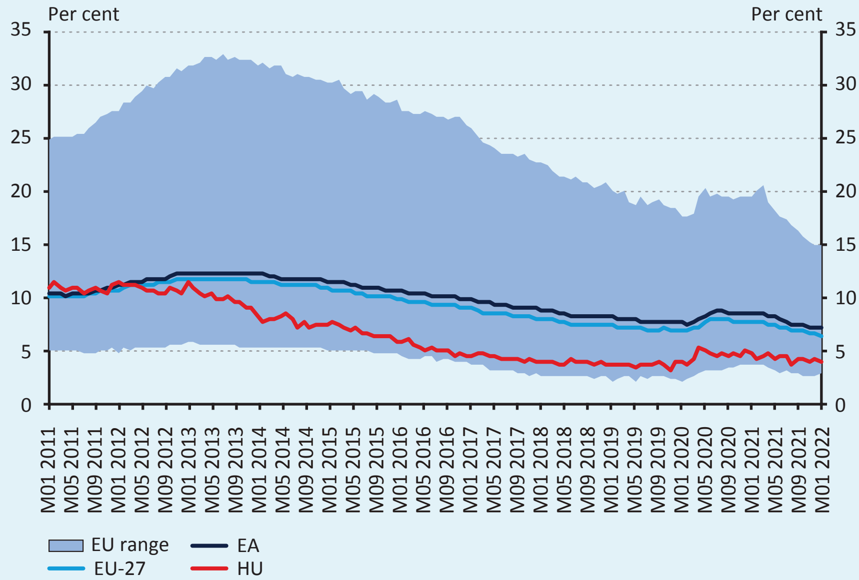
In the next quarters, economic activity will be mostly determine by the war between Russia and Ukraine and the sanctions introduced as a consequence of that as well as the governments' responses to this extraordinary situation. Growth potential of the Hungarian economy is strong, while economic prospects are surrounded by great uncertainty. Following the rapid recovery last year, the Hungarian economy grew extremely dynamically in early 2022 as well. Despite the heightened inflationary environment, real earnings grew at a moderate pace in 2022, and thus household consumption continues to grow, supported this year by a double-digit increase in wages and government measures aimed at boosting household income. Growth in household income is supported by the government payments concentrated to early 2022. Households may use a significant part of the one-off, non-recurring surplus income for augmenting their savings or deleveraging. The conflict between Russia and Ukraine exerts its impact on the Hungarian economy primarily through the channels of external trade and commodity prices. Due to the surge in energy and commodity prices resulting from the war, and the more moderate external demand, growth in investments may continue at a slower pace than previously expected.

1.1.2 Labour market proved to be resilient in Hungary

The Hungarian labour market prove to be resilient during the pandemic, due to which the number of people in employment in Hungary has been continuously exceeding the pre-pandemic level since June 2021. In Hungary, many enterprises responded to the change circumstances resulting from the first wave of the pandemic by the temporary shortening of employees' working hours; however, by now the ratio of part-timers once again came close to the pre-pandemic level. Although the unemployment rate has not yet returned to its historic low of 3.3 percent, registered in 2019, based on seasonally adjusted data the rate of 3.9 percent, seen in the fourth quarter of 2021, is favourable even by international standards.

The labour market of the European Union is characterised by heterogeneity. Greece and Spain still have double-digit unemployment rate, while in the Czech Republic the ratio of the unemployed within the economically active population is merely 2,4 percent in February 2022. In the same month, euro area unemployment rate stood at 6.8 percent. (Chart 1.2).

Chart 1.2
Unemployment rates in the European Union



Note: Seasonally adjusted data.
Source: Eurostat, HCSO.

In 2021, wage dynamics in the national economy, including in the private sector, were more moderate compared to previous years but still buoyant. In 2022, the minimum wage and guaranteed wage minimum – significantly exceeding the previous years – rose by 19.5 and 18.7 percent, respectively, which was already felt in the wage figures seen at the beginning of the year. After the loosening that followed the initial shock generated by the pandemic, the labour market is gradually becoming increasingly tighter since the second quarter of 2020. In the third quarter of 2021, the tightness indicator stood at 30, i.e. there were this many unemployed persons per 100 non-subsidised, advertised jobs, compared to 20 in the same period of the previous year.

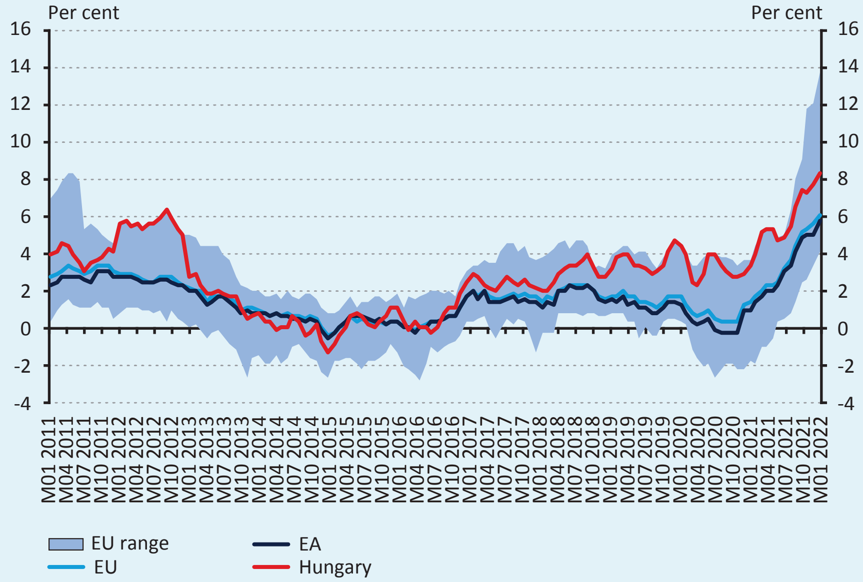
The war between Russia and Ukraine may deteriorate labour market prospects in certain sectors. Strengthening commodity and energy market tensions due to the conflict between Russia and Ukraine undermined companies' profit prospects through an additional increase in corporate expenditures. Mounting difficulties in supply chains may entail a slowdown in production, which may reduce labour demand. The impacts of the war may be the greatest on sectors exposed to Russian and Ukraine imports and market (agriculture, tourism).

1.1.3 High inflation is a global phenomenon

In the first months of 2022, inflation was high across the euro area, significantly exceeding central banks' inflation targets. The harmonised index of consumer prices exceeded even 10 percent in the Baltic states. Last year, as a result of the coronavirus pandemic and the recovery thereafter and due to the soar in energy in commodity prices, euro area inflation rose at an accelerating pace. By February 2022, euro area inflation rose to 5.9 percent from 0.9 percent seen in January 2021. In the first half of last year this was mostly attributable to the impacts of the restart after the coronavirus pandemic. After the restart of the economies, demand growth outstripping supply gave rise to price increases. Global commodity prices (such as oil and metal prices) significantly rose and the multiple increase in international transport costs compared to their pre-pandemic level (tenfold in the case of transportation from China to Europe) were also reflected in the consumer price trends. In the second half of 2021, price increases were mainly attributable to the soar in energy prices due to the gas and electricity prices reaching a historical high. As a result of the foregoing, unprocessed food prices have also significantly increased recently, which – looking ahead – may be exacerbated by the impacts of the conflict between Russia and Ukraine. In the next quarters the European Central Bank (ECB) expect the current high level of inflation to persist, while in the medium run it may decline.

Consumer price trends tend to be similar in the countries of the CEE region. (Chart 1.3). By the end of 2021, the harmonised index of consumer prices reached the band of 8-10 percent, significantly exceeding the central bank targets. Prices continued to increase in the first months of this year, in line with the rise in energy, commodity and food prices. With a view to curbing prices, of the countries in the region, Poland and Romania announced tax cuts and price compensation.

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



Source: Eurostat

In line with the global trends, Hungarian inflation also abandoned the tolerance band. Price trends were determined by the reopening after the pandemic, rising energy, commodity and food prices as well as the by the impacts of the global supply difficulties. International experiences show that the countries characterised by faster reopening of the economy registered a higher price increase. At the time of the global opening of the economy, supply was unable to keep abreast with soaring demand. The underlying reasons for the significant increase in Hungary's inflation observed in the first months of 2022 primarily include the rise in food prices and the significant repricing of industrial goods and market services. Pricing decisions have shown higher volatility and an unusual seasonal pattern in the recent period. The repricing at the beginning of 2022 was twice or three times as high as the figure seen in previous years, and thus in March Hungarian consumer prices rose by 8.5 percent compared to their level a year ago. The higher repricing rate is a general phenomenon, which is attributable to the fact that the rise in global commodity, food and energy prices appears in the consumer prices of a wide range of products. In addition to the foregoing, in the case of industrial goods the global semiconductor shortage also pointed to a rise in consumer prices. In the first months of 2022, core inflation excluding indirect taxes rose to 9.1 percent. The rise in core inflation is attributable to the rise in the prices of processed food and the repricing of industrial goods and market services. Underlying inflation indicators capturing persistent trends (core inflation net of processed food and inflation of sticky price products and services) have steadily rose in recent months.

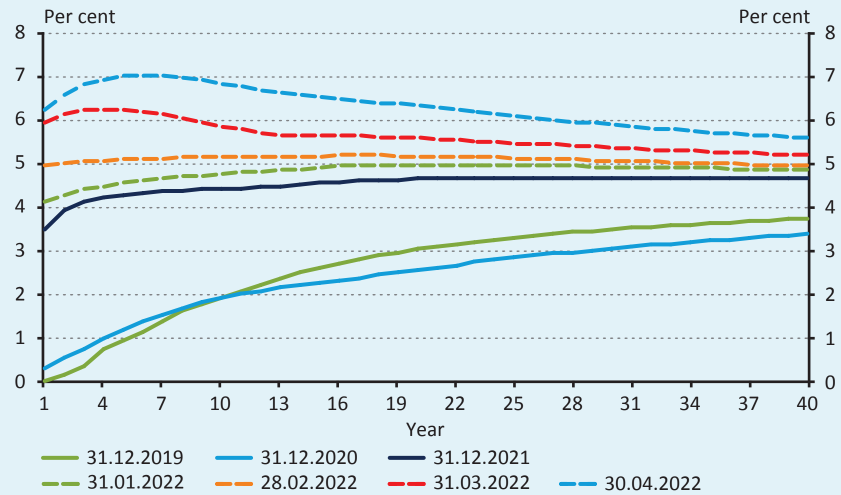
Inflation risks have strengthened. In January 2022, the average world market price of Brent crude oil was USD 85.5 per barrel, and in the first week of March – after the outbreak of the Russia-Ukraine war – it exceeded USD 130 per barrel, unprecedented since summer 2008. Global food prices tended to rise in the past period. Recently the high level of unprocessed food prices was attributable to concerns relate to crops, the rise expenditures together with the soar in demand under globally scarce supply. As a result of the war between Russian and Ukraine and the sanctions imposed on Russia, the price of wheat and maize rose significantly at the end of February 2022. It should be emphasised that in Hungary the weight of articles susceptible to cost fluctuations – unprocessed food and fuel – is significant by EU standards (12.5 percent in total), and thus occasional food or fuel price shocks have a greater impact on the developments in the consumer price index.

1.1.4 Drastically changed yield environment

The rising yield environment resulting from the macroeconomic trends represents major risk for the Hungarian insurance sector. On the one hand, it gives rise to a depreciation in the insurers' assets, of which primarily the revaluation of the fixed-income securities has an impact on the institutions' Solvency II (S2) balance sheet. At sector level, a significant part of insurers' non-unit linked assets are invested directly in government bonds, which may have significant impact on certain market participants when broken down by institutions.

The impact of the significant change in yields also appears on the liability side. The rise in the risk-free yield curve (RFR[1]), relevant for the reserve calculation, may reduce institutions' S2 reserves through the discount effect. As reserves decline, the aggregate of liabilities also decrease, which may result in an increase in insurers' available own funds, which alone may have a positive impact on the capitalisation level. In 2021, the RFR of the Hungarian forint rose and flattened over the entire horizon (Chart 1.4), while in early 2022, in parallel with a stronger rise at the short end, the curve has become steeper as a result of the external events of that time.

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



Source: EIOPA

1.1.5 Restructuring in the government securities market

In parallel with the subsiding concerns related to the coronavirus pandemic, in the first months of 2021 global investor sentiment somewhat improved. However, from the second quarter, strengthening fears of reflation once again had a negative impact on it, while from the second half of the year inflation concerns and the start of the developed central banks' tightening cycles were the main factors that influenced global markets. As a result of this, last year the US and European bond markets registered a significant rise in yields. The rise in developed country yields also impacted yields in the region and in Hungary. Last year, German and US 10-year yields rose by 40-60 basis points and in parallel with this, regional long-term yields moved up by 150-240 basis points.

With a view to strengthening monetary policy transmission and reducing the economic and financial impacts of the coronavirus pandemic, the MNB launched its government securities and mortgage bond purchasing scheme from 4 May 2020. Under the scheme, purchases by the MNB were performed in a flexible framework on the secondary market, at regular weekly auctions and also in the form of non-auction transactions, thereby facilitating the influencing of monetary conditions also at the longer section of the yield curve. In 2021, the MNB purchased government bonds in the amount of HUF 2,515 billion under the scheme, which contributed to the maintenance of market stability. In parallel with the

[1] RFR (risk-free interest rate) is the risk-free yield curve used for the calculation of technical reserves

tightening cycle, proactively launched in June 2021, resorting to all possible instruments of the set of monetary policy instruments and with a view to supporting the repeated achievement of price stability as soon as possible, the MNB gradually reduced, and as of 14 December 2021 it stopped its government bond purchase scheme.

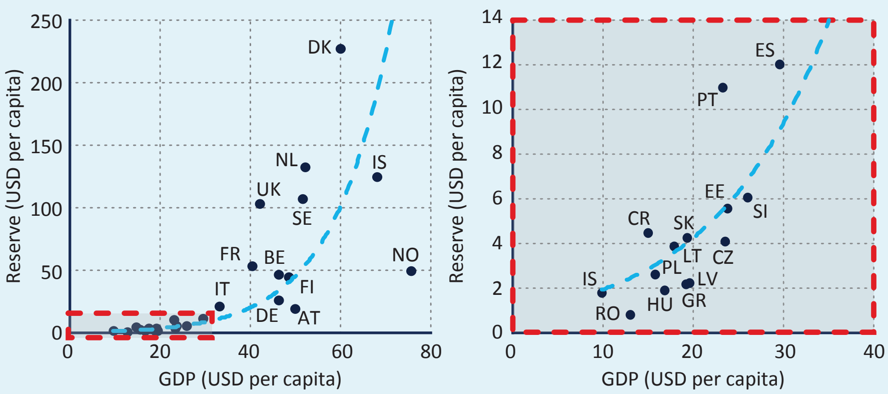
As regards the government securities holding of the key sectors, in 2021 the largest restructuring was that while non-resident investors reduced their holding of forint-denominated government securities by HUF 1,100 billion, the households sector increased it by HUF 900 billion.

The secondary market government securities turnover rose in 2021, while market liquidity was over the historical average in most of the year. The average daily turnover rose from HUF 250 billion, registered at the beginning of the year to around HUF 400 billion by the end of the year, with a significant part of the growth taking place on the 3 to 5-year maturities.

1.2 DOMESTIC SAVINGS ARE NEEDED FOR SUSTAINABLE GROWTH[2]

A general prerequisite for economic development is a substantial rise in and correct structure of capital accumulation. A precondition for dynamic economic growth is a high investment rate, which can be increased by boosting domestic savings. Along with direct government securities purchases and bank deposits, household savings basically appear in the financing of the economy via institutional investors. Their share has been increasing in the past two decades, as globally the financial instruments of institutional investors increased more than banks' financial assets in the past few years. Among institutional investors, insurers and pension funds are the most actively engaged in channelling the small savings of customers into the economy in an aggregate form, and these resources would not necessarily end up in the economy without this process. The example of European countries shows a marked correlation between economic development and savings (Chart 1.5). On the other hand, this causality is also true in reverse: in other words, the amount of savings has a positive impact on economic development by financing the economy using government securities, equity and bond investments. Therefore, increasing the coverage of pension savings programmes is a social policy objective, necessitated by demographic motives and the aforementioned economic policy objectives.

Chart 1.5
Supplementary pension and life insurance reserve per capita, and relation to GDP (2019)



Source: Eurostat.

As long-term institutional investors and due to their customers' geographical and currency preferences, insurers and pension funds can provide stable financing to the economy. The large-scale domestic investment of savings can be promoted by the establishment of regulatory and incentive schemes aimed at this, but they can only achieve a marked effect with broad coverage and high penetration. To this end, countries use various long-term (typically pension) savings incentive solutions, such as tax allowances, direct state supplements (a fixed amount or one based on payments), limiting investment costs, special institutional government securities and auto-enrolment with an opt out option. After compulsory participation, the OECD believes that the next most effective way to increase penetration is auto-enrolment (with an

[2] The sub-section was also included in 2022 in the MNB's publication entitled "New Sustainable Economics – Global Polemical Paper" (in Chapter 10).

opt out option), and that is what it recommends. Richard H. Thaler formulated the default choice effect, and applying this effect to pension supplement schemes, Thaler and Benartzi described the so-called SMarT programme. In essence, people rarely deviate from the default option, because they trust it and deviation requires active participation and an individual decision. Therefore, auto-enrolment and appropriately chosen default options can considerably increase the savings rate, without making people feel that they are incurring a loss.

The differences between pension supplement and life insurance reserves are caused by social traditions and the features of economic development. Western European countries have huge reserves amounting to multiple times their own GDP, in contrast to Central and Eastern European countries where there was no large institutional investor sector prior to the economic transformation in the 1990s. In the short run, the amounts removed from current consumption flow into financing the economy, thereby contributing to sustainable development and exerting a countercyclical effect that reduces inflation.

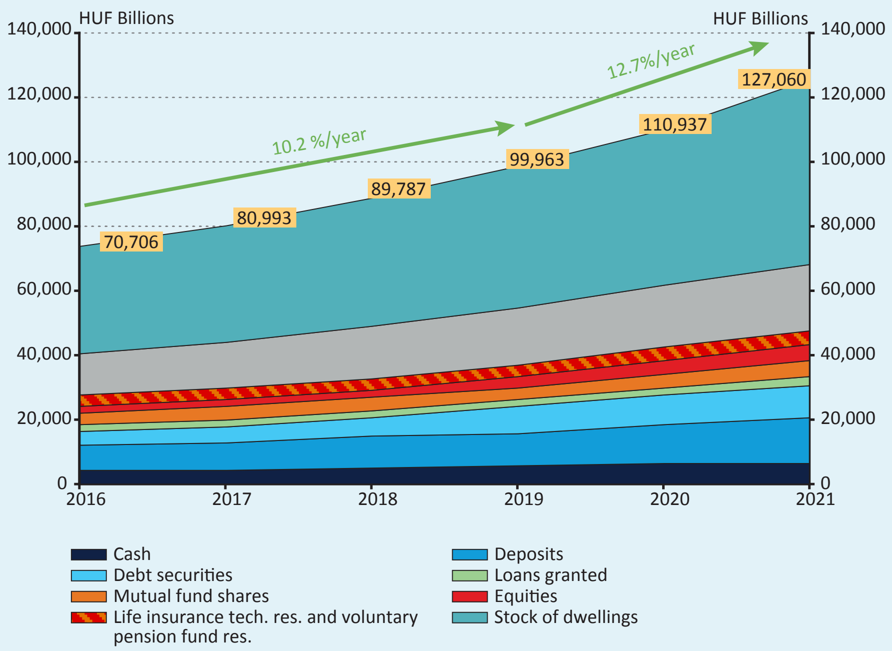
A basic precondition for a welfare turnaround is a high household (domestic) savings rate, and with that the growing size of the Hungarian institutional investor sector can produce positive effects for Hungary. This can be implemented, for example, through the continued development and introduction of the welfare fund concept proposed by the MNB, which would enable the achievement of greater and permanent coverage in a short time, based on the already existing voluntary fund system supplemented with auto-enrolment. As a result, the countercyclical, disinflationary effect can take hold in the years following introduction. In the sector subject to Hungarian regulation, the accumulated savings could be guided, and the investment of the reserves could provide a continuous demand for financing the domestic capital market and government debt.

1.3 DEVELOPMENTS IN THE PORTFOLIO OF HOUSEHOLDS' SAVINGS

1.3.1 Dynamically increasing household assets in 2021

By the end of 2021, gross assets of households, comprising financial instruments and the stock of dwellings, exceeded HUF 127,000 billion, which represents an annual growth of 14.5 percent (Chart 1.6). In the past one year, the biggest contribution to the growth in assets was made, in addition to the stock of dwellings and deposits, by the rise in the value of participations and mutual fund shares (by HUF 13,734 billion in total, they accounted for 85 percent of the total growth).

Chart 1.6
Developments in the gross assets of households



Note: The 2020 and 2021 data related to the stock of dwellings are MNB estimates.

Source: HCSO, MNB

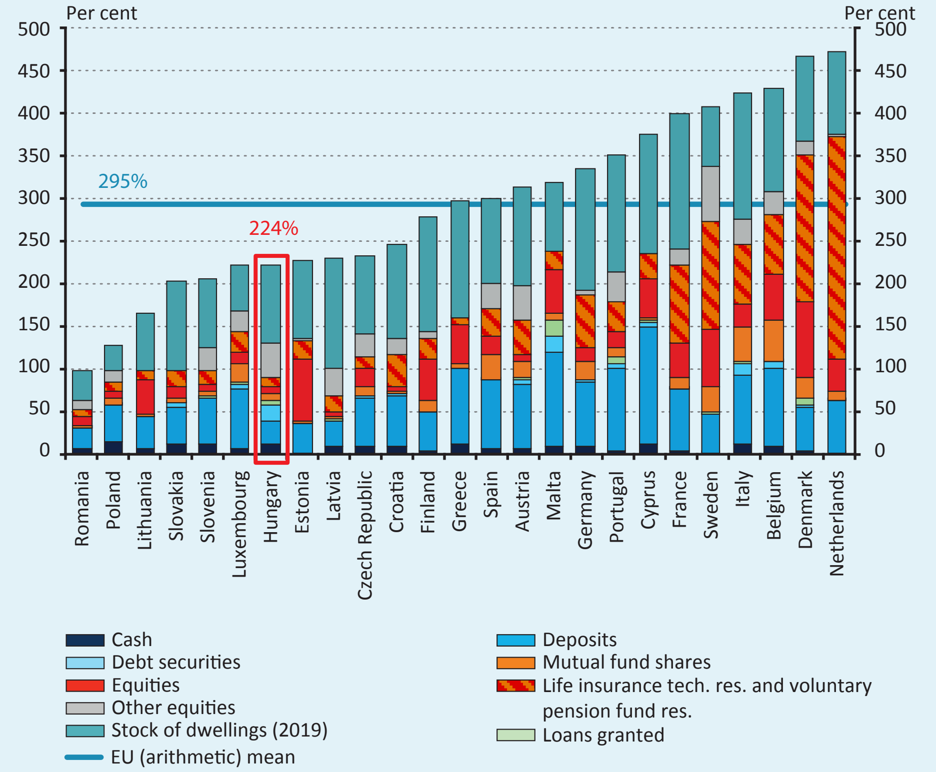
The most dynamic growth was registered in mutual fund shares (23 percent), and the stock of dwellings also grows over the average, by 19 percent. The rise in households' investments in private equity funds had a significant effect on the growth in mutual fund shares. The growth in the value of the stock of dwellings was primarily attributable to the increasing property prices. On the other hand, the growth in the stock of cash, deposits, debt securities, participations, technical and fund reserves was below the average and also fell short of that registered previous year. The more moderate growth in more liquid assets most probably was connected to the rise in inflation.

The life insurance and voluntary fund reserves, serving as means of long-term wealth accumulation, rose at roughly the same rate as the average of previous two years (by 6.8 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 fell to 3.5 percent, while within the gross financial assets of households fell to 6.4 percent. The previous sustained favourable economic activity and fast recovery from the pandemic may have led households to a more extensive build-up of self provision based on long-term products. However, the growth fell short of the increment in other asset components.

1.3.2 The ratio of our financial assets falls short of those of others

Gross assets of Hungarian households, comprising financial instruments and stock of dwellings, amounted to 224 percent of GDP at the end of 2020 (Chart 1.7), 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 295 percent. The average for the countries of the region (the Czech Republic, Poland and Slovakia) is 188 percent, thus the assets of Hungarian households are higher – relative to their economic development – than that of countries of similar development level, according to the statistics. 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 450 percent more). As a percentage of GDP of the individual categories, Hungary is ranked first (tied with Poland and Slovenia) in cash holding and debt securities (together with Malta). In addition, it is among the leaders in other equity and loans granted (ranked 2nd for the first and 4th for the second).

Chart 1.7
Gross assets of EU households as a percentage of GDP, at the end of 2020



Note: The stock of dwellings data relate to 2019.
Source: Eurostat

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, 23rd for the second and 22ns for the third in 2020). Hungarian households are in the mid-range in terms of the proportion of their assets held in mutual fund shares (ranked 14th) 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.

1.4 GENERAL CAPITAL MARKET TRENDS IN 2021

The Hungarian capital market closed a good year in 2021 despite the instability of the global economy caused by the coronavirus pandemic. The key European and US capital market price indices performed exceptionally well also in 2021. The German DAX index, the French CAC 40 and the London FTSE 100 rose by 15.72 percent, 27.98 percent and 12.37 percent, respectively, in 2021. Of the US indices the Dow Jones rose by +20.23 percent, the S&P 500 by +28.79 percent and the Nasdaq Composite by +23.20 percent.

The BUX, the key equity index of the Budapest Stock Exchange performed similarly well, closing 2021 with a plus of 19.8 percent. In 2021, the price of blue chip papers at the Budapest Stock Exchange registered a significant growth. In the equity market turnover the top three equities of the largest turnover – OTP, MOL, Richter – remained unchanged in 2021, but their sequence has changed: OTP is still on the first place, while Richter – ranked second in 2020 – slipped to the third place in 2021 and it was replaced by MOL. The positive capital market sentiment greatly contributed to the fact that in 2021 the customer securities portfolio managed by domestic investment service providers reached a historic high.

In the foreign exchange market, compared to the first trading day of 2021 the forint depreciated by 2.42 percent to the euro on the last trading day of the same year. However, the forint depreciated against the dollar to a larger degree; on the last day of 2021 by 9.35 percent more forint had to be paid in exchange for one dollar than on the first of January.

In 2021, investment funds also registered significant capital inflows. The growth of HUF 1,024 billion in net asset value exceeds the stock registered at the end of 2020 by 14.15 percent. This growth is attributable to two factors: to the yield effect and to the positive capital inflows of investment funds.

Accordingly, it may be concluded that both the international and the Hungarian capital market had a successful year in 2021, on the whole. This positive sentiment and historic high were broken by the outbreak of the conflict between Russia and Ukraine in February 2022.

2 The insurance market and its risks

2.1 OVERALL PICTURE OF THE MARKET

2.1.1 Growing market size under steady number of insurers

In 2021 no change occurred in the ranking of institutions in the entire Hungarian insurance sector (Table 2.1).

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 4 life insurers, 9 non-life insurers and 9 composite insurers. In 2021, gross written premium at sector level was HUF 1,330 billion, representing a year-on-year growth of 10.4 percent. The non-life segment and the life segment contributed to this in a proportion of 58-42 percent.

The non-life segment's premium growth rate rose at the same rate as before the introduction of the insurance tax (2013-2018), i.e. by 7.9 percent compared to previous year. Also taking into consideration the Hungarian branch offices of insurers with registered office abroad, the gross written premium of the insurance sector is HUF 1,426 billion. The share of branch offices within the total gross written premium (6.8 percent in 2021) rose by 0.3 percent compared to the previous year. In 2021, the rise in the number of policies (+1.5 percent) fell short significantly of the growth in gross written premiums compared to the previous year. The number of life insurance policies decreased by 1.0 percent, while non-life insurance policies increased by 2.0 percent over the year. In parallel with the gradual phase-out of the government's restrictive measures and the recovery of the economy, the growth in the portfolios also started to return to its dynamics seen before 2020. Hungarian insurers' return on equity at sector level (ROE in 2021: 20.7 percent) was lower than in the last four years, but its level is sufficiently high, which reflects a positive picture of the insurance sector from a stability perspective. However, it is below the fair and competitive target set in the "10-year future of the insurance sector in 7 points" (FIS), while the return on S2 eligible own funds equity (S2 ROE) of 12.2 percent is within the target range.

Table 2.1
Key data of the insurance sector

	2020	2021		
	Total	By institutions type		Total
Number of institutions (pcs)*	32	Total S2 insurers	22 –	32 –
		Life	4 –	
		Non-life	9 –	
		Composite	9 –	
		Small insurance union	10 –	
	Total	**Life segment**	**Non-life segment**	**Total**
Gross written premium (HUF billions) *(including branch offices)*	1,204.1 *(1,285.1)*	602.8 ↑ *(638.0)*	726.8 ↑ *(788.2)*	1,329.6 ↑ *(1,426.2)*
Number of contracts (thousand pcs) *(number of contracts per capita) ***	14,483 *(1.49)*	2,313 ↓	12,336 ↑	14,649 ↑ *(1.51)* ↑
Technical provisions (HUF billions)	2,319.7	2,031.9 ↑	300.8 ↓	2,332.7 ↑
Balance sheet total (HUF billions)	3,177.9			3,402.2 ↑
Eligible own funds (HUF billions)	662.4			658.4 ↓
Capitalisation level (per cent)	220			196 ↓
Profit after tax (HUF billions)	82.3			80.2 ↓
Return on equity (ROE)	23.9%			20.7% ↓
Return on solvency capital (S2-ROE) ***	12.8%			12.2% ↓
	Small,insurance,unions			
	2019	2020 ****		
Number of institutions (pcs)	10	10 –		
Gross written premium (HUF millions)	530	702 ↑		
Number of contracts – also those shorter than 1 year (pcs)	1,951	2,570 ↑		
Return on equity (ROE)	5.5%	11.9% ↑		

Notes:
** The number of institutions does not contain one supervised joint-stock company falling outside S2.*
*** For the insurance policies per capita ratio we calculated with the total population indicated on the HCSO website.*
**** The S2-ROE index compares the profit after tax to the available capital under Solvency II.*
***** The 2021 data of the small insurance unions is not yet available.*
Source: MNB

2.1.2 Market has not set on a convergence path

The MNB published FIS in February 2018. 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 2.2).[3]

[3] Backtesting was performed considering the changes in the actual macroeconomic figures.

Table 2.2
Target values and actual data of the insurance sector

Objective to be achieved	Target variable	2020 actual data	2021 actual data	2026 target value
1. Wide-ranging self-provision More savings, greater security	life insurance and voluntary pension fund contracts/economically active persons	52.4%	**50.3%**	over **80%**
	ratio of reserves as a percentage of GDP (life technical reserve + voluntary pension fund individual accounts)	7.84%*	**7.25%***	over **10%**
2. Market size convergence Back to the forefront of the region	Penetration (gross written premium/ GDP)	2.53%*	**2.42%***	over **3.0%**
3. Competitive market Increasing competition	Share of TOP 5	60.4%	**60.3%**	under **55%**
4. Efficient sales Half of sales over an innovative channel	ratio of innovative channels	35% (2019)	**32% (2020)**	over **50%**
5. Economies of scale Institutions operating more cost efficiently with dropping margins	ACR values of UL contracts	0.92-5.39%	**0.90-5.40%**	**0.5-5.75%** steadily
	non-life combined ratio (net of tax)	78.8%	**78.2%**	**85-90%** steadily
	cost ratio	30.1%	**29.3%**	**20-30%** steadily
6. Fair and competitive profitability Long-term confidence and stability	ROE	24.3% S2 ROE 12.8%	**20.7% S2 ROE 12.2%**	**10-15%** steadily
7. Well-capitalised insurers Safe and prudent operation	capitalisation level	220%	**196%**	**>150%** steadily

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

The coverage of life insurance and voluntary pension fund contracts fell in 2021 by 2.1 percentage points (to 50.3 percent). The number of contracts decreased only slightly by 0.2% over the year, while the number of economically active persons was corrected 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 7.0 percent (by HUF 259 billion) in 2021. 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 gross written premium 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 7.25 percent of GDP at the end of 2021. The empirical trend and the international trend takes into consideration the changes in the nominal value of GDP, which significantly exceeded that of the reserves, and thus the actual ratio fell short of these paths, both as a percentage of GDP and in its amount.

The growth in insurers' gross written premium returned close to the growth rate that characterised the period before the coronavirus pandemic, its growth in the period under review exceeding only the inflation targeting trend of the three projected growth paths. As a result of the foregoing, the penetration rate exceeded the inflation targeting trend in FIS by 0.5 percentage point and the empirical trend by 0.1 percentage point due to the dynamics of previous years, but is still falls short of the projected level of the rising penetration trend for 2021 by 0.3 percentage point. To reach the latter penetration level, the sector would have needed an additional gross written premium of HUF 190 billion. However, as regards the trend defined in FIS in terms of amount the actual figure exceeded also the rising penetration trend in 2021.

The share of the top 5 market participants (TOP 5) exceeded the projected path by 3.5 percent in 2021. The Herfindahl-Hirschman index (HHI) remained broadly unchanged, which has also slightly moved it away from the steadily declining projected path. The value of the indicators stems from the realignment of the TOP5 market participants, which was not influenced by any institutional merger or a potential loss of market of minor insurers.

In 2020, the ratio of innovative channels[4] in the composition of the insurance companies' sales channels was 32 percent, down by 3 percentage points from a year earlier[5] and also down from 2016. The sector continues to move further and 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 developed.

Similarly to the previous year, the ACR values of the unit-linked contracts[6], affected by the MNB recommendation, do not depart from the limits expected by the central bank. No material shift, exceeding 0.1 percentage point, has been registered in the lowest and highest ACR, as a result of which the values varied between 0.9 and 5.4 percent.

The sector-level combined ratio of non-life insurances decreased year-on-year. This fits into the moderately declining trend after 2013, which was broken only by a minor increase in some of the years. Thus the value of the indicator for 2021 remained below the level of 2016 in the entire sector and significantly fell short of the target band set in FIS.

In 2021, the cost ratio declined by 0.8 percentage point compared to previous year, reaching 29.3 percent, and thus the sector entered the target band 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.

In 2021, the profitability of the sector was more moderate than in the previous two years, but it still represented a higher return on equity (ROE) than the designated target band (10-15 percent). There is no sign of material decline approaching the target band. However, the return on equity under S2 (S2 ROE) at 12.2 percent is in this band.

As regards the sector-level capitalisation level, the designated target of over 150 percent was realised, similarly to previous years. At the end of 2021, the capitalisation level of half of the institutions exceeded 200 percent, and each institution separately fulfilled the 150 percent target. The persistently high level of the institutions' capital position serves as a good foundation for the sector's safe and prudent operation.

2.1.3 Gross written premium rose to exceed HUF 1,300 billion projected in the MNB's vision

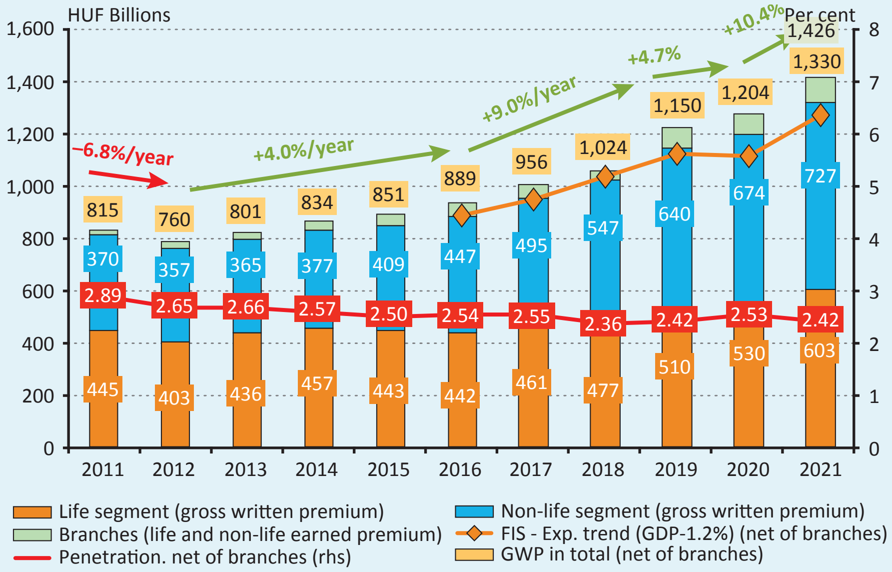
In 2021, the gross written premium of the insurance sector was HUF 1,330 billion in total, which is a 10.4 percent increase compared to the previous year (Chart 2.1). In a breakdown by segments, the gross written premium rose by 7.9 percent in the non-life segment and by 13.6 percent in the life segment during the year. Due to this, the sector exceeded the rising penetration trend level of HUF 1,312 billion, projected for 2026 in FIS. The growth rate returned to the trend observed before 2020, which may be attributable to the recovery of the Hungarian economy. On the other hand, penetration declined due to the same reason, and thus the indicator has somewhat moved away from the target value included in the MNB's vision. The growth of the sector lagged behind that of the entire economy; accordingly, following 2020, insurance penetration managed to decrease further. After 2.53 percent in 2020, it was 2.42 percent in 2021.

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

[5] Due to the late receipt of the data supply, the report does not include the sales mix of 2021, and thus in this publication we can present data for 2020.

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

Chart 2.1
Gross written premium and penetration in insurance sector

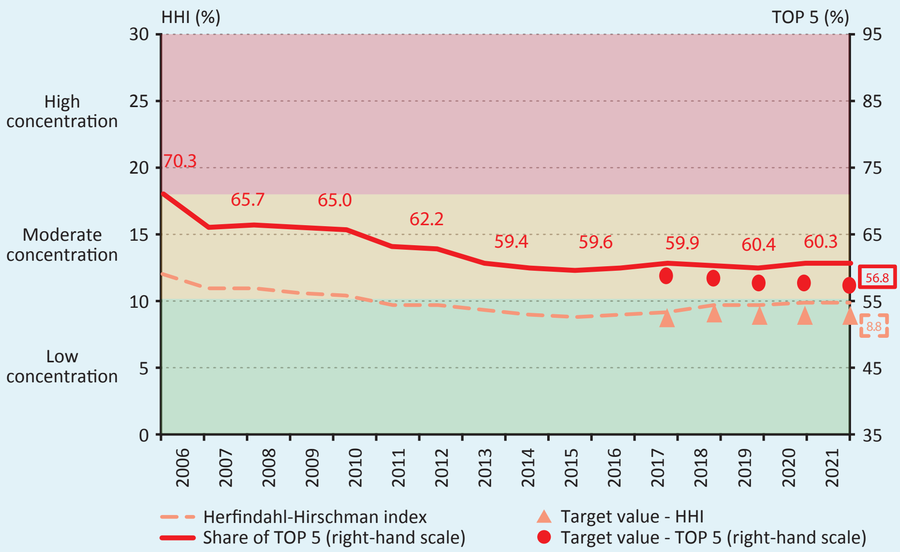


Note: Gross written premium in life and non-life segments, and gross earned premium for branch offices.
Source: HCSO, MNB

2.1.4 No significant decline from the level of around 60 percent in the market share of the TOP 5 market participants

The share of the TOP5 market participants remained broadly unchanged in 2021, declining by merely 0.1 percentage point to 60.3 percent. (Chart 2.2). As regards the entire sector, the share of the TOP5 institutions declined in the life segment, which was somewhat offset by the market acquisition in the non-life segment. In both segments, realignment took place primarily among medium-sized insurers, and thus their share slightly increased in the life segment and decreased in the non-life segment. As the combined result of the foregoing, the HHI remained broadly unchanged at 9.7 percent. The actual data considerably exceeded the concentration path projected in FIS, and the change in 2021 did not bring the sector closer to it either.

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



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

2.1.5 Concentration increased both life and non-life segment

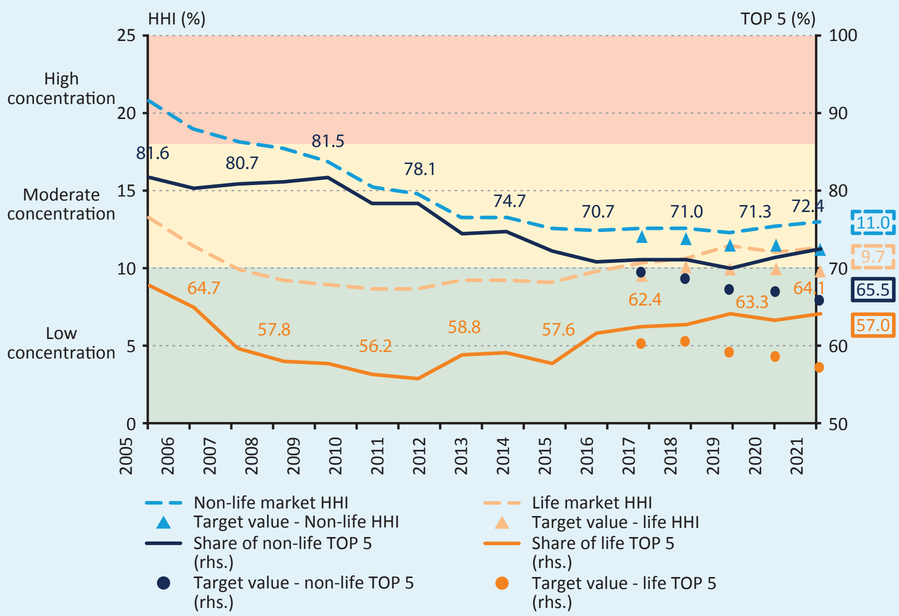
There was a slight increase in concentration in both life and non-life segment in 2021 (Chart 2.3). In the life segment, the share of the TOP 5 institutions rose by 0.8 percentage points, with the HHI rising by 0.3 percentage points. The return of the share of market participants selling single premium life insurances to the ratios seen before the pandemic measures contribute to growth to a large degree. Since this involved only a few actors, the rise in concentration was also relatively significant.

On the other hand, in the non-life segment, the market weight of the TOP 5 insurers increased by 1.1 percentage points, while the HHI shows only a slightly, i.e. by 0.2 percentage points, higher concentration in 2021 year-on-year. In a breakdown by products they acquired market shares not only from small non-life insurers, but also to the detriment of each other.

As a result of the realignment, one insurer has been replaced within the TOP 5 institutions.

The actual figures exceeded the life and non-life segments' path projected in FIS. On the one hand, this may be attributable to the cumulated effect, according to which the actual figure exceeded the values in the FIS path in previous years as well. On the other hand, the shifts in 2021 were of opposite direction in both segments compared to the changes presented in FIS for this year.

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

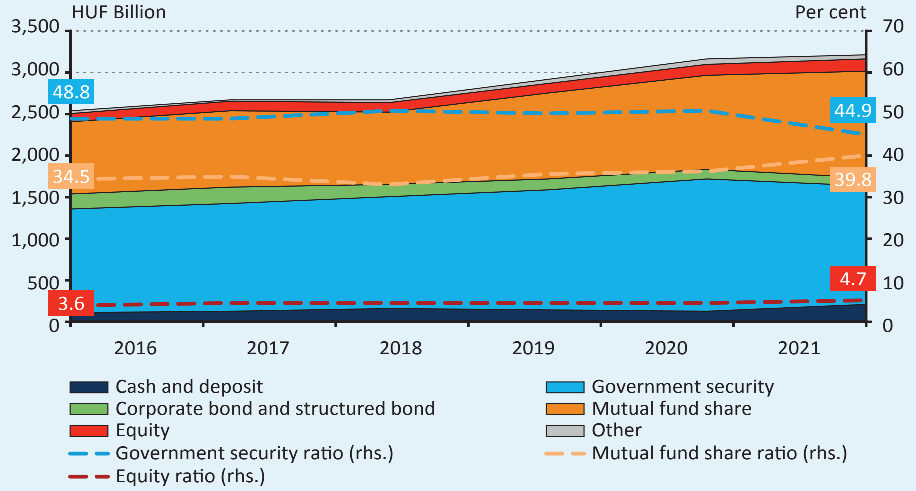


Note: The colour of the background illustrates the strength of concentration under HHI.
Source: MNB

2.1.6 High, but decreasing government securities concentration

The value of the Hungarian insurance companies' total assets rose by a more modest 1.5 percent in 2021, following an increase of 8.5% in previous year. The value of total assets is HUF 3,197 billion, 49 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 2.4). This ratio changed by 4 percentage points compared to previous year to the benefit of unit linked life insurances. 50.8 percent of the insurers' total assets comprised low-risk, conservative instruments (government securities, cash and deposits). This ratio is 3.5 percentage points lower than in 2020. The rest of the assets mostly consists of mutual fund shares, equities and corporate bonds (also structured bonds). In 2021, a reallocation of 0.5 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 higher risk instruments, thus the share of those rose to 81.2 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). 76.8 percent of the investments underlying the reserves for policies other than unit-linked insurance comprised government securities, which continues to be an outstanding ratio, by European comparison.

Chart 2.4
Composition of assets of Hungarian insurers

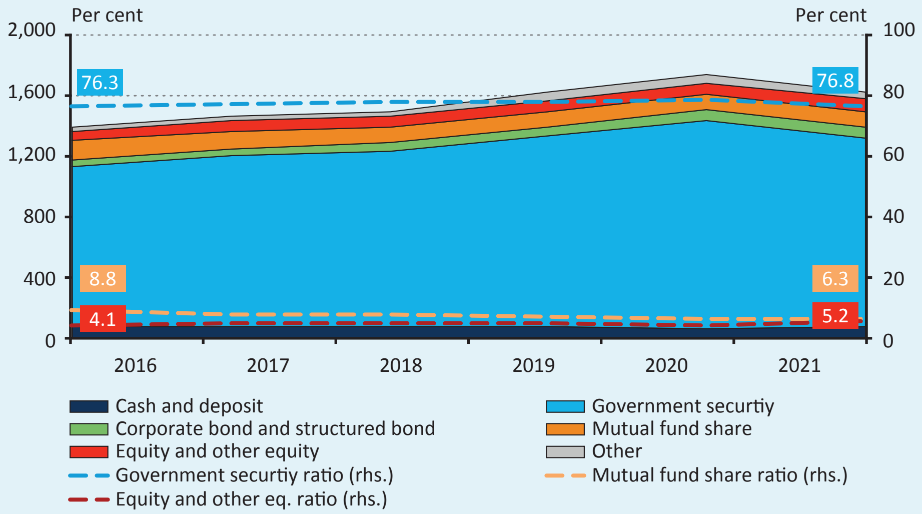


Note: Other includes: real properties, mortgage bonds, loans and other unclassified assets.
Source: MNB

2.1.7 The ratio of government securities within non-UL reserves continues to be significant

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 2.5). Following the halt in 2020 in the slow rise observed in the equity ratio until 2019, it rose by 1 percentage point in 2021. The decline in the share of mutual fund shares, observed since 2017, was followed by an increase of 0.5 percentage point in 2021. There is a minor realignment in the asset categories underlying the non-unit linked reserves to the detriment of government securities for the benefit of cash, bank deposits, mutual fund shares and equities.

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



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

2.2 LIFE SEGMENT

2.2.1 The life portfolio continued to grow rapidly

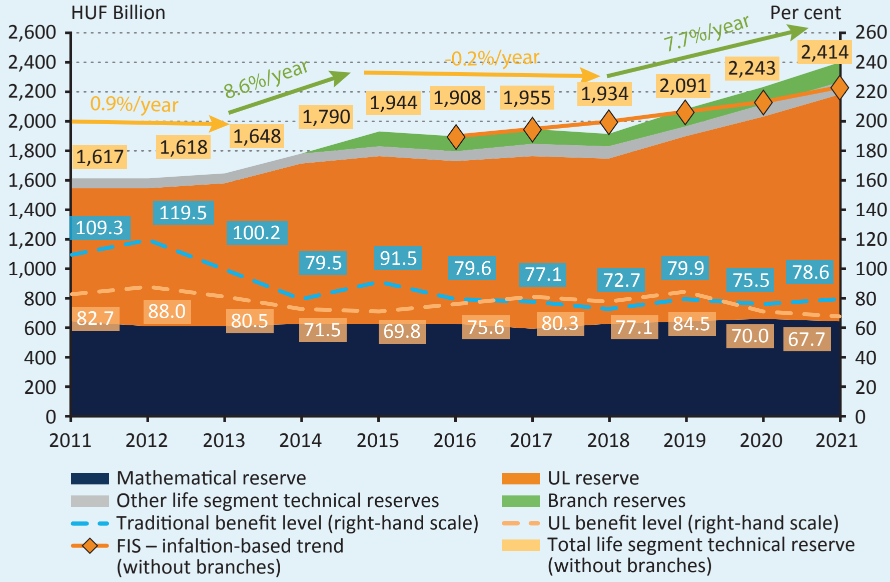
At the end of 2021, the life insurance accounting technical reserves amounted to HUF 2,280 billion (including the branch offices: HUF 2,414 billion), which represents a significant – 7.3 percent (including branch offices: 7.6 percent) – growth compared to the previous year (Chart 2.6). Actuarial reserves linked to traditional life insurances slightly decreased (by HUF 8.9 billion) compared to previous year, while the reserves for unit-linked products, representing a much higher share within life insurance reserve, continued to rise dynamically. In 2021, reserves for unit-linked products rose by 11.7, or HUF 163.0 billion, compared to previous year.

The change in the stock of life insurance premium reserves are mainly attributable to the positive balance of cash flows (incoming cash flows exceeded payments), while 39.3 percent of it is attributable to revaluation, i.e. the realised yields. In the case of the reserves for unit-linked products the realisable yield is typically higher, as the underlying investments are mostly in riskier instruments (equities, investment funds), while the instruments underlying the reserves of traditional products are usually risk-free assets, the potential yield of which is generally lower.

As regards the cash flows, gross written premium of unit-linked products rose to a larger degree (by 14.9 percent) than payments (by 2.6 percent), as a result of which the benefit level was 67.7 percent in 2021, which is lower by 2.3 percentage points compared to previous year. As regards cash outflows, death benefits rose to the largest degree, by 32.8 percent.

At the traditional life insurances, the amount of payments rose to a larger degree, by 12.2 percent. At these products as well the largest increase was registered in the amount of death benefit payments (28.5 percent). The second largest growth was linked to surrenders (17.3 percent). Meanwhile, the gross written premium of traditional products rose by 12.0 percent, and thus the level of benefit payments was 78.6 percent in 2021, on the whole, exceed that of previous year by 3.1 percentage points.

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



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

Source: MNB

2.2.2 Significant inflow of funds in 2021

Recently life gross written premium exceeded the level of benefit payments, and thus the cash flow balance has been positive for several years. Gross written premiums due on life insurance policies have followed a rising trend since 2016, in 2021 amounting to HUF 602.7 billion in total, which is an increase of almost 14 percent compared to 2020 on annual basis, primarily as a result of the top-up payments, which have doubled. In the economic situation developed as a result of the coronavirus top-up payments in the insurance sector developed much more favourably than expected (see Figure 2.7 for details).

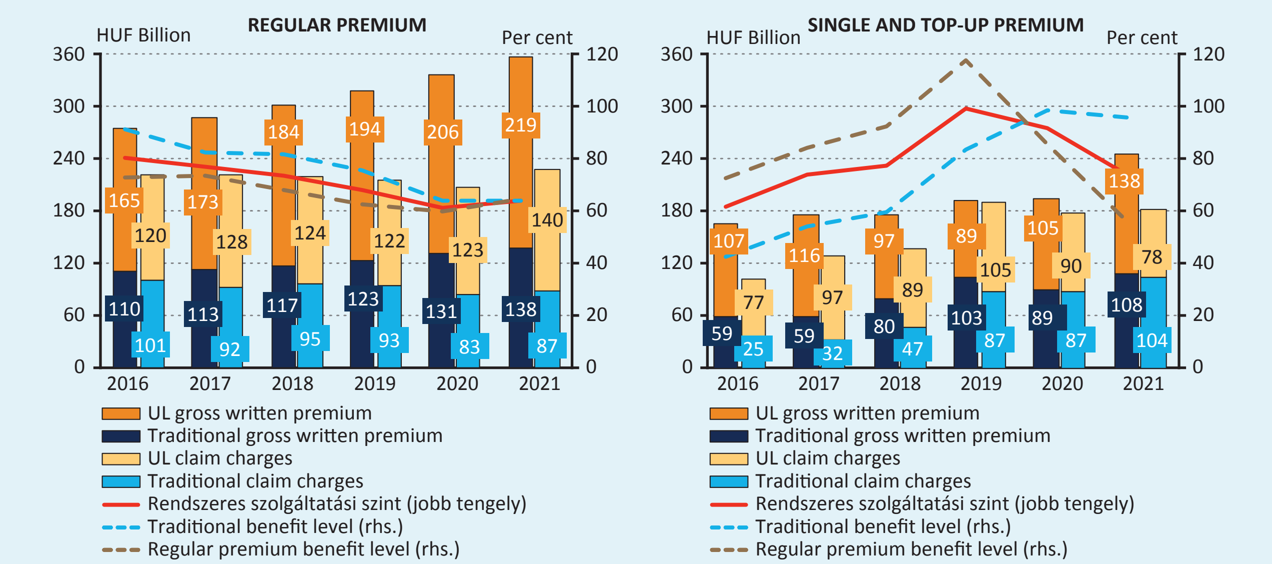
The sector-level benefit payment ratio, calculated based on the single and top-up premiums, was primarily determined by the premium level. As a result of the high top-up premiums and the fall in current year's claim charges payments, the unit-linked benefit payment ratio plunged in 2021 to 57 percent from 86 percent registered in 2020. The claim charges payable on single premium unit-linked polices cancelled in the reporting year due to expiry fell to HUF 21 billion compared to HUF 31 billion in 2020. The difference is attributable to the base effect, since a large unit-linked portfolio at one of the insurers expired in 2020.

In the case of single premium participating policies the benefit payment ratio is still very high (96 percent at the end of 2021). Surrenders, accounting for the vast majority of payments, rose dynamically in 2021, and thus payments under single and top-up premium policies exceeded HUF 100 billion.

Gross written premium on regular premium life insurance policies has been growing at a slow steady rate (+6 percent) since 2017, primarily due to the growth in the unit-linked pension insurance portfolio, and thus in 2021 it amounted to HUF 356 billion in total. In the regular premium life insurance market the benefit payment ratio was 64 percent in the reporting year, which corresponded to the level of benefit payments related to the unit-linked and the traditional life insurance portfolio.

Claim charges on regular premium traditional life insurance policies have gradually declined in the past six years due to the decrease in the benefit payments due to expiry. The latter is still the main reason for benefit payments (44 percent of the benefit payments in the reporting period). However, due to the gradually expiring portfolios in previous years and the declining ratio of traditional policies within new acquisitions, this is expected to decrease further. In 2021, death benefits payments rose by 63 percent compared to the level seen in 2018–2019, which is primarily attributable to the increased mortality rate resulting from the coronavirus.

Chart 2.7
Developments of premiums written, claim charges and benefit level* in the life segment, by premium payment frequency



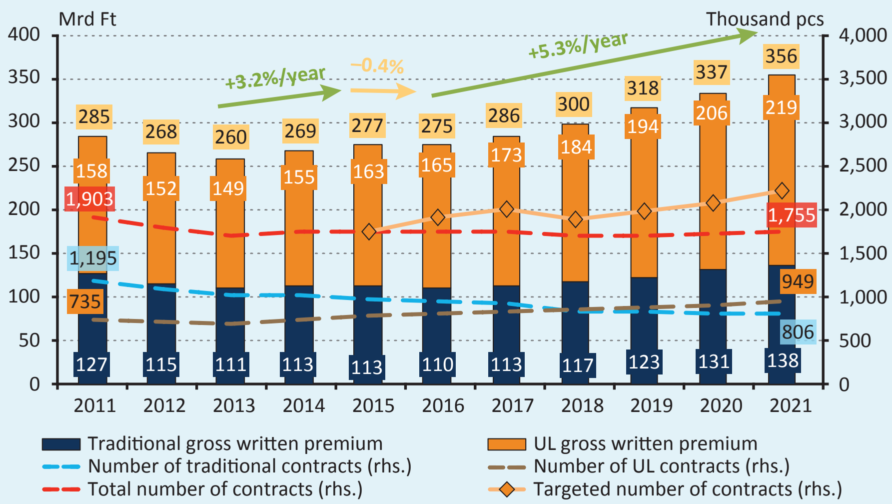
*Note: *The benefit level is the ratio of the claim charges compared to the gross written premium.*
Source: MNB

Claim charges due on the regular premium unit-linked premium soared in 2021 from the stable level observed in previous years (HUF 120-128 billion) to HUF 140 billion due to the surrenders, which also raised the benefit payment ratio. In 2021, insurers paid HUF 95 billion on surrendered policies, which exceeded the amount registered at the end of 2020 by 18 percent. In 2021, the average amount paid on surrendered regular premium unit-linked policies HUF 721,000 on average, while this amount in 2020 was only HUF 612,000. Expiry remains the other main reason for termination, while the level of this corresponds to the figure registered in 2020 (at the end of 2021: HUF 38 billion).

2.2.3 Steadily growing gross written premium on regular premium life policies

The sector-level gross written premium of regular premium life insurance products was able in 2021 as well to continue its growth trend observed in previous years, amounting to HUF 356 billion, exceeding the amount registered at the end of last year by 6 percent, which was primarily attributable to the growth in the unit-linked pension insurance portfolio. (Chart 2.8). Within the regular premium portfolio, the non-pension unit-linked portfolio remains the main source of income for the sector. However, in the absence of any material rise in the number of policies, since 2018 gross premium written increases only at a slow, hardly noticeable rate, slightly exceeding HUF 147 billion in 2021.

Chart 2.8
Development of regular premiums and number of contracts in the life segment



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

As a result of opposite effects, the size of the regular premium life insurance portfolio was unable to grow materially in terms of number of policies, by the end of 2021 being around 1,755,000. The number of regular premium policies is getting further and further away from the target figure projected in FIS, as the increasing trend forecast there has not realised, and thus the gap between the expected and actual number of policies is increasingly wider. In 2021, the actual penetration reached 79 percent of the designated path.

In 2021, almost 88,000 new non-pension unit-linked contracts were concluded, exceeding the 2020 figure by 10 percent. However, this was not felt at sector level due to the decline in the increment of the traditional policies in the reporting year on an annual basis.

The number of newly acquired regular premium unit-linked pension insurances was 55,000 in 2021, outstripping the increment seen in previous years. Thus the portfolio already includes 312,000 policies. In line with the growth in the portfolio, with an increase of 14 percent in annual terms, the related gross written premium amounted to HUF 71.4 billion.

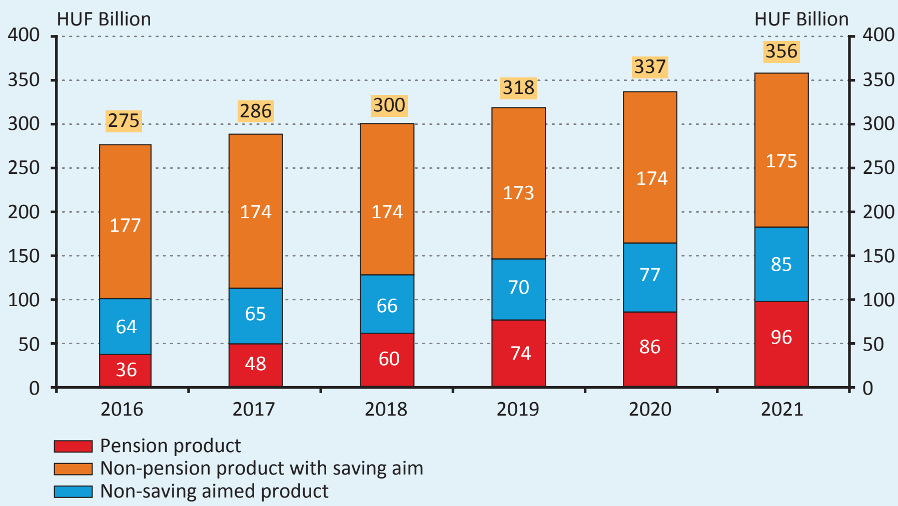
The number of traditional, non-pension policies has been continuously declining since the end of 2019. Despite the increasing acquisition of risk life insurances, due to the low guaranteed yields the traditional savings type life insurances are not an attractive form of savings for customers. On the other hand, in 2021 gross written premium of these products amounted to HUF 112.7 billion (+3.8 percent compared to the end of 2020).

In the reporting year, the growth observed in previous years in the traditional pension insurance portfolio faltered in 2021. The number of policies remained broadly unchanged on an annual basis (+2.5 percent) and thus at the end of 2021 amounted to 106,600. As regards the number of policies, the traditional pension insurance market is rather concentrated. By the end of 2021, 60 percent of the portfolio was held by two institutions. In 2021, gross written premium linked to these products corresponded to the level seen a year ago, amounting to HUF 25 billion.

2.2.4 Pension and risk insurances have strengthened over the years

Gross written premium due on regular premium life insurances has been rising at a slow, steady pace since 2017 (+6 percent), and in 2021 exceeded HUF 356 billion. The growth in gross written premium is still primarily attributable to unit-linked pension insurances, while the premium due on risk life insurance is also increasing. Gross written premium on non-pension savings policies has been stable for years, while the increasing gross written premium on unit-linked policies is offset by the declining gross written premium on the outgoing traditional, savings portfolio (Chart 2.9).

Chart 2.9
Distribution of life insurance regular premiums by the nature of saving



Source: MNB

In 2021, the number of policies in the regular premium pension insurance portfolio was close to 420,000, 75 percent of which are unit-linked policies. The development of the gross written premium of pension insurances corresponds to the composition and change in the portfolio: in the reporting year, premiums received on the increasing unit-linked pension insurance portfolio amounted to HUF 71.4 billion. Growth in the regular premium traditional pension insurance portfolio is well below that of the unit-linked portfolio, with significant deceleration since 2019. It has hardly changed between 2020 and 2021 (+2.5 percent) and the related gross written premium on an annual basis remained practically unchanged (HUF 25 billion).

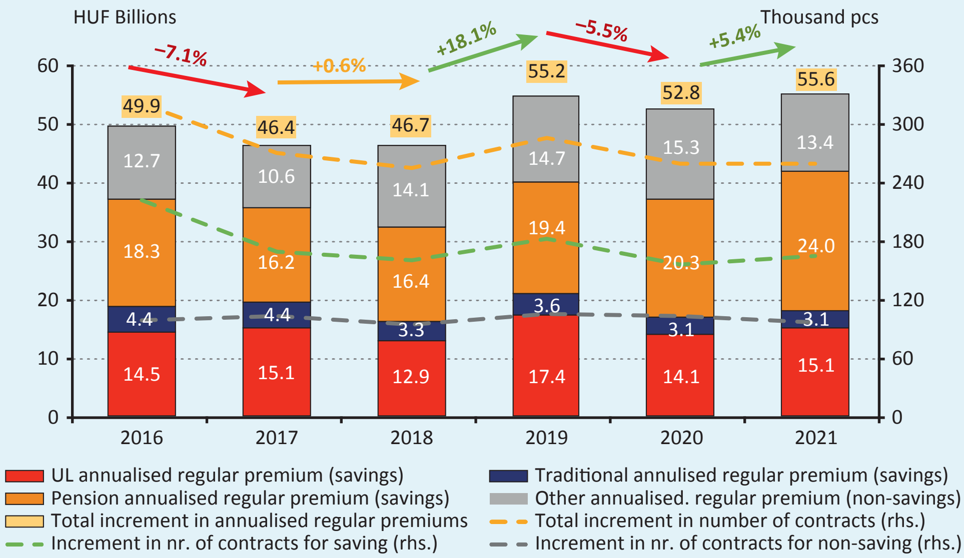
There are still 12 institutions active in the pension insurance market, 2 of which offer only traditional products, while another 2 only unit-linked products. In 2021, 61.5 percent of the gross written premium on regular premium pension insurances is possessed by the Top 5 market participants, and this ratio is rising slowly, but steadily, and thus market concentration is gradually growing.

2.2.5 New acquisition returned to its pre-pandemic high

In the life segment the increment in the number of regular premium policies rose moderately, by 0.5 percent, compared to previous year. The growth is attributable to the savings type life insurances, accounting for 70 percent of the portfolio. At these products the increment in the number of policies rose by 5.6 percent.

GDP growth had favourable impact on the acquisition of savings type life insurances, while the ethical regulation provides a stable background for growth. Unit-linked and pension insurance products remain popular as in previous years. The portfolio premium on the increment increased primarily in connection with the unit-linked products (by HUF 3.7 billion), well exceeding the pre-pandemic level. The portfolio premium on the increment of pension products also rose compared to previous year (by HUF 1.0 billion), but the increment in this product group has not yet reached the 2019 level. The portfolio premium on the increment of traditional savings products has not changed compared to previous year (Chart 2.10).

Chart 2.10
Increment in regular premium life insurance products by regular premium and number of contracts



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

2.2.6 BOTH SINGLE AND TOP-UP PREMIUMS SOARED IN 2021

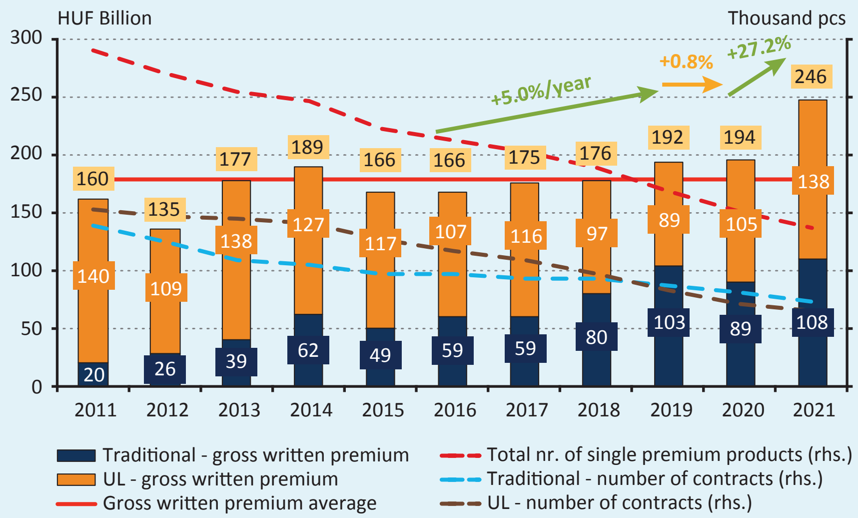
As regards the single and top-up premiums, in 2021 there was an unprecedented, 27 percent, rise compared to 2020 as a result of the top-up premium payments, which have doubled on an annual basis (Chart 2.11). At sector level, HUF 77 billion of the HUF 119 billion top-up premiums was received in connection with non-pension unit-linked policies, 60 percent of which was realised at two institutions. One of the insurers shows its premium on a unit-linked product introduced in the third quarter of 2020, received through a bank sales channel, while at the other insurer the usually high top-up premiums rose further by 2021.

In addition, large – almost HUF 24 billion – extraordinary payments were receive also for traditional, non-pension policies, which is almost fully connected to the successful sales performance of a single insurance company. The regular premium risk life insurance offers to customers a predetermined annualised net yield and the option to make top-up payments to the extraordinary premium account, which due to the predetermined, competitive yield for 2021 made the product even more popular. HUF 15 billion of the HUF 23 billion top-up premium was received in the fourth quarter of 2021.

In 2021, the current year's gross written premium, due on single premium life insurances, amounted to HUF 127 billion, representing a minor growth compared to the end of 2020 (+2.1 percent). It may also be deemed stable in terms of its distribution by segments; 63 percent of it is linked to traditional, non-pension portfolio.

The number of policies in single premium portfolio follows a declining trend, since the loss of portfolio – resulting primarily from the high surrender rate – exceeds new acquisition. Since 2017 the single premium unit-linked increment has been steadily decreasing; in 2021 merely 13,000 new contracts were concluded (one thousand of which are pension insurance), which falls short of the 2020 figure by 24 percent. In 2021, the number of new traditional life insurances was 23,000, a 11 percent decline on an annual basis. The single premium, traditional pension insurance market still does not exist.

Chart 2.11
Development of single and top-up premiums and number of contracts in the life segment



Source: MNB

2.3 NON-LIFE SEGMENT

2.3.1 This time MTPL did not act as the driver of the non-life segment

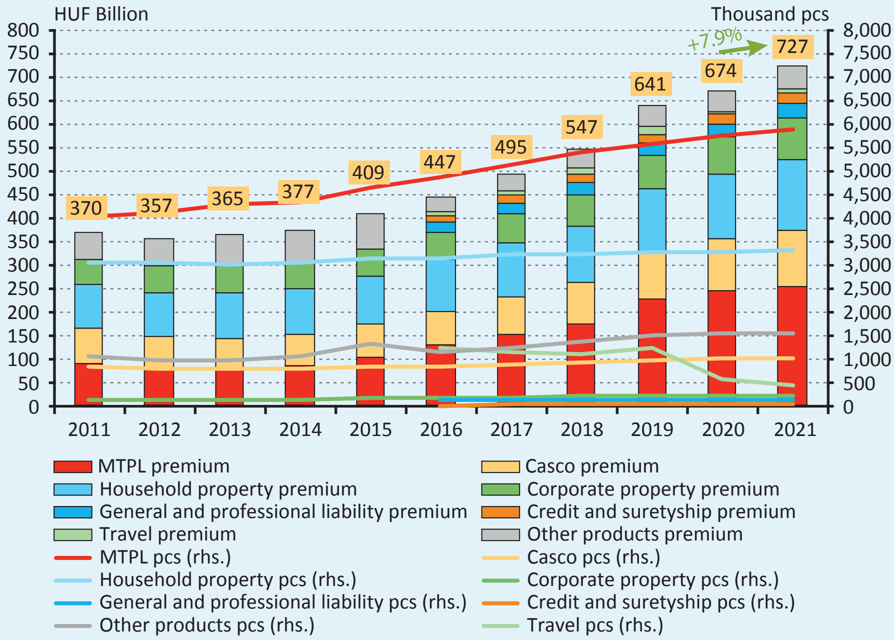
The non-life segment's gross written premium has been rising steadily since 2012, and its dynamics in 2021 exceeded the rate observed in 2020 (Chart 2.12). The growth of 7.9 percent amounts to HUF 53 billion in absolute value, with almost equal contribution by casco (HUF 11 billion), corporate (HUF 12 billion) and household property (HUF 11 billion) insurances. By contrast, the compulsory motor third party liability insurance (MTPL) segment registered only a 3 percent growth. However, MTPL remains the most important branch, since in 2021 it accounted for 35 percent of the non-life segment's total gross written premium and its portfolio of 5.9 million policies account for 47 percent of the non-life insurance portfolio.

As regards land vehicle casco, the policy portfolio growth rate was 1 percent, which lagged behind the 2 percent growth in MTPL. However, in terms of 12-month regular premium per contract, the 8 percent growth registered by casco substantially exceeded the growth of 1 percent for MTPL products. The growth in the number of polices and in average premiums resulted in a total increase of 9.4 percent in the casco gross written premium compared to 2020.

In the area of household property insurances (primarily home insurances), gross written premiums growth of 7.9% was recorded in 2021, the most dynamic increase in the last 10 years. The number of policies in this product category rose more strongly, by 1 percent, compared to previous year. In 2021, the growth in commercial property insurance, accounting for 12 percent of the non-life gross written premium, rose by more than one and a half times, registering an increase of 15.5 percent or HUF 12 billion, compared to 9 percent in 2020.

Anti-epidemic 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 gross written premiums in 2020. In 2021 the market registered a slight correction, but the growth of 25 percent was unable to offset the decline in previous year. The number of travel insurances sold amounted to only one third of the volume registered in the year before the pandemic. The remaining additional products accounted for 7 percent o the non-life market in 2021 and with a growth of 9 percent they had a positive impact on the gross written premium of the insurance segment.

Chart 2.12
Development of gross written premium and number of contracts of non-life segment by products



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

Source: MNB

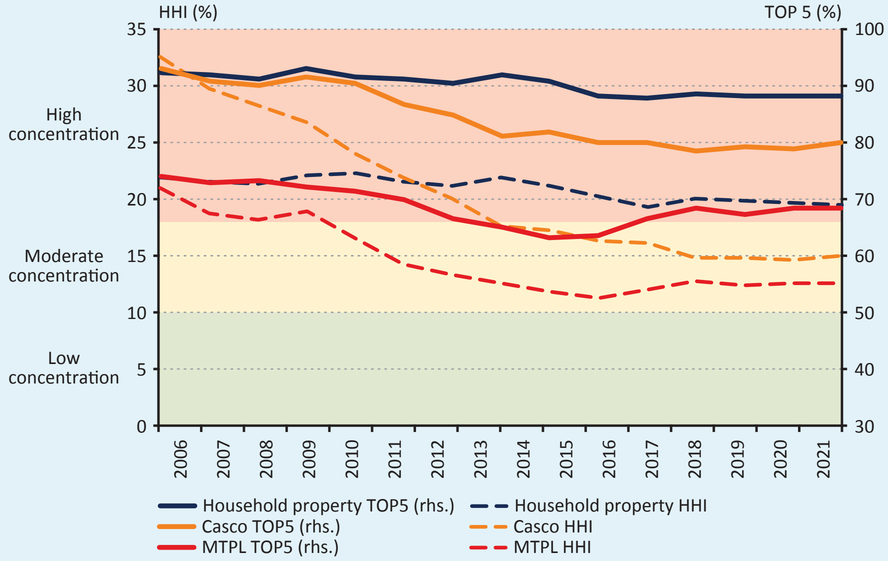
2.3.2 Steadily high concentration at the key non-life insurance products

In recent years, based on HHI and the indicator calculated from the weight of the top five market participants, no substantial change can be observed in terms of concentration ratio at any of the key non-life product groups. (Chart 2.13).

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 2021 both the HHI and the ratio of the top 5 market participants decreased only slightly, by 0.2-0.3 percent, each.

High concentration – even despite the insurance tax – represents high profitability, which may be a good incentive for several insurers to enter this segment. The MNB announced the Certified Consumer-friendly Home Insurance (MFO), which gives priority to the interest of customers, at the end of 2019. This new product has a number of advantages, for example, among other things, it provides coverage for claims jeopardising subsistence, supports digital administration and fast claim settlement. In 2021 already seven insurers offered MFO products. As the qualification spreads, the MFO criteria may result in product supply of more standard content than before, thereby easing comparability, which may foster market competition and reduce market concentration.

Chart 2.13
Share of the five largest insurers (TOP 5) and Herfindahl-Hirschman index (HHI) of the entire sector based on non-life segment's gross written premium by major products

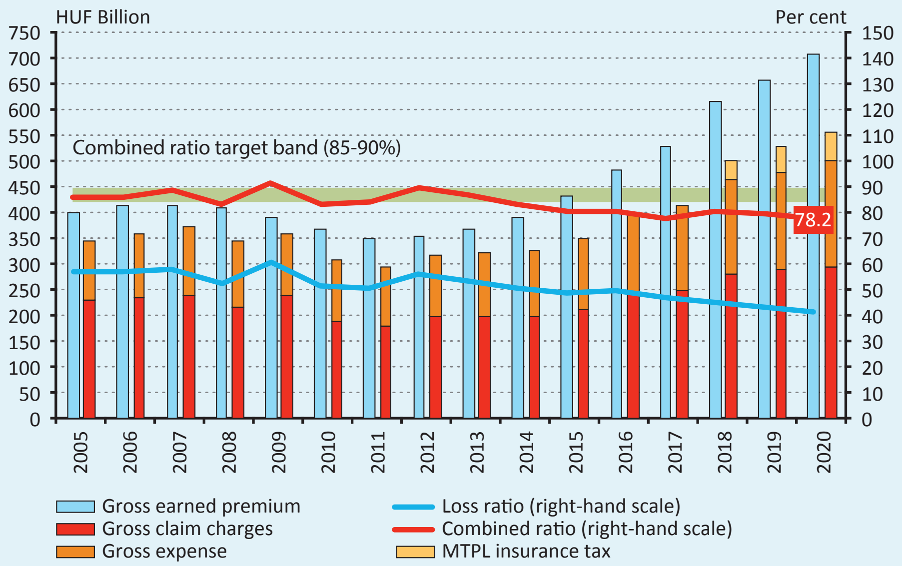


Note: The colour of the background illustrates the strength of concentration under HHI.
Source: MNB

2.3.3 Further decline in non-life combined ratio

In 2021, the sector-level combined ratio of the life segment declined further, to 78.2 percent (Chart 2.14), which was caused by the rise in earned premium in excess of the growth in claim charges. Claims declined by 2 percent, while costs increased by 8 percent (in aggregate by 4.4 percent), accompanied by a further growth of 7.7 percent in earned premiums during 2021. The combined ratio may be deemed low, falling to the low of 2018. Thus the former trend was not broken in 2021, i.e. moving away from the lower bound of target band of 85-90 percent, deemed ideal in FIS, has continued.

Chart 2.14
Development of non-life combined ratio

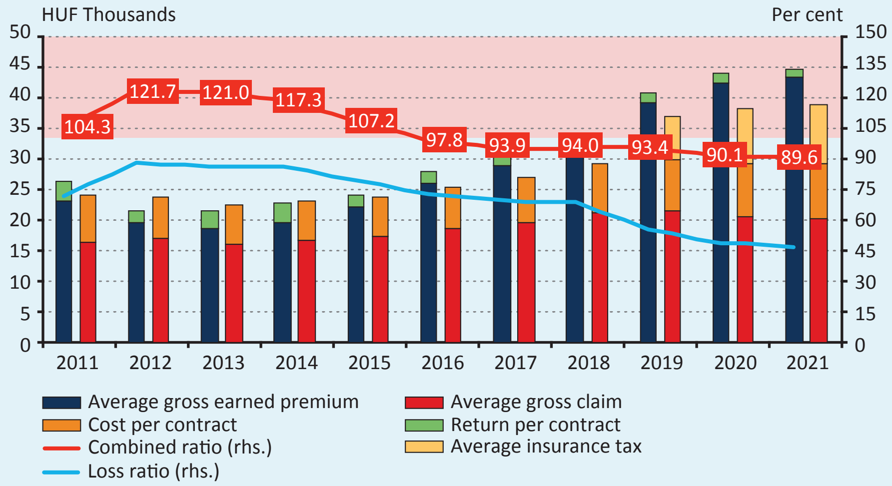


Note: The MTPL insurance tax is calculated from the expenditure data in the profit and loss accounts of insurers.
Source: MNB

2.3.4 MTPL profit improved as a result of COVID

Favourable claims development seen in 2020 continued in 2021 as a result of COVID, i.e. the curfew measures and declined vehicle traffic. In 2021, the loss ratio per policy corresponded to the 2020 figure; however, premium per policy rose slightly, by 3.5 percent, which improved the combined ratio further. The fall in the combined ratio of almost 0.5 percentage point to 89.6 percent represents a 10 percent profit to premium ratio. (Chart 2.15). In 2021, the ordinary profit of the MTPL product amounted to HUF 25.9 billion, exceeding the figure registered last year by 16.3 percent. By 2021, the insurance tax was already fully integrated in the premiums, and the claims development similar to 2020 has consolidated the profit. As regards the future, no similar favourable trends can be expected: According to the MTPL index, which sets out from the quarterly data and regularly published by the MNB, the rise of loss ratios to the level seen before the restrictions has commenced already in the last quarter of 2021. This impact is further exacerbated by the claim inflation effects (spare part prices, exchange rate effects, labour cost increases) well exceeding the underlying inflation rate.

Chart 2.15
Development of combined ratio of motor third-party liability insurance in Hungary

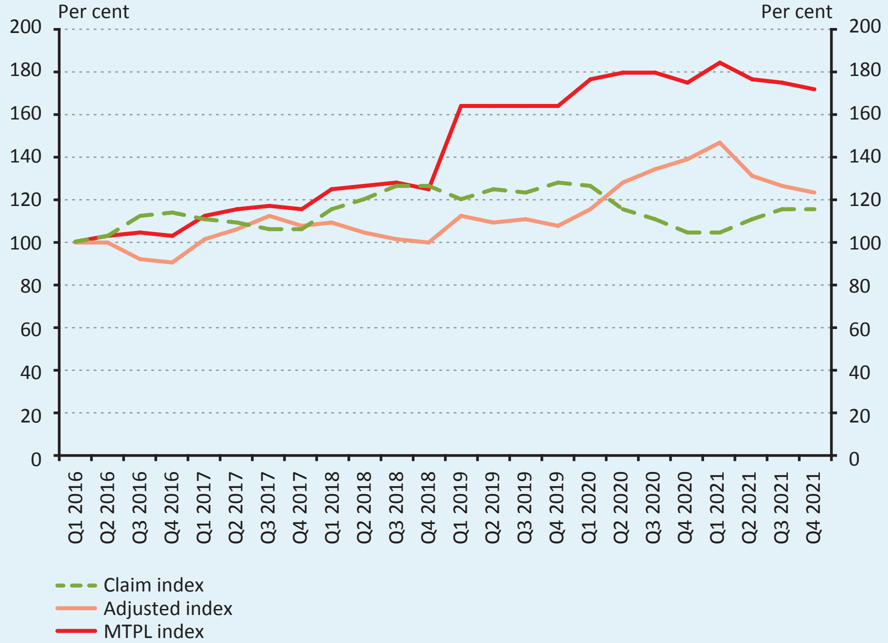


Note: The loss ratio values were adjusted with the change in outstanding loss reserves. The pink area in the chart denotes the band of combined ratio exceeding 100 percent. The MTPL insurance tax is calculated from the expenditure data in the profit and loss accounts of insurers.

Source: MNB

The aforementioned MTPL index is complied on the basis of the Compulsory Motor Insurance Contract and Claims Central Detailed Database (MTPL policy and claim database), which contains all domestic claim and policy data, and thus it provides a comprehensive and current view of the changes in average market premiums. The average portfolio premium of normal cars in the fourth quarter of 2021 is HUF 43,700, which falls short of the previous quarter's figure by 1.5 percent. There was a decline of 1 percent compared to the same period of 2020, which is primarily attributable to the 7 percent decline in the average premium in the capital, while average premiums of policies outside Budapest remained unchanged. The rising trend of claim charges continued in the period under review, and thus it shows already a 13 percent increase compared to the last quarter of 2020. This may have been attributable – in addition to the pick-up in the use of cars, mentioned before – to the rising service and spare part prices, as the claim frequency continues to fluctuate around 3 percent, while the average claim size is rising. Due to the slowly declining average premiums and the rising claim charges, the adjusted index fell further from the high registered in the first quarter of 2021, and thus the gap between claims and premiums is gradually narrowing (Chart 2.16).

Chart 2.16
Passenger car MTPL index



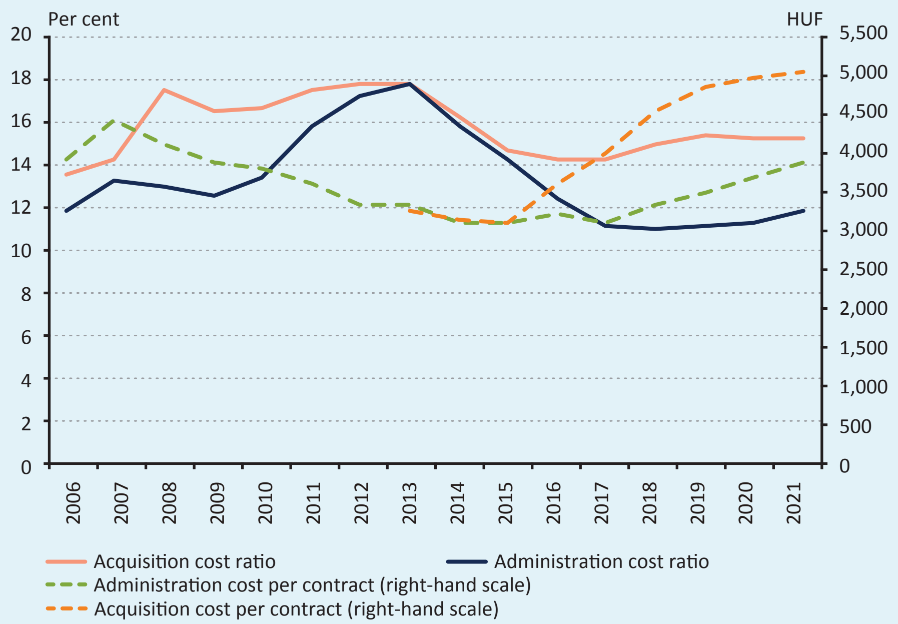
Source: MNB

2.3.5 Rising average cost under stagnating cost ratio

In recent years, the segment's cost ratio (acquisition and administrative costs to gross premiums) has followed a declining trend. The cost ratio is in line with the ideal target of 30 percent, set in FIS for non-life insurances; this index has been below the indicated level since 2015. In 2021, the index stands at 27 percent, 15.3 percent and 11.7 percent of which is attributable to acquisition costs and administrative expenses, respectively. The ratio has hardly changed compared to 2020, only the ratio of administrative expenses has increased slightly. Although there is a slow increase compared to the favourable cost ratios seen in 2017, the market has essentially settled at the level of 27 percent.

In 2021, the administrative cost per policy was HUF 3,877, which exceeds the 2020 figure by 6.2 percent. (Chart 2.17). The index seems to fluctuate on the chart as well; in the period commencing in 2006, the actual values were between HUF 3,000 and HUF 4,500. According to the data, the administrative cost per policy is in line with the gross written premium trends, as it is clear from the charts illustrating gross written premium and costs in the 2011–2018 period of depression. Since the number of policies increased in this period, to ensure the sufficiency of premiums costs had to adjust to premiums. The rise starting from 2017 also follows the growth rate of gross average wages, albeit to a proportionally smaller degree.

Chart 2.17
Development of the cost ratios of motor third-party liability insurance in Hungary



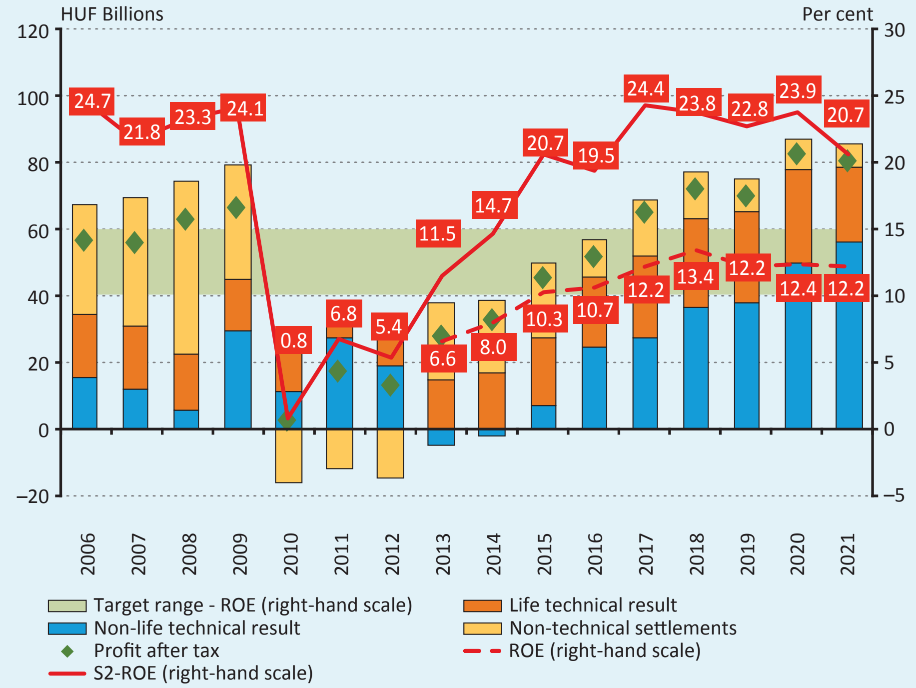
Source: MNB

2.4 PROFITABILITY AND CAPITAL POSITION

2.4.1 Outstanding profits during COVID

The insurance sector once again was highly profitable in 2021. Although the after-tax profit exceeding HUF 80 billion falls short of previous year's record, it exceeds the level registered before the economic crisis. The sector's return on equity (ROE) was 20.7 percent in 2021. ROE value has been increasing dynamically from the year following the 2008–2009 global economic crisis until 2017. In the last four years, this dynamic seems to have lost momentum and profitability seems to have stabilised at pre-crisis levels of over 20%. 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. That is, due to the dominance of the technical result, the profit structure is much more favourable than in the years before the crisis. In 2021, 71 percent of the technical result of HUF 78.8 billion (HUF 56.3 billion) was attributable to the non-life segment, which is higher by one third than a year earlier. However, there was 20 percent decrease in the life segment's technical result in 2021 (currently HUF 22.5 billion) compared to last year. Taken together, the sector's after-tax profit was high in 2021 as well, and although it did not reach a new record, it still exceeded the previous record registered in 2018 by almost HUF 8 billion. (Chart 2.18). The return on eligible own funds (S2 ROE) is stable, moving slightly over 12 percent since 2017, and in 2021 it stood at 12.2 percent.

Chart 2.18
Profitability of the Hungarian insurance sector and its composition



Note: The sector level ROE values (with the exception of 2021) were calculated on the basis of the annual audited data reporting, where equity does not contain the current year's dividend. In the case of the S2 ROE indicator the after-tax profit was compared to the eligible own funds (2013–2014 estimate).

Source: MNB

At the level of institutions, the individual insurers' return on equity (ROE) varies. Of the 22 insurers, only two small insurers operated with a loss in 2021. In addition, 7 market participants managed to turn their negative return on equity registered at the end of 2010 into positive by Q4 2021 (Chart 2.19). No shift in the opposite direction was identified for any of the insurers. The curfew measures and travel restrictions introduced in 2020 and remained partially in place in 2021, have hit hard the profitability of insurers offering travel insurance Although compared to 2020, the sector has started to recover in 2021, it has not reached the pre-COVID level yet. COVID has an opposite impact on insurers the profitability of which comes from motor vehicle insurances, as the declining traffic had a positive effect on profitability. However, insurers regard this as a one-off impact. The negative result of the two loss-making insurers is primarily attributable to economies of scale problems. However, on the whole, based on the shifts and profitability trends, a positive picture unfolds in respect of the insurance sector, both at the level of institutions and the entire market.

Chart 2.19
ROE value of Hungarian insurers

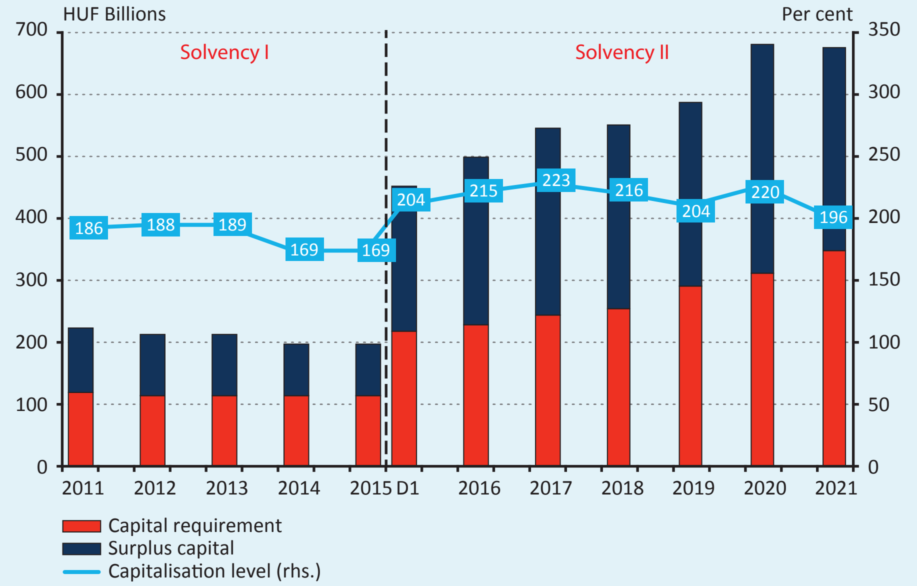
Source: MNB.

2.4.2 Insurers' average capitalisation level remained close to 200 percent

At the end of 2021, capital adequacy at sector level was 196 percent, which is almost twice the regulatory requirement (Chart 2.20). This level has been stable since the introduction of the Solvency II framework in 2016. It differs from 204 percent, the level registered at the changeover on 1 January 2016, by merely 8 percentage points. 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. Owing to the capitalisation level of 196 percent, the sector continues to comply with MNB Recommendation 6/2016 (VI. 14.) on the volatility capital buffer, and it 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.

In response to the pandemic situation, the MNB issued several executive circulars with regard to dividend payments by insurers. In the circular dated 2 October 2020, it indicated its expectation to insurers that – with a view to maintaining the stability of the sector – dividends should only be paid if the institution's capital adequacy after payout remains in the range of 205-243 percent, in line with the average of international and domestic capital adequacy of recent years. As a result of the executive circular, in 2021 dividends were paid only by institutions the capital position of which was better than the average, and thus through the higher capitalisation level, the circular contributed to the mitigation of the risks stemming from the pandemic situation. This restriction was lifted by another executive circular dated 27 January 2022, since due to the insurers' stable capital position and the decline in the insurance risks stemming from the pandemic situation, the MNB did not find it justified to maintain the restriction of dividend payments. On the other hand, the circular emphasised that upon calculating the dividend ratio, the MNB's volatility buffer recommendation, together with the changes in the external environment, and particularly in the yield environment, should be taken into consideration. As a result of the circular, several institutions decided to pay dividends, which reduced the capital adequacy ratio. The yield increase, which commenced in the fourth quarter of 2021, also reduced the capitalisation level, which – due to the market-consistent valuation prescribed by the Solvency II regulation – puts pressure on the capital position from two sides. Namely, in addition to the rise in the solvency capital requirement, the value of own funds declines, since the devaluation on the assets side (mostly government securities) is usually not offset by the change on the liability side. Depending on the outstanding assets and contracting portfolio, these negative impacts appear at the individual insurers to a different degree; however, in view of the dynamically rising yields, continuing in the first quarter of 2022, the capital is likely to decline further.

Chart 2.20
Capitalisation rate at sector level



Source: MNB

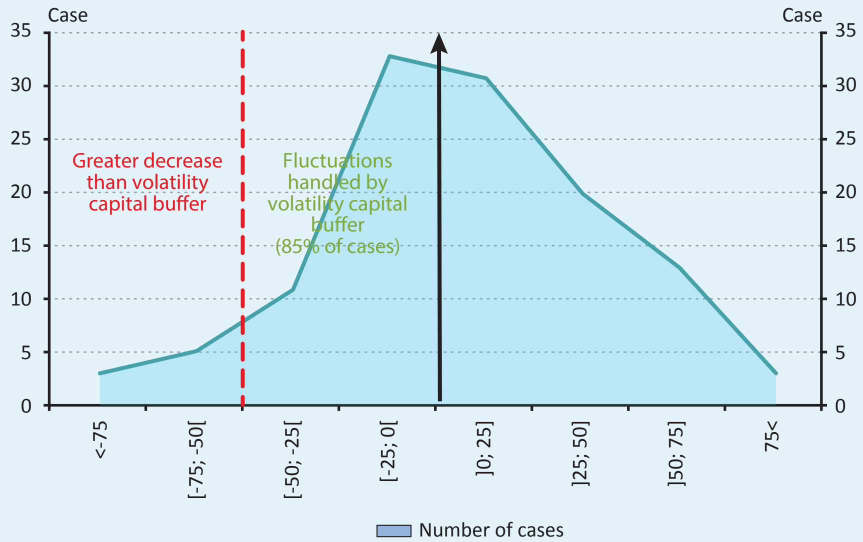
Box 2.1
It is justified to maintain a volatility capital buffer

An important innovation of the Solvency II regulation, effective from 1 January 2016, is the introduction of market-consistent valuation and risk-based capital requirement calculation. Considering the current market prices and based on the preparatory impact analyses, it was expected that the capitalisation level will be volatile under the new regime. With a view to mitigating this risk, the MNB issued Recommendation 6/2016 (VI. 14.) on Volatility buffers ensuring continuous capital adequacy, where it recommended to maintain a capital buffer that provides a 90 percent security level (by default 50 percent of the solvency capital requirement[7]).

The period lapsed since the introduction of Solvency II confirmed the volatility of the system, since although capital adequacy at sector level was steadily close to 200 percent, at the level of institutions the capitalisation level often varied in a wide interval, resulting in high standard deviation. When examining the annual change in the year-end capital adequacy ratios between 2016 and 2020 it is clear that most of the declines (85 percent) were lower that the volatility buffer rate (Chart 2.21). Although this slightly falls short of the targeted 90 percent safety level, the degree of the difference is minimal, and thus the volatility capital buffer recommendation achieved its goal and contributed to the efficient management of equity risks.

[7] Institutions can define the rate of the volatility buffer rate on their own, but they have to prove the adequacy of that to the MNB. If they are unable or do not wish to do this, the volatility capital buffer rate shall be 50 percent of the SCR last reported.

Chart 2.21
Changes in the year-end capitalisation level in percentage points (2016-2020)

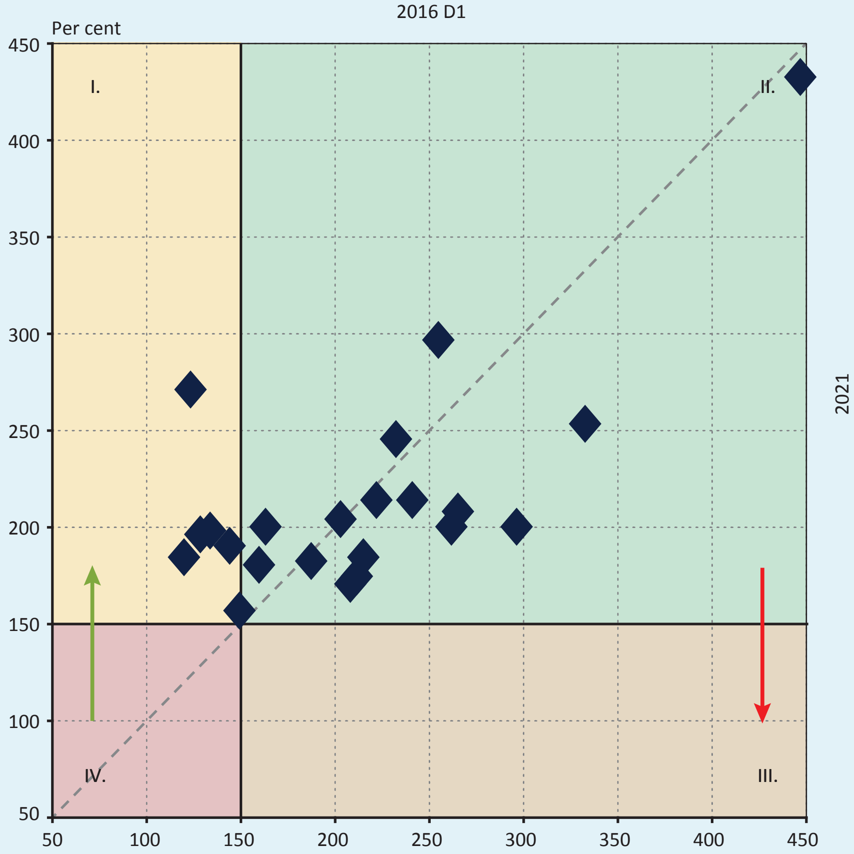


Source: MNB

2.4.3 All insurers are over 150 percent

There are significant differences in the individual capitalisation levels. At the end of 2021, already all insurers reported capitalisation levels exceeding 150 percent, expected by the MNB recommendation, and thus they also complied with the regulatory requirement of 100 percent. Previous year, the MNB maintained the additional capital requirement prescribed for the insurer the capitalisation level of which was below 150 percent. The capitalisation level of the respective institution was over 150 percent even with this. The capitalisation level of half of the institutions declined compared to the initial data supply (Chart 2.22), which is attributable to the lifting of the dividend payment restrictions and increasing yields, mentioned before. Due to the special features of individual institutions (asset composition, liability structure) the degree of this decline varies. The changed yield environment has minimum impact on certain insurers, while the capitalisation level of insurers that are markedly sensitive to interest rate risks sometimes declined to a larger degree compared to the levels seen in previous years. The trend continued in the first quarter of 2022, and thus the close supervisory monitoring of these risks remains justified.

Chart 2.22
Individual capitalisation rates of insurers (2016D1 and 2021)



Note: The Chart 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 2021 already exceeded 150 percent.

Source: MNB.

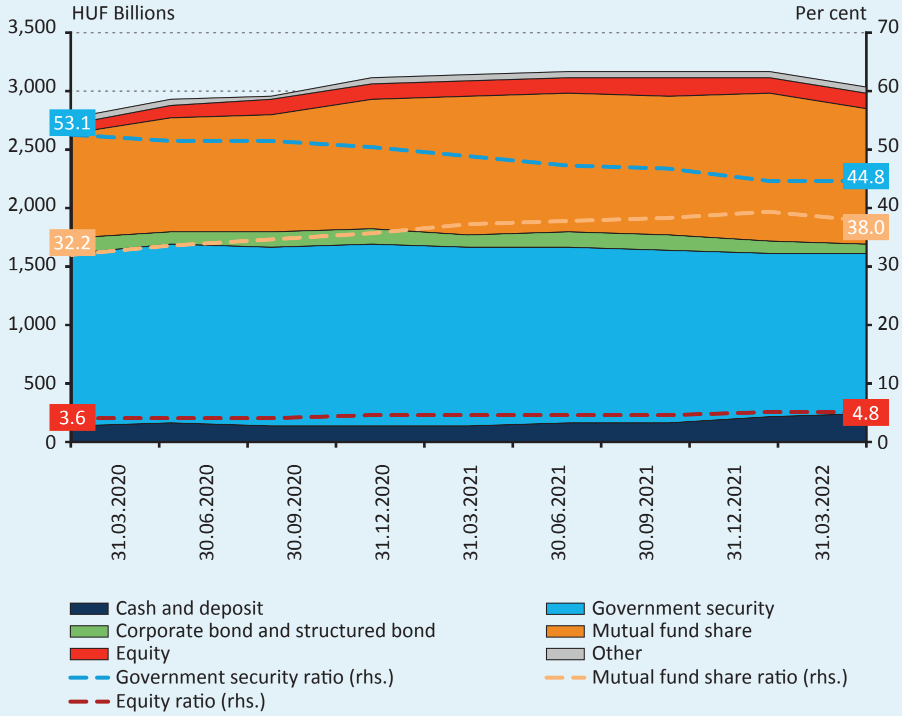
Box 2.2

Exposures to Russia and Ukraine are negligible, it is primarily the devaluation of assets that has a bearing on insurers

When analysing insurers' data for the first quarter of 2022, we find that although the direct exposures related to the conflict between Russian and Ukraine are negligible, the indirect effect are all the more significant, and it is primarily the devaluation of assets that has a negative impact on the insurance market. This phenomenon also reduced the sector-level capital position to 186 percent. The impact of the devaluation generates problems for insurers with traditional life insurance portfolio; nevertheless, all institution comply with the MNB's volatility capital buffer recommendation.

In the first three months of 2022, life insurance technical reserves declined on the whole, which is primarily attributable to the lower value of invested assets underlying unit-linked reserves as a result of the capital market trends. However, the devaluation of government securities portfolio resulting from the rising yield curve had a negative impact also on the non-unit linked assets (Chart 2.23). However, the declining value of assets was partially offset by the growth in gross written premium.

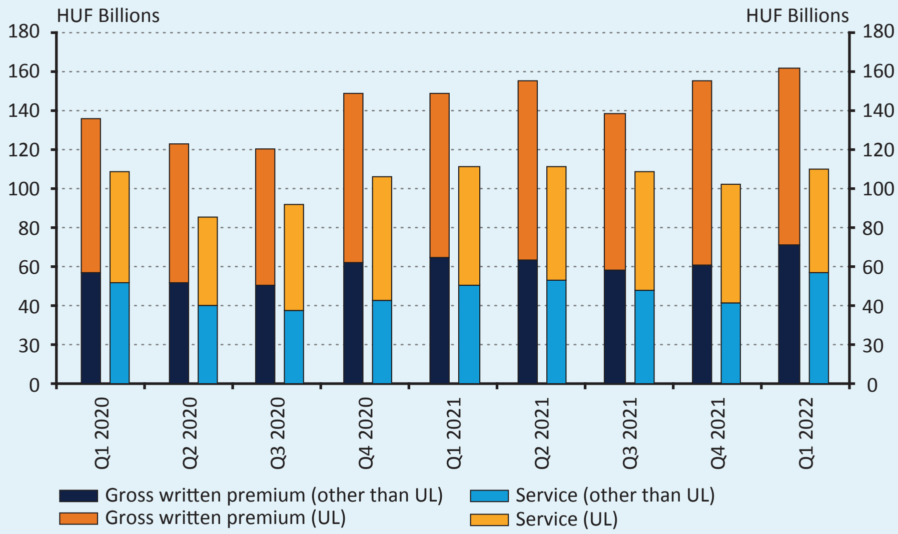
Chart 2.23
Quarterly developments of the asset composition of Hungarian insurers



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

In the first quarter of 2022, gross written premium of the sector rose at a similar rate (9.8 percent) as in previous year. In line with the seasonality, the non-life segment had a larger share, and the life segment had a smaller one. In the case of the latter, single and top-up premiumsremained the main drivers, primarily at the traditional products (Chart 2.24). Insurance benefit payments amounted to HUF 110.6 billion, which is almost the same as the figures reported for the first quarter of 2020 and 2021. Compared to the same period of previous year, benefit payments under regular premium products significantly rose, while those under single premium products declined. As a combined result of the foregoing, the benefit payment level of regular premium products increased, while that of single premium products decreased. No trend change was observed in customer behaviour, i.e. in surrenders; the number of surrenders submitted by customers was lower at sector level than in the same period of previous year. Contrary to this, these values may be higher at certain insurers, but the degree of the rise is manageable. Due to the rising yield curve the position of alternative products improved, which may primarily jeopardise the retention of single premium policies.

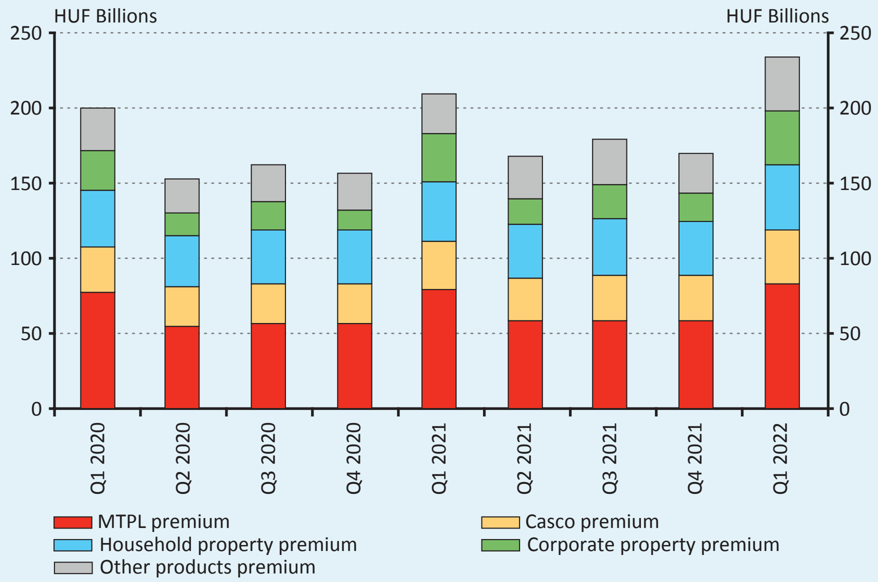
Chart 2.24
Quarterly cash flows in the life segment



Source: MNB.

Growth in gross written premium of the main products in the non-life segment (MTPL, casco, household and corporate property insurance) remained slightly below the average, while the rest of the products registered a more dynamic growth (Chart 2.25). Since claim developments do not always justify the increase in gross written premium seen in the quarter, it may be attributable to the rise in inflation expectations. On the other hand, travel insurances registered an outstanding growth in gross written premium, realising a threefold year-on-year growth from the low base, practically reaching the pre-pandemic quarterly level. As regards the profit of the non-life segment, inflation may have a dominant effect: due to the fast rise in costs and claims, and to the lengthy repricing of the portfolio through indexation, the 2022 profit of the non-life segment is likely to fall short of the amount registered in 2021.

Chart 2.25
Quarterly development of gross written premium of non-life segment

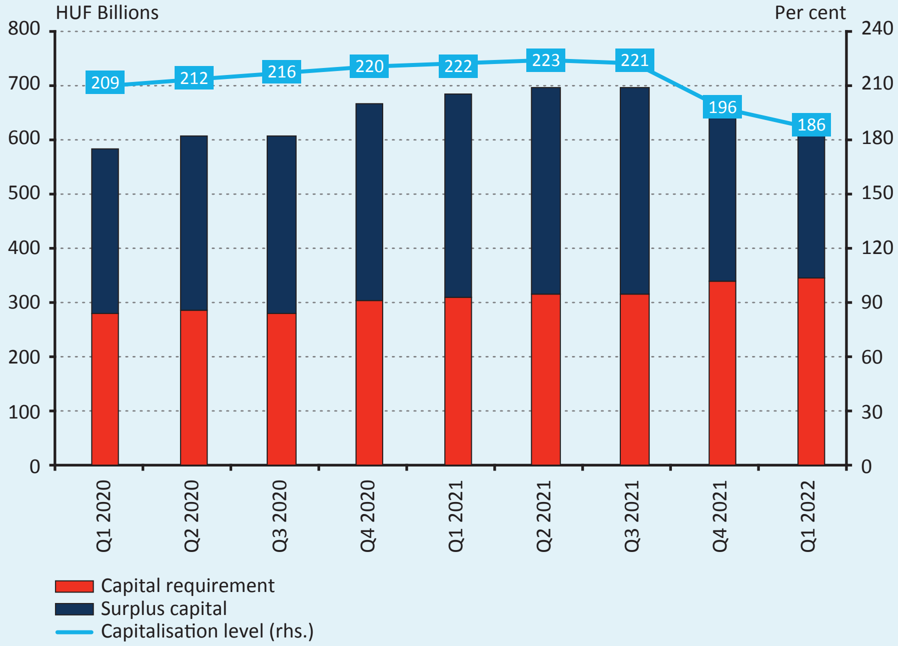


Note: Categories belonging to the "other products" category, with a share of at least 3 percent: general and professional liability insurance, payment protection insurance, travel insurance, accident insurance, cargo and transport insurance, health insurance, surety and guarantee, extended warranty, various financial losses and legal expenses insurance.

Source: MNB

The capitalisation level – also due to the dividend restrictions proposed by the MNB in the executive circular – significantly improved in 2020 and 2021, and rose above 220 percent. The capital adequacy ratio related to the end of 2021 was already lower, due to the rise in the yield curve, which commenced in the fourth quarter of 2021, and to the rising dividends planned by the insurers. The continuing rise in the yield curve in 2022 reduced sector-level capital adequacy to 186 percent (Chart 2.26). The unfavourable impact of the significant yield increase is primarily attributable to the revaluation of government securities portfolios held at own risk, which the revaluation of the liability side was usually unable to offset. Rising interest rate risk, and through that the increased solvency capital requirement, are additional factors that reduce capital adequacy. Solvency risk rose primarily at insurers with large, traditional life insurance portfolio. However, the sector – both in aggregate and at individual level – complies with the requirement specified in the volatility capital buffer recommendation.

Chart 2.26
Quarterly evolution of capitalisation rate at sector level



Note: Data for 31 December come for the annual data supply.
Source: MNB

The outbreak of the Russia-Ukraine war found the sector in a stable condition. Also owing to the supervisory restriction on dividend payments, at the end of 2021 the capitalisation rate at sector level was twice as high as the regulatory requirement (196 percent), and thus the shock absorbing capacity of the market proved to adequate against the changes in the economic environment in the first quarter of 2022. With a view to identifying and managing the potential risks, the MNB actively monitored the potential sources of risk, as a part of which it requested information from the insurers on daily basis and regularly consulted the peer supervisory authorities.

The MNB assessed, among other things, the direct asset exposure related to assets in the region hit by the war, the degree of which proved to be negligible: it amounted to less than 1 percent of the total asset value and did not exceed 4 percent at any of the institutions. Moreover, the vast majority of the affected assets were included in unit-linked asset funds, and thus the direct prudential impact of those may be deemed marginal. On the other hand, several asset funds have been suspended as a result of the events. The MNB also assessed the impact of the change in foreign exchange rates, but this also proved to be minimal. The open foreign currency position of the sector is immaterial; moreover, the foreign exchange risk sub-module of the Solvency II solvency capital requirement comfortably covers the exchange fluctuations seen in February and March.

2.5 RISKS OF THE INSURANCE MARKET

2.5.1 RISING ENVIRONMENTAL RISKS, STABLE CAPITAL

Risk category	Risk groups	Risk rating	Risk prospects	Evaluation in words
Business model	Environment Strategy, business plans Profitability	●	↑	Increasing GDP and rising, but increasingly volatile insurance yields in 2021. The external environment has changed dramatically. The sector-level positive profitability indicators declined, but the sector's profitability remains stable. *Under declining pandemic impact, risks may increase as a result of the conflict between Russia and Ukraine, which commenced in February 2022.*
Corporate governance	Exercise of owner's rights Internal governance Risk assessment system and ORSA Internal control	●	→	Overall, adequate owner's control and internal governance system characterises the sector. The challenges of the usually hybrid work is adequately addressed by the internal governance and control system. Significant control capacity due to the effects of the protracted pandemic situation. During its on-site and ongoing supervisory activity, the MNB pays special attention to inspecting the adequacy of institutional corporate governance. *For the time being, the functioning of the organisation and management is stable, with a stagnant risk outlook.*
Financial and operational risks	Insurance risk Market risk Credit risk Operational risk Other relevant risks	●	→	Significant increase in the gross written premium of the life segment and favourable claim development in the non-life segment. Rising yields led to a fall in the market value of the government bond-heavy own portfolios. 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 risks	Capital Reserves	●	↑	Higher dividend payments after the lifting of restrictions and the higher risk-free yield level reduced the level of equity. Generally adequate reserve policy *Rising risk outlooks due to deteriorating market and external environment.*
Market entry risk	Products Customers	●	→	Deficiencies in IDD requirements (suitability assessment/declaration, customer information) and PRIIPs, KIDs and complaints handling. *Enhanced supervisory focus and consumer-friendly products may reduce the risk rating in the longer run.*

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

As regards the external market and regulatory environment, to be taken into consideration upon the assessment of the business models, it can be stated that in 2021 the Hungarian economy rose by 7.1 percent on average.

Annual inflation, which followed a rising trend, was 5.1 percent in 2021 on average, while core inflation rose only moderately, to 3.9 percent. The change in the consumer price index was primarily determined by the fuel price changes, and to a lesser degree by the price developments of the other product groups.

During 2020, insurers adjusted to the anti-pandemic measures, aligned their strategic and business plans with those, which proved adequate in 2021. Due to this, the majority of insurers were able to operate profitably on the basis of the plans they have developed, with no significant disruption to services. Under declining pandemic impact, risks may increase as a result of the conflict between Russia and Ukraine, which commenced in February 2022.

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 aggregated after-tax profit in 2021 was HUF 80 billion, which is slightly lower than in previous year, but the ROE exceeded the target band set in FIS.

As regards the owner's control and internal governance system, insurers properly identified the risks of the external environment and overall responded adequately to those. The hybrid (at work/ from home) working arrangements in the sector are operational at the whole institutional level, with challenges being adequately addressed by governance and control systems. However, this operation also requires significant control capacity due to the prolonged environmental impacts, while for the time being organisation and governance seem to be stable. Stability is also confirmed by the experiences of the supervisory inspections, while they identified individual shortcomings in respect of internal governance and controls. The MNB expects no change in the moderate risk level in the short term, with a stagnant risk outlook.

In terms of insurance risk, both segments operate under stable profitability. The non-life segment registered steady growth in the portfolio and gross written premium. The MTPL and home insurance branches were characterised by favourable claim development in the past two years. Good performance of the key branches has more than offset the continued low sales of travel insurances. The technical result of the non-life segments developed favourably in the past period and rose further in 2021. Following a more moderate growth in previous year, gross written premium of the life segment rose significantly, by 13.7 percent, in 2021. The life insurance policy portfolio slightly decreased compared to previous year, due to the fall in the traditional life insurance portfolio. No unfavourable trends can be seen in the area of surrenders. However, due to the uncertain macroeconomic and financial environment, a potential rise in surrenders remains a risk and the trends of life insurance sales are also surrounded by significant uncertainty.

Rising yields led to a fall in the market value of the government bond-heavy own portfolios. In connection with the digitalisation developments, accelerated due to the environmental impacts, IT, IT security and portfolio management risks remain significant. This assessment is based on the findings of supervisory inspections. As regards other significant risks, liquidity risk is 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.

After the low yield environment, which characterised recent years, yields rose by the end of the year. The devaluation of investments susceptible to yield fluctuations resulted in the fall of Solvency II own funds at certain market participants. In addition, solvency capital requirement usually also increased due to the rise in the capital requirement calculated for the market risk module. Accordingly, the change in the yield environment had an unfavourable impact on the capitalisation level on the whole. Developments in the capitalisation rate at sector level at the end of 2021 were significantly influenced by the fact that the MNB – due to the decrease in economic uncertainty – lifted the restriction on dividend payments introduced during the pandemic. Several institutions opted for the payment of previously postponed dividends, as a result of which their level of capitalisation became lower. However, the capitalisation level of the Hungarian insurance sector continues to comply with MNB Recommendation 6/2016 (VI. 14.) related to the holding of volatility capital buffer. Yields continued to rise also in the first quarter of 2022, and thus the risks stemming from this are likely to increase.

The consumer protection risks identified in connection with the products, and the nature and number of the infringements identified during the comprehensive audits and the investigation of individual cases shows a minor decline compared to the previous risk level; nevertheless, no trend change can be identified yet.

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 – reduced customer risk to some extent. In 2021 as well a large number of findings were made 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 thus the focus has increasingly shifted to the quality of the complaint responses and the qualitative analysis of consumer-centric 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 reconstructibility and thus regulatory supervision even more efficient) and may therefore further reduce customer risk in the period ahead. In addition to the foregoing, the MNB communicates its expectations and presents good practices also through executive circulars and recommendations. Additional legislative changes – which, for example, describe claim settlement expectations more specifically than before – supervisory set of instruments developed in cooperation with the EU professional organisations as well as the enhancement of certified consumer-friendly product standards may strengthen consumer-centric approach and ultimately may reduce product risks in the market.

3 Funds market and its risks

3.1 OVERALL PICTURE OF THE MARKET

3.1.1 The fund market is on the rise even under increasing risks

By the end of 2021, the aggregated balance of voluntary pension funds individual accounts exceeded HUF 1,700 billion, and the assets per contract rose by 6.5 percent, reaching HUF 1,547,000. In 2021, the membership fee contributions credited to individual accounts (coverage reserve) of voluntary pension funds was outstanding, amounting to HUF 116 billion, which represents an increase of 7.5 percent compared to the 2020 figure of HUF 108 billion. Although 19 out of 33 institutions realised an operating loss in 2021, the operating result of the sector as a whole was a profit. Although operating expenditures exceeded operating revenues, the deduction of yield realised on the savings of non-paying members pushed the operating result to the positive range. The yield on the voluntary pension funds' coverage reserve was HUF 37.6 billion in 2021, and thus at sector level – mostly due to the devaluation of bonds – they realised an asset-weighted average net yield of 2.6 percent, showing a real yield of minus 4.4 percent when adjusted for inflation. The average asset-weighted net rate of return at sector level, calculated from the average 15-year yield rates, is 5.49 percent, which – considering the 15-year average December/December inflation rate of 3.40 percent – represents a real yield of 2.02 percent (Table 3-1).

Contributions credited to health and mutual aid funds' coverage reserves increased by 9.3 percent in 2021. It may be regarded as a positive trend, reflecting the strengthening of self-provision, that individual contributions have increased by 8.4 percent, more than three times the amount paid a decade ago at sector level. In 2021, the sector realised a positive operating result, as the operation of 9 out of 16 institutions was profitable on an annual basis. In 2021, on health and mutual aid fund merged with another health and mutual aid fund, and a smaller mutual aid fund opted for winding-up through dissolution without legal successor, and thus the number of institutions in the health and mutual aid funds sector decreased by two.

Table 3.1
Key data of the voluntary funds sector

	Pension funds				Health and mutual aid funds			
	2020		2021		2020		2021	
Number of institutions (pcs)	33		33 –		18		16 ↓	
Number of members (thousand persons)	1,106		1,105 –		1,025		1,055 ↑	
Number of members paying membership fee (thousand persons | %)	550	49.8%	569	51.5%	328	32.0%	358	33.9%
Total funds portfolio (HUF billions)	1,625		1,729 ↑		69		72 ↑	
Of this: Coverage reserve (HUF billions)	*1,606*		*1,710* ↑		*65*		*67* ↑	
Asset value per contract (HUF thousands)	1,453		1,547 ↑		63		64 ↑	
Membership fee payments (HUF billions)	113		121 ↑		49		53 ↑	
Of this: Membership fee payments allocable to coverage reserve (HUF billions)	*108*		*116* ↑		*46*		*50* ↑	
Claimed tax credit (HUF billions)	17		17 –		10		11 ↑	
Payments against the coverage reserve (HUF billions)	89		96 ↑		54		60 ↑	
Operating profit/loss (HUF billions)	-0.22		0.30 ↑		-0.07		0.35 ↑	
Reserves for operational purposes (HUF billions)	16.4		16.3 ↓		4.2		4.6 ↑	

Source: MNB

When the expected impacts of the 2022 tax measures (personal income tax refund to families with children, personal income tax exemption for workers below 25) on the funds' business were surveyed, several institutions noted that they expected a year-on-year decline in the revenues from membership fees in the fourth quarter of 2021, as usually the largest volume of individual contributions is received by the funds in the last quarter, and the personal income tax refund in 2022 may reduced degree of this. In the fourth quarter of 2021, there was a moderate year-on-year growth dynamics of individual membership fee contributions at the voluntary pension funds, while health and mutual aid funds registered a slight decrease in the amount of individual membership fee contribution compared to the fourth quarter of 2020, i.e. the growth trend has faltered. On the whole, the previously expected potential crowding-out effect of the personal income tax refund available in 2022 did not materialise in the fourth quarter of 2021 in membership fee contributions. A positive impact of the personal income tax reimbursements on the funds may be that surplus funds may appear at certain fund members, which may also be channelled to the funds sector subject to proper communication by the funds.

In the voluntary pension fund sector, the amount of payments affecting the coverage reserve was 8.5% higher than in the previous year. In 2021, payments were made in the amount of HUF 96 billion compared to HUF 89 billion paid in 2020. The rise in payment from the coverage reserve was mostly attributable to the growth in yield payments. In 2021, members received almost HUF 20 billion as yield payments, representing an increase of 32 percent compared to almost HUF 15 billion paid in 2020. The number of members of the voluntary pension fund sector stagnated. The steady ageing of members remains a risk for the future sustainability of funds.

The number of members in the health and mutual aid fund sector increased by more than 30,000 persons. The approximately 55,000 new entrant fund members exceeded the number of those who left the funds (15,900), died (3,300) and excluded for non-payment of membership fees (4,600). Almost 65.4 percent 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 stabilisation of the member headcount may be expected.

3.1.2 Membership fee incomes rose in both sectors in 2021

In 2021, in the voluntary pension fund sector the amount of both the individual contributions and the employer's membership fee contribution increased. The amount of individual and employer membership fee contributions rose on an annual basis also at the voluntary health and mutual aid funds. Growth in employer contributions slightly exceeded the annual growth rate of member contributions.

While in the voluntary pension fund sector membership fee payments allocable to the individual accounts (coverage reserve) were HUF 107.9 billion in 2020, in 2021 individual and employer's contributions were credited to the institutions' individual accounts (coverage reserve) in the amount of HUF 115.9 billion, which represents a significant growth of 7.5 percent compared to the contributions in 2020. Voluntary pension fund benefit payments amounted to HUF 51 billion both in 2020 and 2021. The use of annuity benefits is still not popular among the members, and their ratio is negligible within the benefit expenditures.

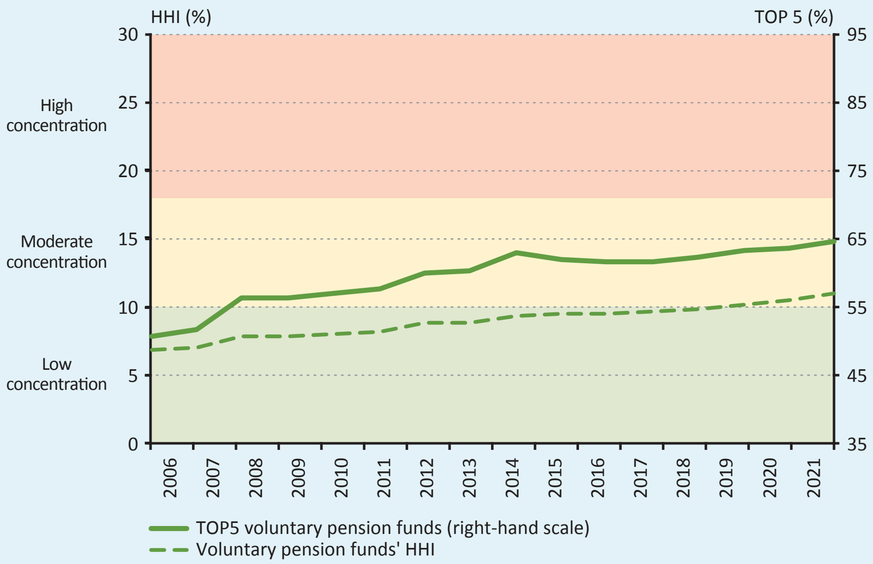
Following an increase of HUF 2.7 billion, the assets of health and mutual aid funds amounted to HUF 72 billion the end of 2021, of which the assets allocable to the individual accounts (coverage reserve) amount to HUF 67 billion. Although the amount of benefit payments exceeded the membership fee payments allocable to the individual accounts (coverage reserve), the claimed tax credits and the revenue from targeted benefits were able to offset this effect, thereby increasing the coverage reserve amount. The amount of benefit payments exceeded the sum of the members' and employers' contributions. Compared to the previous year, the latter was higher by 13.7 percent in the health and self-help funds sector

3.2 VOLUNTARY PENSION FUNDS

3.2.1 Slow increase in the pension fund concentration ratio

In the voluntary pension fund sector the number of funds remained unchanged in 2021. 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 2021 (Chart 3.1). The market share of the TOP 5 funds, based on membership fee income, also increased compared to 2020. 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 TOP 5 institutions based on assets and number of members.

Chart 3.1
Developments in voluntary pension fund concentration



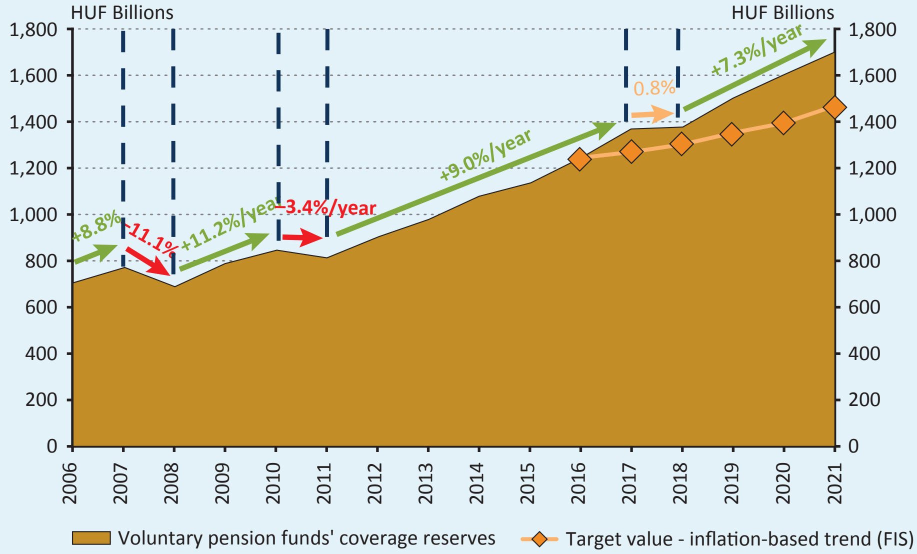
Note: The colour of the background illustrates the strength of concentration under HHI. Contrary to the practice of previous years, this year quarterly data were used only in respect of 2021. The figures of previous years were updated with the annual audited data. Due to this, the chart may differ from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

Source: MNB

3.2.2 Steady growth in assets

At the end of 2021, the balance of the voluntary pension funds' individual accounts (coverage reserve) was HUF 1,710 billion, exceeding the value registered at the end of last year by 6.5 percent (HUF 1,606 billion). Of the growth trends specified in FIS this growth rate exceeded only the inflation targeting trend in 2021 and not the trends determined relative to GDP. In the period of 2018-2021, the sector level coverage rate of voluntary pension funds rose dynamically, by 7.3 percent annually on average. (Chart 3.2). At the end of 2021, the sum of the individual accounts receivables of members entitled to payment or becoming entitled to payment within one year during the accumulation period has already reached HUF 1,490 billion, which is an increase of 0.1 percentage points compared to the end of 2020 and equivalent to 87.1% of the coverage reserve. The risk of a significant decrease in assets resulting from large-scale benefit claims is mitigated by the actual positive trend that a large part of the members eligible for payment regard their pension fund saving as a profitable long-term investment instrument and instead of spending it they wish to continue augmenting it the funds system.

Chart 3.2
Developments in the voluntary pension fund coverage reserves

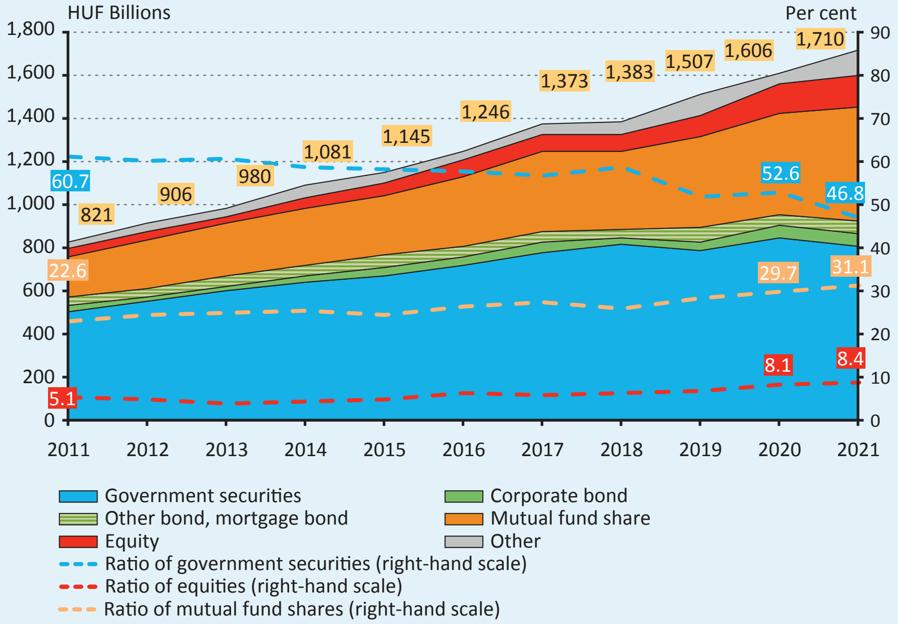


Source: MNB.

3.2.3 Government securities portfolios have depreciated

Investments in Hungarian government securities to account for the largest part of the voluntary pension fund sector's coverage reserve; however, direct exposure in 2021 fell by 5.8 percentage points compared to the end of 2020 from 52.6 percent to 46.8 percent. (Chart 3.3). As a result of the re-weighting, particularly the ratio of fixed-term deposits (within the other category) and investment fund instrument category increased. Within the funds' portfolios the ratio of direct equity investments rose in 2021 by 0.3 percentage point compared to 8.1 percent registered at the end of 2020, which is fully attributable to the rise in the ratio of foreign equity investments. Thus the exposure at the end of the year was 8.4 percent, 5.4 percent of which was domestic, and 3 percent foreign equity. The ratio of mutual fund shares within investment instrument categories rose from 29.7 percent to 31.1 percent, of which the ratio of domestic and foreign mutual fund shares was 20.1 percent and 11.0 percent, respectively. The ratio of corporate bond investments remained broadly unchanged, rising to 3.8 percent from 3.7 percent registered at the end of 2020. By the end of 2021, the share of real estate investment funds within the funds' portfolio rose from 1.9 percent registered at the end of 2020 to 2.2 percent, while the ratio of direct real estate investments remained unchanged, standing at 0.6 percent also at the end of 2021. Total real estate exposure (direct and indirect together) amounted to 2.8 percent at the end of 2021. The ratio of mortgage bonds remained broadly unchanged, standing at 0.92 percent at the end of 2021.

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



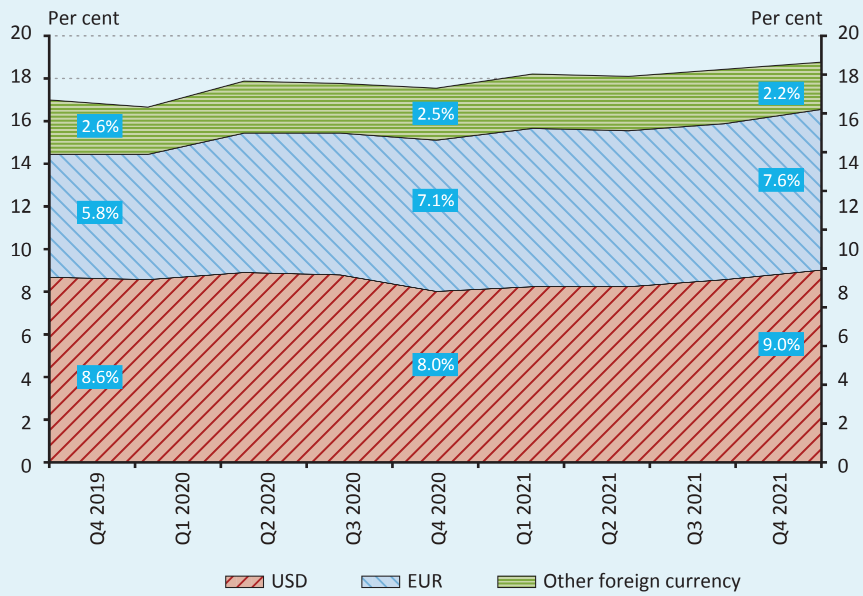
Note: Other includes: bank accounts, fixed deposits, forward contracts, direct real estate investments, equity loans, other securities listed at the stock exchange or other regulated markets, receivables from securities lending and the net value receivables and payables from securities transactions.

Source: MNB

Box 3.1
Foreign currency exposure of the voluntary pension fund sector

Pursuant to Government Decree No. 281/2001. (XII. 26.) on Regulation Governing the Investment and Financial Management of Voluntary Mutual Pension Funds, upon the valuation of the voluntary pension fund's assets, the foreign currency value of positions resulting from investments abroad or from investments denominated in foreign currency must be expressed in forint using the mid-rate of the MNB published on the balance sheet date, or in the absence of that, the most recently mid-rate published by the MNB. In practice, this means that the investment result for any chosen period is affected not only by changes in the value of assets but also by changes in the value of the forint against foreign currencies. In 2020 and 2021 the foreign currency exposure of the total voluntary pension fund assets rose by 63 and 121 basis points, respectively, and thus at 31 December 2021 it stood at 18.9 percent. Within the total foreign currency exposure, the largest exposures are the USD and EUR exposure, with 9.0 percent to the USD and 7.6 percent to the Euro at 31 December 2021 (Chart 3.4).

Chart 3.4
Foreign currency exposure of the voluntary pension fund sector

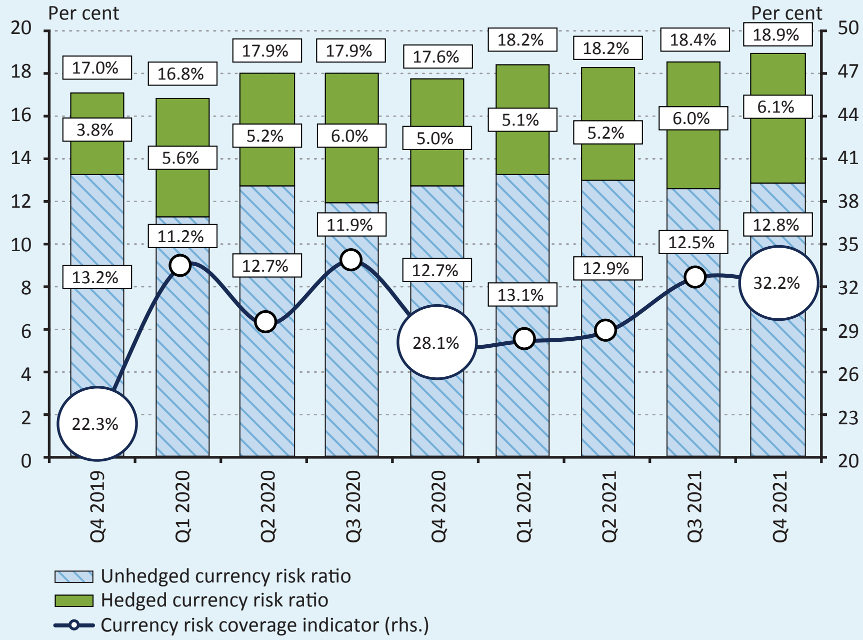


Source: MNB.

If the forint depreciates against the foreign currencies during any selected period, it has a positive impact on the investment result. If the forint appreciates, it has a negative impact. This is referred to as currency risk. In the past two years (2020, 2021) changes in the foreign exchange rates had a positive impact on the investment result, since in 2020 and 2021 the forint depreciated against the US dollar by 0.9 and 9.5 percent and against the euro by 10.5 and 1.1 percent, respectively. In order to mitigate this currency risk, usually forward sale contracts are concluded, i.e. the parties agree now on the exchange rate at which they will exchange the foreign currency to forint in the future. From the moment of concluding the forward contract, the transaction value and the revaluation difference of the foreign exchange rate included in the value of the invested asset move oppositely, and thus their combined result may as well be zero. Let us illustrate this with a simple example: if during a given period the forint appreciates against the foreign currencies, the exchange rate revaluation difference included in the value of invested assets will be negative, because when the asset is sold at the end of the period one unit of foreign exchange contract will be worth less forint than at the beginning of the period, and thus upon the conversion less forint can be realised; however, the value of the forward foreign exchange sale contract will be positive, as the parties agreed on the exchange rate in advance, which is higher than the spot exchange rate at the end of the period, i.e. they can sell the foreign currencies for a higher price than the actual market rate at the end of the period.

In the case voluntary pension funds we see that while at the end of 2019 they hedged 22.3 percent of the currency risk by forward contracts, at the end of 2020 and 2021 they already hedged 28.1 percent and 32.2 percent of it, respectively. (Chart 3.5). By increasing the hedge level, the sector prevented the rise in the level of unhedged foreign exchange risk despite the fact that the total foreign currency exposure rose both in 2020 and 2021. Between 31 December 2019 and 31 December 2021 the value of unhedged foreign currency exposure fluctuated between 11 and 13 percent. This means that the general 10 percent revaluation of forint relative to foreign currencies had a profit impact of around 1.1-1.3 percent on yields.

Chart 3.5
Currency risk in the voluntary pension fund sector

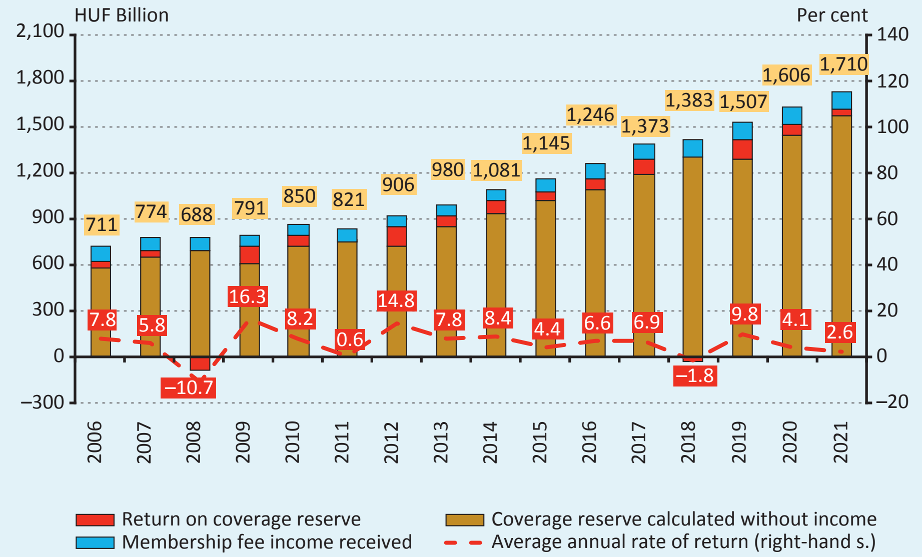


Source: MNB.

3.2.4 Devaluation of bonds lowered average yields

In 2021, the voluntary pension funds realised an asset-weighted average net yield of 2.63 percent at sector level (Chart 3.6), showing a real yield of -4.44 percent when adjusted for inflation. However, there are major differences between the yields of funds in 2021. In 2021, net yields on the voluntary pension funds' portfolios varied between -7.34 percent and 26.18 percent. The impacts of the coronavirus pandemic were felt in 2021 as well; nevertheless, most of the voluntary pension funds closed the year with positive net yield. In the first and third quarters of 2021 roughly three-quarters of the portfolios realised positive net yield, while in the second quarter all but 4 portfolios showed positive yield. In this period, typically only the bond-heavy portfolios with lower risk appetite realised close to zero or negative net yield. By the end of the year, due to the rise in the yield curve, government securities portfolios significantly depreciated, which had major effect on performance in the fourth quarter. Then only one-thirds of the portfolios realised positive yield.

Chart 3.6
Developments in voluntary pension fund coverage reserve, membership fee income, volume of yields and net annual average rate of return



Source: MNB.

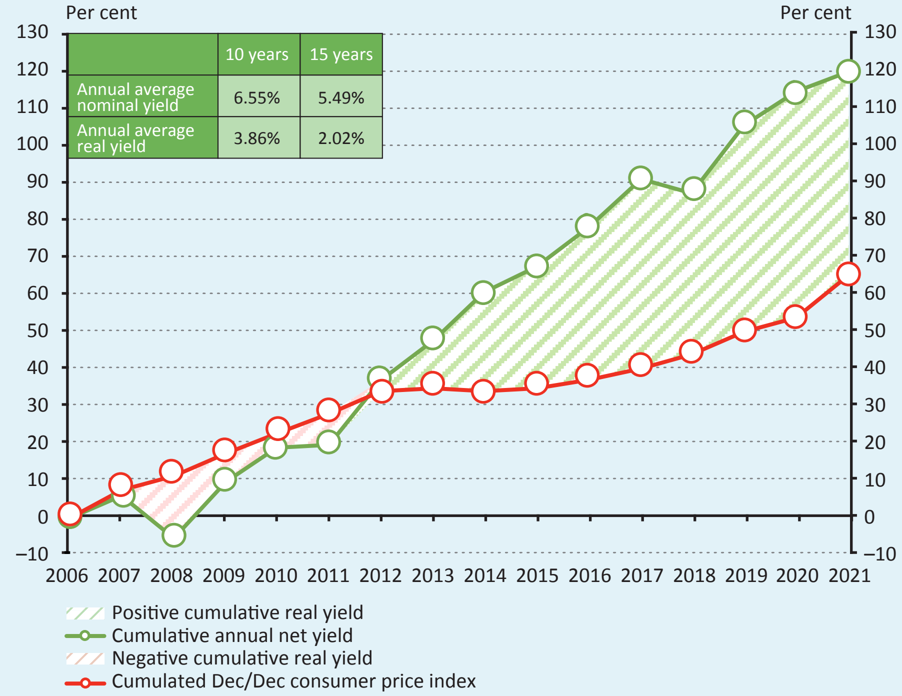
The purpose of pension savings is to supplement the state old-age pension materially. Following the negative yields realised in 2018 by voluntary funds, in 2019 and 2020 funds realised yields which exceeded inflation, which also evidences that the voluntary funds' savings should be assessed on a longer 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.

3.2.5 Long-term real yield is in the band of 2-4 percent, accompanied by low cost level

Based on data supplied by the funds, the MNB has published the pension funds' 15-year average rates of return for seven years now. Based on 2007-2021 returns, the average asset-weighted net rate of return at sector level, calculated from the average 15-year yield rates, is 5.49 percent, which – considering the 15-year average December/December inflation rate of 3.40 percent – represents a real yield of 2.02 percent (Chart 3.7).

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.

Chart 3.7
Long-term cumulated net yield of the voluntary pension fund sector



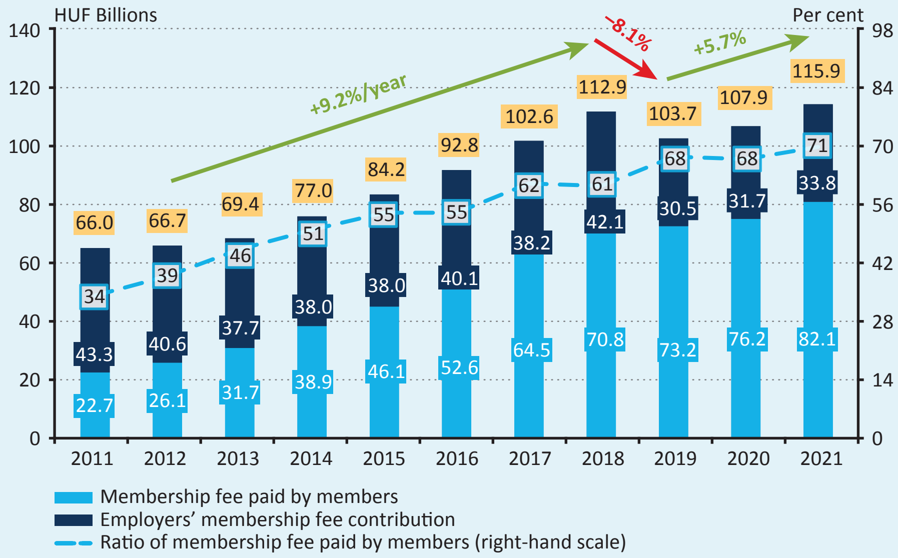
Source: MNB.

The MNB introduced the annual cost ratio for pension fund products ($ACRP_{PF}$) through a recommendation. The $ACRP_{PF}$ expresses the costs deducted from a member's contributions and savings, in a single figure. 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 adjusted fee burden ratio of voluntary pension funds at sector level was 0.69 percent, the classic fee burden ratio was 0.64 percent, while the average 30-year $ACRP_{PF}$ was 0.85 percent. The $ACRP_{PF}$ data, available since 2020, support the picture obtained from the analysis of the fee burden ratio, according to which the voluntary pension fund is a cost-effective, long-term investment and form of savings for supplementary pension purposes.

3.2.6 Outstanding voluntary pension fund contribution of HUF 116 billion in 2021

In the voluntary pension fund sector membership fee payments allocable to the individual accounts (coverage reserve) were HUF 107.9 billion in 2020. In 2021 an outstanding individual and employer's contributions were credited to the institutions' individual accounts (coverage reserve) in the amount of HUF 115.9 billion, which represents a significant increase of 7.5% compared to the contributions in 2020 (Chart 3.8). The previously expected potential crowding-out effect of the personal income tax refund available in 2022 did not materialise in the membership fee contributions. In 2021, in the voluntary pension fund sector the amount of both the individual contributions and the employer's membership fee contribution increased. Growth in employer contributions slightly exceeded the annual growth rate of member contributions. The amount of individual contributions and employer contributions rose by 7.8 percent and 6.6 percent, respectively. Receipts were still dominated by individual contributions; individual membership fee incomes account for 70.8 percent of the total annual membership fee income. It can be observed that over the last 10 years, the shares of the individual and employers' contribution almost fully swapped place in the sector.

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



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

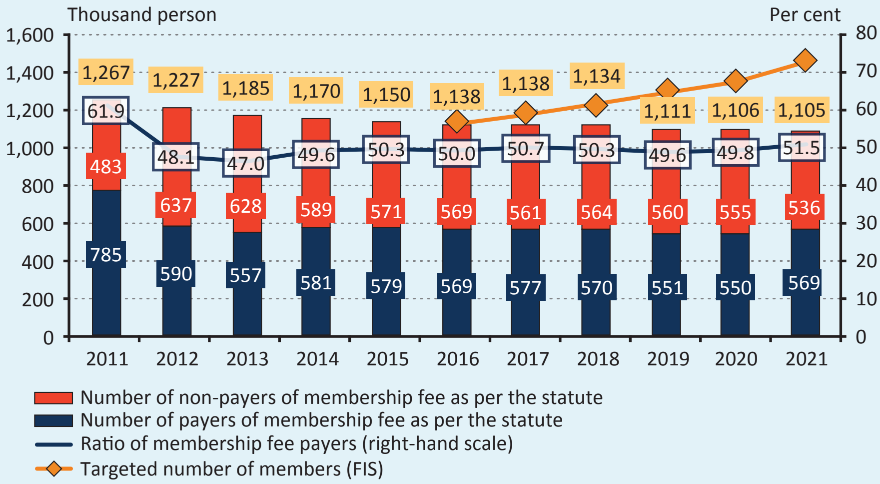
3.2.7 Stagnating member headcount, moving away from target

In 2021, the ratio of members paying membership fee in voluntary pension funds was 51.5 percent, which is an increase of 1.7 percentage points compared to previous year and the highest rate in the past 10 years (Chart 3.9). The number of members has been slightly but steadily declining in the voluntary pension fund sector, moving further away from the ideal path presented in FIS with a self-provision outlook over the past year. Focusing on the recruitment of members, approaching non-paying members and fostering their activity remain a priority.

In 2021, the number of members of the voluntary pension fund sector stagnated. In 2020, despite the extraordinary year, nearly 30,000 people joined the funds as members. In 2021, significantly more new members, exceeding the number registered in previous years, 40,600 new members joined the voluntary pension fund scheme. Of the new entrants 23,300 members joined through recruiters. The trend in the number of new entrants can be considered positive as it was sufficient to maintain the number of members, but to increase it, a larger number of new entrants is needed. The average age of the members was 47.5 years in 2019 and 48 years in 2020, and thus the increase in the average age of membership has not been halted. An analysis of data from previous years shows that the average age of the sector's member increased by 4.5 years by 2020 compared to 2011. 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; 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 3.9
Ratio of payers of the voluntary pension fund membership fee



Source: MNB.

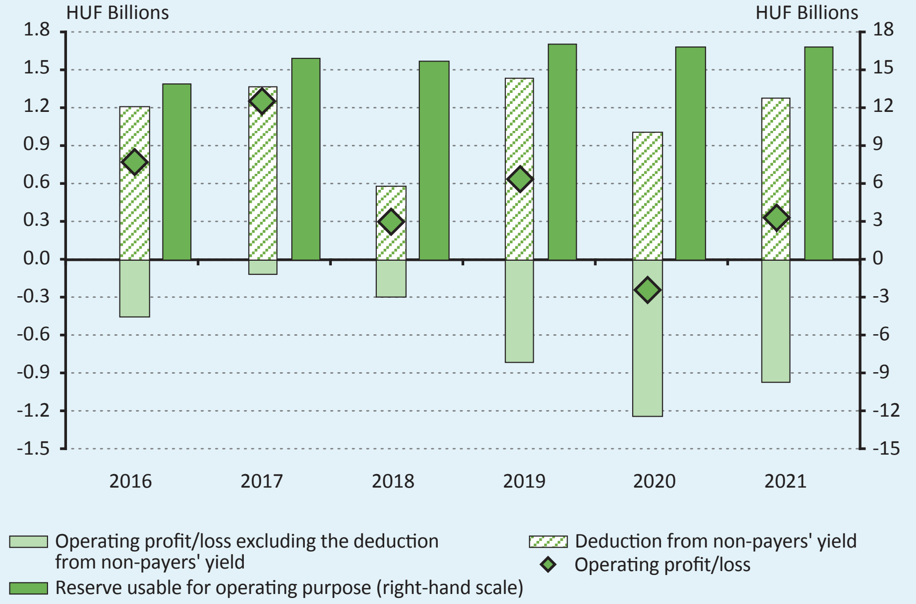
The ratio of the non-payment of membership fees has fluctuated around 50 percent in the past 8 years, which may still be deemed high and represents a risk in terms of fund long-term operation. According to the business model of the voluntary funds, the operating expenses must be covered by the amount deducted from the members' payments and by donations for operating purposes. Yet in this way non-payers do not contribute to the sustainability of the operation. According to the applicable law, from the start date of non-payment of the member contribution, the fund is entitled to reduce the member's yield on the investment of his individual account by an amount corresponding to the part of the prevailing minimum membership fee allocable to the operating and liquidity fund but not exceeding the yield, and credit it to the operating and liquidity fund. 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 part of the passive members as a paying members.

3.2.8 Following the halt last year, 2021 was profitable

In 2020, the operation of the voluntary pension fund sector was loss-making. 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. Although 19 out of 33 institutions realised an operating loss in 2021, the operating result of the sector as a whole was profitable. Although operating expenditures exceeded operating revenues, the deduction of yield realised on the savings of non-paying members pushed the operating result to the positive range. 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). The MNB puts special emphasis on the monitoring of funds' operating position, both during the ongoing supervision and supervisory inspections. If as a result of persistently loss-making operation or due to other reasons the reserves of fund available for operation approach or fall below the expected prudential minimum level, the MNB applies a variety of measures (prudential talks; request for action plan; prescribing an operational and liquidity report; initiating a targeted inspection) at the respective institution.

At the end of 2021, the operating reserves of the voluntary pension fund sector registered a year-on-year decrease of 0.4 percent at sector level (Chart 3.10).

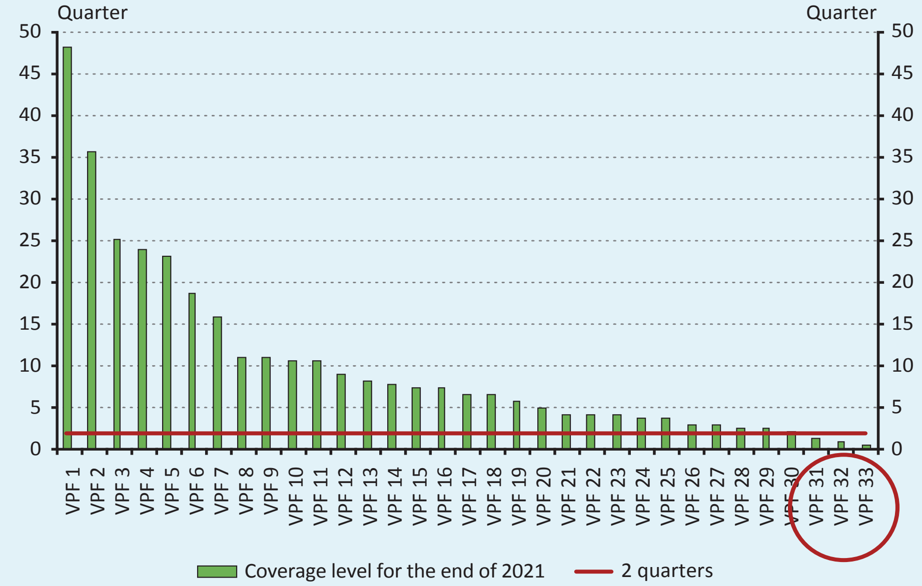
Chart 3.10
Development in operating profit/loss of voluntary pension funds



Source: MNB.

According to the index developed by the MNB, in the voluntary pension fund sector 3 institutions failed to meet the expectedprudential requirement of 2-quarter operating coverage level at the end of 2021. (Chart 3.11). According to the index, if revenues fall to 0, and the current and the average costs calculated on the basis of the previous 3 quarters exist, the reserves available for operation must ensure the operation of the institution for at least 6 months (two quarters). In the case of these funds we treat the operating coverage situation as a matter of priority.

Chart 3.11
Coverage levels of voluntary pension funds



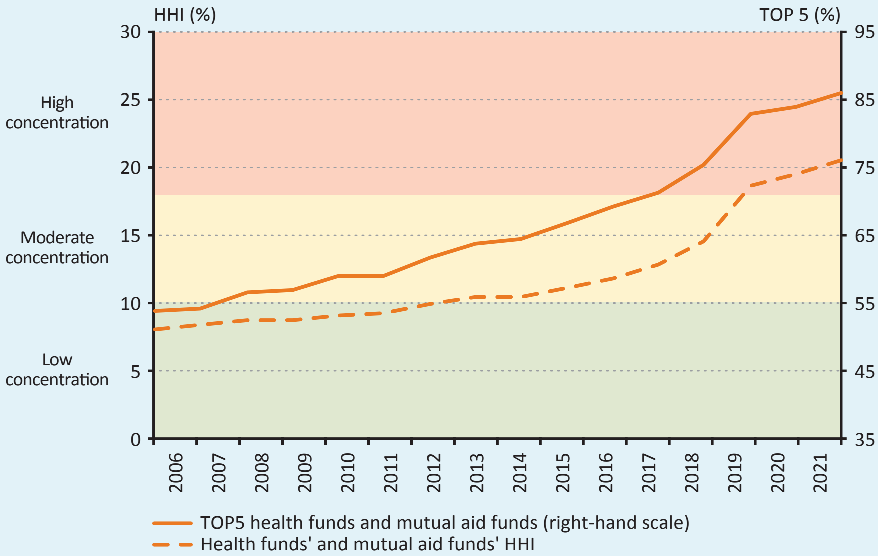
Source: MNB

3.3 HEALTH AND MUTUAL AID FUNDS

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

The concentration ratio both in the health and mutual aid fund sectors continued to increase (Chart 3.12). The increase is due to the dissolution of one institution and to the merger of an institution. When analysing the concentration of membership fee payments we found that 85.8 percent of the membership fee payments and 81.4 percent of the employers' contributions in health and mutual aid funds sector come from contributions related to the TOP 5 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 3.12
Developments in the health and mutual aid funds' concentration



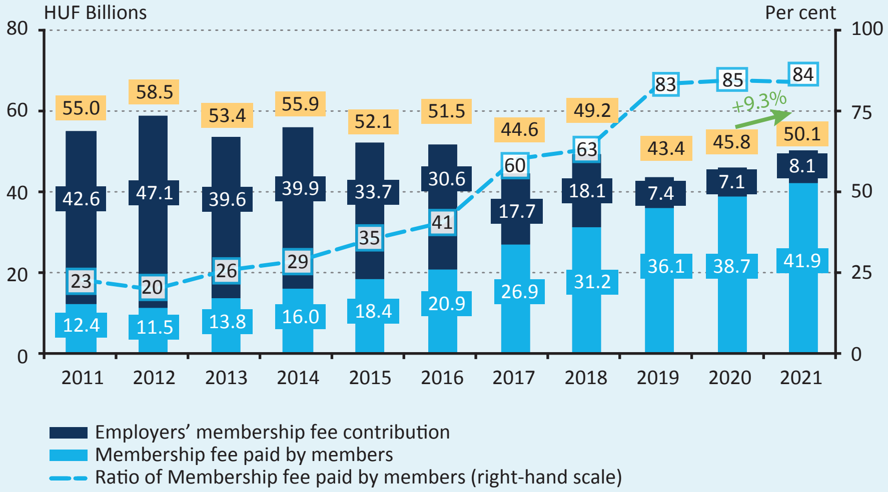
Megjegyzés: A háttér színezete a HHI szerinti koncentráció erősségét szemlélteti. A korábbi évek gyakorlatához képest idén a negyedéves adatokat csak a 2021. év vonatkozásában használtunk. A korábbi évek számadatai frissítve lettek az éves auditált adatokkal. Ennek okán a grafikon eltérhet az előző években publikáltaktól.

Source: MNB

3.3.2 Health fund contributions also increased, but still fall short of previous levels

Contributions credited to health and mutual aid funds' coverage reserves increased by 9.3 percent in 2021 than in the previous year. (Chart 3.13). It may be regarded as a positive trend, reflecting the strengthening of self-provision, that individual contributions have increased by 8.4 percent, more than three times the amount paid a decade ago at sector level, and have been steadily rising in recent years. Employers' contributions increased significantly by 14.2% compared to the previous year, following a drop in 2020. Compared to 2011 the share of individual and employers' contributions completely swapped places; special emphasis is placed on the members' individual payments. It is still typical that the payments of membership fee type are 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 3.13
Membership fee income credited to the health and mutual aid funds' coverage reserves, broken down by payers



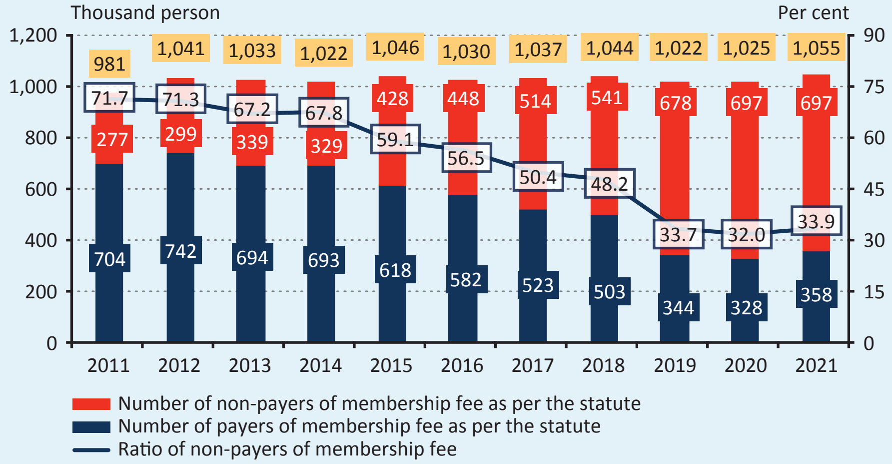
Source: MNB.

3.3.3 Number of members is at an all-time high, moderate improvement in willingness to pay membership fees

The number health and mutual aid fund members increased by 30,000 in 2021, despite the exclusions for non-payment of the membership fee (4,600 persons) and the number of members leaving the funds (15,900 persons). The more favourable development in the number of new members compared to previous year also had a positive impact on the number of members, but the increase in the number of members was mainly due to the fact that while in 2020 28,700 members were excluded for non-payment of the membership fee, in 2021 the membership of only 4,600 members was terminated. Accordingly, the balance of increasing and decreasing factors affecting the number of members was more favourable in 2021 than in the previous year. Reaching almost 55,000 new entrants was therefore enough to achieve a growth in the number of members. 34,300 of the entrants joined the funds through recruiters. By the end of 2021, the ratio of membership fee payers rose by 1.9 percentage points (Chart 3.14), breaking the steadily declining trend that characterised recent years. The growth may be attributable to the fact that in 2020 a large number of non-paying members were excluded, and thus in 2021 these members no longer had a negative impact on the membership fee payment ratio.

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. In 2011, 71.7 percent of the membership qualified as payers according to the statute, while in 2021 only 33.9 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 this 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 3.14
Developments in the number of members not paying health and mutual aid fund membership fee



Source: MNB.

3.3.4 Health and mutual aid benefits are of outstanding volume and increasingly diversified

Benefit payments (HUF 59.5 billion) rose significantly by HUF 7.1 billion compared to last year, which substantially exceeded the membership fee income allocable to the coverage reserve (HUF 50.1 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 subsectors. 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 39.2 percent after a decrease in the ratio by 3 percentage points, followed by healthcare services at 32.5 percent after an increase in the ratio by 3 percentage points, (e.g. dentist, diagnostic medical imaging) and financial support for the purchase of therapeutic equipment at 16 percent after an increase in the ratio by 0.4 percentage point.

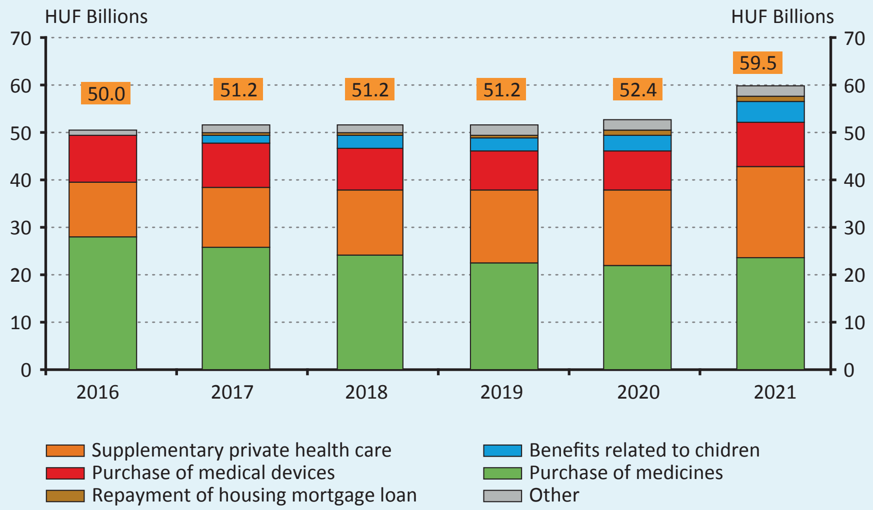
There was no significant change in the composition of services; at the same time, the restructuring of the benefit expenditures, observed in previous years, continued in 2021 as well (Chart 3.15). In 2021, the share of the financing of healthcare services rose to 32.5 percent from 21 percent registered in 2016, while the share of financial support for the purchase of medicines and therapeutic equipment declined from 75.6 percent to 55.2 percent. It should be noted that special nutriments or vitamins purchased for preventive purposes also belong to the category of financial support for the purchase of medicine.

Payments of benefits related to childcare declined from 7.2 to 6.9 percent, while the share of amounts paid as assistance for the repayment of home mortgage loans increased from 1.6 percent to 1.8 percent in 2021.

In 2021, the amounts paid increased compared to 2020 in all five fund benefit categories, listed above.

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 Hungarian Association of Pension and Health Care 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.

Chart 3.15
Developments in the health and mutual aid funds' benefit payments



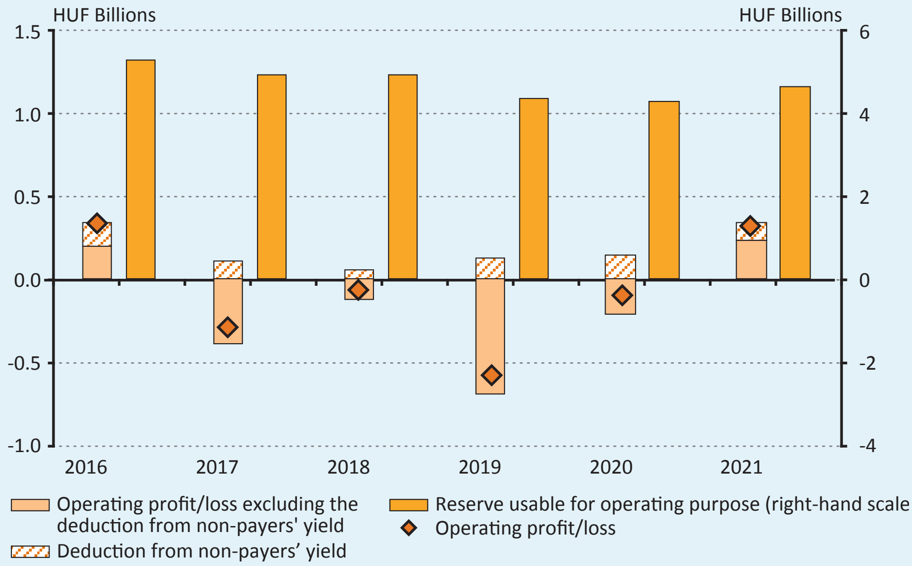
Source: MNB.

3.3.5 Health and mutual aid funds once again realised operating profit after years of losses

The operating result of health and mutual aid funds at sector level was negative every year between 2017 and 2020. At some of the funds the negative operating result was caused by the fact that with a view to eliminating the shortcomings detected by the MNB examinations and approaching the younger generation they started major investments, e.g. in the area of IT infrastructure. However, in 2021, the sector realised a positive operating result, the operation of 9 out of 16 institutions was profitable on an annual basis. The sector-level operating profit was attributable to the fact that the annual growth rate of operating revenues significantly exceeded that of operating expenditures. In 2021, fund members utilised fund benefits more actively. Benefit payments significantly rose and higher membership fees were paid to cover those. Due to the higher membership fee payments, the membership fee revenues of funds credited to operating reserves also rose, by 10.5 percent, compared to previous year. 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). If as a result of persistently loss-making operation or due to other reasons the reserves of fund available for operation approach or fall below the prescribed prudential minimum level, the MNB applies a variety of measures (prudential talks; request for action plan; prescribing an operational and liquidity report; initiating a targeted inspection) at the respective institution.

By forming sufficient operating reserves, funds may secure their own operating conditions and continuity of operations in potential negative periods. At the end of 2021, the operating reserves of the health and mutual aid fund sector registered a year-on-year increase of 8.6 percent at sector level, which broke the downward trend of previous years (Chart 3.16).

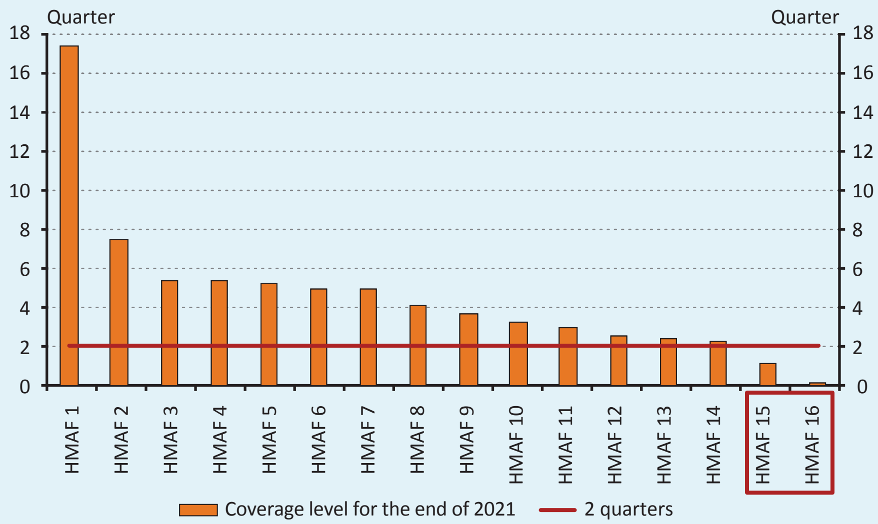
Chart 3.16
Development of operating profit/loss of voluntary health and mutual aid funds



Source: MNB.

According to the index developed by the MNB, in the health and mutual aid sector 2 institutions failed to meet the prescribed prudential requirement of 2-quarter operating coverage level at the end of 2021. In the case of these 2 funds the MNB treats the operating coverage situation as a matter of priority (Chart 3.17).

Chart 3.17
Coverage levels of voluntary health and mutual aid funds



Source: MNB.

Box 3.2
In the first quarter of 2022, devaluation of assets had a significant impact on the funds sector

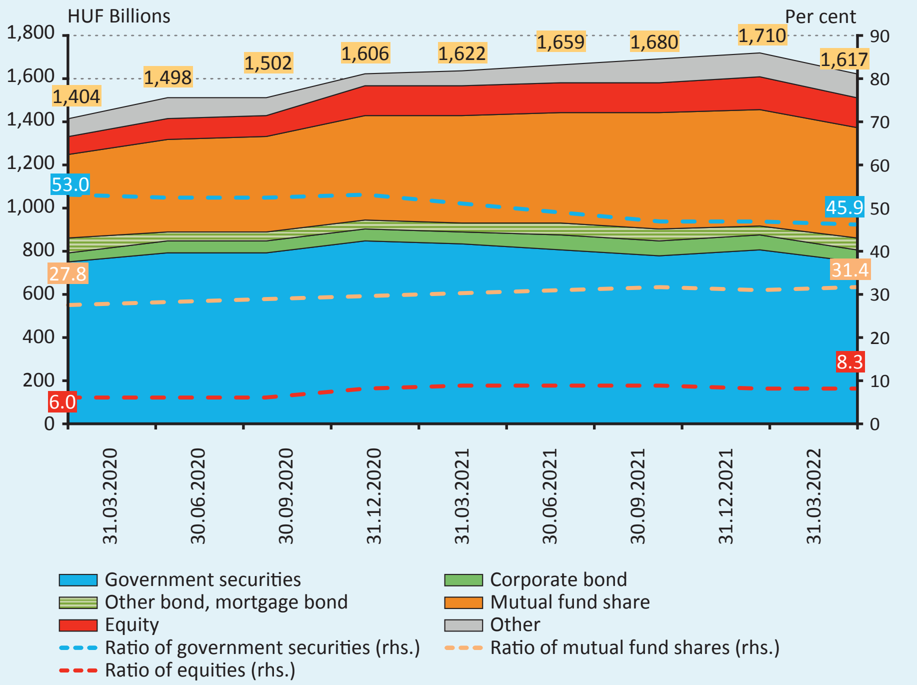
Having analysed the voluntary funds' data for the first quarter of 2022 we found that the extraordinary world market environment had negative impact on the assets managed by the voluntary pension funds and also on the benefit payments. However, the aggregate amount of individual and employer contributions rose year-on-year. Developments in the voluntary funds' savings should be analysed on a longer horizon. Experiences to date show that the poorer investment result of certain periods was not only offset by the positive result of subsequent periods, but even exceed it. The MNB measured the impacts of the Russia-Ukraine conflict on the funds sector also as part of the daily reporting, based on which it can be established that the ratio of Russian assets with direct impact account for a negligible part of the individual funds' coverage portfolios. The management of the risk of yield generation is expected to be a major challenge for institutions and asset managers in the coming periods as well.

Compared to the end of 2021, the amount of the voluntary pension fund sector's coverage reserve fell to HUF 1,617 billion by the end of the first quarter of 2022. This falls short of the amount registered at the end of the previous quarter (HUF 1,710 billion) by 5.5 percent, and it is also lower than the amount registered in the first quarter of 2021 (HUF 1,622 billion). The decline was primarily attributable to the extremely intensive fall in capital market prices resulting from the changed world market environment and to the negative investment result of the voluntary pension funds as a consequence of that. On the other hand, the fact that benefit payments exceeded the membership fee payments allocable to the coverage reserve also had a minor impact. The MNB measured the impacts of the Russia-Ukraine conflict on the funds sector also as part of the daily reporting, and continuously monitored the changes in the voluntary pension fund members' assets, the instruments impacted directly and indirectly by the conflict, the ratio of those to the respective portfolio and to the fund's coverage reserves, the changes in its value as well as the developments in contributions, payments and benefit claims. In addition, funds also reported in the daily data report those coverage or optional portfolio of the funds the market value of which changed by at least 5 percent compared to the previous valuation date. No Ukrainian assets of direct exposure has been identified in the funds' portfolios. The ratio of Russian assets of direct exposure in the individual affected funds' coverage portfolios was between 0.03 and 3.56 percent on 31 December 2021 and between 0.03 and 2.42 percent on 31 March 2022. The ratio of Russian assets in the aggregate amount of the all affected funds' coverage portfolio was 1.56 percent on 31 December 2021 and 1.05 percent on 31 March 2022. The decline in the outstanding exposure to Russian assets was attributable to the withdrawal of part of these assets from the funds' portfolios and, at part of them, by a decrease in the market value of Russian assets.

In the first quarter of 2022 the direct government securities exposure was 45.9 percent, representing a decline of 5 percentage points compared to 50.9 percent registered in the first quarter of 2021 (Chart 3.18). Within the funds' portfolio the ratio of direct equity investments declined from 8.6 percent to 8.3 percent year-on-year. The ratio of mutual fund shares and corporate bonds within the investment asset categories rose from 30.2 to 31.4 percent and from 3.8 to 3.9 percent, respectively, in the first quarter of 2022, year-on-year.

In the first quarter of 2022, the number of members stagnated in the voluntary pension fund sector and half of the members qualified as paying members. In the first quarter of 2022, the membership fee contributions credited to the coverage reserve amounted to HUF 25.7 billion, exceeding the year-on-year figure by 7 percent. (Chart 3.19). The sum of the individual membership fee incomes and of the employers' membership fee contributions exceeded those registered in the first quarter of 2021 by 7.5 percent and 5.8 percent, respectively. Based on the data for the first quarter of 2022, disbursements against the coverage reserve increased by 14.6 percent year-on-year. The growth was mainly caused by the higher lump sum pension benefit payments between the second half of February and end of March 2022. The lump sum pension benefit expenses exceeded the lump sum benefit expenses registered in the same period of previous year by more than HUF 4 billion. The volume of payments after the end of the waiting period did not change significantly compared to the previous quarter. The amount paid to members from the coverage reserve in the first quarter of 2022 exceeds membership fee income by some HUF 5 billion, which is in line with seasonality of these cash flows. On the other hand, the degree of their difference exceeds the year-on-year figure of HUF 2.5 billion.

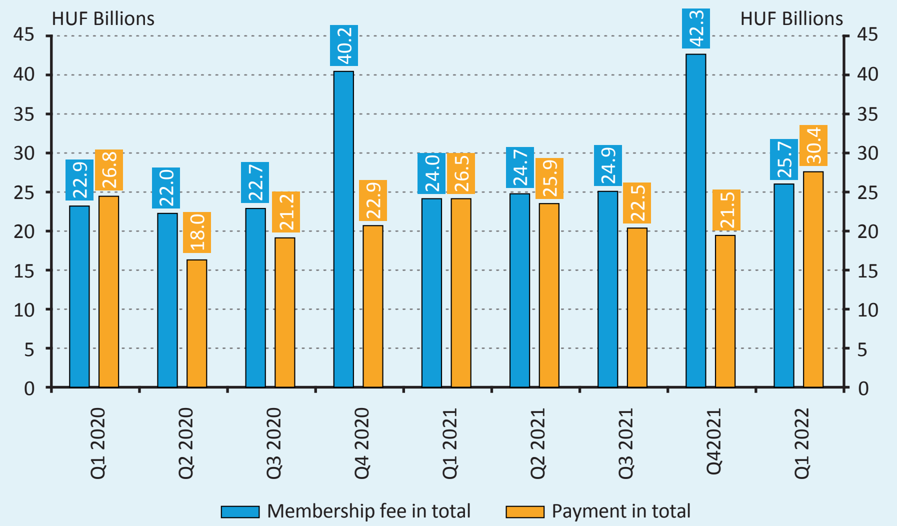
Chart 3.18
Quarterly distribution of the voluntary pension funds' investments by asset groups



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

Source: MNB.

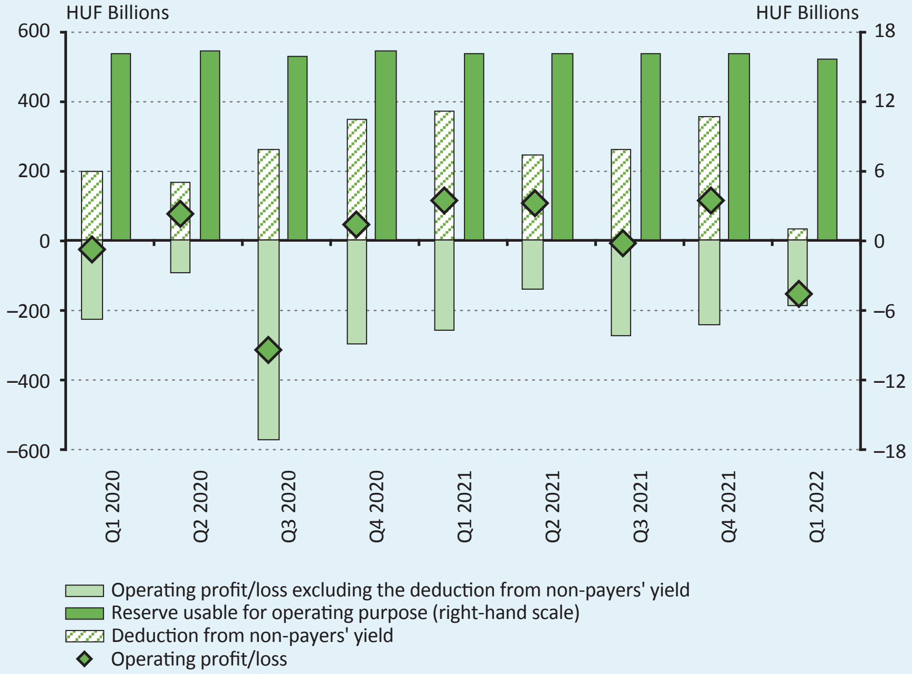
Chart 3.19
Cash flows of the voluntary pension funds coverage reserve



Source: MNB

In the first quarter of 2022, 21 voluntary pension funds realised an operating loss, which was attributable a two-thirds of them to negative operating investment result. Although it was possible to enforce a deduction from the yield of non-paying members, the sector still realised a loss of HUF 162 million (Chart 3.20). This significantly (by HUF 276 million) fell short of the yea-on-year figure, when in addition to the more favourable investment results funds were also more profitable in their operating activities. As a result of this, in the first quarter of 2022 the volume of reserves available for operating purposes also decline quarter-on-quarter. At the end of the quarter, 2 voluntary pension funds did not have the prudentially expected level of reserves available for operation for 2 quarters, assuming the full absence of operating revenues. These funds must sort out their operating conditions in order to raise their operating reserves to the required level. In the first quarter of 2022, the health and mutual aid fund sector was characterised by an operating loss, as the operating result of 11 institutions was in the negative range.

Chart 3.20
Quarterly development in operating profit/loss of voluntary pension funds



Source: MNB

In the first quarter of 2022, the number of members declined by 14,317 in the health and mutual aid fund sector, despite the fact that more new entrants have become fund members than in the previous quarter. Accordingly, the quarterly growth trend seen since the first quarter of 2021 halted. The decline was mainly caused by the increase in the number of leaving members and the large number – 22,219 – of exclusion due to non-payment of the membership fee. The ratio of paying members is 33.7 percent, exceeding the year-on-year value by 2.4 percentage points. This is presumably attributable to the fact that the members excluded due to the non-payment of membership fees no longer had a negative impact on the membership fee payment ratio in the first quarter of 2022. Despite the year-on-year fall in employer contributions, payments in the amount of HUF 11.3 billion were credited to the coverage reserve of the health and mutual aid fund sector, which represents a year-on-year growth of 16.9 percent. The amount of the membership fee paid by members exceeded the figure registered in the first quarter of 2021 by 21.6 percent, while employer membership fee contribution fell short of it by 6 percent. Accordingly, the growth is fully attributable to the rise in the membership fees paid by members. Fund benefit payments increased by 13.8 percent year-on-year. This may be attributable to the fact that fund members utilised fund benefits more actively and paid higher membership fees to cover those.

At the end of the first quarter of 2022, 77.4 percent of the health and mutual aid fund sector's coverage reserves was invested in Hungarian government securities. This represents a year-on-year decline of 5.6 percentage points and a quarter-on-quarter growth of 2.5 percentage points. Further 7.66 percent of the exposures are in other bonds and mortgage bonds, 6.93 percent in fixed deposits, 3.5 percent on bank account and in cash, and 3.3 percent in mutual fund shares. Equity exposure remained below 1 percent, and thus the fall in equity market prices in the first quarter of 2022 had negligible impact on the sector. The sector's investment result largely depends on the domestic government securities market yields. The weighted average remaining maturity of the Hungarian government securities portfolio was 2.4 years at 31 December 2021, which has not changed materially in the first quarter of 2022. In this period, the 1-year and 3-year yields rose by 2.24 and 2.22 percentage points, respectively. On the whole, the portfolio of health and mutual aid funds usually consists of shorter maturity bonds, and typically keep them until maturity, and thus their coverage reserve tend to be less susceptible to changes in market prices.

3.4 RISKS OF THE FUNDS MARKET

3.4.1 RISK OF YIELD GENERATION INCREASED AT THE FUNDS

Risk category	Risk groups	Risk rating	Risk prospects	Evaluation in words
Business model	Environment Strategy, business plans Sustainability of operation	🟠	⬆	Operating profit in the voluntary funds sector. Risks related to the sustainability of the business model, typically at the smaller institutions. *Rising risk prospects due to the potential spillover effects of the Russia-Ukraine conflict and rising inflation. High inflation expectations.*
Corporate governance	Ownership Internal management Risk management system Internal control	🟡	➡	There are shortcomings in the documentation of the activities of audit committees. Control of outsourced activities is not always comprehensive. During its on-site and ongoing supervisory activity, the MNB pays special attention to inspecting the adequacy of institutional corporate governance. *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 operating and liquidity reserve Operational risk	🟡	➡	Increasing contributions. Benefit payments increased at health and mutual aid funds. Risks related to the coverage of operations. The rise in average age may represent a risk in the longer run. *Due to the increasing IT development requirements, the risk is not expected to decrease.*
Risk of sustainability and reserves	Investment risk of coverage reserve Capital Operating and liquidity reserve	🟠	➡	Portfolio management aligned with the extraordinary situation, including closer monitoring of investment portfolios also by asset managers and custodians. High inflation and high non-payers rate. Favourable long-term returns. *Persisting risk of volatility.*
Risk of market presence	Products Customers	🟢	⬆	The number of complaints is low. Favourable ACRPF values. PEPP as a possible competing product. *Meeting the challenges of digitalisation may put small funds in a difficult position, and thus their risks may increase.*

Note:

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

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

In 2021, the voluntary fund sector operate profitably. Risks related to the sustainability of the business model, appear typically at the smaller institutions. The high ratio of non-payers continues to carry operational risks. Due to the potential spillover effect of the Russia-Ukraine conflict and high inflation additional risks may develop.

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 sometimes incomprehensive. The quality of internal audit activity still calls for improvement at most funds.

In the voluntary fund sector, contributions increased significantly compared to the previous year. Under higher than usual capital market volatility, voluntary pension funds realised positive yield in nominal terms, but negative in real terms at sector level. Long-term (10- and 15-year) yields remain favourable and positive also in real terms. In 2021, voluntary pension funds were characterised by portfolio management aligned with the capital market volatility. The investment portfolios were more closely monitored also by the asset managers and custodians.

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 degree of benefit payments was similar to that of previous year. 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. There was a significant increase in the amount of benefit payments for the health and mutual aid funds. Among the product and benefit types provided by the institutions, the purchase of medicines and therapeutic equipment, and services available within the framework of social insurance continue to account for the largest share.

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 or maintained at the same level.

Despite the unusual market effects, 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 pension funds market

In the strategic objectives of the MNB's current cycle, which started in 2020, – in line with "stability and trust" core values – consumer protection received even greater role than before. In this ideology, the prudential and consumer protection supervision are equal tasks that reinforce each other, reflecting the conviction and expectation that the prosperity of market institutions can be achieved only upon the simultaneous realisation of prudent operation and consumer-centric approach. The holistic, horizontal and vertical operation of prudential and consumer protection supervision, which appraises systemic trends from a high perspective, but at the same time is able to see the details of business operation, exploits the synergies between functional areas, the direct sharing of information and multi-level relationships with market participants, and eliminates possible redundancies. In addition to its ongoing supervisory activity and the inspections carried out in 2021, the integrated structure has worked well also in the cooperation with EU and national professional organisations over the past year, demonstrating its responsiveness and initiative in an ever-changing environment and amid a series of interrelated, often unprecedented, difficulties.

Similar to 2020, the tasks related to the COVID-19 virus situation represented special challenges last year as well. The MNB closely monitored the situation in 2021 as well – just like throughout the entire period since the start of the pandemic situation – and requested the institutions that they should show a consumer-friendly, fair and equitable conduct. The MNB's experts promptly reviewed the problems identified in connection with the pandemic situation, and took measures as necessary, due to which Hungary successfully addressed the risks identified by EIOPA in 2021 as well. (These include e.g. risks related to business continuity and operational risk; the lack of forbearance measures and flexibility vis-à-vis customers who have failed to meet their contractual obligations; risks related the business model and poor quality of certain travel insurance products; measures of insurers that fail to map changes in risks and consumer needs; complicated language of the exclusions in the contracts and lack of clear communication; and complex and expensive unit-linked products and structural problems in the unit-linked market.)

The new approaches and initiatives yielded tangible results recently, since despite the known difficulties favourable trends have unfolded in several areas.

4.1 LIFE INSURANCES

4.1.1 Stable level of costs at insurers, increasing transparency at pension 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[8]. The provisions cover all savings life insurance products, including mixed and unit-linked life insurance and pension insurance. For the latter two product groups, the MNB formulated requirements with regard to the maximum ACR depending on the maturity[9]. 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

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

[9] 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

Recommendation No 1/2017 (I. 12.) of the Magyar Nemzeti Bank on pension insurances 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 level of costs 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 institutions 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 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.

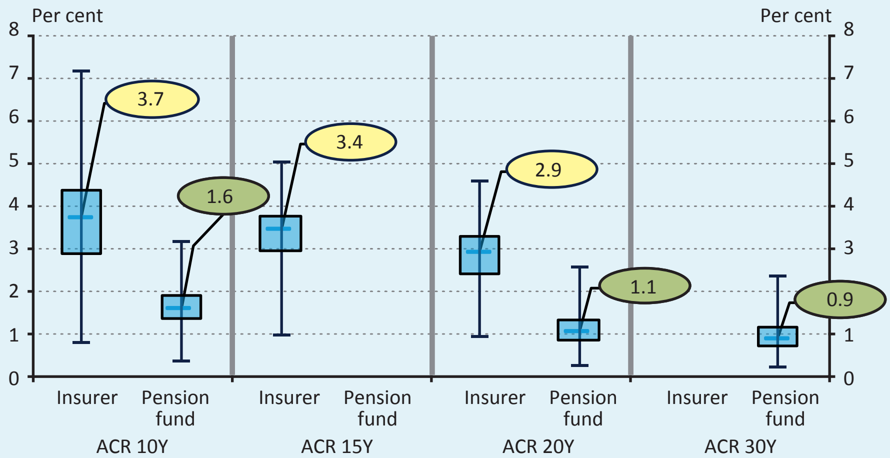
When examining ACR values other characteristics of the funds and portfolios should be also taken into consideration. For example, in the case of particularly low-risk portfolios with assets held in money market instruments or short-term bonds, the cost related to investing, and hence the ACR, can be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

When examining ACRs we observed that for funds operating a system that provides optional investment portfolios, 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 requirements of MNB Recommendation No 12/2016 (XII. 1.) on the setting up and operation of the optional portfolio system of voluntary pension funds, according to which "upon developing the asset-proportionate costs, those are expected to be proportionate to the nature and composition of the assets (holdings) and to the complexity of its management; accordingly, different asset management fees may be also specified for the individual optional portfolios". 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, employment-based 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 4.1.

Chart 4.1
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

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.

4.1.2 Elements of the ethical concept work well

In accordance with the provisions of its previous supervisory strategy, with a view to restoring and reinforcing trust and fostering transparency, the MNB elaborated its ethical life insurance concept in 2015 along the principle of fair treatment[10]. The elements implementing the objectives of the concept (tightened investment rules, transparency of cost, stricter cost control) entered into force gradually from 2016, while the MNB expects compliance with related requirements from 1 January 2017. In order to strengthen the trust of customers in insurance products and thereby to build long-term, stable portfolios, the MNB formulated in the unit-linked recommendation – amongst others – its requirements related to the products, sales and investment management. The recommendation also formulates requirements with regard to the maximum value of the unit linked life insurances' annual cost ratio (ACR) on various maturities, which plays special role in the cost control of saving life insurances.

As a result of the compliance with the ACR limit, there was a spectacular decrease in the ACR values and in the past 3 years they stabilised at the present level. While at the end of 2015 ACR value varied between 0.5 and 13 percent, by 2019 this scale shrank to 4.6 percent, primarily due to the termination of the distribution of products with excessive ACR values. In 2019, even the maximum of the ACR values belonging to all asset funds of all products are below the most stringent ACR limit[11]. At the end of 2019 the average ACR value also declined compared to 2015; however, in this case the decrease is much smaller, which evidences that the average was distorted only by a few outliers already in 2015.

4.1.3 New types of risks – improving complaint statistics in recent years in the life insurance and pension funds segment

In recent years, the MNB's consumer protection activity – as a result of the change in the domestic and EU regulatory environment, the spread of innovative products and sales method, digitalisation and environment-conscious trends and through the continuously changing consumer attitudes and expectations inspired also by the new challenges of the recent period – has broadened and become more complex. In 2021, the MNB's customer service department received 306 consumer petitions related to the insurance market, 13 to the funds sector, as well as 4,359 customer service requests related to insurers and 176 to funds (of which 1,244 was received in email, 3,111 over the phone, and 180 in person).

Due to the new challenges, expectations and the continuously changing – extremely hectic and often unprecedented in 2021 as well – circumstances, quantitative and qualitative audit planning – based on large volume of data and intending to understand the essence, the cause-and-effect relations and impacts of problems – setting out from the identification and assessment of risks affecting a large number of consumers, gained increasing importance. This planning is equally based on numerical analysis (identifying outliers, atypical patterns or distinct trends) and on the summary of received customer enquiries and reports, the identification of problem accumulation or joining the collective EU audit activities. Increasingly complex tasks require both the existence of stable core values and standards – set out in a strategy at a principle level – and the development of innovative solutions with a new approach. The inspection of the due application of POG, i.e. product oversight and governance guidelines, determine the MNB's supervisory activity.

The impact of the ethical concept, launched in 2016, is being felt gradually but increasingly strongly, due to the general characteristics of life insurance product types and the overall domestic stock of policies. Before the introduction of the concept, numerous concerns arose in connection with the life insurance sector, jeopardising market growth. In the first years after the introduction the number of new, savings-type regular premium life insurance policies declined. However, the portfolio premium allocable to new policies rose significantly already then, well reflecting the qualitative realignment of the portfolio. After a temporary rise in life insurance complaints, they started to follow a declining trend. The complaint statistics of life insurance for pension purpose show an increase in the period under review, but this is in line with the soar in the number of policies after the introduction of the product type, while the ratios projected on the increasing portfolio reflect an improvement. It can be stated that the ethical concept fosters the swap of the old low-premium contracts for the new, high-premium contracts in the portfolio through it long-term reliability. However, in addition to the competition

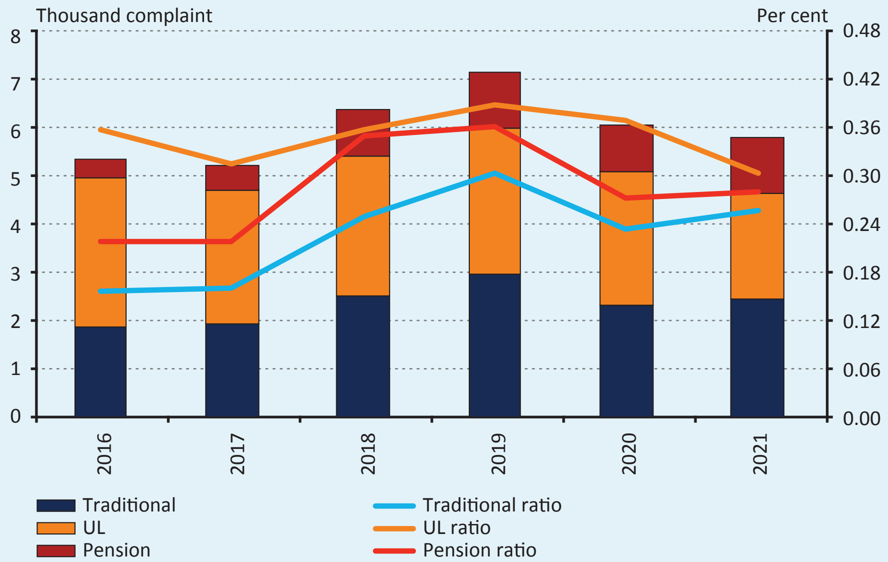
[10] The elements of the ethical life insurance concept include the transparency of costs, minimum limits for surrender value, ACR limits, cancellation of initial units at the unit-linked products and the "principle of best execution".

[11] Value of ACR for 10 years 4.25 percent (in justified cases with departure 5.75 percent).

in the area of premiums, it is equally important that a competition of services also commenced between insurers, thereby creating a proper value proposition for customers. In the price-value constellation, the key issue is the tending the product type and providing service, one of the key indicators of which is the complaints statistics.

As a result of the ethical concept fully implemented from 2017, and due to the increasing number and proportion of new policies concluded under the new regime and the expiry of old policies, the life insurance complaint statistics seem to show a downward trend from 2019. Positive trends can be identified not only in the ratio of the product types to the total portfolio, but also in the actual number of products. The only exception to this is pension insurance, where the portfolio has built up dynamically in the years following the relevant regulation's entry into force, while the complaint ratios projected on the portfolio also show a positive picture owing to the ethical approach (Chart 4.2).

Chart 4.2
Number and ratio of life insurance complaints within the portfolio



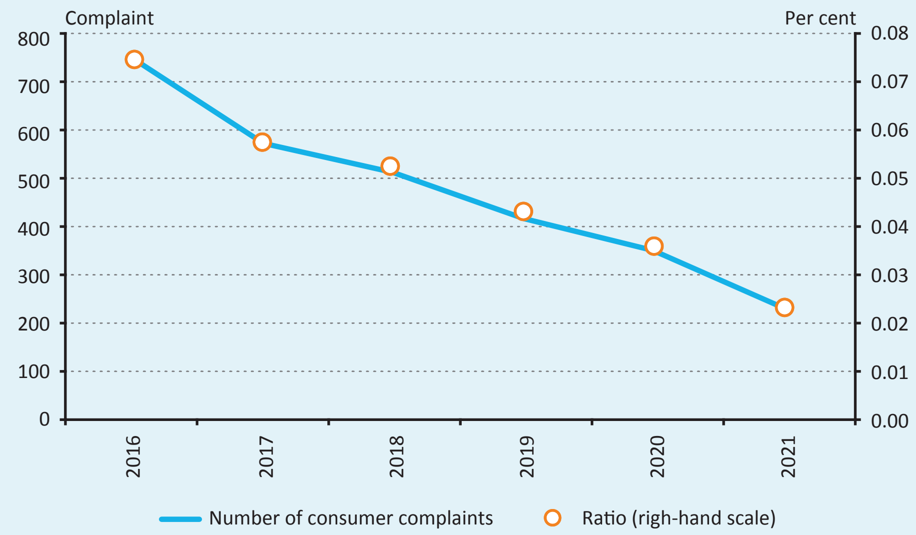
Note: Traditional and unit-linked (UL) categories net of pension insurances.
Source: MNB

Similar to life insurances – in recent years – the number of complaints in the pension fund sector is also negligible compared to the entire portfolio: in 2021, in the market, which is traditionally well regulated and tightly supervised, only 1,354 complaints were received concerning the entire fund sector.

4.1.4 Strong improvement in UL insurance complaint statistics

In view of the complexity of the products, the risks largely borne by the policyholder and the typically long duration, the MNB has paid particular attention – within life insurance – to consumer complaints regarding unit-linked saving life insurances and the implementation of the MNB's Recommendation No. 8/2016 (VI. 30.) on life insurance issued earlier in 2019. Similar to the number of complaints related to traditional life insurance – as a positive trend – the number of complaints related to unit-linked policies also follows a downward trend with improving underlying portfolio indicators, for example in terms of the savings value per policy or the average holding period (Chart 4.3).

Chart 4.3
Number of consumer complaints related to the provided information prior to concluding the contract and to the intermediaries and its ratio to the number of consumer contracts at unit-linked life insurances and unit-linked pension insurances



Source: MNB.

Complaint statistics for savings specifically optimised for pension savings are increasing in absolute terms, in sync with the recent soar in the portfolio, but not worsening on average.

4.1.5 Customer value of unit-linked products is a priority also in Europe

The issue of value for money for customers of unit-linked products has also received increasing attention at European level recently. One of the main conclusions of EIOPA's Cost and Past Performance reports is that unit-linked products are often costly and that high level of cost have a significant negative impact on the yields that customers can realise. During its market monitoring activity, EIOPA has identified the low value for money of unit-linked products as a risk affecting the European market as a whole.

The product intervention measure initiated by the Polish supervisory authority (KNF) in 2021 also highlighted the existence of consumer protection risks. Pursuant to the Regulation (EU) No 1286/2014 on PRIIPs , the main conditionof the product intervention on the Polish market is that only those unit-linked products are eligible (and can be distributed on the Polish market) that offer consumers a fair profit opportunity. EIOPA published its opinion on the KNF measure in March 2021[12], in which it acknowledged that the interests of consumers are significantly injured by the Polish unit-linked products, and that product intervention is therefore justified and necessary.

The MNB had already recognised the existence of similar consumer protection risks inherent in the Hungarian unit-linked products, which was a key factor that led to the development of the ethical life insurance concept. The main objective of the ethical regulation, which came into force in full from 1 January 2017, is to strengthen customer-centric approach and ensure the long-term sustainability of products by increasing customer confidence.

These objectives are also increasingly stressed in the European legislation. The Insurance Distribution Directive (IDD) and the related POG Regulation[13] aim to strengthen customer-centric approach in product governance processes and to

[12] Opinion of the European Insurance and Occupational Pensions Authority on the proposed product intervention measure of Komisja Nadzoru Finansowego of Poland

[13] One of the basic objectives of Directive 2016/97 on Insurance Distribution (IDD) is to ensure an identical level of customer protection across the European Union and to strengthen customer confidence. The related Delegated Regulation 2017/2358 specifies Product Oversight and Governance (POG) requirements. The aim of the Regulation is to ensure that insurers approve, distribute and monitor products in a customer-centric way and regularly review their products in this respect.

address the consumer protection risks identified at European level. However, it will take time to implement the new rules properly and, due to the principal based legislation, the supervision of the new regulations is not uniform at European level. To strengthen the common European approach, EIOPA issued a Supervisory Statement[14]in November 2021, which provides guidance to the market and to the national supervisory authorities on the main principles to be followed when implementing and supervising the POG regulation. Integration of these principles in the product governance processes can ensure the same level of customer protection across the European Union and the strengthening of customer confidence.

It can be stated that the ethical concept – as a pioneering initiative when it was first developed and introduced – has lived up to expectations: its “cleansing” effect on the market, on the portfolio as a whole, is undeniable, and it has helped to preserve the value of savings even in the cumulative negative circumstances of the past period. However, in the 5 years since its introduction, the changing yield environment, consumer expectations, market innovations and the European Union regulatory initiatives – some elements of which take the Hungarian concept as an example – call for its review, which will be a task in the coming period.

4.2 NON-LIFE INSURANCES

4.2.1 The market for Certified Consumer-Friendly Home Insurance is expanding

The introduction of the Certified Consumer-Friendly Home Insurance (MFO) in 2019 was perhaps the most spectacular and impressive initiative of the MNB’s activities in recent years aimed to strengthen overall consumer-centric attitudes and market practices. The MNB summarised its audit findings, market analyses and also performed consumer surveys. Unfavourable market practices were identified in the pricing of home insurance products and in the settlement of claims, which were mostly attributable to the low intensity of competition. Moreover, the harmful market practices resulted in excessive cost level and latent over-insurance, and ultimately low loss ratio. The MNB specified the certification criteria also considering family-friendly, green and digital aspects. The consumer-friendly home insurances will provide customers with higher quality service compared to the products presently available on the market, without unnecessary covers and surplus expenses, in easily comparable manner, guaranteeing customer-friendly service.

The MFO certification prescribed minimum requirements for the insurers, derogate from which is permitted only to the benefit of the customer. This ensures that products of higher service quality, more easily comparable by the customers come on to the market, which may be customised with additional riders, thereby facilitating the selection of the scheme that best fits the individual needs. The MFO 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 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.

2021 was once again a significant year in terms of MFO: 8 institutions have already obtained the MFO certification, and thus already a significant part of the home insurance market offers a consumer-friendly product. In addition to the market stimulation efforts of large institutions, similar intentions of other insurers and also of the MNB, are realised, while there is a qualitative improvement from a consumer perspective. These product types 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.

When the framework was elaborated, the central bank supplemented its permanent tasks with the annual review of the compliance with the application criteria by the institutions that won the certification in 2019-2020. The professional consultations, institutional and consumer feedback, and the experiences gained from IT and other improvements necessary for compliance, and the enhancement of those made it necessary to amend the institutions’ contractual terms and conditions and the re-examine of those by the MNB. The purpose of the review of the framework was to facilitate the market entry of institutions and foster the wide-ranging distribution of the product. Insurers may also offer loyalty and partner allowances with their MFO product or family discounts for those with children. Compared to the past – with

[14] Supervisory Statement On assessment of value for money of unit-linked insurance products under product oversight and governance

a view to supporting digital processes – insurers can now more easily assess customers' needs before signing a contract, in such a way that all information that they need for the proper calculation of premiums remains available. Insurers can now amend the advertised premiums and sums insured for their MFO products on a quarterly basis, instead of annually, which may stimulate the competition for consumers. Naturally, the premiums of already existing policies may only be modified once a year.

In addition to the direct sales channels of institutions, it will foster sales by brokers and multiple agents that according to the amended application criteria the web-based support system for calculating the premiums and concluding contracts must be made available to intermediaries contracted to sell MFO products free of charge.

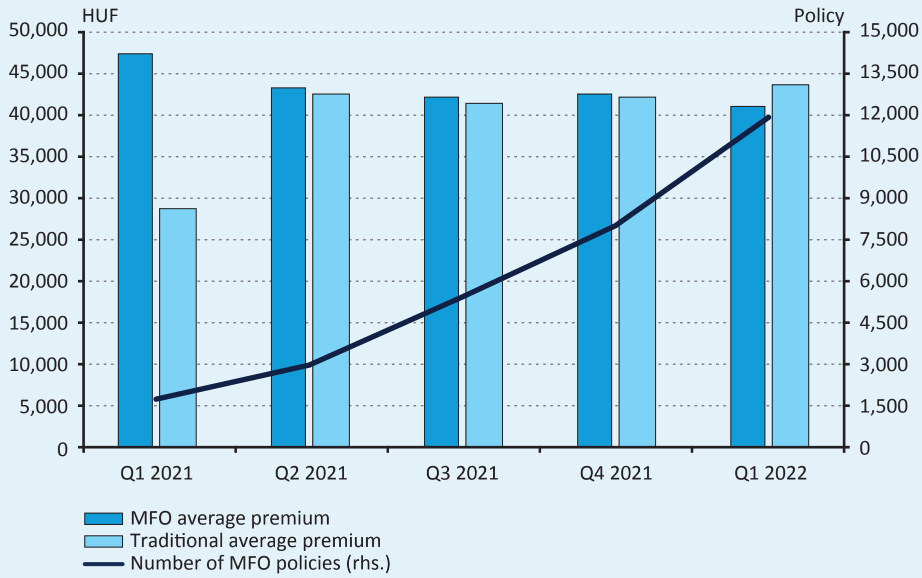
The free calculator on the MNB's website also helps consumers to review the offers and navigate between products. The comparative calculator facilitates the viewing of a table of personalised offers based on the pricing formulas provided by insurers. The platform, which was created in order to strengthen 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.

Box 4.1
The average premium of MFO products is already lower than that of traditional policies by the first quarter of 2022

The number of MFO products in the domestic insurance market increased to seven in 2021 and to eight by the first quarter of 2022.

The more than 13,000 MFO policies sold until the end of April 2022 by insurers certified as consumer-friendly insurer movable and immovable assets worth HUF 516 billion for a premium of more than HUF 0.5 billion. As a result of the emergence of MFO products and the rise in the portfolio, the average premium of these products has become increasingly competitive and in 2022 it is already lower than that of traditional home insurance products (Chart 4.4).

Chart 4.4
Development of the average premium of MFO



Source: MNB.

In order to facilitate joining the MFO certification scheme and the sale of MFO products already on the market, in February 2022, the MNB decided to modify the application criteria. Based on the feedback from market participants, the new version of the application criteria includes substantial changes to the provisions on the frequency of tariff amendments, the deadlines for compliance with requirements calling for IT developments, it simplified the need assessment process, expanded the scope of discounts available under the MFO product, and contains provisions with regard to claims settlement documents, the limitation period and the making of the web service available to intermediaries, which makes the application process easier.

For the purpose of individual calculation of competing CHHI offers and comparison of products, the MNB developed a calculator, which is available since March 2021, and in August it was expanded with an online data navigation function, i.e. after the comparison, the user can navigate from the MNB website to the website of the selected insurer and conclude the contract. Thus the digital process simplifies administration, reduces lead times and, last but not least, fosters environmental awareness. Until April 2022, the calculator had almost 30,000 visitors.

4.2.2 Group Insurances

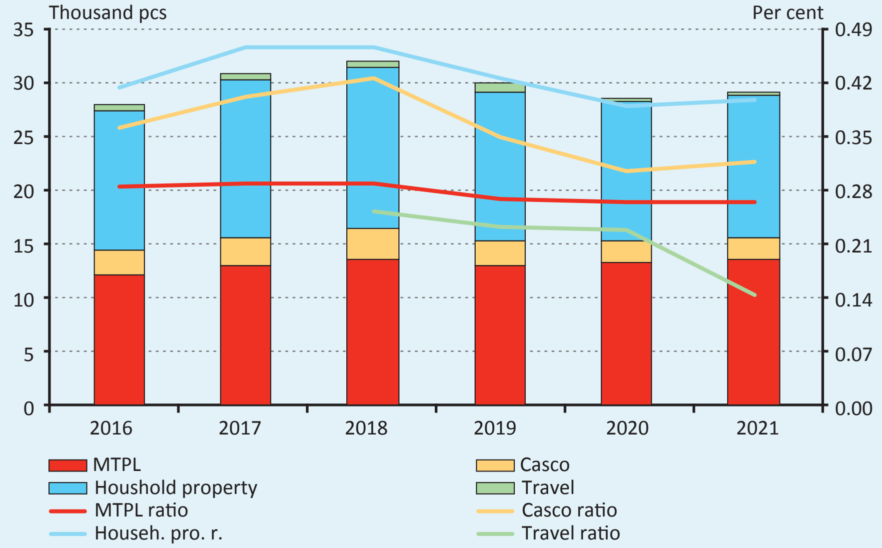
In recent years, group insurance has become a market defined by an increasing number of institutions, often pursuing cross-border activities. Although in a fluctuating manner, but again in 2021, a significant number of cases related to group insurances claims the MNB's attention. In addition to the increase in number of cases, the problem connected to group insurances sold through innovative sales channels within the framework of new types of agreements between institutions is a clearly identifiable trend. Based on notifications by consumers, the MNB investigates the activity of certain group insurance policyholders related to the recruitment of new policyholders. The respective group insurances are intensively promoted and distributed by the enterprises concluding the contract with the insurer (the core activity of which is often not in the financial area) to their customers joining the contract as insured persons and undertaking the payment of premiums and other contractual obligations. On the other hand, according to the notifications, consumers do not always receive adequate information on the contract terms and conditions or the possibilities of filing complaints related to the insurance contracts before joining. Addressing the identified problems also raises the need to review the existing requirements to provide information and the provisions on the distribution of group insurance, and to develop regulations that are aligned with innovations. At present the European Commission also deals with group insurance related issues affecting consumers, focusing on the topics of providing advance information before concluding the contract and the product distribution activities of the parties who conclude contracts with the respective insurers.

4.2.3 The number of non-life insurance complaints shows a trend decline

Similar to previous years, the inspection of MTPL and casco car insurance products – also represented in a large number of individual submissions – was stressed also in the comprehensive audits. Overall, it can be stated that, in addition to the MNB's supervisory efforts and specific administrative activities, its "soft" measures and initiatives (such as the certified product scheme, recommendations, guidelines, executive circulars) – even if those are not always legally binding – resulted in a favourable, solid decline in complaints statistics also in the non-life segment. Further strengthening of consumer-centric attitudes, encouraging consumer-friendly practices, and examining and enforcing legal compliance in relation to the provision of information and claims settlement will remain in the focus of the central bank's activities.

Between 2018 and 2021, the ratio of complaints related to compulsory motor third-party liability insurance stagnated, while the ratio of complaints related to casco car insurance per policy fell sharply due to the increased attention paid to this product type, reflected in comprehensive investigations in addition to the assessment of individual complaints (Chart 4.4). The travel insurance market shrank to large degree in 2020–21 due to the COVID-19 pandemic situation. As a result of this, the number of complaints also declined significantly. On the other hand, the enhanced attention paid to the segment by EIOPA and the MNB in recent years yielded improvements in the segment also in terms of proportion. The improvement in the statistics of household property insurances, and particularly of home insurance, is attributable – in addition to the persistent attention during the inspections – to the preparatory work and professional consultations lasting for years in connection with the MFO concept, since – as a kind of indirect positive impact – institutions tend to integrate also in other product types expectations, customer-centric approaches and equitable complaint management procedure that are specifically defined in the certified consumer-friendly framework

Chart 4.5
Number and ratio of non-life insurance complaints



Source: MNB

Box 4.2
The MNB reviews the practice of claim settlement rules, tightened in 2021, in a thematic inspection

The MNB laid down its consumer-centric approach also in its strategy. The authority wants to strengthen this both in the ex officio inspections and in the assessment of individual cases through the certified product frameworks and legislative initiatives.

Section 123/A of Act LXXXXVIII of 2014 on Insurance Business (Insurance Act) entered into force 26 June 2021, which formulates expectations with regard to the claim settlement procedures related to insurances in the non-life insurance segment, specified in Annex 1 to the Insurance Act. In connection with the introduction of the provision the need arose to clarify whether the insurance market participants are ready to comply with the relevant regulation. Formerly the Act contained no expectations with regard to the provision of information connected to claim settlement, and thus the survey and monitoring of the insurers' current practice have become a top priority in consumer protection terms.

In autumn 2021, the central bank launched a thematic inspection with the participation of the 7 largest insurance institutions, dominating the market, which – based on the incoming data – assesses at market level and also by institutions whether in connection with the non-life insurances insurers make available on their website the claim settlement documents to the injured parties, whether the content of those comply with the legal provisions and whether in connection with the claim event they comply by the deadline with their obligation to provide information during the claim settlement procedure, as stipulated in Section 123/A of the Insurance Act. With a view to complying with the statutory requirements and deadlines, institutions had to enhance their record-keeping IT systems, claim settlement procedures and, in certain cases, also their organisation.

In connection with the MTPL, which has been well regulated by statutory provisions before the new rule of the Insurance Act as well, the supervision of the operation of claim settlement procedures had been easier and more specific in the past as well. After the current amendment of the Insurance Act – in view of the fact that home insurances affect a wide range of consumers and the size of the claims and the claim settlement lead time may significantly vary – the thematic inspection focuses on the claim settlement practice related o home insurances.

In addition to the inspection, the MNB assesses the topic across the entire market as part of it ongoing oversight activity, by interviewing additional institutions. Ongoing communication with the institutions and the request for data help us obtain a comprehensive, accurate and current view of the present situation and the tasks of the near future, and facilitates sharing the MNB's expectations, clear and uniform interpretation and good practices with the market participants.

4.3 BROADENING SET OF INSTRUMENTS FOSTERING CONSUMER-CENTRIC APPROACH

In line with the principle of effectiveness, which is increasingly being examined from the consumer's perspective each year, the MNB has set the triple goals of transparency, clarity and comparability as a general value and expectation also in 2021. Adapting to rapidly and often unpredictably changing circumstances call for a high degree of flexibility, an increasingly initiative and proactive attitude, striving for prevention and continuous presence, instead of subsequent detection and sanctioning of problems. According to its measure of success, the goal is to achieve systemic, preferably market-wide, progress and improvement, ultimately through an overall increase in consumer satisfaction and confidence.

In the light of the foregoing, the central bank has reviewed, assessed and, where necessary, improved its procedures in the course of its in-depth and complex internal working group activities. It has introduced necessary methodological changes, implemented new aspects in its own internal processes, in the daily supervisory and inspection activities related to insurers and funds, and – relying on the available set of administrative instruments – also tried to influence the business processes and consumer-friendly and consumer-oriented service provider attitudes of the supervised market participants by sharing good practices, publishing recommendations and introducing certification frameworks. In addition to the foregoing, it has also taken steps to enhance consumer confidence and general financial awareness of the population through its education initiatives, transparency of supervisory activities and by promoting the transparency and comparability of financial products.

In the central bank's internal procedure the integration of consumers' requests for opening proceedings in larger investigation, including a slightly different approach to the "ne bis in idem" principle than before and together with that the investigation of the submitted petitions to a larger degree than before gain increasing importance. A key core value and approach is to provide consumers with an even more effective inspection methodology for their individual purposes (including informing consumers who make complaints as soon as possible and even more effectively about their options in the framework of the MNB's procedures and other legal remedies and options to enforce their interests). The more active use of the forms of communications other than those formally closing the inspections – order, resolution – perfectly supplementing those (e.g. management letters, consumer protection warnings, actions brought in the public interest) is a strengthening trend with increasingly wider scope. The central bank remains committed to fostering the finding of reassuring solutions for all parties through its daily activity also beyond its administrative instruments, without coercive force, by purely outlining the options.

In addition to improving internal processes, putting the values and principles set out in the strategy into practice through new approaches, and making better use of the synergies of integrated operations based on close cooperation and convergence between the prudential and consumer protection areas, the MNB also continuously develops its set of other instruments – from product development through sales to product care and service – with a positive impact on the entire product life-cycle. The regulation for ethical insurances was introduced in 2017 for life insurances, and among other things, the consumer protection measures of the MNB decree issued on the subject of the life insurance need assessment, brought major changes in the transparency of costs and in the product features, thereby exerting clearly positive impact on the affected markets. However, there are still problems that call for attention and intervention. In order to eliminate unwanted phenomena, the MNB makes efficient use of the instruments outside its role as a public authority: recommendations, certifications, public education campaigns and warnings. Its objective is to ensure that by improving the behaviour and attitudes of market participants the products and processes developed are the most appropriate for consumers.

Also in line with its intention to broaden its set of monitoring and investigation instruments – in order to assess and reconstruct information at the time of contracting and to identify risks in a preventive way based on large databases – it submitted an application in 2021 to participate in the Technical Support Instrument (TSI) Programme of the European Commission's Directorate General for Structural Reform Support (hereinafter DG Reform) in two topics:

1. Developing a Mystery shopping process, exploring possible new methodologies;

2. Development of a risk assessment framework and related methodology in the area of Conduct Supervision.

At the beginning of 2022, the European Commission sent a notice on the positive decision on the application, and its specialised DG will provide the budget for the implementation of the projects. The practical work will start in the first half of 2022 and is expected to cover a period of last 1–1.5 years. The development of these elements of the supervisory processes and instruments will be realised in a trilateral international cooperation, with the European Commission, providing the funding, EIOPA acting as technical contributor and the MNB.

4.4 STRENGTHENING CROSS-BORDER CHALLENGES

As a result of Hungary's EU membership, our financial markets are also open to institutions providing cross-border services in Hungary. According to the relevant EU legislation, institutions engaged in such activities must comply with the same legal requirements as the institutions with registered office in Hungary. However, the MNB has a limited set of instruments at its disposal for their prudential supervision. In the absence of a formal instrument, the available options include cooperation with other national supervisory authorities, the involvement of EU authorities and direct but non-coercive consultations with the institutions concerned.

The MNB is determined to apply and enforce the consumer protection rules applicable to all financial services providers operating in Hungary – regardless of their place of establishment or legal form – in a uniform and consistent manner, and to take strong action, as necessary, against non-resident insurance providers that do not operate in accordance with the requirements of the legislation, in order to protect the rights of domestic consumers.

Accordingly, the supervision and inspection of institutions rendering cross-border services was a key duty in 2021 as well, with special regard to contractual terms and conditions departing from the standard practice, investment schemes representing particularly high risk, or sensitive target groups – such as elderly and financially less aware people – in need of special protection.

4.4.1 Continued focus on consumer protection supervision of cross-border institutions

In recent years, special attention has been paid to the settlement of the effects of the United Kingdom's withdrawal from the European Union (Brexit), and to ensuring that the rights of the affected domestic consumers are not jeopardised, which still required active attention in 2021. The treaties settling the details of the withdrawal left most financial market supervision and consumer protection issues open, allocating the detailed regulation partly to bilateral agreement to be worked out later, and left some issues within the competence of the national supervisory authorities. In legal terms, it created a quite unique and unprecedented situation that as a result of the withdrawal institutions resident in the United Kingdom were legally considered as "third country" institutions, and in this context the statutory basis for their activities in Hungary ceased to exist. In this situation, the MNB has strived from the outset for a solution which, as a primary consideration, ensured that the contractual rights of domestic consumers are fully enforced, without prejudice to their interests. The MNB regularly communicates with all insurers established in the United Kingdom active in the Hungarian market in the form of rendering cross-border services, and it monitors the fulfilment of its expectations for a controlled run-off of the relevant portfolios through continuous data supply: Expectations:

- 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 existing contract immediately when the terms and conditions permit it;
- customer service and complaint handling functions in native language shall maintained throughout the duration of the contract;
- regular data supply to the MNB from the beginning of 2021.

Owing to the measures taken by the MNB, the number of affected portfolio is gradually declining, without infringing the rights of domestic consumers. The impact of the United Kingdom's exit on Hungarian consumers is limited, but the MNB will continue to pay special attention to the potential impact of Brexit on Hungarian consumers and the fulfilment of the provisions of the treaty.

In addition to the Brexit problem, the oversight of certain institutions providing cross-border services in Hungary, based in EU member states at present as well, also generates tasks for the supervisory authority. The MNB, in close cooperation with EIOPA, has been proactively monitoring the activities of a life insurer operating in a cross-border service since the very beginning of the inspection, which has been ongoing for several years, and has been actively supporting coordination and information exchange through its participation in a cooperation platform of the host countries concerned. Due to previous measures taken by the MNB, the Hungarian contract portfolio of this insurer has not increased for more than two years, but the insurer's exposure to the domestic market remains significant. The MNB continues to assess its compliance with the domestic legal framework in its operations related to Hungarian policyholders.

4.4.2 Active participation in regulatory tasks at international level, IDD and PRIIPs in practice

In the insurance market – as a result of the EU legislative process aimed at the protection of the retail investors – following the entry into force in 2018 of the EU regulation containing standard requirements for the information and distribution processes of packaged retail investment products and of the EU insurance distribution directive prescribing the creation of standard notices and the publication of the intermediaries' commission, an obligation to provide written information of defined format and content has been introduced. When developing the key information document (KID), which according to the requirements should not exceed three pages, the objective of the legislator was to enhance the transparency of the information on the products' risks, performance and costs by information provided in an easy-to-read, concise and transparent form, and facilitate better understanding and comparability of risks related to investments in packaged retail investment and insurance products (PRIIPs), thereby supporting the making of informed investment decisions.

The Commission projected the review of the delegated regulation already when it was published. The review was based on a consumer testing exercise organised by the Commission on the effectiveness of the different presentation of performance scenarios and a public consultation (CP) conducted by ESAs, the results of which were used to make a first-round proposal for the modification of the delegated regulation. The original schedule has been amended several times recently, and the report was discussed and amended by the Board of Supervisors in several rounds, with the final version adopted in January 2022. In addition, for the new regulation to move through the EU legislative process, the single support of the three specialised organisations (EBA, ESMA, and EIOPA) was required, after which the Commission will submit it to the European Parliament, and once it is supported and adopted by the European Parliament, implementation by the Member States can commence.

The purpose of the revision of the delegated regulation is to allow the application of the PRIIPs KID also to funds that have been temporarily exempted from the requirements of the PRIIPs regulation and to clarify the regulatory issues identified during the implementation of the PRIIPs KID, in particular with regard to performance scenarios.

The amendments proposed in the report concern the presentation and content of the information contained in the KID (methodology of calculations, presentation of risks, performance and costs), covering the following main topics:

- Performance scenarios: Future performance should be calculated using different methodologies for different PRIIPs. Thus the presentation of the performance scenarios would be simplified compared to the current situation, as it would be necessary to present the intermediate holding period only for PRIIPs with a recommended holding period over 10 years. In addition, the stress scenario would only remain in place for PRIIPs where it exceeds the volume of possible payouts.

- Past performance: The presentation of past performance in the KID is still supported under the methodology used in the UCITS KIID (annual volatility) for all PRIIPs; however for PRIIPs with a long holding period this methodology would not be appropriate. By presenting past performance in KID, the 3-page limit (Level 1 regulation) should be modified.

- Cost indicator: The presentation of costs in two tables would remain in place. Table 1 would show only the total costs in currency and (annualised) percentage form. Table 2 would provide a breakdown by cost type, with an explanation of each type of cost. Table 2 for insurance-based investment products would continue to include the RIy at the end of the recommended holding period, while for other PRIIPs the cost would be reflected as an annual average percentage of the investment in line with MiFID II. As the RIy does not comply with the cost indicator expected by MiFID II, several changes in the calculation were necessary to ensure consistency.

- Transaction costs: The calculation methodology would be simplified, taking into account the principle of proportionality:

For PRIIPs offering multiple underlying investment options, the amendment would require the cost of the underlying product and the underlying options to be presented separately. The MNB monitored in 2021 as well with special care compliance with the provisions of IDD and the PRIIPs regulation, both in the assessment of individual petitions related to contracts concluded under the new regime and in the comprehensive inspections. During the inspections the MNB found that the KIDs still exceeded the volume limits in some cases, particularly in the case of those insurance products that offer several underlying investment opportunities, thus making overview and comparability difficult. It is also a recurring problem that the applied wording is not properly structured and is written using difficult to understand legal terms. It is still the case that the KID is handed over right before signing the proposal, which – in the MNB's opinion – does not qualify as "in good time". Nevertheless, there are improving trends and a homogenisation at market level, which is proactively reinforced by the MNB through its findings on the documents examined in the specific inspection and by sharing good practices.

4.4.3 The MNB's activity in European Union's joint consumer protection working groups

Work carried out in an international cooperation is becoming increasingly important also in the MNB's consumer protection activity. The insurance consumer protection area provided wide-ranging and proactive expert support for several projects of EIOPA in a number of working groups during 2021 as well.

Similar to the special importance attached to the supervision of cross-border institutions and the definition of their specific operational framework within the domestic supervisory tasks and topics, recently the Cross Border Notification (CBN) Project also received special attention from EIOPA, where significant progress has been made in the development of consumer protection notifications and their practical use between the peer supervisory authorities. EIOPA's Cross-border Notification (CBN) project was launched in July 2020 with the aim of a complete reform of supervisory cooperation, notifications and authorisation procedures. The new rules are applied since July 2021. Meanwhile, the second phase of the project was launched in the summer of 2021, with the aim of developing a common IT platform, managed by EIOPA with the support and involvement of the ITDC. In connection with this, the internal project of the MNB, underlying Hungary's international involvement, was launched in August 2021, for the purposes of assessing and developing further tasks and possible internal developments, with the involvement of several functional areas.

In the Committee on Consumer Protection and Financial Innovation (CCPFI), in addition to the 5 scheduled meetings, a number of extraordinary meetings were held, of which the ones organised due to the Committee's Call for Advice on Retail Investor Protection and for the assessment of the current COVID-19 situation deserve special mention. In addition, a number of permanent topics were discussed outside the meetings throughout the year in the form of ongoing online consultations and information exchanges, such as the annual Consumer Trend Report, the Cost and Past Performance analyses, and thematic reviews.

During 2021, the central bank's insurance and money market consumer protection experts participated in the work of the PRIIPS SubGroup (in addition to the annual meetings, several extraordinary meetings were held in response to the Commission's Call for Advice on Retail Investor Protection), actively contributed to the Project Group on Supervisory Handbook (with a focus on the PRIIPs Key Information Documents and other mandatory disclosures) and to the IAIS Peer Review (ICP 19 - Conduct of Business) project, ended in spring 2021. The NOVIS Platform met continuously with their participation, and a Mystery Shopping Workshop – also linked to our DG reform application – was held in autumn 2021.

In addition to the active participation in the working groups, the tasks of the international cooperation also included the completion of several questionnaires, including the Product Oversight Governance Peer Review, the questionnaire on occupational pension institutions, the IAIS - "Market Conduct Survey on Use of Key Indicators to Assess Conduct of Insurers", the European Commission's (COM) Call for Advice on Digital Finance, a larger scale survey on the review of the "Distance Marketing Directive" and a request directly from the EU Commission's Directorate General Justice and Consumers to contribute to a study in support of the review of Directive 2002/65/EC concerning the distance marketing of consumer financial services (DMFSD).

Our EU activities also include reviewing alerts, notifications and comments received in the framework of the Internal Market Information (IMI) Consumer Protection Cooperation, preparing summaries and necessary consultations.

4.4.4 Participation in international cooperation outside the European Union

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 2021, we were also actively involved in the development of IAIS Issue Papers and other surveys (e.g. ICP9 - enforcement questionnaire).

In 2021, the MNB also participated in the OECD survey on the implementation and transposition of the 2012 Recommendation on High-Level Principles on Financial Consumer Protection and the identification of new needs, taking into consideration that since the adoption of the Recommendation ten years ago, the size and nature of the consumer financial services market have grown and changed significantly, new types of financial products, services and distribution channels have emerged, and global trends have affected financial consumers. A report on the results of the survey was prepared and the recommendation was amended on the basis of the responses and feedback, where the general approaches –overarching principles – and also the principle were supplemented with 3 new approaches

• impact, opportunities and risks of digitalisation;

• impact of sustainable financing;

• financial well-being of consumers and 2 new principles

• accessible and inclusive financial system;

• high-quality financial products.

5 Intermediaries and their risks[15]

5.1 SIGNIFICANT INCOME GROWTH IN THE INSURANCE INTERMEDIARY MARKET

The fall in the number of licensed insurance intermediaries, lasting since 2019, continued in 2021, albeit at a slower pace. (Table 5.1). The decline may be partly attributable to the fact that it remains difficult for smaller actors to comply on a continuous basis with the high level of legal and professional requirements, prescribed as a prerequisite for their operation. By contrast, commission income on the sale of insurance and indirect revenues in both the life and non-life segment increased. Intermediaries' revenues rose by 10.7 percent compared to 2020.

Table 5.1
Key data of insurance intermediaries

	Insurance intermediary	
	2020	2021
Number of institutions (pcs)*	410	**398**
Broker	*369*	*358*
Multiple agent	*41*	*40*
Number of natural persons (persons)	13,362	**12,385**
Amount of commission income or indirect remuneration (HUF billion)	93.7	**103.7**

** 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 Growth in almost all sales categories

In 2021 there is already no trace of the mixed picture seen in 2020 in terms of the fees and number of mediated products and revenues. Only two sub-categories show a minimal decrease, while all other categories, including the main categories, registered growth of variable intensity, in some cases even a dynamic increase (Table 5.2). The highest growth in mediated premiums is observed in travel insurance, where due to the low base effect the amount of mediated premiums rose by 98.2 percent year-on-year, while the number mediated policies increased only by 12.9 percent. This shows that average premiums increased significantly, which may reflect rising premiums due to increasing travel risks. Unit-linked life insurance was the other sub-category with significant growth, where under a 33.7 percent increase in mediated premiums, intermediaries' revenues relate to this category increased significantly, but at a much lower rate than premiums, by only 22.5 percent, which implies that the growth was in products applying incentives below the premium/commission cap.

[15] 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. In all other cases, it is named specifically.

Table 5.2
Sales data of insurance intermediaries

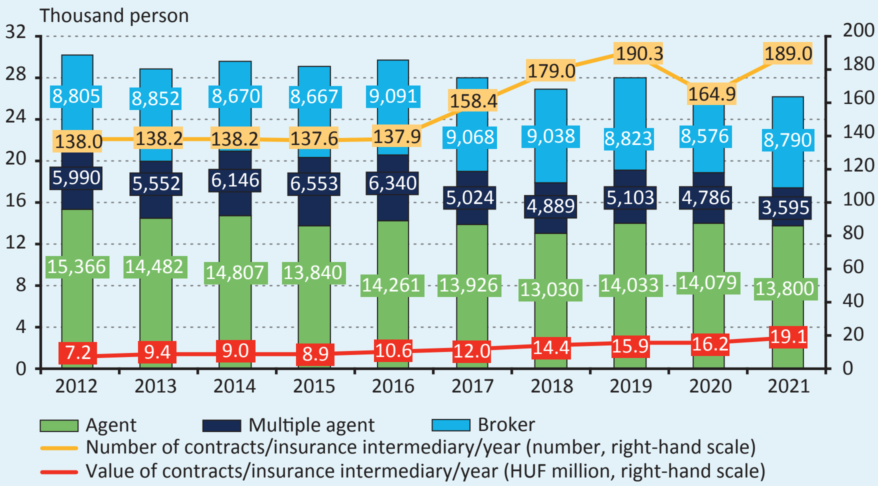
	Value of contracts HUF billions		Number of contracts pcs		Commission income HUF billions	
	2020	2021	2020	2021	2020	2021
Non-life segment	176.0	**183.1**	2,071,296	**2,208,059**	71.5	**76.4**
Compulsory motor third-party liability insurance	96.2	97.2	1,457,817	1,492,552		
Home insurance	4.9	5.6	109,926	120,272		
Casco motor liability insurance	29.5	33.7	196,926	203,833		
Corporate and institutional property insurance	28.2	29.5	53,627	53,990		
Travel insurance	1.6	3.1	147,184	166,193		
Other, non-life insurances	15.6	14.0	105,816	171,219		
Life segment	40.7	**53.1**	127,441	**132,640**	22.2	**27.2**
Traditional life insurance	4.0	4.3	69,771	69,217		
Unit-linked life insurance	35.5	47.4	55.628	60.813		
Other life insurance	1.2	1.4	2.042	2.610		

Source: MNB

5.1.2 Number of multiple agents fell by one-quarter

After a stagnation in the number of natural persons acting as intermediaries for brokers and multiple agents in 2018–19 and a 4 percent decrease in 2020, the number of intermediaries fell by 7.3 percent by the end of 2021 (Chart 5.1). The decline is attributable to the significant, 24.9 percent, fall in the number of multiple agents, which is only partly explained by a major player's becoming a tied agent. While the per capita mediated premiums rose significantly, by 17.6 percent, the efficiency of those continuing to act as intermediary also increased, which may have been caused by the departure of those, partly inactive, persons who were less able to adapt to the recently often changing circumstances. Insurers' tied agent networks also have a large share in the sales mix. The number of persons acting as tied agents seems to have stabilised over the last three years, but it should be noted that the headcount numbers in the table do not include potential duplications, and thus in some cases an intermediary selling non-competing products of several insurers may appear only as one person in the table below.

Chart 5.1
Number of natural person insurance intermediaries

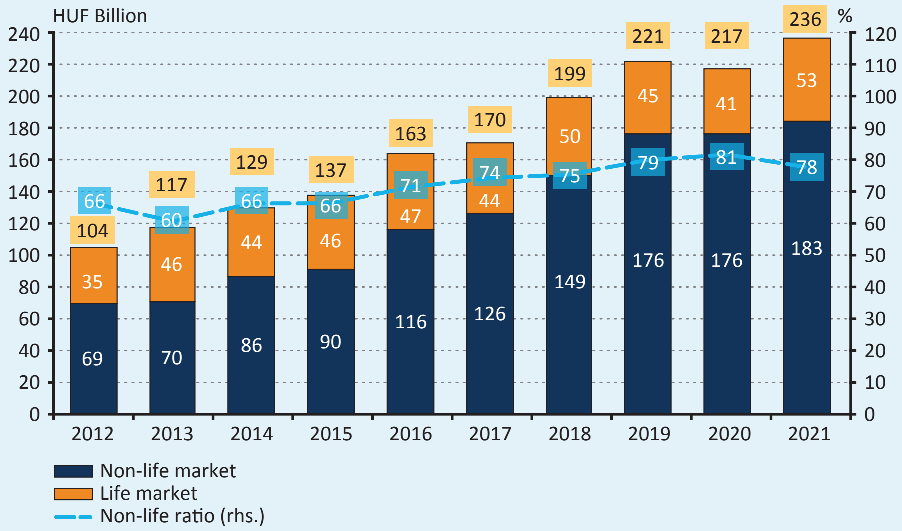


Source: MNB

5.1.3 The 9 percent growth was driven by the life segment

The decade-long upward trend in mediated premiums supported by continued growth in mediated non-life premiums, halted in 2020. Those did not even fall in 2020, during the pandemic, and increased by a further 4.0 percent in 2021, despite the fact that the number of new cars put into service – which limited the scope for growth in motor insurance, representing the largest item – fell minimally. The 9.4 percent growth in the number of home insurance policies and 15.4 percent growth in premiums is remarkable, which resulted mainly from the increasing number of mediated retail mortgage loans and intermediaries' diversification efforts, and partly from the renewed home insurance offer including the Certified Consumer-Friendly Home Insurance (Chart 5.2). Corporate insurance grew by around 4.6 percent, despite the fact that the number of policies increased only marginally. The latter may already show a rise in premiums to reflect the increasing price of buildings and materials, which may continue in 2022, reinforced by the fact that the appetite for insurance may increase due to the rising potential claim amounts resulting from the higher costs. 2021 brought a turnaround in mediated life insurance premiums, which increased by 30.7 percent after a decline in the previous 3 years. The growth is driven by a rise in insurance-based investments. From the previous data, it may have been anticipated that the previous steady increase in the share of non-life premiums would decline, as it did from 81.2 percent registered in 2020 to 78.5 percent by the end of 2021. The fact that travel insurance started to recover after 2 years did not change this significantly.

Chart 5.2
Development of insurance premiums mediated by brokers and multiple agents



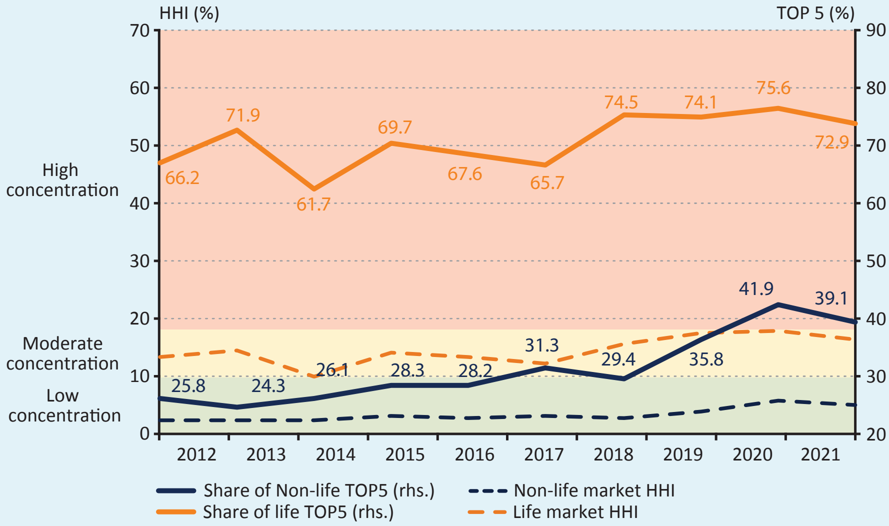
Note: The data shown in the chart contain the insurance premium of the contracts mediated in the reporting year (new acquisition). (Accordingly, it does not include the insurance premiums of contracts contained in the pre (closing) portfolio.)
Source: MNB

5.1.4 TOP 5 below market expansion level

For the first time in recent years, market concentration calculated on the basis of mediated gross written premium and portfolio premium declined in both the life and non-life segments (Chart 5.3). In the life segment, the Herfindahl-Hirschman Index (HHI) fell to 16.1 percent, close to the level seen 3 years ago, but it is still in the moderate range. In parallel with this, the market share of the TOP5 intermediaries also fell to 72.9 percent, since their growth failed to exceed the average market growth rate.

In the non-life segment, both concentration indicators declined. The HHI index, which showed low concentration before as well, declined further to 4.7 percent and the TOP5's share fell for the first time since 2018, albeit not significantly, to 39.1 percent in 2021. Thus the growth of the market leaders in the non-life segment also lagged behind the average market growth.

Chart 5.3
Share and Herfindahl-Hirschman index of the TOP 5 independent insurance intermediaries based on gross written premium and regular premium, by segments

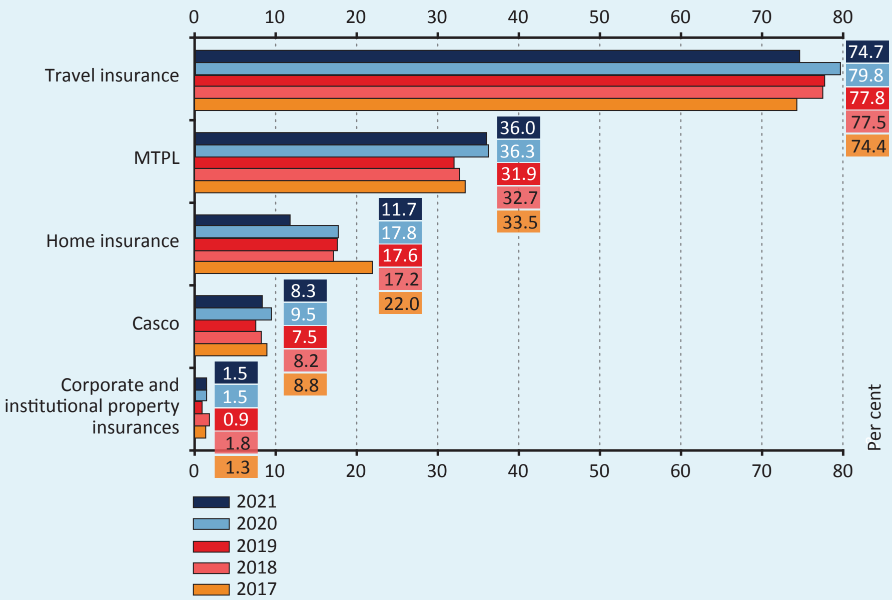


Note: The colour of the background illustrates the strength of concentration under HHI.
Source: MNB

5.1.5 Electronic sales declined in all categories

Earlier expectations that previously planned but postponed improvements due to the pandemic and lockdowns could be realised during this period, and that new digital developments and simplified procedures could boost purely electronic (unmanned) sales in all business segments, have not materialised in the short term. Current figures show that in terms of purely electronic sales 2021 was a step back, as even travel insurances – traditionally mediated mostly online – registered a significant decline, essentially falling back to the level seen in 2017 (Chart 5.4). The most spectacular decline in this respect was observed in home insurances, performing over the average in total intermediation, where the 11.7 percent ratio of policies sold electronically, is just over half the 2017 figure.

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



Source: MNB

5.2 SIGNIFICANT INCOME GROWTH ALSO AT FINANCIAL MARKET INTERMEDIARIES

In the case of financial market intermediaries, the decline in the number of institutions continued. Intermediaries of lower capitalisation level and those without a strong vision for the financial market decided to surrender their licence due to market volatility, difficulties and negative outlook. On the other hand, there was a tangible increase in the number of natural persons, as enterprises had to meet the labour needs of the market, picked up through subsidised loans, and the resulting above-average administrative burden of mortgage lending. However, the increased burden was also clearly reflected on the other side, with revenues of independent financial market intermediaries increasing by 36.0 percent (Table 5.3).

Table 5.3
Key data of independent financial market intermediaries

	Financial market intermediaries	
	2020	2021
Number of institutions (pcs)*	499	**488**
Broker	*12*	*15*
Multiple agent	*344*	*333*
Multiple special intermediary	*6*	*5*
Hire purchase intermediary	*137*	*135*
Number of natural persons (persons)	11 965	**12 459**
Commission income (HUF billions)	16,1	**21,9**

**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

5.2.1 30.6 percent of mediated retail loans are subsidised

In all main product categories except for financial lease, both the number and the amount of mediated loans increased significantly. The amount of mediated retail loans increased by 34.9 percent, which is attributable to an outstanding, 43.0 percent, increase in mortgage loans and an above-average, 38.6 percent, rise in personal loans (Table 5.4). From 2021, data on mediated loans with state interest rate subsidies are also available, according to which the ratio of subsidised loans is only 17.0 percent in mortgage loans, while the ratio of interest subsidised personal loans is 81.8 percent, indicating that the significant growth and dynamics in personal loans are driven by unsecured prenatal baby support loans.

Table 5.4
Sales data of independent financial market intermediaries

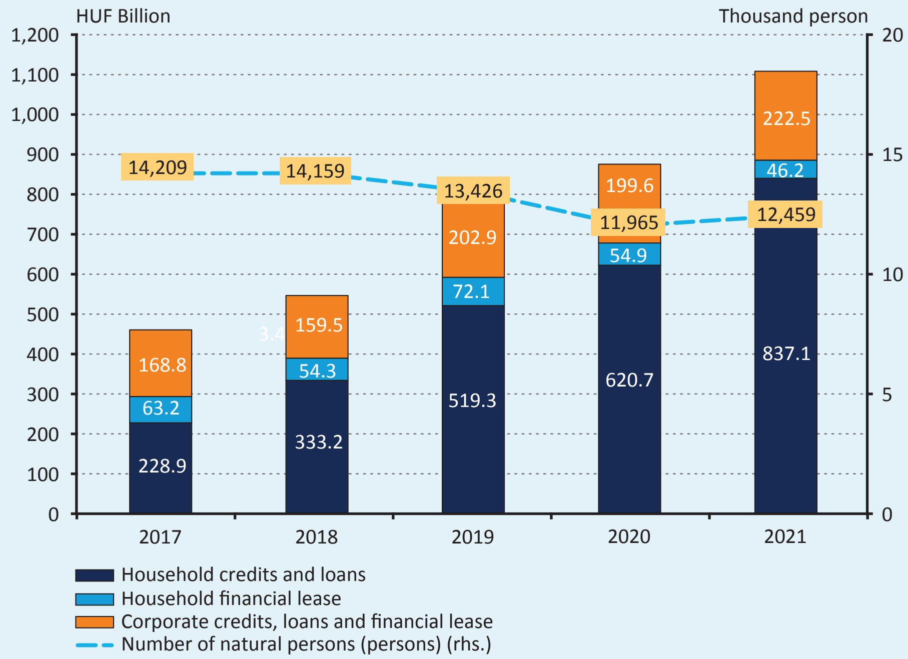
	Value of contracts HUF billions		Number of contracts pcs		Commission income HUF billions	
	2020	2021	2020	2021	2020	2021
Corporate credits, loans and financial lease	199.6	**222.5**	18,010	**21,073**	2.4	**3.2**
Total household credits and loans	620.7	**837.1**	126,863	**155,054**	10.9	**15.2**
of this: Mortgage	*425.5*	608.6	*36,008*	45,001	*7.6*	10.8
Motor vehicle	*0.2*	0.0	*77*	58	*0.0*	0.0
Personal loans	*124.3*	172.2	*18,068*	*24,542*	*1.7*	2.3
Credit card	*0.5*	11.5	*606*	3,522	*0.0*	0.0
Other	*70.3*	44.8	*72,104*	81,931	*1.7*	2.1
Total household financial lease	54.9	**46.2**	15,413	**12,172**	1.3	**1.3 –**
of this: Real property	*5.8*	6.3	*369*	408	*0.1*	0.1
Motor vehicle	*49.1*	*39.8*	*14,916*	*11,680*	*1.2*	1.2
Other	*0.1*	0.1	*128*	84	*0.0*	0.0

Source: MNB

5.2.2 Headcount and efficiency

The steady decline in the number of natural person independent intermediaries for 4 years stopped in 2021, even registering a 4.1 percent growth, which may be attributable to the already mentioned higher administrative burden related to the increased client needs (Chart 5.5). In addition to the increase in the headcount, the efficiency of intermediation has also clearly increased, as the amount of loans per salesman increased by 21.3 percent, while the average amount of loans per contract increased only by 7.6 percent. Accordingly, the difference between the two figures indicates an increase in efficiency.

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



Source: MNB

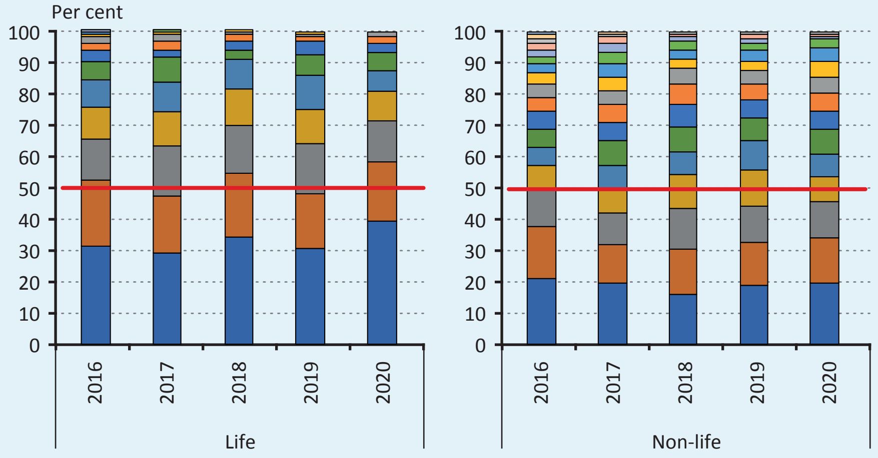
5.3 CONSUMER PROTECTION RISKS

5.3.1 Brokers prefer a few insurers, and even fewer of them are preferred by multiple agents

The imprudent practice, which led to the consumer protection risk[16] presented last year affecting the insurance intermediary market, according to which it may represent an operation contrary to the activity licence in the case of independent insurance brokers acting on behalf of customers, if they offer an insurance product by significantly narrowing the market supply, is obvious also when projected on sales. Although the distribution of non-life insurance contracts sold by intermediaries among insurers is more favourable than in the life segment, based on the trends in recent years, the proportion of insurance contracts in mediated by brokers, in full compliance with the rules of the insurance profession, may imply that insurers appear in the portfolio of brokers not necessarily in accordance with their market share (Chart 5.6). This phenomenon is much more spectacular in the life segment.

[16] Magyar Nemzeti Bank – Report on insurance, funds, capital market risks and consumer protection, 2021., Section 5.3

Chart 5.6
Concentration of sales by brokers by insurer



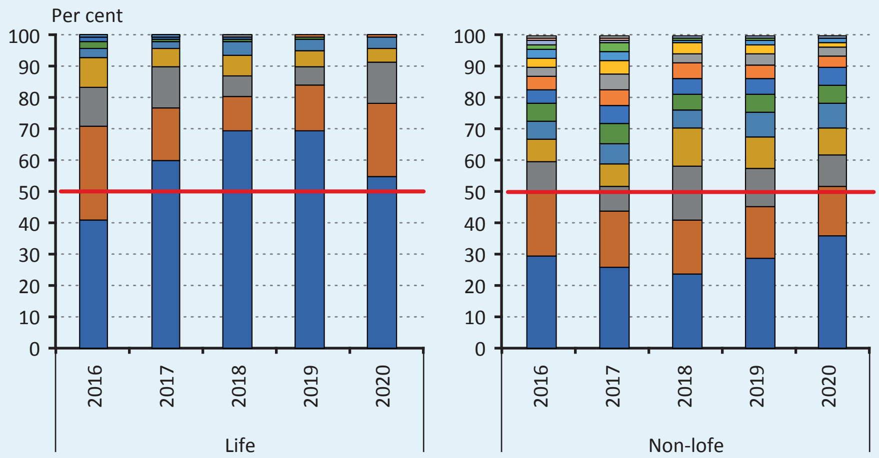
Source: MNB

In the case of multiple agent insurance intermediaries, sales are even more concentrated (Chart 5.7). In the life segment, it is clear that in each year under review, except 2016, more than half of the mediated policies mostly augmented the portfolio of a specific insurer. However, the distribution is qualified by the different legal requirements applicable to tied multiple agent insurance intermediaries, pursuant to which they act in the interest of the insurers commissioning them, offering a sufficient number of competing products to their customers. Partly for this reason, in the case of sale by multiple agents customers meet a more limited offer compared to sales by a broker.

Despite the different form of operation, the figures show that the sales activity of multiple agents also differs significantly at the market level and in comparison with that by brokers, especially in the life segment, where their activity is very similar to that of agents.

The MNB has carried out a number of inspections concerning the operation of intermediaries contrary to their licence, which poses a significant consumer protection risk, since the lack of a sufficient number of offers may prejudice customers' needs and interests. In the case of all detected infringements, the MNB imposed sanctions to ensure the termination of the infringing situation and restore statutory operation.

Chart 5.7
Concentration of sales by multiple agents by insurer



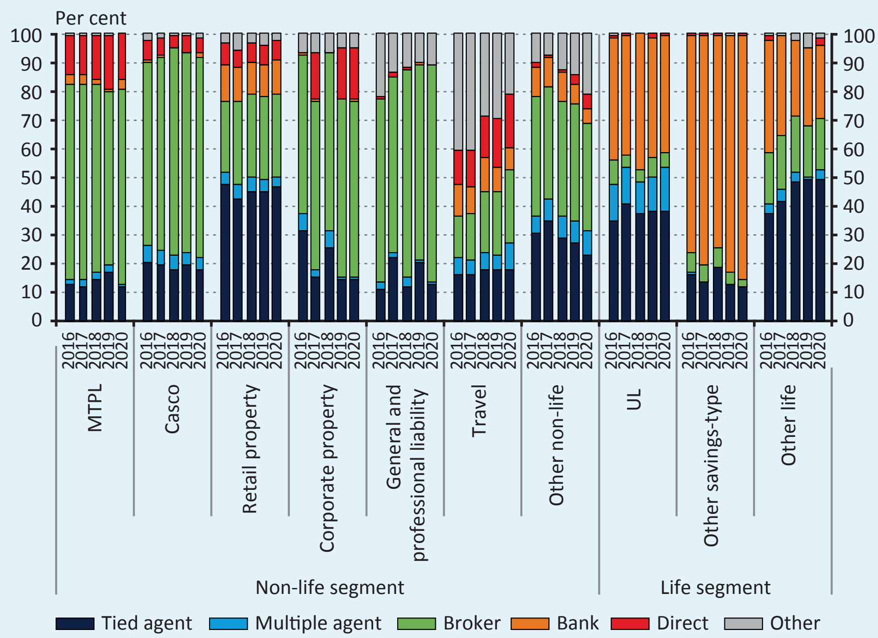
Source: MNB

5.3.2 Low sales by brokers in the life segment

The distribution of sales channels by main product categories also clearly demonstrates the dominant role of intermediaries in the insurance market. The non-life segment, in particular the motor and professional liability insurances, has been dominated by brokers for many years. However, the network of tied agents is also significant in this segment, through which the vast majority of retail and corporate property insurance is sold. In the life segment, it is mostly the unit-linked and other life insurance products where sales by tied agents is strong. The latter is dominated by the banking channel. Accordingly, the trend whereby brokers are more active in the non-life segment and multiple agents in the life segment remains dominant, leaving the sales potential inherent in other segments unexploited.

In view of the foregoing, the insurance intermediary market remains an essential part of the insurance sector, but due to this crucial role, and in particular the risks inherent in customer relationships, the MNB will continue to pay special attention to the prudent functioning of market participants and to the mitigation of their consumer protection risks.

Chart 5.8
Insurance channel mix by main product categories



Source: MNB

5.3.3 Certified Consumer-Friendly Home Insurance - Intermediary activity: there is still room

Certified Consumer-Friendly Home Insurance (MFO) sets minimum benefit payment standards that are in the best interest of the customer, which can only be deviated from to the benefit of the customer, and ensures that customers receive a higher benefit for a given premium by balancing premium and benefit payment.

In view of the fact that the express and primary objective of MFO is to give priority to consumers' interests and needs, by analysing and taking into consideration the home insurance products available on the market and incorporating the MNB's prudential and consumer protection experience in the insurance market, insurance intermediaries are expected to include in their product range as many MFO products as possible and to present them to customers when making an offer.

MFO is available on the home insurance market since March 2020. In compliance with their legal obligations, intermediaries selling home insurance had to be prepared for the mediation of these products, including appropriate product trainings. However, the marketability of the product also depended on compliance with the technical baseline requirements.

By spring 2022, all technical and other obstacles to the sale of MFO products through intermediaries have been removed, and thus the MNB collected information through extraordinary data supply on the activity of intermediaries active in the sale of home insurances, covering a significant part of the market, on their MFO sales activity.

The data clearly show that there is still significant room for the mediation of MFO products, as although the sales figures for the 6 months preceding the data request show a moderate upward trend, nearly 95 percent of the mediated home insurance policies are still uncertified products.

The MNB is committed to the consumer protection benefits of MFO and will continue to use all available means to investigate and monitor whether intermediaries are providing information to potential customers in the home insurance market on the opportunities and consumer protection benefits offered by MFO, with the due diligence expected of them.

5.3.4 Managing incompatibility and conflict of interest situations

In 2021, the MNB conducted two thematic inspections on conflicts of interest concerning insurance brokers and multiple agents. The inspections focused on compliance with the EU Regulation on conflict of interest and incentives for insurance-based investment products (IBIP) under the EU Insurance Distribution Directive (IDD) and on the verification of measures taken by brokers to prevent conflict of interest situations arising from their remuneration. Both the inspection and the supervisory experiences show that the measures taken by the market to comply with the legislation vary widely. In this context, an important element of regulatory compliance is individualisation, i.e. that each market participant should define potential conflict of interest situations and the measures to be applied in relation to its own operations, also according to its size. Accordingly, the method of framing regulations by transposing the provisions of the law word for word – without the aforementioned individualisation – into the internal regulation of the respective intermediary should be expressly avoided. Compliance with the law is also supported by the justification of the findings of the comprehensive analysis to be performed with regard to incentives, the identification of potential conflicts of interest inherent in the incentive scheme supporting insurance sales and the identification of meaningful, proportionate and practical measures to address them, in particular to prevent the respective situation. It is important and critical to examine the remuneration by product in order to identify the extent to which the natural person who mediated the product may have been influenced by the level of remuneration for the sale when recommending the product. The assessment of remuneration and incentives should be carried out comprehensively for all products, as the legislation does not differentiate the fulfilment of obligations on a quantitative basis. Accordingly, examining the impact of incentives only on the sales top-selling products may give a false picture, as a conflict of interest may arise not only if the salesman gives preference to the highest remunerated product over the customer's interest, but also if marginalises the product less supported by incentives, which product or group of products (and the potential conflict of interest situation) is thus not covered by the analysis. It may also show a similar and unrealistic picture, if the potential outlier is determined compared to the average of the incentive rates. The thematic inspections also drew attention in the case of brokers to the use of terminology in the context of remuneration, including the misuse of the term "commission". The MNB expects all market participants to apply the terminology used in the legislation accurately at all times, as specified for their activities.

5.3.5 Risks of intermediaries

According to data at the end of 2021, there are 886 institutions supervised by the MNB and subject to an independent licence, including 398 insurance intermediaries and 488 financial market intermediaries. The summary table below shows the classification of intermediary-specific risks by risk category defined by the MNB.

Risk category	Risk groups	Risk rating	Risk prospects	Evaluation in words
Business model viability	Environment Strategy	●	➡	As regards the legal and regulatory environment, the amendment of the itemised small business tax (KATA) entered into force on 1 January 2021, under which an individual can only be registered as a small taxpayer in relation to a single legal relationship. In addition, from 10 March 2021, the provisions of the new EU Regulation on Sustainable Finance Disclosures (SFDR) must be applied in Hungary as well. The impact of the performance of the world's major economies also plays a role in the analysis of environmental factors.
Corporate governance risks	Owner's control Internal governance Conflicts of interest Compliance	●	➡	Based on the experiences gained from the inspection and the complaints received, several intermediaries are suspected to provide customers with an insufficient number of offers. In addition to the inspections, the MNB deemed it necessary to clarify the issue of the revenue anomaly in a prudential meeting at several institutions. No major change occurred in the ownership structure in 2021. The focus of the thematic inspection conducted in 2021 was on conflict of interest and incompatibility – compliance with the IDD – and based on the findings of the inspection, the MNB plans to issue market guidelines in the second half of 2022.
Financial and operational risks	Material conditions Registration requirements Qualification requirements Registers Trainings, courses	●	➡	Failure to comply with the mandatory training and refresher courses, and the documentation of those is an ongoing shortcoming both in the financial market and insurance intermediary areas. These shortcomings were also confirmed by the experiences gained during the inspections conducted in 2021. Intermediaries with high commission income, and through that with high market share, accounting for significant part of market commission income, submitted their regular semi-annual and annual data supplies on time, but several intermediaries with a smaller market share have missed the reporting deadlines.
Market entry risk	Service delivery Marketing, customer acquisition Complaints management	●	➡	The MNB continuously monitors the market presence of intermediaries and their marketing activities. Based on the data provided by intermediaries, in 2021 intermediaries received 1,972 customer complaints in total, which is an increase compared to the previous six months, but still negligible compared to the millions of products mediated. 573 complaints were classified by intermediaries as substantiated customer complaints. The handling of complaints is generally adequate, but the MNB inspections usually reveal weaknesses of minor risk in this area as well.
Partner (product owner) risks	Portfolio quality risk Dependency risk	●	➡	In terms of portfolio quality and dependency risk, the MNB has not identified any significant market-wide problems in 2021, similar to previous years.

Note:

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

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

6.1 MARKET PRESENCE

The analysis of non-banking group financial enterprises, i.e. financial enterprises not subject to consolidated supervision, is based on unaudited data for the end of 2021. We used preliminary data for 2021 for the analysis[17]. For the purpose of the analysis, with a view to eliminating the distorting effect, the MNB ignored the data of two financial enterprises – with the exception of total stock data and number of financial enterprises – pursuing special activity, not related to the usual course of business of financial enterprises.

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

	2017	2018	2019	2020	2021
Balance sheet total of financial enterprises not belonging to a banking group (HUF billions)	1,108	1,163	1,505	1,581	1,748
Number of financial enterprises not belonging to a banking group	219	223	223	225	227

Note: The table shows the current data of the financial enterprises that submitted data supply to the MNB in the respective period
Source: MNB

In the year under review, 4 non-banking group financial enterprises started their operations and 4 financial enterprises ceased their activities, of which one institution surrendered its licence based on its owner's decision and in the case of three institutions the MNB initiated the withdrawal of their licence and dissolution (due to non-compliance with the licensing conditions or insufficient capital).

Due to the changes in the legislative changes related to regulatory capital requirements for financial enterprises, the MNB continues to monitor closely the changes in the equity of financial enterprises already operating or being under authorisation on 31 December 2019. According to the legislative requirements institutions holding an activity licence for granting credits and loans must have a minimum equity capital of HUF 100 million in the first step, while institutions without a licence for granting credits and loans must have a minimum equity capital of HUF 75 million by 31 December 2023[18]. Almost 70 percent of non-banking group financial enterprises holding a licence on 31 December 2021 already satisfied the increased capital level. As regards the remaining institutions, setting out from profitability data of previous years, the number of financial enterprises not subject to consolidated supervision that will not be able to meet the first-stage capital increase from their own resources without capital injection by the owner is expected to be around 50. The MNB expects that over the next two years the activity licence and the licence for granting credits and loans will be returned by certain financial enterprises the owners of which are undercapitalised, or alternatively, new well capitalised owners may appear on the scene.

[17] It also gives rise to a difference compared to the 2021 report is that in 2021, audited data for 31 December 2020 were not available, while this report now includes audited data for 2020.

[18] In the second step, by 31 December 2026, institutions with a licence to grant credits and loans must have a minimum equity of HUF 150 million, while institutions without such licence must have a minimum equity of HUF 100 million.

The sector continues to show the same concentration ratio as in previous periods, in terms of activities, profitability and refinancing. In the sector, clearly those institutions are able to pursue profitable financial services activities that have been present in the market for several years, and thereby having a client base of sufficient size and supported by well capitalised owners.

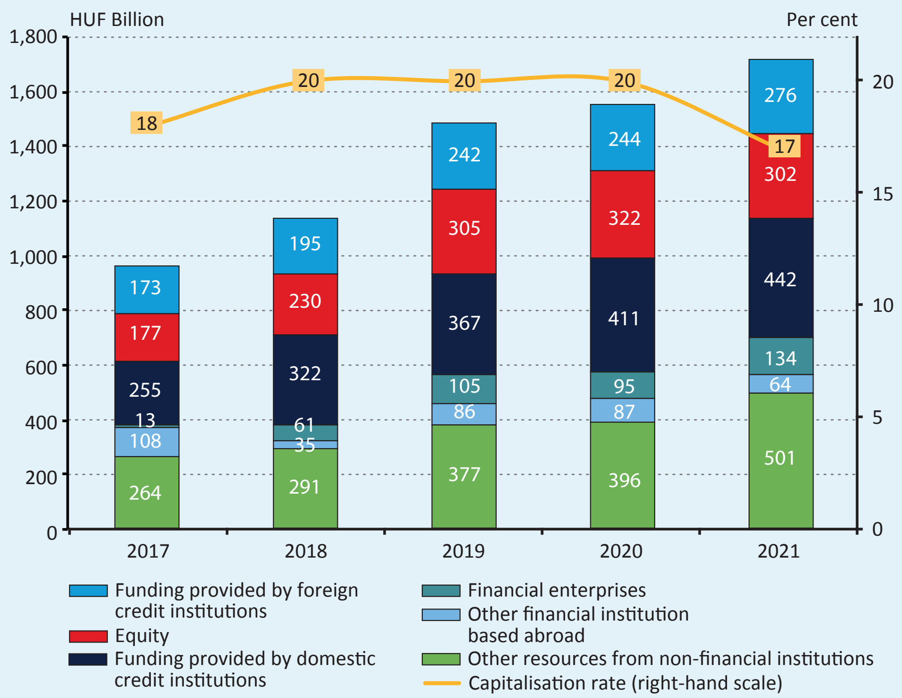
6.2 UNDER A MINOR DECLINE IN EQUITY, ALL REFINANCING ELEMENTS GREW

In 2021, the growth in external funding for the operation of the sector continued, which was reflected by a rise in domestic and foreign credit institution funding and other resources. The ability to raise external funding shows that investing in financial enterprises remains attractive.

A significant and growing share of the growth in domestic credit institution financing is represented by the increase in the funding provided by MFB Hungarian Development Bank Zrt., which is reflected both in the number of financial enterprises financed and in the increase in the amount of refinancing provided for operations. In addition to the increase in external refinancing, the stable operation and growth of the sector is also supported by the increase in financing provided by owners and related companies, which was the highest in 2021 in the 5 years under review.

The decrease in the equity of the sector is mainly attributable to 6 financial enterprises. Equity of these institutions decreased by roughly one billion forints compared to 2020, mostly due to dividend payments charged to the retained earnings accumulated as a result of the successful operation of previous years. The MNB identified no risks to be highlighted in relation to the payments, as the equity of these institutions exceeds several times the level of increased initial capital prescribed for 31 December 2026.

Chart 6.1
Developments in the liability structure of financial enterprises not belonging to a banking group



Source: MNB

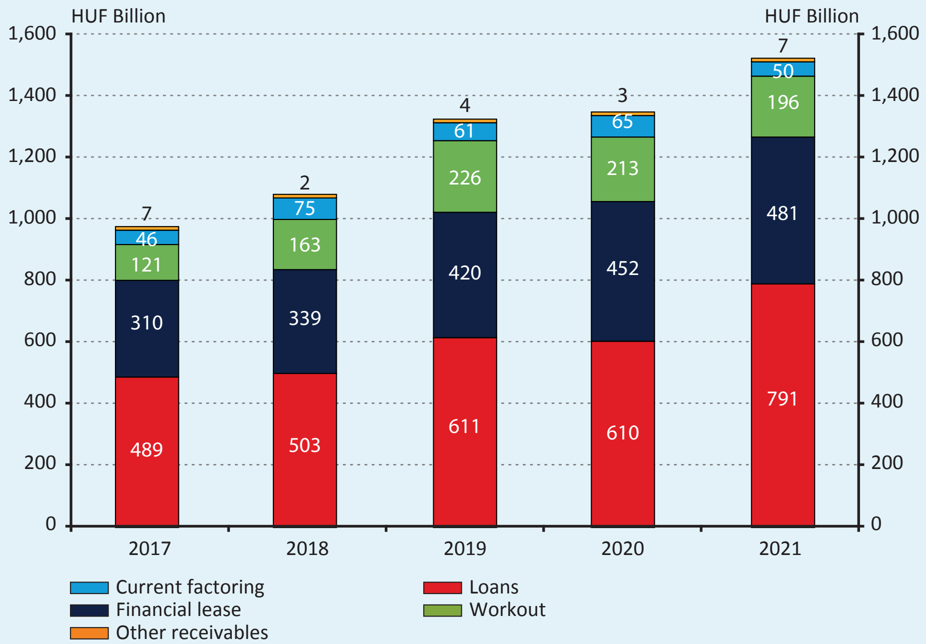
No change occurred in the activity of larger institutions, with a balance sheet total over HUF 5 billion, refinanced by domestic credit institutions; they are mostly engaged in granting credits and loans. There is also a high concentration of refinancing by credit institutions, as 85 percent of refinancing by domestic credit institution refinancing in 2021 concentrated at 26 financial enterprises in total. The vast majority of the rapidly growing stock of other resources domestic and foreign funding from non-supervised institutions. There is more than a twofold increase in the ratio of owner financing compared to 2020. It was mostly the larger financial enterprises with foreign owners were able to raise funds in this way.

6.3 DYNAMICALLY GROWING OUTSTANDING RECEIVABLES

In 2021, 144 financial enterprises increased their balance sheet total compared to the previous year, with 16 institutions achieving an increase over HUF 5 billion, which was mainly the case at the institutions engaged in granting credits and loans.

Following the stagnation in 2020, the gross outstanding receivables of the institutions under review significantly increased in 2021, although it has not yet reached the growth rate of 2019. The primary activity of the institutions continues to be the granting of credits and loans, which accounts for 52 percent of gross receivables, followed by financial lease with 32 percent, workout with 13 percent, while current factoring accounts for only 3 percent of total gross receivables.

Chart 6.2
Composition of gross outstanding receivables of financial enterprises not belonging to a banking group, by activity type



Source: MNB.

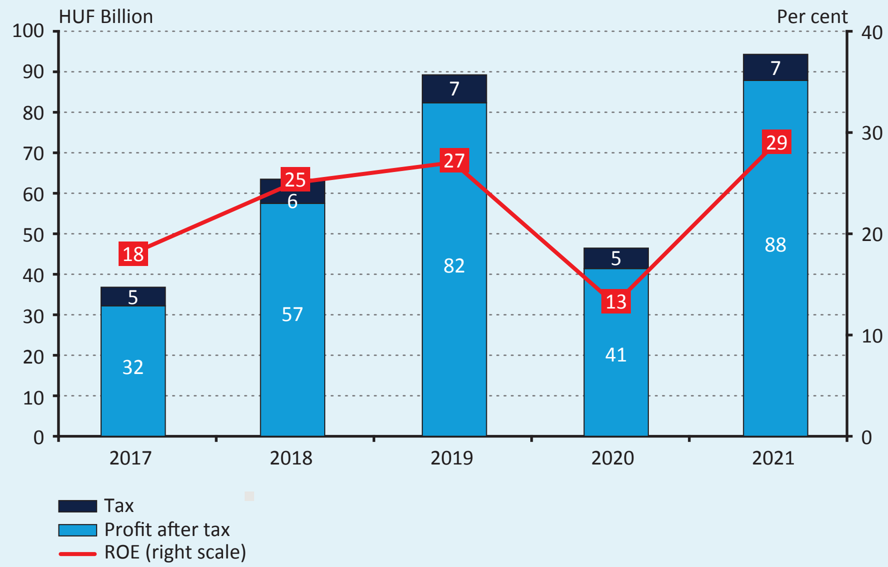
The increase in outstanding receivables in 2021 is clearly attributable to a growth in the volume of granting credits and loans. When examining the last 5 years, there was a soar in lending to non-financial institutions in 2021. It should be noted that a significant part of the increase was due to the growth in the loan portfolio of institutions belonging to the same group of interests. Slowdown in the growth of the financial lease portfolio continued, while the gross outstanding workout receivables are the lowest in the last 3 years.

6.4 OUTSTANDING PROFITABILITY AFTER ONE LEAN YEAR

By the end of 2021, profit after tax more than doubled compared to the previous year's audited figures. Following a decline in 2020, the profitability of the institutions under review increased significantly last year, in accordance with the expectations, and even exceeded the 2019 figures.

When examining the distribution of earnings, it is obvious that a significant part of the growth in profits can be attributed to merely 12 financial enterprises. These institutions realised a profit over HUF 0.5 billion and they are mainly engaged in lending or workout activities. It is a positive shift in the distribution of profitability that while in 2020 only three financial enterprises (pursuing workout and lending) managed to achieve a profit after tax over HUF 1 billion, in 2021 eight institutions exceeded this figure. In addition, the number of institutions with a negative profit after tax decreased from 39 to 33.

Chart 6.3
Changes in profit/loss and return on equity of financial enterprises not belonging to a banking group



Source: MNB

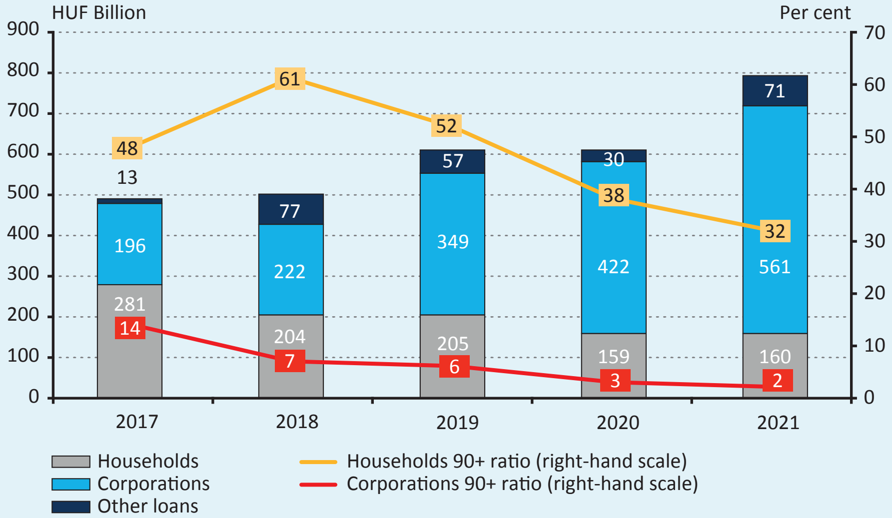
Financial enterprises engaged in workout and lending activities continued to be the most profitable, accounting for a significant ratio of positive profit after tax. The profitability of the workout activity improved, while the portfolio of receivables purchased decreased both in terms of amount and number of units in 2021.

6.5 STRENGTHENING OF CORPORATE LENDING

Total lending by non-bank financial enterprises rose 30 percent in 2021 compared to 2020. This growth increased the portfolio by HUF 181 billion. Within the lending by non-banking group financial enterprises the 4-year declining trend and shrinking sector of households halted in 2021, but the change in the outstanding portfolio is minimal. Households are becoming less and less represented in the overall portfolio of institutions. In 2021 only 20 percent of total placements were to this segment. The stagnation in the retail loan portfolio occurred despite the fact that many customers opted for the deferment of repayments provided by the moratorium on payments, the effect of which is also reflected in the portfolio.

Corporate lending accounted for a significant part of the 30 percent increase in lending, as loans disbursed in 2021 exceeded the figure registered in base year 2020 by HUF 139 billion, which was greatly attributable to the increase in lending by financial corporates linked to single group. The ratio of corporate loans increased significantly in recent years, reaching 71 percent of total lending last year.

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



Source: MNB

The growth in the lending segment of non-banking group financial enterprises in the other loans category was also significant compared to previous year. In 2020, the other loans portfolio amounted to HUF 30 billion, and in 2021 it rose to HUF 71 billion. Compared to the total loan portfolio, the ratio of other loans increased from 5 percent of 2020 to 9 percent by 2021. The increase in the other loans portfolio is attributable to the intra-group activity of a larger group of institutions operating in the non-banking group financial enterprises segment.

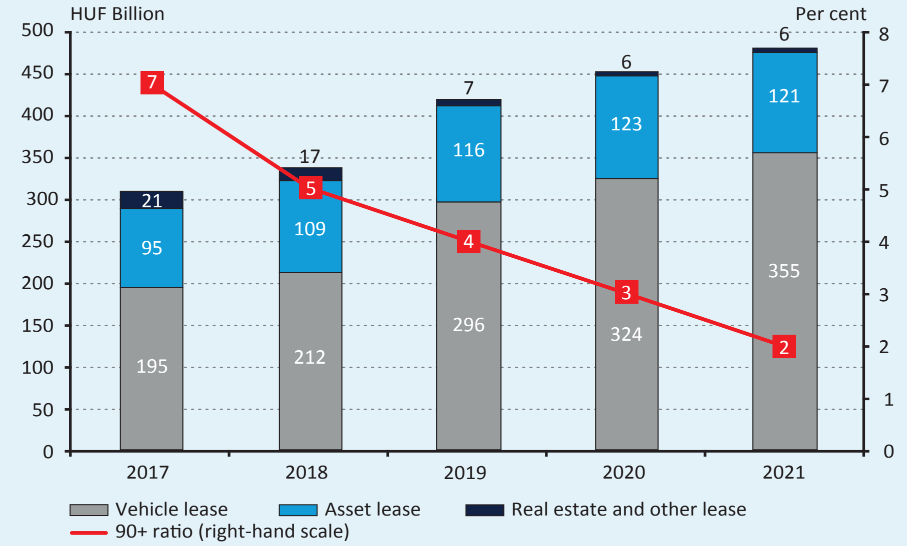
Payment discipline in both the corporate and household segments continues to show an improving trend. Since 2018, households' portfolio of loans in arrears fell from 61 percent to almost half, i.e. to 32 percent, by the end of 2021. It should be noted that several financial enterprises still manage long-overdue receivables that were disbursed many years ago, but the speed of outflows from these non-performing portfolios exceeds the growth of new non-performing portfolios. The ratio of overdue corporate loans is excellent, falling from 14 percent registered in 2017 to 2 percent by 2021. Portfolios improved not solely as a result of the moratorium on payments, but the respite provided by government measures significantly helped to halt deterioration in the quality of the portfolio.

During 2021, a financial enterprise took over the pawnbroking business from a bank, which included the entire receivables portfolio and around 80 agency contracts. As a result of this the financial enterprise's outstanding receivables reached HUF 4 billion by the end of the year, making it the second largest pawnbroking actor in the sector.

6.6 GROWTH IN THE LEASING PORTFOLIO IS PRIMARILY DRIVEN BY THE RISING MOTOR VEHICLE LEASE

Leasing is a significant market segment for non-banking group financial companies, which shows a rising trend year by year. The rising trend continued in 2021 as well and the total lease portfolio grew by HUF 29 billion compared to 2020, which is an increase of 6.5 percent. However, the moratorium on payments also slightly inflated the portfolio. Over the past year, several economic events hindered vehicle manufacturing and supply processes. As a result of those, despite the rise in car prices, the number of transactions in the sector rose, i.e. the impact of these economic events has not yet been reflected in the portfolio, except that the average amount of financing increased.

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



Source: MNB

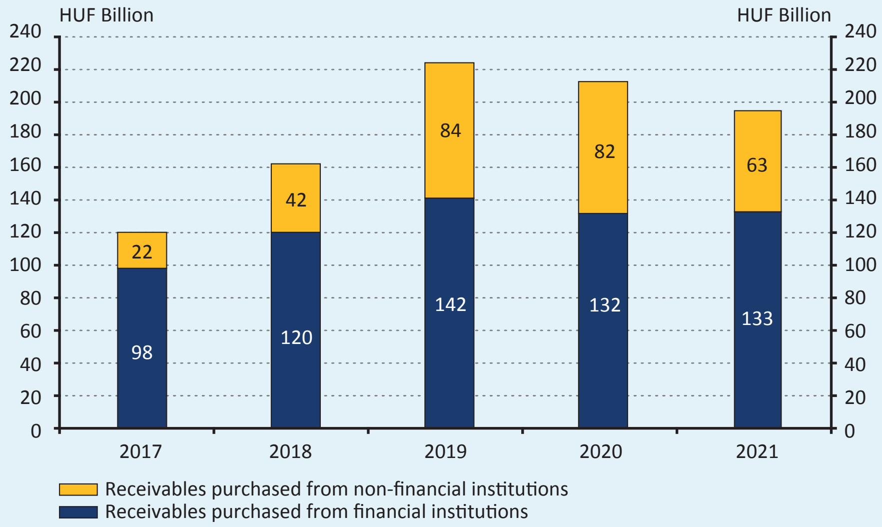
97 percent of the lease portfolio is concentrated at 11 institutions in the sector. The same ratio was also observed in previous years, which has not change in 2021 either. Of these 11 leasing companies, only 3 were loss-making in 2018 and 2019, while in 2020 and 2021 all 11 institutions realised positive after-tax results, and their market operations have been profitable for years. The volume of results achieved in 2019 by the institutions that dominate the sector was typically the same as in 2018. In 2020, the decline observed in the profitability of leasing companies was common in the entire non-banking group financial enterprise sector. In 2020, the profit of 6 out of 11 institutions, which cover almost the entire leasing portfolio, fell below their 2019 results. The decline affected only that year. The profitability figures of leasing market participants improved significantly and returned to the levels of 2018 and 2019.

6.7 FURTHER DECLINE IN WORKOUT PORTFOLIO

In 2021, the trend that started in the previous year continued, with a further decline both in the receivables purchased and in the entire portfolio of receivables managed by the sector. Total receivables managed by financial enterprises fell by 8 percent in 2021, exceeding the decline of 3.5 percent registered in 2020. Within this, the 1 percent rise in the portfolio purchased from financial institutions is more of a stagnation, while the portfolio purchased from non-financial institutions fell by 23 percent.

The decline in portfolio is presumably due to a significant drop in the volume of packages offered for purchase in the workout market, and thus the portfolios that changed hands fell by around 19 percent. Accordingly, the portfolio of receivables purchased by workout companies was unable to offset the fall due to transactions resulting from the portfolio management, which also fell slightly. The shrinking of the supply of receivable packages is most likely due to the moratorium on payments.

Chart 6.6
Composition of the workout portfolio of financial enterprises not belonging to a banking group



Source: MNB

The rise in the volume and ratio of repayments reflects the improved efficiency of the workout activity of financial enterprises engaged in workout, and it may also be the result of certain debtors participating in the moratorium on loan instalments using the released funds for repayment.

In 2021, only 3 non-banking group financial enterprises achieved a portfolio growth in excess of HUF 1 billion, compared to 7 enterprises in the previous year.

Receivables purchased from financial institutions are typically of larger amount, with significant dominance, but their ratio has not changed in 2021, accounting for 44 percent of total receivables based on the number of contracts and for 68 percent of the book value of the portfolio.

The amount of receivables from retail mortgage loans secured by real estate fell by 12 percent, while the number of such contracts decrease by 11 percent compared to 2020, reflecting a further improvement in the efficiency of workout, in line with the processes supported by the increase in the value of real estate.

Financial enterprises, which are predominantly engaged in workout, still tend to rely on credit institution refinancing funds to a lesser degree and fund their activity from their own or from the owner's resources.

The profitability of financial enterprises engaged in workout improved significantly in 2021, as their profit after tax more than doubled compared to 2020. However, this is not a trend, as the 25 percent fall in the profitability of actors with significant portfolios in the workout sector in 2020, followed by an outstanding increase in 2021, was also due to accounting changes and exchange rate movements. The equity of the enterprises engaged in the management of overdue receivables fell by around 17 percent despite the significant increase in profit after tax, which is attributable to a large dividend payment.

6.8 CONSUMER PROTECTION

Following 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 2021, and monitored domestic developments and the effects of legislative changes.

In addition to the review of the policies submitted during the authorisation procedures and the inspections, the central bank also examined the advertisements, website and other press releases of the supervised institutions, 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 2021, in connection with the provisions on the moratorium on loan instalments, in addition to regular monitoring the MNB issued an executive circular calling on financial institutions, including financial companies engaged in lending activities, to ensure customer-friendly management of the settlement of customers' debts accumulated during the moratorium. It monitored the information and commercial communication practices of financial enterprises related the moratorium on loan instalments, which required fewer measures and warnings than in the previous year.

The central bank also verified the implementation of previously issued recommendations and continued to use tool of consumer protection warning on a regular basis when it identified practices that could potentially prejudice consumers' interests or infringe 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 No 2/2019 (II. 13.) on the workout activity performed vis-á-vis consumers (Workout activity recommendation), which entered into force on 1 May 2019, was also in the focus of continuous oversight. In addition, in the pawnbroking sector, in connection with the takeover of a large portfolio by a financial enterprise, the MNB Recommendation 24/2018 (VII. 5). on pawnbroking received special attention, to be complied with by market participants engaged in pawnbroking from 15 September 2018. During the year, the verification of the adequacy of the information published on the institutions' websites also received special attention.

In 2021, the MNB continued the examination of compliance with the provisions of the PTI[19]/LCR 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 consumer protection targeted inspection. The central bank also carried out a thematic inspection to verify compliance with the Recommendation on the workout. On request inspections were typically launched in connection with financial enterprises' complaint handling and customer information practices. In addition, several customer reports were received, in relation to which the central bank called upon financial enterprises to comply with the provisions of Recommendation 9/2020 (VII. 14.) for financial enterprises on the application of consumer protection principles. In addition, the MNB examined during the individual licensing procedures, on a preventive basis, the rules and requirements relating to consumer protection legislation and MNB recommendations.

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

7 Capital market and its risks

At the end of 2021, 34 investment service providers were active on the Hungarian capital market. The HUF 48,106 billion volume of customer securities managed by them – HUF 41,335 billion by credit institutions and HUF 6,771 billion by investment firms – exceeded the HUF 39,077 billion value of customer securities registered in 2020, by 23.1 percent The number of securities accounts increased by 7.3 percent in 2021. The HUF 445.2 billion capital market turnover realised by supervised institutions last year represents a 30.5 percent increase compared to the previous year.

Table 7.1
Key data of investment service providers

Investment service sector	2020			2021		
	Credit institutions	Investment firms	Total	Credit institutions	Investment firms	Total
Number of institutions (pcs)	20	15	35	20	14	34
Customer securities portfolio (HUF billions)	34,293	4,784	39,077	41,335	6,771	48,106
Number of securities accounts managed (thousand pcs)	1,465	252	1,718	1,492	351	1,843
Capital market turnover (HUF billions)	306,069	35,076	341,145	366,979	78,230	445,209
Profit after tax (HUF millions)		12,815			20,180	
Solvency capital/Capital adequacy ratio (percent)		274.6%			763.1%	

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

Assets managed in the amount of HUF 11,875 billion at the end of 2021 by 42 investment fund managers exceed the value registered previous year by 11.3 percent, which is a new historic high. The growth is mainly attributable to the increase in assets managed in mutual funds and voluntary pension funds. Contrary to previous year, in 2021 the growth dynamics was essentially attributable to the investment fund sector: the assets of investment funds managed by investment fund manager amounted to HUF 8,294 billion at the end of 2021, exceeding previous year’s figure by 14.1 percent. In absolute terms, in 2021 as well the largest growth was realised in the net asset value of investment funds (HUF 1,024 billion).

Table 7.2
Key data of investment fund managers

Investment fund management sector	2020	2021
Number of institutions (pcs)	41	42
Number of funds managed (pcs)	661	675
Volume of assets managed (HUF billions)	10,668	11,875
Profit after tax (HUF millions)	45,872	45,955

Forrás: MNB

7.1 INVESTMENT SERVICES MARKET: TURNOVER AND BALANCES

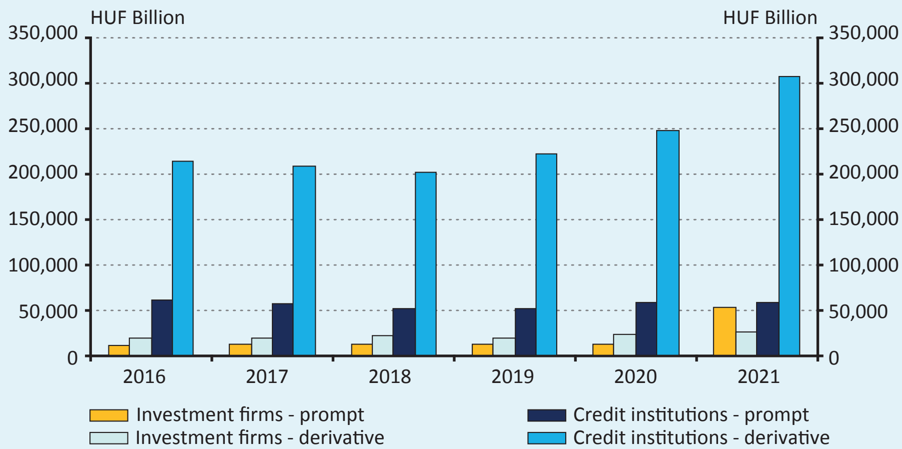
7.1.1 Capital market turnover was characterised by vigorous growth in 2021

Investment service providers – credit institutions providing investment services and investment firms – realised a total capital market turnover of HUF 445,200 billion in 2021, which exceeds the turnover of HUF 341,100 billion reached in 2020 by 30.5 percent. In 2021, the capital market turnover increased at credit institutions providing investment services and also at investment firms: the capital market turnover of credit institutions of HUF 367,000 billion in 2020 exceeded the level of HUF 306,000 billion registered in 2020 by 19.9 percent, while the capital market turnover of investment firms more than doubled, rising from HUF 35,100 billion in 2020 to HUF 78,200 billion in 2021. (Chart 7.1)

In the case of credit institutions, a significant increase was observed in the stock exchange segment in 2021: the stock exchange derivatives turnover of credit institutions increased by 48.2 percent to HUF 5,700 billion, while the stock exchange prompt turnover of credit institutions rose by 15.1 percent to HUF 2,700 billion. The OTC derivatives turnover of credit institutions increased by 24.2 percent to HUF 303,200 billion, while the OTC prompt capital market turnover of credit institutions decreased minimally, by around 0.6 percent to HUF 55,300 billion.

The more than twofold increase in the capital market turnover of investment firms is attributable to the market entry of a new investment firm with foreign background and thereby becoming subject to supervision. With the emergence of the new investment firm, the turnover generated by[20] forwarded orders soared from HUF 5,300 billion in 2020 to HUF 44,800 billion at sector level in 2021: the increase mainly affects the prompt and derivatives stock market segment. Capital market turnover generated by non-forwarded orders increased by 12.4 percent to HUF 33,400 billion. Within this, investment firms' exchange-traded derivatives turnover grew strongly, increasing by 28 percent to HUF 3,700 billion in 2021, while OTC derivatives turnover rose by 19.2 percent and came close to HUF 17,000 billion. OTC prompt turnover of investment firms increased modestly: the turnover of HUF 6,600 billion registered in 2021 exceeds the figure seen in previous year by 11.9 percent.

Chart 7.1
Developments in the capital market turnover



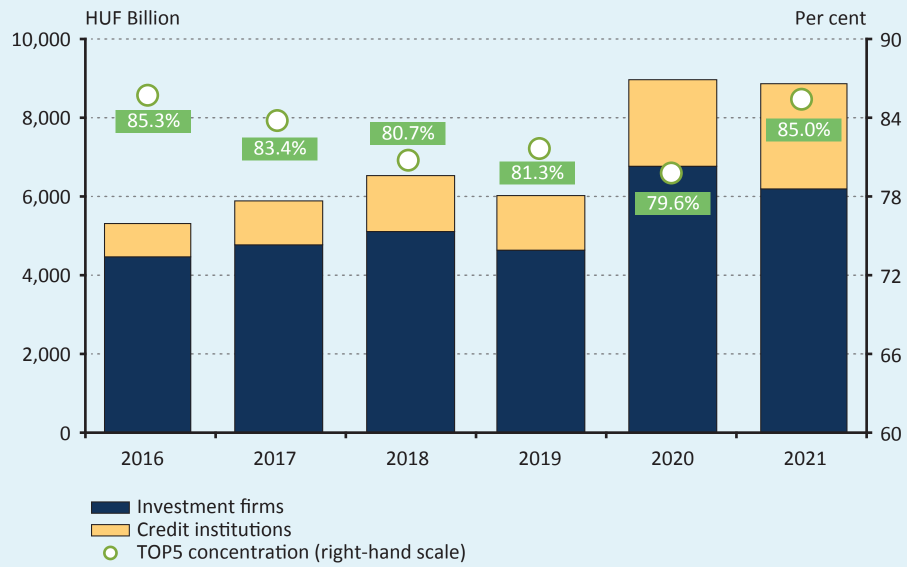
Source: MNB.

[20] The "forwarded order" column includes transactions where the order received from the customer is executed not by the respective investment service provider but forwarded to another investment service provider who actually executes the order.

7.1.2 Strong growth in prompt stock market turnover generated by households

In 2021, prompt stock market turnover remained broadly unchanged: the 2021 prompt stock market turnover of HUF 8,787 billion falls short of the 2020 level of HUF 8,876 billion by 1 percent, but it is still 40-50 percent higher than in the years before 2020 - i.e. it appears that the high prompt stock market turnover generated by the 2020 capital market turbulences is not a one-off phenomenon. The trend of previous years continued in 2021: the share of investment firms in the stock exchange prompt turnover fell from 75.6 percent registered in 2020 to 69.9 percent by 2021 – in 2017, 2018 and 2019 it amounted to 81.1 percent, 78.1 percent add 76.9 percent, respectively. Compared to previous years, the 5 investment service providers with the highest prompt stock exchange turnover in 2021 have not changed, and thus it included 3 investment firms and 2 credit institutions last year as well, but the order of credit institutions has changed due to a one-off effect. The concentration of prompt stock exchange turnover increased strongly in 2021 due to the one-off effect mentioned before: the share of the 5 investment service providers with the largest prompt stock exchange turnover soared by 5 percentage points from 79.6 percent in 2020 to 85 percent in 2021. (Chart 7.2)

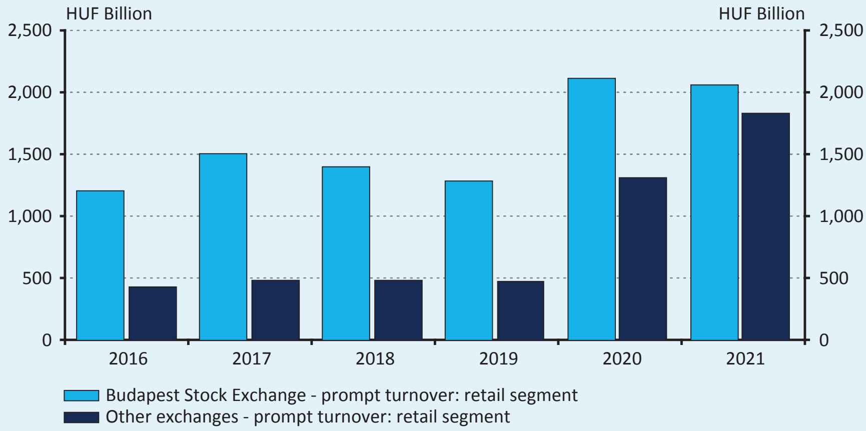
Chart 7.2
Stock exchange prompt capital market: turnover and concentration



Source: MNB.

Stock exchange demand generated by households significantly contributed to the developments in the prompt stock exchange turnover in 2021. The HUF 3,851 billion of prompt stock market turnover generated by households – residents and non-residents together – in 2021 exceeds the 2020 figure of HUF 3,390 billion by 13.6 percent, and it is roughly 100-135 percent higher than the turnover registered in previous years. Retail turnover on domestic and foreign stock exchanges showed opposite trends in 2021: while retail prompt turnover on domestic stock exchange decreased by 2.7 percent to HUF 2,034 billion compared to the previous year, it increased by 39.9 percent to HUF 1,817 billion on foreign stock exchanges. Accordingly, the ratio of retail prompt turnover on foreign exchanges in total prompt stock exchange turnover soared from around 25 percent registered in the years before 2020 to 38 percent in 2020 and then to 47 percent in 2021. (Chart 7.3) There was a significant increase in the activity of non-resident households on the domestic stock exchange in 2021, as the turnover of HUF 20-30 billion registered in previous years increased tenfold reaching HUF 294 billion in 2021.

Chart 7.3
Stock exchange prompt capital market: Retail segment



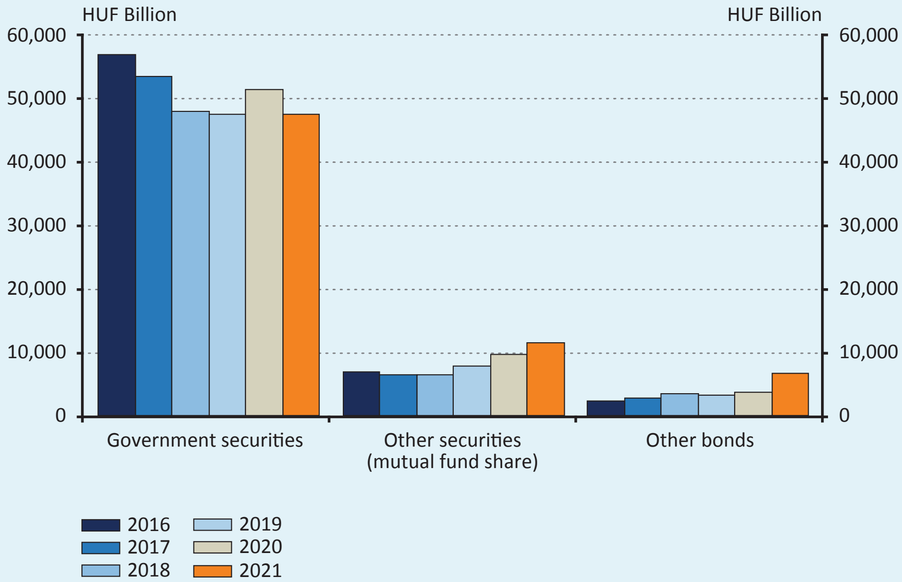
Source: MNB.

The concentration of stock exchange derivative turnover decreased further, albeit minimally: the share of the top five investment service providers realising the highest stock exchange derivative turnover decreased from 73 percent of 2020 to 72 percent by 2021 (it was 75 percent in 2019). The stock exchange derivative turnover rose significantly, by HUF 2,261 billion to HUF 9,081 billion in 2021, which corresponds to an annual growth of 33.2 percent. The stock exchange derivatives turnover of credit institutions providing investment services grew by 37.1 percent on an annual level in 2021, reaching HUF 5,309 billion, with two institutions accounting for the bulk of the growth. Investment firms' stock exchange derivatives turnover increased by 28 percent on an annual level reaching HUF 3,772 billion. Accordingly, the share of investment firms in stock exchange derivatives turnover fell by 1.7 percentage points to 41.5 percent in 2021. Similar to previous years, the composition of the top 5 investment service providers with the highest stock exchange derivatives turnover changed in 2021 as well: while in the case of credit institutions rendering investment services only the order changed, one of the 2 investment firms joined the top 5 enterprises as a new actor in 2021.

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

The OTC prompt capital market turnover of HUF 61,603 billion realised by domestic investment service providers in 2021 remained broadly unchanged (HUF 61,547 billion in 2020), but it still exceeds the value of HUF 56,750 billion in 2018 and HUF 57,114 billion in 2019. The turnover is the combined result of two opposite effects: while credit institutions' OTC prompt capital market turnover decreased by 1.2 percent, that of investment firms increased by 11.9 percent to HUF 6,606 billion. Thus, the dominance of credit institutions in the OTC prompt capital market decreased: the share of turnover realised by investment firms in the OTC prompt capital market increased from 9.6 percent in 2020 to 10.7 percent by 2021. The increase observed at investment firms is essentially attributable to the developments in the OTC prompt capital market turnover of 3 investment firms. The decrease in credit institutions' OTC prompt capital market turnover is mainly due to the decrease observed at credit institutions operating as branch offices. In 2021, the number of investment firms active in the OTC prompt capital market segment remained unchanged at 9. In the OTC prompt capital market, the turnover of government securities decreased by 7.5 percent to HUF 47,533 billion in 2021. The decrease relates to credit institutions operating as branch offices. There was a soar in the OTC prompt capital market turnover of other bonds: turnover of HUF 6,549 billion in 2021 exceeds the turnover of HUF 3,580 billion registered in 2020 by 82.9 percent. Within the other bonds category, the turnover of corporate bonds and credit institution bonds surged in 2021: the turnover of HUF 4,277 billion in corporate bonds and the turnover of HUF 1,511 billion in credit institution bonds exceeded the figure registered in 2020 by 152 and 137 percent, respectively. In the case of corporate bonds and credit institution bonds 59 percent and 39 percent of the increment is linked to a single institution, respectively. By contrast, the OTC prompt turnover of mortgage bonds, also included in the category of other bonds, fell by 39 percent to HUF 761 billion: the decrease affected mainly the three most active credit institutions. The HUF 11,373 billion OTC prompt turnover of mutual fund shares exceeds the figure registered in 2020 by 17.5 percent – the increase affected the entire sector. (Chart 7.4) The concentration of OTC prompt capital market turnover decreased in 2021: the top 5 market participants with the highest turnover covered 63.3 percent of the OTC prompt turnover, falling short of 66 percent registered in previous year by 2.7 percentage points (70 percent in 2017, 68.7 percent in 2018 and 64.7 percent in 2019). The composition of the top five investment service providers realising the highest OTC prompt turnover has changed in 2021: 1 credit institution replaced by 1 investment firm.

Chart 7.4
OTC prompt turnover by types of securities

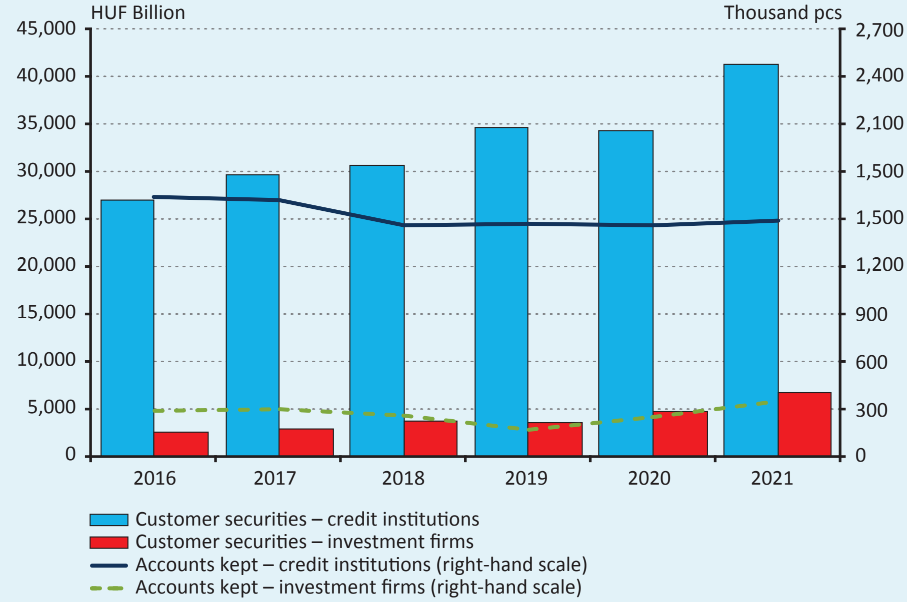


Note: due to their negligible OTC turnover equities are not included in the chart
Source: MNB

7.1.4 Customer securities portfolio reached a new historic high 2021 after record growth

In 2021, under rising exchange rates, the total market value of the customer securities portfolio managed by investment service providers increased by 23.1 percent from HUF 39,077 billion in 2020 to HUF 48,106 billion – the annual growth rate of 23.1 percent is a historic high (customer securities portfolio grew by 10.2 percent in 2017, 5.9 percent in 2018, 11.3 percent in 2019 and 2.1 percent in 2020). The customer securities portfolio of HUF 41,335 billion, managed by credit institutions at the end of 2021, exceeded the figure of HUF 34,293 billion registered in 2020 by 20.5 percent. The customer securities portfolio managed by investment firms increased by 41.5 percent in 2021: the HUF 6,771 billion portfolio under management at the end of 2021 exceeded the 2020 figure by HUF 1,987 billion – the significant increase is attributable to the market entry of a new investment firm with foreign background. Accordingly, the ratio of customer securities portfolio managed by investment firms within the total customer securities portfolio reached a new historic high in 2021: the ratio of 16.4 percent in 2021 exceeds the 2020 figure by 2.4 percentage points and the figures of 8-10 percent registered in previous years by 4-6 percentage points. In 2021 a growth was registered in all asset categories of the customer securities portfolio managed by credit institutions rendering investment services. In line with capital market developments, the equity portfolio managed by credit institutions rendering investment services increased by 34.3 percent from HUF 11,640 billion of end of 2020 to HUF 15,627 billion. The mutual fund share portfolio managed by credit institutions also showed strong dynamics: the portfolio of HUF 9,745 billion at the end of 2021 exceeds previous year's figure by 24.8 percent. The government securities portfolio held by credit institutions rose by 4.7 percent to HUF 13,021 billion, while the corporate bond portfolio grew by 26.7 percent to HUF 2,067 billion – the latter change is linked essentially to a single institution. In 2021, in the customer securities portfolio of investment firms, a growth was registered in all asset categories except for corporate bonds: equity portfolio rose from HUF 1,843 billion of 2020 to HUF 3,143 billion, while the mutual fund shares portfolio soared from HUF 1,629 billion of 2020 to HUF 2,398 (a growth of 70.6 and 47.2 percent, respectively). The significant growth is attributable to the market entry of a new investment firm with foreign background. Within the investment firms' customer securities portfolio, government securities increased by 6 percent to HUF 862 billion, while corporate bonds decreased by 36.5 percent to HUF 271 billion. The decrease is related essentially to one institution. In 2021, the number of customer securities accounts held by investment service providers increased by 7.3 percent. The number of customer securities accounts held with credit institutions increased by 1.8 percent to 1,492,000 by the end of 2021, while investment firms registered an increase of 98,000, and thus the 351,000 accounts at the end of 2021 represent a 39 percent year-on-year growth. The significant increase is attributable to the market entry of new investment firm with foreign background. (Chart 7.5)

Chart 7.5
Customer securities portfolio

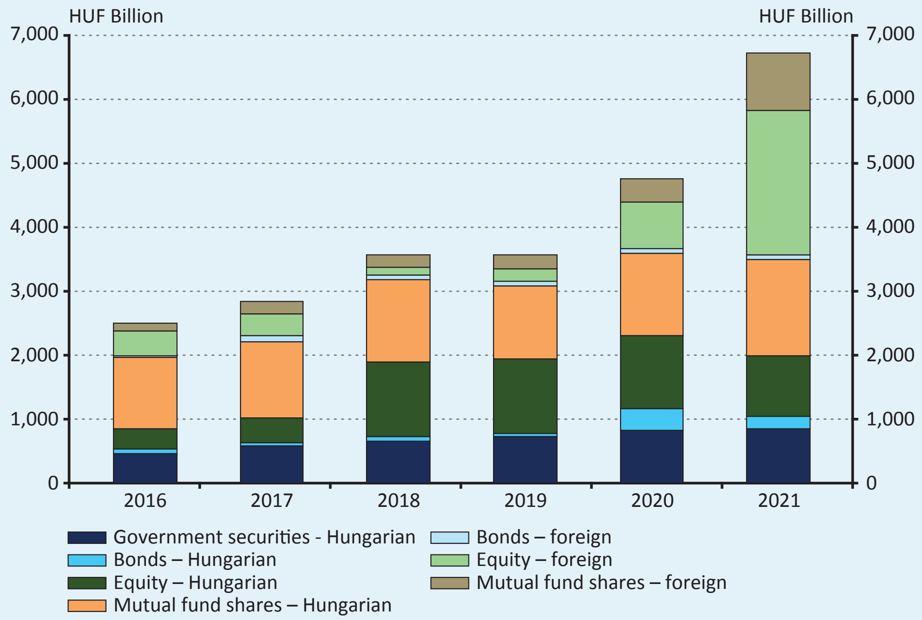


Source: MNB

7.1.5 The ratio of foreign issuers in investment firms' customer securities portfolio increased significantly due to a one-off effect

The ratios of investment firms' customer securities portfolio by asset classes remained unchanged at sector level. The equity asset class remains at the first place, with a share of 46.4 percent in 2021 (2020: 38.5 percent), followed by the mutual fund shares asset class at the second place with 35.4 percent (2020: 34 percent), the government bond asset class at the third place with 12.7 percent (2020: 17 percent) and the corporate bond asset class at the fourth place with 4 percent (2020: 8.9 percent). When examining the domestic-foreign breakdown of asset classes, the market entry of the new investment firm with foreign background significantly increased the weight of foreign-issued equities and mutual fund shares. However, it should be noted that government securities issued by Hungary accounted for 97 percent of total government securities holdings, which is lower by 2 percentage points than the figure seen last year. Overall, the portfolio of foreign-issued customer securities held by investment firms increased from 25 percent of 2020 to 48 percent in 2021, reflecting the market entry of the new investment firm with foreign background. (Chart 7.6)

Chart 7.6
Customer securities portfolio by asset classes



Source: MNB.

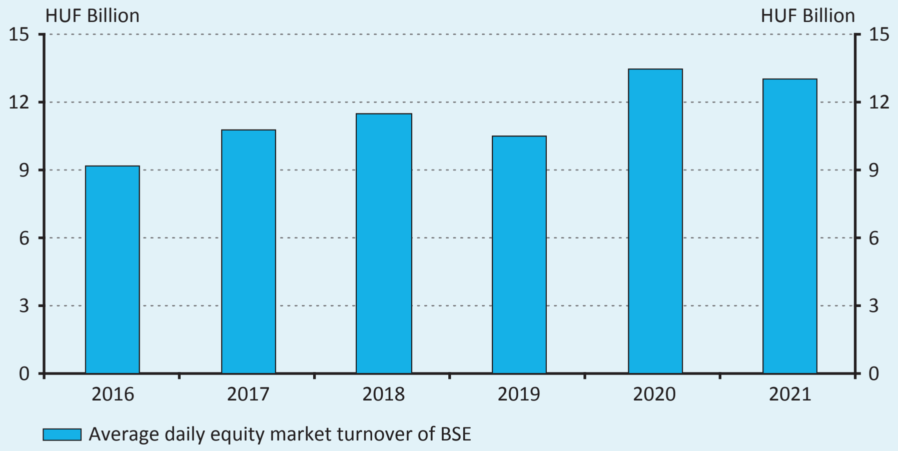
7.2 REGULATED MARKET

7.2.1 Turnover on the Budapest Stock Exchange increased overall

The total turnover of the Budapest Stock Exchange in 2021 grew by 9.7 percent on an annual basis which falls short of the growth of 19.2 percent registered in 2020 (2019: -6.1 percent; 2018: +2.8 percent; 2017: +3.1 percent). The growth is driven by the performance of the derivatives market: derivatives turnover soared by 30 percent in 2021 reaching HUF 3,122 billion. By contrast, the prompt market fell in 2021 by around 4.1 percent to HUF 3,381 billion compared to the outstanding prompt market turnover of HUF 3,526 billion in 2020, resulting from the capital market turbulence and increased investor activity caused by the coronavirus pandemic. However, it exceeds the 2019 level by 27.3 percent. The increase in derivatives turnover in 2021 is attributable to the 43 percent soar in foreign exchange futures turnover (2020: HUF 1,871 billion; 2021: HUF 2,679 billion), while turnover of other derivatives products decreased: index futures turnover fell by 23 percent to HUF 211 billion and equity futures turnover by 13 percent to HUF 219 billion. Derivatives market concentration declined further in 2021, although it remains strong: the turnover generated by the top 5 stock exchange members covered 83.9 percent of total derivatives market turnover, down by around 2.7 percent from 86.6 percent in 2020.

The fall of HUF 145 billion decline in the prompt market turnover in 2021 affected practically all sub-markets, which is attributable to a HUF 95 billion (2.8 percent) decline in Hungarian equity turnover, a HUF 23 billion (19.4 percent) decline in certificates turnover and a HUF 27 billion (95.3 percent) decline in mortgage bond turnover. (Chart 7.7) The turnover of mortgage bonds has been extremely hectic in recent years: while it was negligible in 2017 (HUF 70 million), it surged to HUF 60 billion in 2018, fell to HUF 648 million in 2019 and then rose to HUF 28 billion in 2020. The concentration of trading volume by prompt section members continued to increase in 2021: the turnover generated by the top 5 exchange members covered 87 percent of the total prompt market turnover, representing a strong, 3.5 percentage point increase compared to 83.5 percent in 2020. The composition of the top 5 stock exchange members has not changed compared to 2020.

Chart 7.7
Average daily equity market turnover of the Budapest Stock Exchange

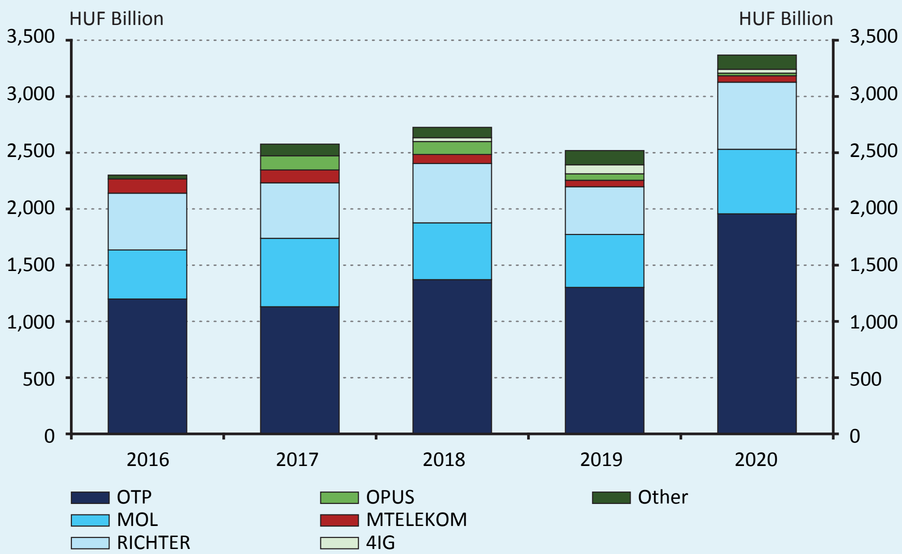


Source: MNB.

7.2.2 Concentration of turnover continued to increase on the Budapest Stock Exchange

In terms of issuers, in the equity market turnover the composition of the top three equities of the largest turnover – OTP, MOL, Richter – remained unchanged in 2021, but their order has changed: OTP is still on the first place, while Richter – ranked second in 2020 – slipped to the third place in 2021 and it was replaced by MOL. Equity market concentration continued to rise in 2021 from its previous high level: the share of the top three issuers with the largest turnover in the total equity market turnover increased from 92.8 percent in 2020 to 93.5 percent in 2021 (83.4 percent in 2019). The main contributor to the increase in the concentration ratio was the 2 percent increase in the turnover of OTP equities (HUF 1,954 billion in 2020; HUF 1,994 billion in 2021), while Richter's turnover decreased by 11.9 percent to HUF 521 billion and that of MOL by 6.7 percent to HUF 538 billion. Among the other large issuers, Mtelekom's equity turnover decreased by 27.9 percent (2020: HUF 56 billion; 2021: HUF 41 billion) and Opus' equity turnover by 65.1 percent (2020: HUF 31 billion; 2021: HUF 12 billion) in 2021. The equity turnover of Masterplast in 2021 registered a fourfold growth compared to the previous year, reaching HUF 37 billion. (Chart 7.8)

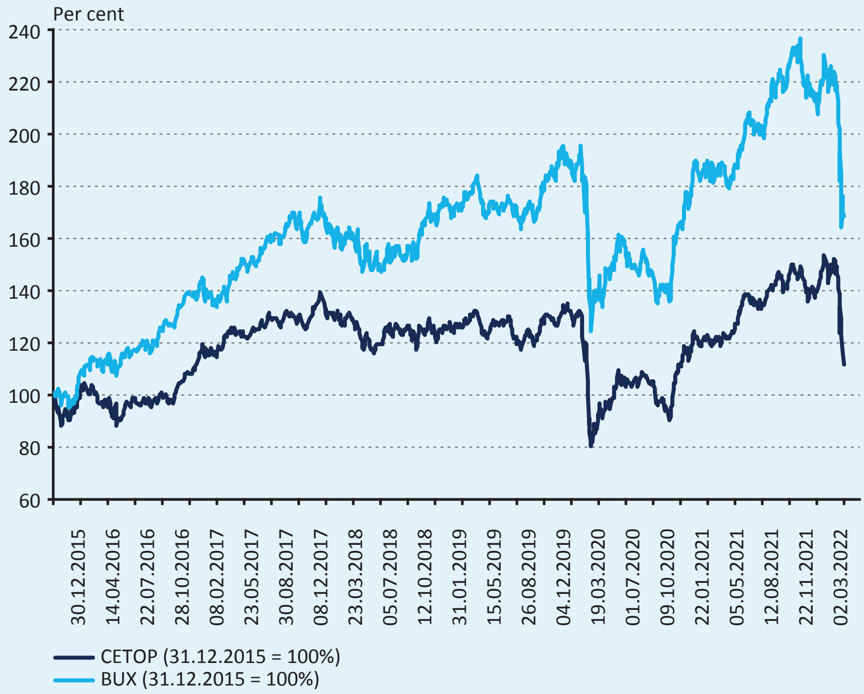
Chart 7.8
Annual stock exchange turnover of issuers



Source: MNB.

In 2021 the BUX index rose by 20.6 percent from the closing value of 42,048 registered at the end of December 2020 to the closing value of 47,238 points at the end of December 2021. The BUX index reached its historic high on 4 November 2021 at 55,926. (Chart 7.9)

Chart 7.9
Changes in the BUX and CETOP indices



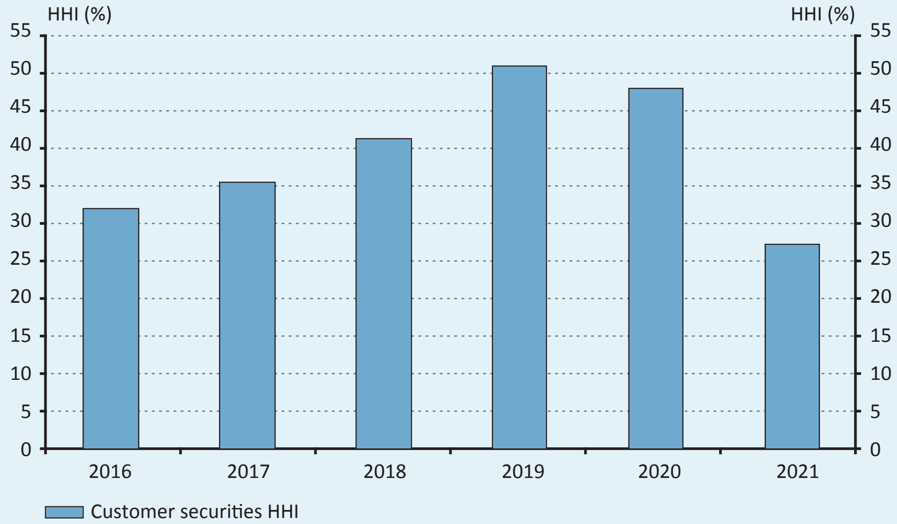
Note: CETOP is the Blue Chip Index of Central Europe and includes the 25 Central European equities of the highest capital value and stock exchange turnover. The composition of the index is revised twice a year, in March and September.
Source: MNB

7.3 RISKS AFFECTING INVESTMENT FIRMS

7.3.1 Market concentration significantly decreased in the investment firm sector

The concentration of investment firms' customer securities portfolio calculated by the Herfindahl-Hirschman Index (HHI), fell significantly, by 20.6 percentage points to 27.3 percent by the end of 2021 compared to 2020: this is attributable to the market entry of a new investment firm with foreign background, which entered the domestic market with a relatively large customer securities portfolio. Accordingly, the concentration ratio of the sector in terms of customer portfolio declined, which is certainly a positive development. (Chart 7.10) However, the declining trend in the market share of small investment firms continued in 2021: the market share of the 4 investment firms with the smallest customer securities portfolio decreased from 2.6 percent of 2020 to 2 percent (2.6 percent in 2019).

Chart 7.10
Market concentration of customer securities portfolio

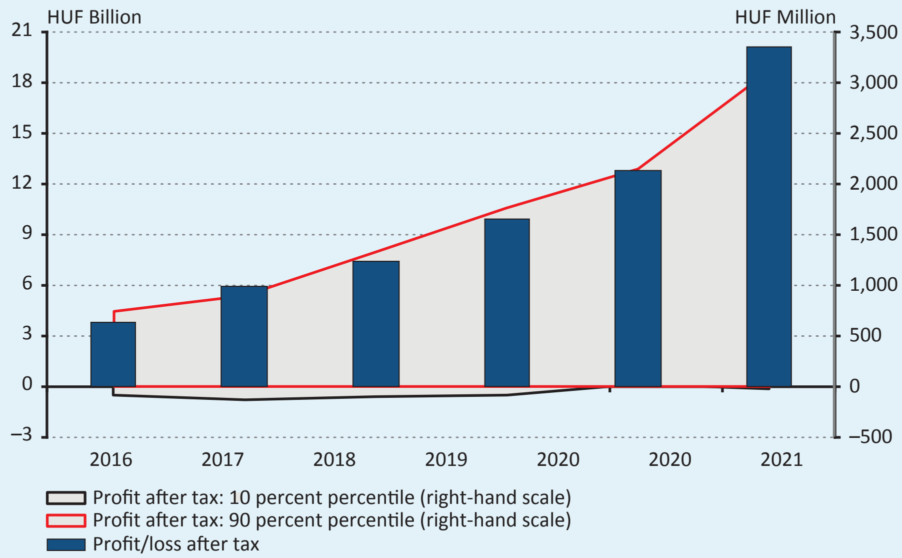


Source: MNB

7.3.2 Sector profitability at another historic high

In 2021, the investment firm sector's – including branch offices – profitability continued to rise sharply: the after-tax profit of HUF 20.2 billion in 2021 exceeds the after-tax profit of HUF 12.8 billion registered in 2020 by 57.8 percent (the annual growth rate in 2020, 2019, 2018, 2017 and 2016 was 29.5 percent, 33.6 percent, 24.1 percent, 55.8 percent and 25.6 percent, respectively) and reached a historic high. (Chart 7.11) The significant increase in the after-tax profit of investment firms is partly due to an increase in their capital market turnover and partly to the market entry of an investment firm with foreign background in 2021. The after-tax profit of 9 of the 14 investment firms that operated at the end of 2021 increased, that of 4 decreased, while 1 investment firms entered the market in 2021.

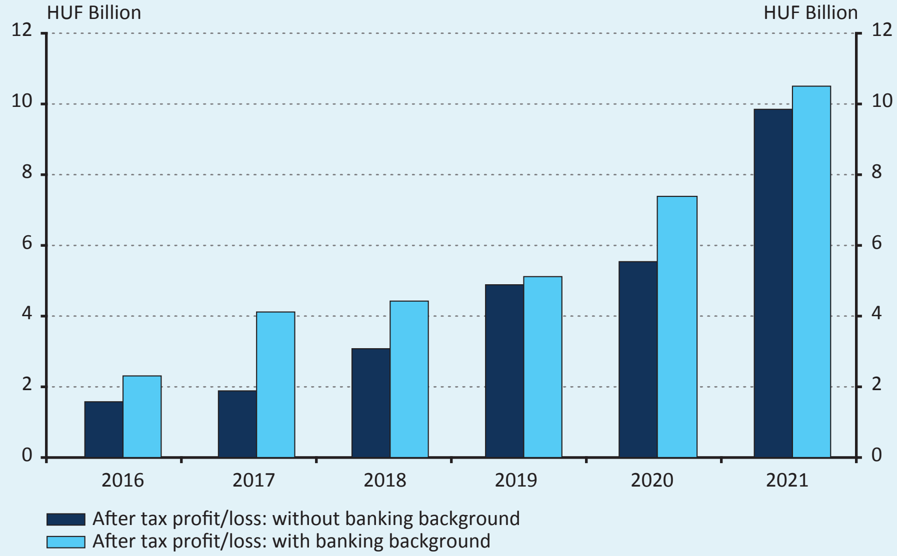
Chart 7.11
Profitability of investment firms



Source: MNB

Improved profitability at sector level is also evidenced by the fact that the profitability of independent investment firms not belonging to a banking group continued to increase in 2021: on a comparative basis, their profit after tax increased by HUF 2.5 billion from HUF 5.5 billion in 2020 to HUF 8 billion in 2021 (+45 percent). The growth was comprehensive across the sector: the 2021 after-tax profit of 9 of the 11 non-bank investment firms holding an activity licence already in 2021 exceeded previous year's profit. In 2021, one investment firm surrendered its activity licence to operate, but this had no impact on the sector as a whole. The investment firm with foreign background, which entered the market this year, practically brought an already operating firm to Hungary with outstandingly high profitability. (Chart 7.12)

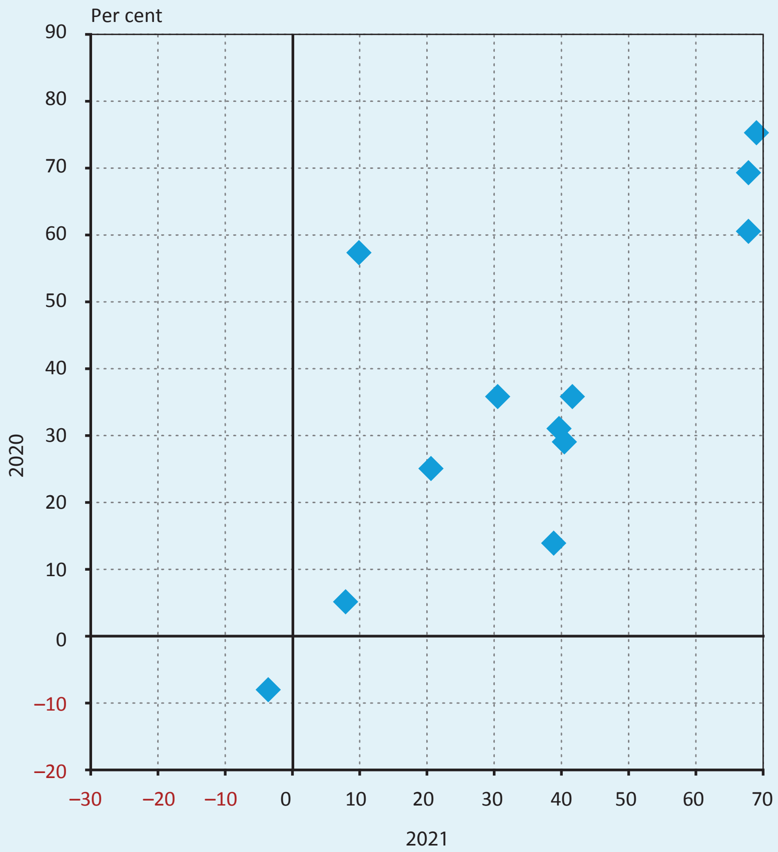
Chart 7.12
After-tax profit/loss of investment firms with and without a banking background



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

While in 2020 only 3 investment firm realised a loss, by 2021 this number declined to 2, since an investment firm that was loss-making in 2020 returned its activity licence. The 2 investment firms that were loss-making in 2021 were also loss-making in 2020: one of them received its activity licence in 2017, has no customer portfolio and no customer accounts, while at other loss-making investment firm it is its business model that causes profitability problems. The improvement in the sector-level profitability is also evidenced by the after-tax return on equity (ROE): Chart 7.13 shows that investment firms cluster to the right from the vertical zero axis.

Chart 7.13
ROE value of investment firms (percent)

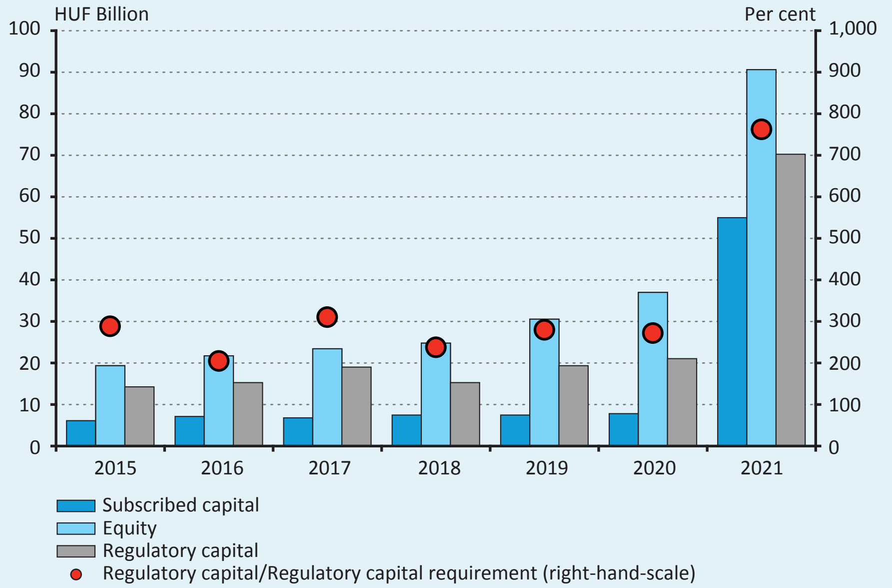


Source: MNB

7.3.3 Adequate capital adequacy at sector level

The subscribed capital of investment firms rose from HUF 7.7 billion of 2020 to HUF 54.8 billion in 2021: the growth is primarily attributable to the market entry of a foreign-backed investment firms. Accordingly, the equity of investment firms also increased significantly: equity at sector level rose from HUF 36.9 billion of 2020 to HUF 90.5 billion in 2021. As a result of the market entry of the investment firm with foreign background the capital adequacy of the investment firm sector also significantly approved: the own funds to capital requirement ratio soared from 274 percent of 2020 to 763 percent. The solvency capital of all 12 investment firms with a registered office in Hungary exceeded the capital requirement at the end of 2021. (Chart 7.14) It should be noted that from 2021, a new capital requirements regime entered into force for investment firms – see: Box 7.1

Chart 7.14
Capital and capital adequacy ratio of investment firms



Source: MNB.

Box 7.1
IFR/IFD

Regulation (EU) No 2019/2033 of the European Parliament and of the Council (IFR), substantially modified the capital requirements calculation for investment firms. The capital requirement based on credit, market and operational risk exposures defined by CRR (CRR Pillar 1) has been replaced by the definition of capital requirements based on the K-factors (Pillar 1 under the IFR), which includes exposures to counterparties, markets and the investment firms (e.g. volume of financial assets and funds under management, size of managed portfolio, turnover volume of executed customer orders, default risk of trading book positions, etc.) related to investment services activities. However, the IFR preserved the CRR's capital adequacy logic in the sense that investment firms' minimum solvency capital must be the higher of the permanent minimum capital requirement, a quarter of the fixed overheads or the capital requirement based on risk exposures (K-factors). The MNB conducted its first annual supervisory review and evaluation process (SREP) in the first quarter of 2022, for 30 September 2021, based on the new capital requirement calculation requirements, following the application of the IFR from 26 June 2021. 2022 will be the first full year when firms will be required to apply the regulatory capital requirements based on the IFR requirements specified in SREP and the capital requirement calculation procedures revised in SREP. Based on SREP experience, among domestic investment firms subject to the IFR, 3 firms are required to hold own funds corresponding to the permanent minimum capital requirement, 3 firms are required to hold own funds equal to a quarter of fixed overheads and 3 institutions are required to hold own funds corresponding to the value of the K-factors in 2022. Among the new types of risk exposures introduced by the IFR, domestic investment firms are typically affected by capital requirements related to custody activities (financial and liquid assets held and managed) and the volume of customer orders managed, while in the case of institutions with a trading book the capital requirement related to counterparty and trading partner default risk also represent a significant weight. As a result of the IFR requirements, including the new types of risk exposures (K-factors) on which the capital requirement is based and the associated capital requirement coefficients, the Pillar 1 capital requirement for investment firms that determine their own funds based on their risk exposures rather than on the minimum capital requirement or overhead costs has decreased overall. SREP experience shows that the capital adequacy ratios of these firms strengthened (the majority of firms will have several times the regulatory capital requirement set under the SREP, some of the service providers may have 17-20 times higher own funds). Nevertheless, the MNB expects investment firms to maintain their available own funds and not to adjust it to the potentially lower level of capital requirements resulting from the regulatory changes.

7.3.4 Sector level risk map of the investment firms

Risk category	Risk groups	Risk rating	Risk prospects	Evaluation in words
Market risk	Risky investment products may come to the fore in the hope of higher yields		⬆	Higher government debt resulting from pandemic situation that unfolded in 2020, rising inflation and general uncertainty concerning the protraction of the pandemic, together with the Russia-Ukraine war commenced in early 2022, have increased market risks. Several countries started a monetary tightening cycle, as a result of which bond market performance deteriorated. Due to the economic impacts of the war between Russia and Ukraine equity markets became extremely volatile.
Credit risk	Compliance with regulatory requirements		➡	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		➡	Risk to profitability may be represented by the continuously tightening regulatory requirements related to product distribution. Competition between service providers may have a negative impact on the profitability of certain firms.
Capital adequacy	Changeover to IFR/IFD regime		➡	The regulatory capital adequacy of investment firms is stable. Due to the changeover to the IFR/IFD regime – will fundamentally changes the capital calculation rules – the sector will comply with the new capital requirement.

Note:

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

The profitability of investment firms – ignoring one-off effects – was outstanding in 2021 as well. However, the potential impact of the Russia-Ukraine conflict and related economic sanctions in 2022 on the capital market will have an adverse effect on business and financial planning. In 2021, the sector's capital adequacy remained stable, and compliance with the new capital requirements introduced by the IFR/IFD prudential regulatory regime is expected to result in an improvement in institutions' capital adequacy ratios from 2022. It is still the case that ongoing compliance with and preparation for the application of international regulatory requirements (such as the MiFID II Quick fix, the IFR/IFD prudential framework, the SFDR sustainability framework and security settlement discipline of CSDR) 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 was stable in 2021, with no new investment firm entering or existing firms leaving the market. Concentration within the sector slightly strengthened further due to a merger and acquisition transaction between investment firms. During 2021, the volume of customer assets managed by the sector increased significantly, and competition between service providers also increased.

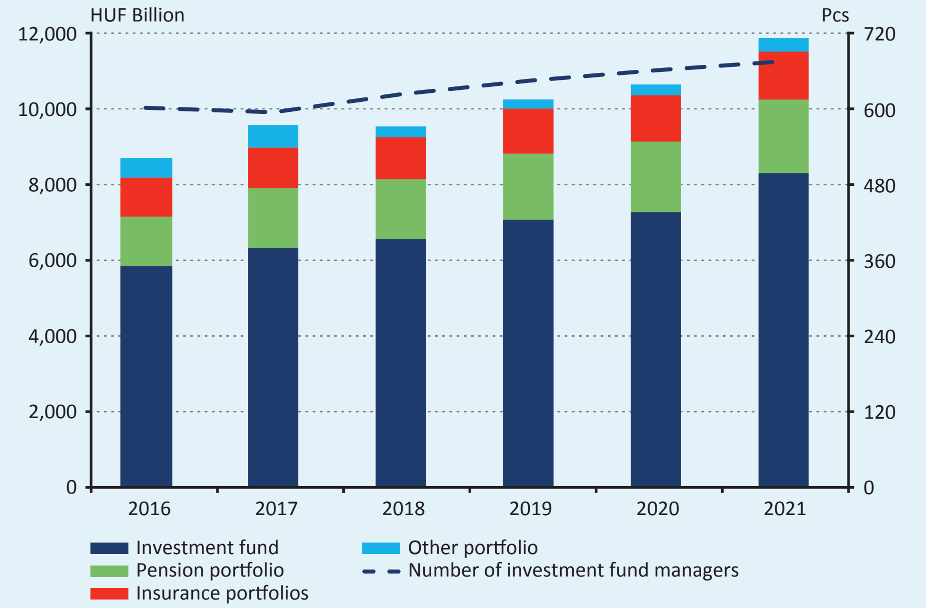
7.4 FUND MANAGEMENT MARKET AND RISKS AFFECTING INVESTMENT FUND MANAGERS

7.4.1 Dynamic growth in the assets managed by investment fund managers

The number of investment funds rose from 661 registered at the end of 2020 to 675 by the end of 2021. The previous increasing trend of real estate funds continued in 2021 as well and accordingly, the number of real estate fund rose from 154 in 2020 to 171 by the end of 2021. By contrast, the number of securities funds decreased from 507 of 2020 to 504 in 2021. The number of public real estate funds – also available to small investors – did not change in 2021.

In 2021, even amid of the global economic instability caused by the coronavirus pandemic, the volume of assets managed by the domestic investment fund managers continued to grow and reached a new historic high: the volume of assets managed in the amount of HUF 11,875 billion at the end of 2021 exceeded the amount of HUF 10,668 billion at the end of 2020 by 11.3 percent (the volume of assets managed by investment fund managers rose by 4 percent in 2020 and by 7.5 percent in 2019, fell by 0.2 percent in 2018 and increased by 9.7 percent in 2017). In absolute terms, the net asset value of investment funds continued to grow to the largest degree in 2021: the net asset value of investment funds in December 2021 in the amount of HUF 8,294 billion exceed the net asset value registered in 2020 in the amount of HUF 7,270 billion by HUF 1.024 billion (14.1 percent). In the case of funds, the assets of voluntary funds managed by investment fund managers increased significantly: the amount of HUF 1,649 billion in 2021 exceeds the 2020 figure by 7.1 percent. In 2021, in terms of dynamics growth in other portfolios ranked first: assets managed in these portfolios in the amount of HUF 336 billion exceeded the 2020 figure by 15.1 percent. In 2021, the number of investment fund managers managing other portfolios decreased by 2 to 8. The assets managed by investment fund managers in insurance portfolios – similar to previous years – continued to increase also in 2021, albeit at a lower rate: the portfolio of HUF 1,278 billion exceeds the value registered in 2020 by 2 percent. (Chart 7.15)

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

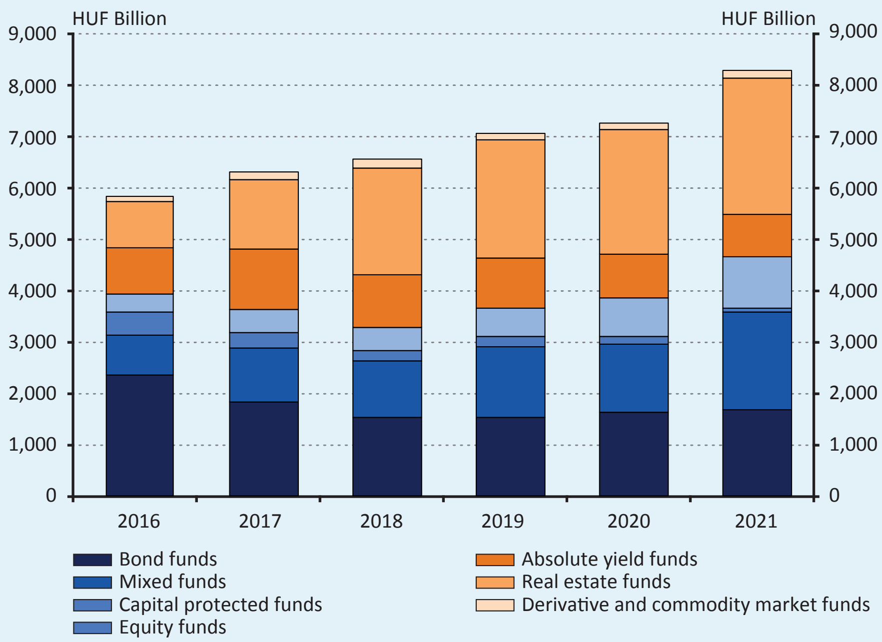


Source: MNB.

7.4.2 Capital inflows caused net asset value of mutual funds to rise to a new historic high

In 2021, despite the global economic instability caused by the coronavirus pandemic, the net asset value of investment funds increased by 14.1 percent to HUF 8,294 billion. Contrary to the previous two years, in 2021 the growth in the assets of investment funds is mainly attributable to net capital inflows: accordingly, of the HUF 1,024 billion increase in net asset value, HUF 699 billion is attributable to net capital inflows, while the remainder comes from yields. The assets managed by investment funds investing in interest-bearing assets, i.e. liquidity, money market, short-term bonds, long-term bonds, and bonds without duration target, increased by 2.5 percent to HUF 1,677 billion. However, the restructuring within fixed income investment funds continued: the assets managed in liquidity and money market funds fell by 72 percent to HUF 7 billion and by 11.5 percent to 23 billion, respectively, while the net asset value of short-term bond funds rose by 6.3 percent to HUF 1,210 billion. Overall, the assets managed in mixed funds increased by HUF 565 billion to HUF 1,898 billion. The largest growth both in absolute and relative terms was realised by dynamic mixed funds: the 2021 portfolio of HUF 527 billion exceeds previous year's figure by HUF 332 billion (+170.8 percent). In the case of mixed funds, the largest increase in both absolute and relative terms was observed in dynamic mixed funds: the portfolio of HUF 527 billion held in dynamic mixed funds in 2021 exceeds the figure of HUF 195 billion registered previous year by HUF 332 billion, i.e. by 170.8 percent. The net asset value of bond-heavy mixed funds and balanced mixed funds also increased: the net asset value of bond-heavy mixed funds was HUF 584 billion, exceeding previous year's figure by 12.6 percent, while the net asset value of balanced mixed funds was HUF 787 billion, up by 27 percent compared to 2020. Following the growth of 32.9 percent in 2020, the net asset value of equity funds rose in 2021 by 37.1 percent – the closing balance of HUF 1,013 billion exceeds the volume of assets managed in 2020 in the amount of HUF 739 billion by HUF 274 billion: half of the increase is due to net capital inflows, while half of it comes from yields. The decline in the assets of capital protected funds over the past five years continued and accelerated in 2021: the net asset value of these funds in 2021, at HUF 86 billion, falls short of the 2020 figure by 41.1 percent – i.e. the portfolio declined to its one fifth in five years. 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 2021: at the end of 2021, the assets managed in real estate funds in the amount of HUF 2,650 billion exceeded the 2020 closing value of HUF 2,429 billion by 9.1 percent. (Chart 7.16)

Chart 7.16
Breakdown of the investment funds by investment policy

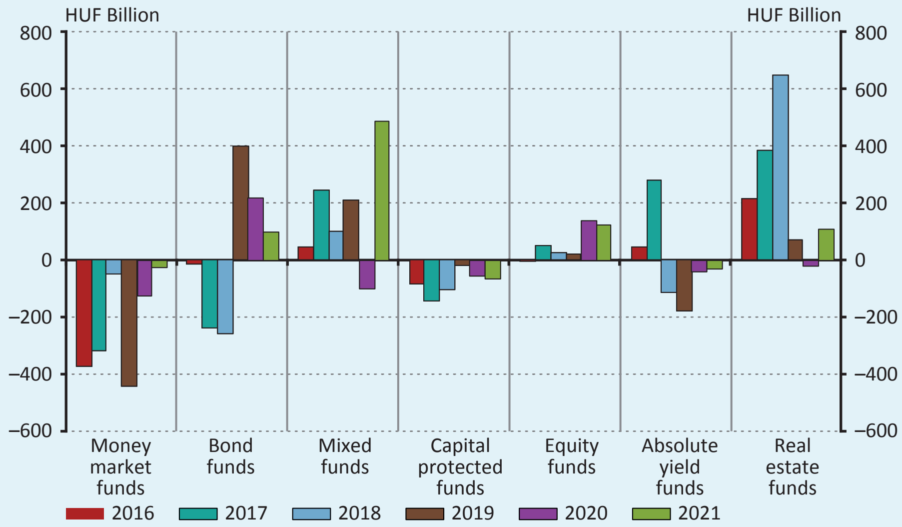


Source: MNB.

7.4.3 Net capital inflows of investment funds at a historic high

Investment funds were characterised by net positive capital inflow at sector level in 2021 as well, significantly exceeding the value registered in 2020: 2021 resulted in net capital inflow of + HUF 699, compared to the figures registered in 2020, 2019, 2018 and 2017 in the amount of + HUF 12 billion, + HUF 67 billion, + HUF 260 billion and + HUF 270 billion, respectively. The largest net capital inflows in 2021 were generated by mixed funds. Equity funds also realised significant net inflows in the amount of HUF 123.1 billion. Capital protected funds suffered the largest net withdrawal of capital (-HUF 61.6 billion). Trends in recent years show that this product has failed to meet investors' yield expectations. Money market funds suffered additional withdrawal of capital in 2021 as a result of the low yield environment (- HUF 22 billion). Investment funds investing in interest-bearing assets, experienced positive capital inflows (HUF +97.4 billion) in 2021, (2017: HUF -545 billion, 2018: HUF -298 billion, 2019: HUF -41 billion, 2020: HUF +94 billion). Withdrawal of capital from absolute return funds continued in 2021, albeit at a declining rate: net withdrawal of capital amounted to HUF 31.1 billion in 2021 compared to almost HUF 41 billion registered in 2020. This significantly falls short of the net withdrawals of capital in 2018 and 2019 in the amount of HUF 112 billion and HUF 174 billion, respectively (Chart 7.17)

Chart 7.17
Net capital flows of investment funds

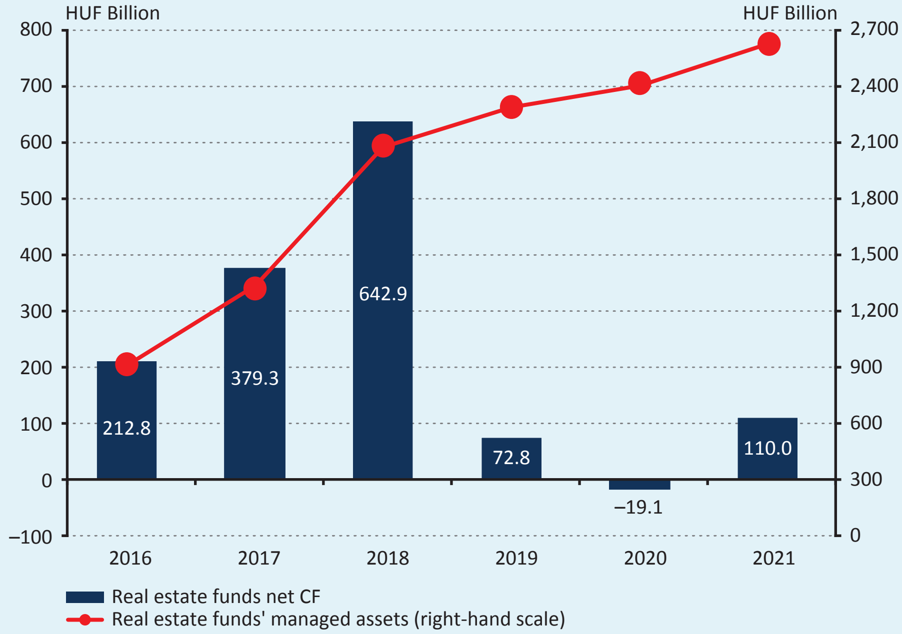


Source: MNB.

7.4.4 Real estate funds characterised by moderate capital inflows in 2021

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. However, moderate capital inflow was observed once again in 2021. (Chart 7.18) Net asset value of funds investing in direct real estate increased from HUF 2,181 billion in 2020 to HUF 2,204 billion in 2021: of the increase of HUF 123 billion, the investment yield realised on the managed portfolio amounted to HUF 95 billion, while net capital inflow was HUF 28 billion. The net asset value of funds investing into indirect real estate rose by HUF 99 billion in 2021, from HUF 248 billion of 2020 to HUF 347 billion. Of the HUF 99 billion increase in net asset value, HUF 82.3 billion is attributable to net capital inflows and HUF 16.7 billion to yields realised on investments.

Chart 7.18
Portfolio and net capital inflows of real estate funds

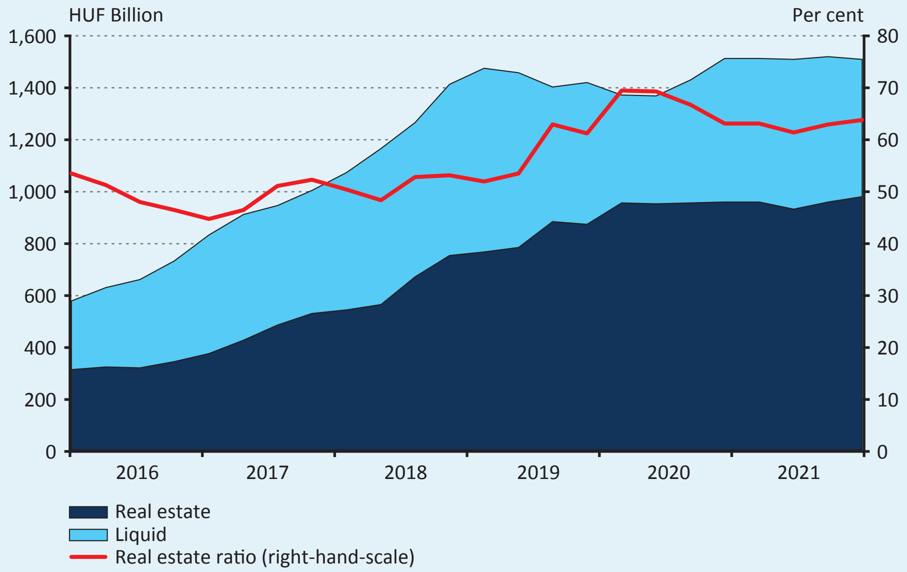


Source: MNB.

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

In 2021, 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 2021 in the amount of HUF 1,529 by 0.6 percent. The growth registered in 2017, 2018, 2019 and 2020 was 36.9 percent, 41.6 percent, 0.4 percent and 6.9 percent, 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 2019 and partly to the launch of the Hungarian Government Securities Plus household government securities. The growth in assets managed by of public real estate funds was practically stagnated. Of the HUF 9 billion increase in the net asset value of public real estate funds in 2021, HUF 53 billion is attributable to yields, while HUF 44 billion is due to net capital outflows. 2021 was characterised by steady net capital outflows throughout the year, which was offset by yields. The largest withdrawal of capital took place in the second quarter of 2021, when HUF 23.5 billion was withdrawn from public real estate funds. Despite the withdrawal of capital, the real estate investment portfolio of public real estate funds was between 63 and 64 percent, which is roughly the same as the value of 61 percent registered at the end of 2019. (Chart 7.19) Public real estate funds continued to be characterised by strong concentration in 2021 as well: the top three public real estate funds with the highest net asset value accounted for 75.9 percent of the public real estate funds' total net asset value, which was below the level registered in 2020 by 1.5 percent.

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

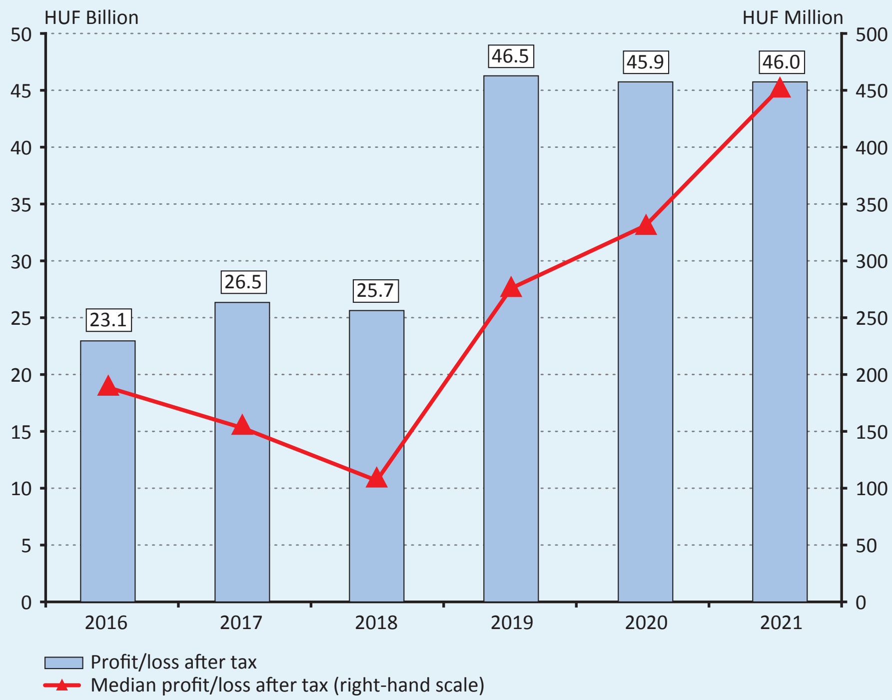


Source: MNB.

7.4.6 Profitability in the fund management sector remains high

The after-tax profit of the investment fund management sector maintained the level of HUF 45.9 billion registered in 2020 also in 2021, which seems to have stabilised over the last 3 years. 4 investment fund managers were loss-making in 2021, while the after-tax profit of 10 fund managers fell significantly (by 47 percent) compared to 2020. However, the investment fund management sector almost doubled its after-tax profit compared to 2017. In addition to the foregoing, the fund management sector appears to be sounder in terms of profitability, which is also confirmed by the median of after-tax profit rising year by year. (Chart 7.20)

Chart 7.20
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 2021: the after-tax profit/loss of the top market participants with the highest after-tax profit accounted for 57.1 percent of the entire sector's after-tax profit in 2021, which falls short of the 2020 figure by 4.46 percent.

In 2021, the business model of investment fund managers continued to be characterised by outstanding profitability for those fund managers that were in business already in 2019, 2020 and 2021. This is also confirmed by the high level of the ROE ratio –after-tax return on equity. (Chart 7.21)

Chart 7.21
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	●	↑	Higher government debt resulting from pandemic situation that unfolded in 2020, rising inflation and general uncertainty concerning the protraction of the pandemic, together with the Russia-Ukraine war commenced in early 2022 increased market risks. Several countries started a monetary tightening cycle, as a result of which bond market performance deteriorated and the yield advantage of real estate funds decreased. Due to the economic impacts of the war between Russia and Ukraine equity markets became extremely volatile.
Profitability	Market yield environment	●	→	The profitability of the fund management sector in 2021 was significantly improved by the soaring equity market, which increased the sector's revenues through performance fees. The competition generated by the yields realisable on household government securities eased. Investments flowing into real estate funds declined. Uncertainty in the market environment and geopolitical tensions may continue to pose risks to securities and real estate prices,
Corporate governance	Sustainability aspects, tightening international expectations	●	→	Delay in the EU sustainability legislation is a greater challenge for fund managers. In the uncertain environment, the risk of "greenwashing", i.e. the sale of products that are deceptively claimed to be green.
Operational risk	Risk management systems	●	→	At some of the fund managers, the risk management, liquidity management and back office processes call for enhancement
Capital adequacy	Profitability	●	→	Despite the pandemic, the fund management sector closed a positive year in 2021, 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.

Note:

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

Direction of risk — *increasing* ↑ *stagnant* → *decreasing* ↓

The impact of the capital market turbulence in 2021 affected the investment fund management sector more significantly primarily in the area of market risks, as a result of which in 2021 the sector's inherent risk remains high in this respect. According to expectations, the sector will face significant risk also in the periods ahead. Although the fund management sector was still characterised by capital inflows in 2021, the inflation environment, repeated interest rate hikes and the Russia-Ukraine war may have a particularly negative impact on the market's capital inflow dynamics in 2022. In 2021, the liquidity of investment funds received special attention and it remains a key focus also in 2022. Delay in the EU sustainability legislation represents a challenge for fund managers. In the uncertain environment, there is an increased risk of "greenwashing", i.e. the sale of products that are deceptively claimed to be green.

7.5 CAPITAL MARKET CONSUMER PROTECTION

In line with the objectives set out in the MNB's supervisory strategy for 2020–2025 (consumer-centric approach, strong consumer protection), the focus of capital market consumer protection supervision is on ensuring that the implemented product sales practices are combined with the transparent, clear and fair presentation of the costs connected the provision of investment service and the risks linked to financial instruments, resulting in the recommendation of capital market investments suitable for customers. Guided by this consumer protection approach, the MNB has carried out consumer protection inspections on a number of topics in recent years.

7.5.1 Annual subsequent cost reporting

According to the statutory requirements, investment service providers are also required to provide their customers, at least annually, with subsequent information on the costs of all services used by them and the financial instruments sold to them. In 2020, the MNB assessed, within the framework of continuous oversight, how investment service providers comply with this obligation. According to the survey Hungarian market participants applied different solutions in terms of the content, format and timing of information sent to customers. On the basis of the identified good practices and the foreign good practices learnt through participation in the various international working groups, the MNB issued an executive circular to draw the attention of service providers to the practices it expects them to follow, primarily in order to provide customers with more consistent subsequent information on costs, thereby also helping them compare different service providers. Another important objective was to ensure that customers have timely access to information.

The MNB assessed compliance with the requirements of the executive circular in 2021, when the first annual information round following the circular have been completed by all service providers. The central bank's experience shows that the vast majority of service providers complied with the timing envisaged by the central bank: 13 out of the 15 surveyed institutions sent the information to the vast majority of customers within or shortly after the deadline of the end of April set in the circular. Overall, the sector informed its customers about costs on average a full quarter earlier than in 2020, but some of the service providers improved their performance in this respect by half a year. With regard to customers terminating their contract, the MNB prescribed different deadlines in order to minimise the time between termination and the sending of the last information. The 2021 survey showed that some service providers had met the central bank's expectations already last year, while others were still in the process of developing or enhancing their procedure. The MNB saw progress also in other requirements of the circular: overall, the information and the additional explanations became more extensive and standardised, and the formatting also moved to a direction of more consistent market practices.

7.5.2 Suitability assessment thematic inspection

In addition to reinforcing consumer protection issues in its comprehensive inspection, the MNB conducted – at ESMA's initiative to strengthen convergence between national supervisory authorities – a thematic inspection already for the second time. In 2020, all providers of investment advisory or portfolio management services were involved in the suitability assessment. The thematic inspection aimed to assess compliance with investor protection obligations involving the provision of investment advice. The key focus of the assessment was on the content and evaluation logic of the suitability questionnaires, the risk rating of recommended instrument and rating methodology, the suitability reports to support the investment advice, and the cost-benefit analysis to be performed when switching between investments.

During the thematic review, the MNB also identified several good practices as well as practices that represent consumer protection risk. A total of 62 findings requiring action were issued for the 13 inspected institutions. 23 of those were sent by the central bank to the institutions as obligations issued in the form of a decision and 39 in the form of a management letter. At the end of the inspection, in addition to the individual feedback from each institution, the MNB also issued an executive circular, in which, in addition to describing positive practices, it further elaborated on the requirements of certain obligations set out in the legislation or in the respective MNB recommendation, and sometimes illustrated with examples.

In the context of obtaining information underlying the suitability assessments, the MNB regarded it as a positive practice for service providers to reduce the weight of customer self-assessment and to opt for solutions that focus on objective assessment through the formulation of questions and answers and through control questions. In connection with this, it was also identified as good practice to assess the characteristics of the customer to be tested through several questions in a sub-topic, opening up the possibility of carrying out consistency checks between responses and taking account of any inconsistencies in the final assessment. As regards the updating of the questionnaires, the MNB found that, in line with its expectations, service providers update the information on the customer at least every 3 years (some service providers do this more frequently, for example annually), but also called upon institutions to provide information to customers in a proactive manner.

In the area of risk classification of products, the MNB identified anomalies at several institutions, where the risk classification of certain products or product groups by the service provider did not reflect the actual risk of the products or where products of different risk classification according to objective measures were assigned a similar risk rating. These anomalies were addressed by the MNB in the decisions addressed to individual institutions. It also highlighted the importance of this in the circular, in particular to ensure that the classification is based on a documented, traceable methodology.

Identifying potential substitutes and selecting from these the best offer for the customer based on certain criteria, as part of the investment advisory service, was another cardinal topic. In principle, the legislation allows for the recommendation of any of the substitute products, but it is an essential consideration that the cost and complexity of the products are assessed as part of the analysis. The MNB also expects institutions to provide additional justification for the selection of more expensive or complex products, as well as record-keeping and traceability of these situations. The MNB found that substitute products at most institutions are interpreted solely in the case of investment funds, and different types of products are not compared. In the MNB's view, although it is the investments funds where the possibility of two funds substituting each other is the most obvious, this could also be the case for other products, especially if the target market characteristics defined by the service provider – which fundamentally determine the customer base for which the products are to sold – are also the same for these products. In the circular, the MNB drew the attention of service providers to this opinion, highlighting the expectation that the methodology should also include what other aspects, if any, beyond the target market characteristics are taken into account by service providers when assessing fungibility. The MNB has also stressed its expectation that, in addition to transaction costs, other costs, in particular those that are included in the price of the product, should be taken into consideration when choosing the potential substitute product that is ultimately offered to the customer.

It is a statutory requirement concerning investment advice that institutions should prepare a suitability report summarising the essence of the advice and substantiate the suitability of the product(s) offered to the counterparty, taking into consideration the customer's investment objectives and personal circumstances. In the MNB's experience, all of the inspected service providers prepare suitability reports, but many institutions made only general statements in support of their advice. Accordingly, the MNB has formulated it as a requirement that the information available on the product and the customer should be worded directly in the suitability report, thereby making the comparison clear.

In investment advice, situations that lead to a switch between investments are common. In such cases, the adviser will propose to sell a product already owned by the customer and buy a different product. This can be done in one conversation, but often the sale transaction is not settled promptly, and the parties return to question of reinvesting the released amount a few days later. According to the law, institutions must carry out a cost-benefit analysis for this type of advice, whereby they ascertain that the monetary (e.g. higher yield) or non-monetary (e.g. change of investment horizon, increase in diversification, increase in liquidity) benefits that can be realised by the switch exceed the costs of switching, such as transaction fees and any additional ongoing and exit costs associated with the new product. The MNB found that several service providers interpreted the concept of switching between investments in an overly narrow sense, i.e. only for certain product types, only if both transactions belonged to the same product type, or only for advice made at the same time to sell and buy. The central bank regards this as unrealistic and drew the attention of service providers to this. Another common problem that the MNB identified when analysing the cost part of switching is that service providers only considered the immediately visible costs, i.e. transaction costs, while other costs, mainly those that are included in the price of the product, are ignored.

The MNB has set different deadlines for addressing the shortcomings identified in the inspection, and thus it will continuously assess the actions taken by institutions by the end of 2021 and the first half of 2022. The monitoring experience shows that the majority of service providers complied with the MNB's expectations.

7.5.3 Product governance thematic inspection

Product governance obligations have been introduced in the investment services market by MiFID II, with the focus of the regime being on identifying the target market for products and developing a distribution strategy. When identifying target markets, service providers essentially examine products and product groups as to the level of investment knowledge and experience expected by the product, the recommended horizon of the investment, the investment objective achieved and the risk tolerance and loss-bearing capacity required to achieve these objectives. This obligation applies to both the producers and distributors of the product. The latter are essentially expected to adapt to the target market characteristics and distribution strategy defined by the producers of the product, and relying on the information received from the producers of the product and from their own customer base they are also expected to define the target market for the products they distribute. The definition of the distributor's target market is particularly important in cases where the distributor is not related to the producer of the product (e.g. in the case of exchange-traded products). The statutory requirements assume continuous (at least annual) exchange of information between producers and distributors of products, as the actual sales data of distributors can also contribute significantly to a more accurate definition of the target market by the producers.

In order to strengthen supervisory convergence, ESMA called for involvement of supervisory authorities in this area as well. Accordingly, in 2021 the MNB launched a thematic inspection for the third time, this time involving 16 institutions. The main objective of the inspection was to examine whether the level of regulation, the related processes and approvals concerning product governance in the institutions, both in their capacity as product producers and distributors, are adequate in terms of the methodology for specifying target market characteristics and reviewing the characteristics, and whether the target market (and negative target market) characteristics set for specific products and product groups are indeed appropriate, taking into account all relevant product characteristics.

The thematic inspection will be closed in 2022. The MNB did not find any serious irregularities, but identified disquieting practices from a consumer protection perspective in several institutions. A recurring problem was that the target market criteria were not always well defined for certain products and product groups. At some of the service providers, certain elements of the criteria prescribed by the MNB were not assessed, while at others, although all aspects were included in the assessment, the differentiation between products was insufficient or, in particular at higher risk products, the target market characterisation was inadequate.

According to the statutory requirement, products can be essentially sold within the defined (positive) target market, but in justified cases it is also allowed to sell outside it. In this respect, several service providers define cases outside the target market where the customer does not meet some criteria, but this does not necessarily exclude him from the circle of sales. Service providers must also define a negative target market. Customers belonging to this market are usually incompatible with the product based on certain characteristics, but the product can be sold in this case as well subject to justification. In the MNB's experience, most service providers permit such transactions for services that do not involve investment advice, while certain institutions make an exception to this in justified cases (e.g. for diversification or hedging purposes) also within the framework of advisory service. Several institutions failed to define a negative target market for high-risk, complex products. The MNB called upon the respective institutions to rectify this omission. During the inspection, the MNB also paid special attention to the exchange of information between distributors and product designers, which was adequate at most institutions. However it identified cases where, for example, this could not be achieved in accordance with the MNB's expectations due to the lack of adequate records of sales outside the target market and on the negative target market.

The MNB, together with other supervisory authorities, reported the main findings of the inspection to ESMA, which will revise and supplement its recommendations on the basis of the reports, where appropriate.

7.5.4 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) 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. As part of it continuous oversight activity, the central bank monitors the advertisements and websites of the more popular cross-border service providers that advertise in Hungarian in the social media or on other websites, primarily with regard to the prescribe information elements, such as mandatory risk warnings and the balance and accuracy of messages related to CFD trading. The MNB did not identify any serious infringement, but identified consumer protection risks in the information provided in several cases, due to which it contacted the for which it referred several cases to the foreign supervisory authority supervising the institution. Given the high risk of CFDs, the MNB will continue to monitor service providers' advertising activity.

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 7.5
CFD trading – marketing and risk warnings

In its consumer protection monitoring activities, the MNB focuses on the inspection of investment firms' distribution strategies, including the provision of objective, balanced information when selling products. The requirement to provide fair, clear and non-misleading information is particularly important when selling high-risk products such as CFDs.

During the inspection of the marketing activities of foreign service providers most active in reaching Hungarian investors, the MNB found that online broker companies offering execution-only services tend to create advertisements that promise simple, quick and easy profits.

These service providers try to attract the attention of potential customers through active marketing, by highlighting the positive aspects of the CFD products they sell and often shifting the focus towards presenting the wealth and ease of trading in technical terms. These features of advertising can falsely create the impression for potential investors that user-friendly trading interfaces and techniques that make trading simple reduce the risk factors inherent in such products. This is clearly disproved by the risk warnings published by service providers, which is mandatory to be published by service providers under the ESMA product intervention decision and the MNB's restrictive measures. The percentage of accounts that are affected by a loss, shown in the warning, is high, i.e. typically 60-80 percent.

Another element to be highlighted is misleading communication regarding costs. Marketing materials often highlight the low levels of traditional costs (e.g. buying and selling commission), despite the fact that in the case of these products other types of costs are relevant (e.g. spread, overnight funding). Service providers' marketing strategies are also characterised by the use of highly popular social networking sites to target a wider range of consumers, thereby increasing the risk of selling outside the target market. This type of risk is particularly severe, as CFD trading is only recommended for investors with specific knowledge, experience and risk appetite. The MNB identified the marketing of products to the target market as another important aspect for its consumer protection inspections, which may be compromised in this respect, as described above.

In the light of the foregoing, it is of utmost importance from a consumer protection perspective to inspect the distribution strategy for high-risk products in the target market and to monitor compliance with the measures imposed by the MNB on an ongoing basis, in particular the proper publication of risk warnings.

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.

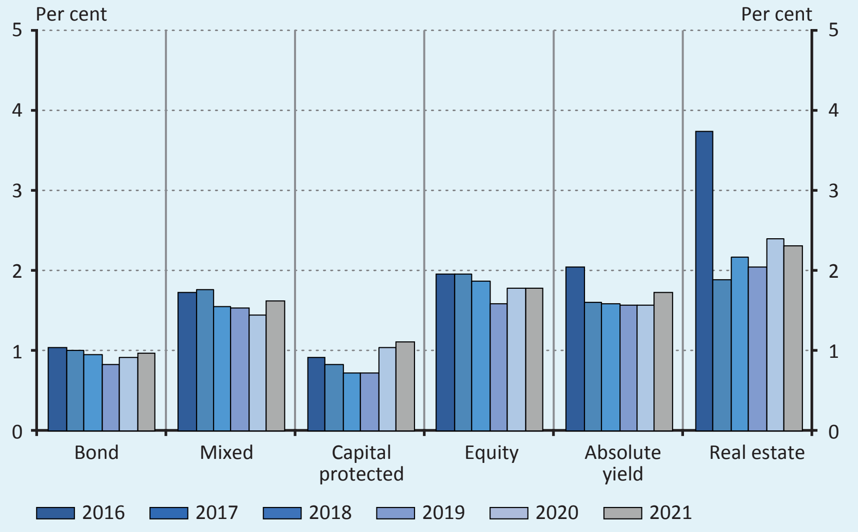
The introduction of risk warning requirements will therefore increase the ability of customers to obtain information on the real risk of CFD trading and will provide an opportunity to compare service providers operating within the EEA.

7.5.5 Costs of public investment funds in 2021

When examining Total Expense Ratio (TER)[21] in the preliminary unaudited individual data supply, we found that the funds with low average expense ratios are bond funds that invest in interest-bearing instruments (such as liquidity, money market, short-term, long-term bond and without duration target). The expense burden of these funds moderately increased in 2021. 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. The TER on capital protected funds also rose moderately. 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. No increase in costs was identified at equity funds, while at the absolute return and mixed fund there was a modest increase in cost burdens in 2021. The average TERs for bond and equity funds typically declined over the past five years. When examining the same period, while real estate funds registered an increase a few years ago, and in 2021 they once again decreased slightly. (Chart 7.22) (Chart 7.23) After receiving the audited data, the MNB publishes TERs broken down by fund, in line with previous practice.

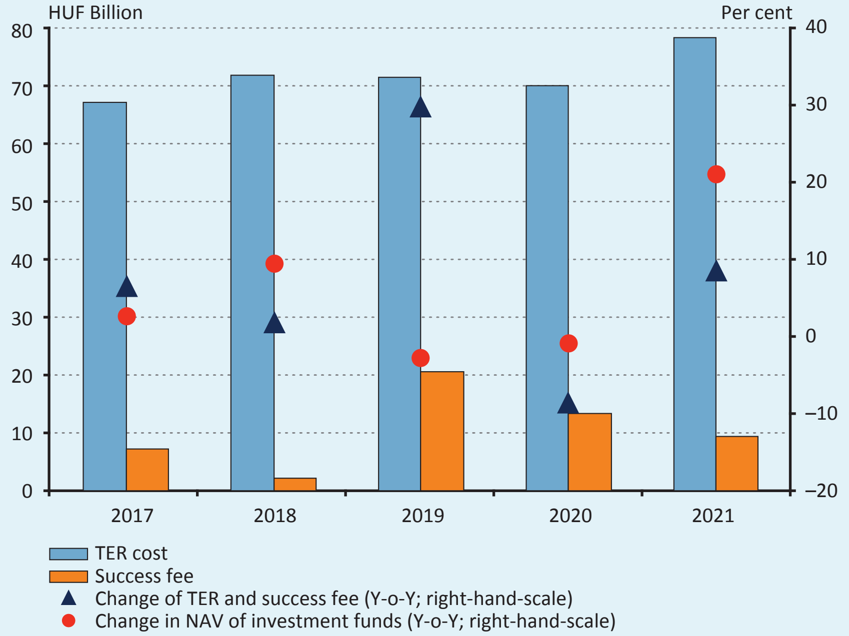
[21] TER (Total Expense Ratio) shows the total expenses of an investment fund as a percentage, making it possible to compare different investment funds from a cost perspective.

Chart 7.22
Changes in the TER of domestic public investment funds



Source: MNB.

Chart 7.23
Changes in the TER costs and success fees of domestic public investment funds



Source: MNB.

Source: MNB.

Box 7.6
MNB Recommendation No 11/2021 (VII. 1.) on success fees applied by investment fund managers

Success fee is one type of the costs that potentially may occur at investment funds. An investment fund manager using such fee may charge a success fee if the investment fund managed by it is able to outperform the predetermined level or benchmark of performance during the specified period.

In the Hungarian investment fund management market, more than a quarter of the roughly 400 public investment funds charge success fees. According to past practice, funds most often calculated the success fee based on the short-term government bond (ZMAX[22], RMAX23) or other money market index. From 2022, this practice required clarification, for which preparations were made in 2021.

The MNB, on the basis of the ESMA's guidelines, has therefore formulated recommendations to ensure that the success 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 the ESMA Guidelines published in 2020 was issued in summer 2021 and must be applied by all investment funds using success fees from 1 January 2022.

The most important objective of the draft recommendation is to ensure that the success 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, and not to make way for manipulation. Accordingly, the recommendation contains a separate chapter on the consistency of the success fee model with the specific characteristics of the fund. It defines the process for verifying and reviewing the objective, the criteria to be taken into consideration in this process as well as the consistency indicators.

The recommendation also sets out the mandatory elements of the success fee calculation method and establishes it as a principle that it should be in line with the interests of investors and ensure that success fees are always proportionate to the fund's actual investment performance.

As regards the frequency of the settlement of the success fee, the MNB's 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 success 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.

According to the recommendation, the success 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 recommendation is that the success fees should not encourage fund managers to take excessive risks.

Finally, the recommendation sets out the transparency requirements for the success 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 success fees actually charged, as well as the percentage rate of the fees charged, in the key investor information, the information necessary to justify the success 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 success fee, in particular the conditions and the date of paying of the success fee, and specific examples of the success fee calculation.

[22] 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 [23] The RMAX index is an index of the average change in the market price of government securities maturing within one year.

Box 7.7
Impact of the Russia-Ukraine conflict on the Hungarian capital market

The supervision of capital market institutions in the first quarter of 2022 was determined by the Russia-Ukraine war. The Russia-Ukraine military conflict unfolded in February 2022 and the resulting economic and financial sanctions also had an impact on the capital market sector. This is well illustrated by the fact that on 3 January 2022, the first trading day, the key index of the Budapest Stock Exchange, i.e. the BUX was at 51,924 points, while on 3 May 2022 the BUX stood at 43,592 points, i.e. registered a decline of more than 16 percent. Despite the pressure on capital market prices by sellers, domestic investment service providers appear to be stable, and thus the collateralisation of derivative positions of their customers meets supervisory requirements.

Assets under management by investment service providers at the end of the first quarter of 2022 amounted to roughly HUF 47,000 billion at market value, which is a decrease of HUF 1,900 billion (3.8 percent) compared to 3 January 2022. The devaluation of investments of Russian exposure already played a significant role in the decline in the amount of the managed portfolio, albeit not across the sector as a whole but affecting several major market players. Although several investment funds had Russian exposures, the degree of those exposures is negligible compared to the entire sector. These funds did not experience any panic-stricken redemption and the investment fund managers adapted to the changed market sentiment. In terms of numbers, only two investment fund managers had a specifically Russia-focused equity fund, the securities trading of which had to be suspended as the trading and quoting of several securities in the fund's portfolio ceased. It should be noted that portfolio and number of customers managed by suspended investment funds represents a negligible part of the entire sector. In the investment fund management sector, the net outflows from public and private investment funds since the outbreak of the war up to 11 May amounted to HUF 48 billion, i.e. 0.6 percent of the total portfolio. During this period, subscriptions and redemptions amounted to HUF 634 billion and HUF 682 billion, respectively. Despite the war conflict, capital outflows from investment funds have not been significant, amounting to only a few percent of total assets under management. The MNB experiences low outflows also in the case of real estate funds. At present this sector shows pretty stable and high liquidity, partly due to strict supervisory requirements. Accordingly, the situation of real estate funds is adequate, with a sector-level liquidity over 45 percent. It can be stated that as a result of the war conflict, the asset valuation method has become a priority issue in addition to liquidity and risk management, which is also closely monitored by the MNB. The Russia-Ukraine conflict has complicated the pricing of several securities, and reduced their liquidity. Concerning this issue, the MNB reminded institutions of the provisions of the previous circular. According to the report of the European supervisory authorities, the war that started two months ago continues to have moderate effect on the European fund management sector; nevertheless, pricing and valuation problems persist on the continent. Based on the list of securities affected by the sanctions against Russia, supervisory authorities, including the MNB, monitor compliance with sanctions. The MNB pursues close prudential supervision of investment service providers and investment fund managers – similar to the previous period of the pandemic – due to the volatile markets caused by the war. Overall, capital market service providers preserved their stability despite the turbulent environment.

7.6 ISSUER OVERSIGHT AND MARKET SURVEILLANCE

7.6.1 Investigation of market abuses

The MNB continued its fight in 2021 as well to curb and prevent market abuses, such as market manipulation, insider trading and other activities suitable to mislead investors. In 2021 29 market surveillance procedures were in progress due to breaching the rules in the MAR Regulation, of which 22 were launched for market abuse, 4 for insider trading and 3 for the prohibition of uncovered short selling and suspected failure to comply with the reporting and disclosure obligations for short selling. In 2021, the MNB launched 13 market surveillance procedures for market abuse and closed 11, and initiated criminal proceedings in 5 cases. The MNB imposed measures and sanctions on 6 individuals and a total of HUF 26.5 million in market surveillance fines.

Among the market surveillance procedures closed in 2021, it is worth mentioning one market surveillance procedure concerning the activities of a natural person stood in terms of the amount of the fine. In the course of the investigation, the MNB obliged the client to pay a market surveillance fine of HUF 10 million for violating the legal provisions on the prohibition of market manipulation specified in the EU Regulation on market abuse and prohibited the client from repeatedly breaching the legal provisions on the prohibition of market manipulation contained in the EU Regulation on market abuse. During its market surveillance activities, the MNB found that the client had submitted an abnormally high number of self-trading stock exchange orders in the period under review i.e. it had executed transactions where he was both the buyer and the seller. Furthermore, in addition to self-trading, the client placed a high number of orders during the period under review which were later cancelled. The cancelled orders may have given the false impression to other market participants that the respective securities had high turnover, given the large number and the very high volume of buy and sell orders recorded.

In addition to the foregoing, in 2021, 340 reports were submitted concerning suspected market manipulation and insider trading activity. The number of such reports almost doubled in 2021 compared to the previous year.

Box 7.8
About market manipulation in general

The MNB also monitors potential market abuses and carries out market surveillance procedures to investigate such abuses, in order to ensure the transparent functioning of financial and capital markets, increase the safety of investments and protect investors. An important basis for these procedures is MAD I, MAD II, i.e. the EU Market Abuse Directives, and the Market Abuse Regulation (MAR), one of the aims of which is to provide a single regulatory framework for the most serious market abuses, including insider dealing, unauthorised disclosure of inside information and the sanctioning of trading practices that constitute market manipulation.

During the market surveillance procedure, the MNB conducts an evidence, including on-site inspections, interviews with witnesses and the client being the subject of the procedure, and contacts foreign peer authorities. If the MNB establishes an infringement at the end of the market surveillance procedure, it may sanction the infringing activity in accordance with the law. In such cases, the fine may be as high as HUF 2 billion for individuals and HUF 4,667,550,000 for enterprises.

However, the MNB not only uses sanctions, but also places great emphasis on prevention. It operates its own monitoring system to identify market abuse cases, and also relies on the extraordinary data supply by the supervised institutions submitted on the STOR report template to the MNB as well as on the reports of individuals. Following the EU GDPR's entry into force and the modification of the relevant domestic regulations, the MNB handles these types of notifications according to special rules. The central bank receives reports of market abuse – which may as well be anonymous – through dedicated communication channels specifically established for this purpose and treats them confidentially.

The MNB monitors the activities of market participants using a number of different filters. Based on these filters, it pays particular attention to suspicious trading patterns that involve market manipulation: manipulation of the indicative opening price and closing price; artificial generation of turnover in a given security; investigation of self-trading; and layering (a market participant trying to manipulate the order book with a small number of orders).

With regard to the classification of the conduct described above, it may be stated that the mere fact that certain transactions give or may give false or misleading signals on an objective basis with regard to the supply and demand of the financial instrument in question, already establishes market manipulation. Market manipulation may also occur where there is only a possibility that transactions may convey false or misleading signals to capital market participants.

7.6.2 Investigation of unauthorised activities

7.6.2.1 Cleansing the market of illegal financial service providers

Timely detection and effective action against activities performed in the absence of a licence or notification relying on the available tools remains a priority for market surveillance. Reducing the unauthorised activities of operators providing services without a licence or notification is of key importance for both supervised institutions and the customers using the services in question, in terms of increasing the protection and resilience of the financial sector.

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

In 2021, the MNB initiated 15 market surveillance procedures for suspected unauthorised activities, i.e. activities carried out without authorisation or notification, and closed 12 market surveillance procedures, in connection with which it imposed market surveillance fines in the total amount of HUF 115 million. Similar to previous years, the MNB continued to conducted a wide range of investigations also in 2021, with market surveillance procedures covering a variety of suspicious financial, investment and insurance activities. On the other hand, a significant number of the investigations focused on unauthorised “deposit taking” and lending.

During its market surveillance procedure conducted with regard to the activity of F-hold Kft., the MNB found that the company had regularly granted loans for profit and acquisition of assets to several Hungarian consumers and companies, with or without interest, in more than 240 cases over a longer period of time, in the total amount of approximately HUF 1.8 billion. Upon concluding the market surveillance procedure, the central bank prohibited F-hold Ltd. from engaging in unauthorised financial services activities for good and imposed a market surveillance fine of HUF 100 million for unauthorised activities.

The year by year growth in the number of consumer reports of unauthorised activities reflects an increase in financial awareness in Hungary, which may lead to reduced financial vulnerability. The MNB places great emphasis on raising financial awareness: in the “Warnings for investors” section of its website, financial consumers can review the warnings issued by the MNB and the peer foreign supervisory authorities, and in the website’s search engine for legal market operators, they can check whether the person offering a financial service or investment product is licensed or registered by the MNB before they use it. The MNB also publishes on its website the main characteristics of unauthorised financial activities and extracts of decisions on market surveillance procedures that have been closed with a finding of infringement. The MNB’s website, its customer service and its financial advisory offices in the countryside also provide all the necessary information on financial operators operating in compliance with the law.

In 2021, 270 reports and over the last five years more than one thousand reports of suspected unauthorised financial activity were received. The number of reports increased by around 30 annually, i.e. the number of notifications of unauthorised activities almost doubled between 2017 and 2021.

Box 7.9
Making electronic data temporarily inaccessible

One of the MNB's missions is to ensure the stability, smooth, transparent and efficient functioning of the financial intermediary system and the protection of all participants in the financial intermediary system at all times. According to the experience of the market surveillance area, persons and organisations carrying out activities without the MNB's authorisation or without notification (i.e. unauthorised) most often try to advertise and promote their unauthorised activities as widely as possible by taking advantage of the opportunities offered by the internet.

By appearing to be credible and honest on the internet, unauthorised individuals and organisations gain the trust of many investors, who then are often willing to hand over their savings to unauthorised financial operators for investment. In all cases, the conduct of actors committing this type of breach may also give rise to suspicion of criminal offences, in particular the crime of unauthorised financial activity, or property crime, such as fraud and embezzlement, which typically result in significant subsequent financial loss/damage to investors.

Due to the increasing number of online financial frauds, in order to protect Hungarian investors, it has also been set as a goal of the market surveillance area to expand the set of supervisory instruments and allow the MNB to apply the temporary measure of making electronic data temporarily inaccessible (practically blocking certain websites), subject to appropriate legal safeguards. This purpose of this measure is to make websites promoting unauthorised activities inaccessible to potential investors, thereby preventing them from promoting their activities further.

Based on the amendment to the MNB Act promulgated in May 2021, from 15 January 2022, the central bank may, on the one hand, order the temporary inaccessibility of electronic data as a temporary safeguard measure until the conclusion of the market surveillance procedure and, on the other hand, order the temporary inaccessibility of electronic data as a temporary safeguard measure for 365 days on not more than two occasions after the conclusion of the market surveillance procedure establishing the infringement, as follows.

In its market surveillance procedure, the MNB may order the temporary inaccessibility of data (electronic data) published via an electronic communications network, the disclosure of which prepares or facilitates the performance of an activity without authorisation or notification, until such time as a decision on the merits is made, as a temporary protective measure, if the interests of the clients (investors) of the person or entity under examination in the market surveillance procedure are jeopardised by the published data. In addition, the amendment provides that, where it is necessary for the protection of investors' interests, the MNB may, as a precautionary measure, order for 365 days the temporary inaccessibility of electronic data the disclosure of which has prepared or facilitated the performance of an unauthorised or unregistered activity and where the MNB has applied a prohibition measure in its decision establishing the infringement. The MNB shall review the justification for maintaining the safeguard measure, which temporarily prescribed making electronic data inaccessible, 365 days after it becomes final and decide whether to terminate it or, if necessary to protect investors' interests, to maintain it in force for a further 365 days.

All electronic communications service providers are subject to the MNB's decision on making electronic data temporarily inaccessible. The MNB will impose a procedural fine of HUF 1 million to HUF 5 million on electronic communications service providers for breaching their obligations in relation to the decision to make electronic data temporarily inaccessible. The National Media and Infocommunication Authority (NMHH) organises and supervises the implementation of the temporary inaccessibility of electronic data on the basis of Act C of 2003 on electronic communications.

The temporary inaccessibility of electronic data, i.e. the blocking of the websites of unauthorised service providers within the framework of the market surveillance procedure, is a way to protect investors' interests on a broad scale, in particular by rapidly minimising the possibility of the person or entity carrying out the unauthorised activity to contact new potential investors, thereby reducing losses to investors and contributing to an even more effective supervision of the financial intermediary system and to the efficient protection of investors' decisions.

7.6.2.2 Developments in the 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.

As a result of consumer searches, the MNB's keyword advertisements have already appeared 1.5 million times in 2021, and as a result, nearly 115,000 more people have visited the MNB's Warnings subpage. Each visit and click reduces the chances of someone becoming a victim of a breach.

Box 7.10
Risks of crypto instruments in Hungary

Every year, the MNB receives a significant number of market surveillance notifications concerning activities involving crypto instruments instead of financial instruments. It is therefore important to emphasise that the MNB currently has no mandate or powers to manage crypto instruments, and thus this asset class may carry particularly high risk for investors. This is exacerbated by the fact that due to the current lack of a single EU regulation there are many opportunities that may appear as an investment, but in fact they are nothing but a simple deception or fraud.

According to Chainalysis' survey, crypto instruments equivalent to less than USD 22 billion were received between 1 July 2020 and June 2021 at addresses linked to Hungary. According to the survey, 55 percent of the crypto instrument flows linked to Hungary were received by the increasingly popular decentralised financial industry (DeFi), while 45 percent of it flowed to centralised crypto instrument providers (e.g. exchanges, custodian, wallet providers), which are controlled by some central actor. The vast majority of transactions examined in the survey took place in the Ethereum blockchain crypto currency - i.e. Ether. This was followed by transactions in stablecoins. Surprisingly, the survey shows that Bitcoin is less significant in terms of transactions in Hungary. According to the survey, these indicators place Hungary in the mid-range of the Western, Central and Northern European region, ahead of Croatia, Estonia, Lithuania and Malta. Hungary is ranked 102nd out of 157 in the global ranking of crypto currency acceptance. It should be noted that the Visegrád 4 countries are ahead of Hungary in the ranking.

Despite the fact that Hungary ranks lower in the global ranking, it is still faced with the same benefits and risks connected to crypto instruments as everybody else. While the benefits (e.g. cost-efficiency, lack of centralised actors, decentralised solutions, etc.) are undisputable, from a consumer protection perspective, there are also many risks associated with crypto instruments and the activities carried out with them. These are exacerbated by the fact that the oversight of crypto instruments, apart from money laundering aspects, is not ensured. Blockchains have limited capacity and scalability limitations, which can cause disruptions in transaction execution and generate significant transaction costs for users in the event of excessive network traffic. Several promising initiatives have emerged to address this problem (e.g. blockchain on blockchain, interconnected blockchains).

The first market risk to be mentioned is the volatility of crypto assets. This market may also be subject to market manipulation and misleading communications that undermine transparent pricing. This may be coupled with volatile liquidity in the markets. Therefore, a consumer may not be able to conclude a transaction for the crypto instrument at a fair price, he may not be treated fairly, or may not be able to exit the position due to the lack of a potential buyer.

Consumers also face crypto crimes such as fraud, transactions with stolen assets and darknet activities as well as money laundering. In such cases, it is also possible that there is no crypto instrument at all and the consumer has become a victim of scam. Moreover, protocols may also pose IT risks, their vulnerability can be exploited by hackers, developers, or the user can lose the private key that gives access. On the other hand, some products that provide exposure to crypto assets are rather complex and sometimes have features that may increase the size of losses in the event of adverse price movements. The complexity of these products makes them unsuitable for many consumers.

It is therefore essential that consumers have enough information (read), are aware of and weigh up the risks before carrying out any transaction with crypto instruments (e.g. buying, selling, lending, borrowing, etc.) and, if they decide to do so, manage them appropriately, in particular minimise any potential loss.

At present, the MNB has no mandate or powers to manage crypto-assets. However, the EU regulation of digital solutions (e.g. crypto instruments, artificial intelligence, etc.) is in progress and will become applicable around 2025. If the Parliament decides that the MNB should perform the oversight of these solutions, the supervisory authority will have the means to prevent unlicensed or unfairly operating service providers, thereby enhancing consumer protection.

7.6.3 Issuer oversight

At the end of 2021, the securities issued by 40, 8 and 66 companies were traded on the regulated market operated by BSE (Xbud), on the Xtend multilateral trading facility and on the Xbond multilateral trading facility, respectively. In 2021, the MNB issued 28 decisions as part of its continuous supervisory activity, including 14 decisions imposing supervisory fines in the total amount of HUF 6.1 million. In addition, in 154 cases, it has sent requests for information or statements to issuers, shareholders or auditors. In 2021, the central bank launched three target inspections on IFRS concerning public issuers.

In 2021, the equities of Eprolius Real Estate Plc were admitted to the principal market of the Budapest Stock Exchange (i.e. Xbud). There were no delisting. In 2021, equities of 3 issuers (Nap Nyrt., OXO Technologies Holding Nyrt., Polyduct Nyrt.) were admitted to the Xtend multilateral trading market for small and medium-sized companies of the Budapest Stock Exchange.

The monitoring of issuers' compliance with regular and exceptional disclosure requirements is the backbone of the ongoing oversight of issuers. As part of the regular disclosure, the issuer of the securities admitted to trading on a regulated market must regularly inform the public of the main data on its assets, income and operations, and also inform the Supervisory Authority at the same time as the disclosure. Based on the provisions of Act CXX of 2001 on the Capital Markets (Capital Market Act) and MoF Decree 24/2008 (VIII.15.) on the detailed rules of the information obligation in relation to publicly traded securities (MoF Decree), the key regular disclosure obligation comprises the publication of annual and semi-annual reports. In addition, issuers are required to publish the number of voting rights attached to their shares by series for the last day of each calendar month, indicating the holdings of treasury shares, and the amount of share capital without delay, or on the next business day, at the latest. As part of the extraordinary disclosure obligation, the issuer of a security admitted to trading on a regulated market is required to disclose to the public without delay, or within one working day at the latest, any information which directly or indirectly affects the value or yield of the security or the assessment of the issuer. The detailed rules for extraordinary disclosures are also included in the MoF Regulation (e.g.: significant change in the issuer's plans or strategy compared to the last disclosure by the issuer, large orders, significant increase or decrease in the issuer's new investments or assets, change of auditor and the reasons for such change, etc.)

Any of the information subject to the regular and extraordinary disclosure requirements may contain insider information that already falls within MAR. The MAR regulatory framework is designed to curb and prevent market abuse. The most important of these are the proper handling and public disclosure of insider information as soon as possible, the prohibition of market manipulation and insider trading. Mar also specifies an obligation to report transactions and periods of prohibition on entering into transactions in respect of persons in management positions (including persons closely related to persons in management positions).

The MNB's objectives include encouraging voluntary compliance of public issuers of securities, rather than imposing sanctions subsequently, and to provide as broad information as possible on the MNB's expectations and the practices required by law. To this end, in 2021, the central bank provided even more resources for the education of market participants and held a total of 16 customised issuer workshops in 2021, which provided an opportunity to clarify issues related to capital market obligations.

In addition to the foregoing, compliance of issuers with the MAR regulation bears utmost importance for the MNB. In this context, the MNB had the opportunity to provide market participants with detailed information on the MNB's expectations and the practices required by the legislation at several events with high attendance. The Capital Markets Professional Day was organised by the MNB in December 2021 for participants of the regulated market and the Xtend multilateral trading facility, attended by 174 delegates of 50 issuers. In addition, the BSE organised two forums for issuers registered in the Xbond multilateral trading facility in 2021, at which experts from the MNB also participated as speakers. A total of 134 people attended these events.

In addition to the customised consultations and presentations, the MNB also issued an executive circular in 2021, which aims to formulate the MNB's expectations regarding compliance with MAR, thereby increasing the predictability of law enforcement and fostering the uniform application of the relevant legislation. In addition to the foregoing, the MNB follows the practice that new entrants to the Xbond market always receive a general information letter explaining their obligations under MAR.

Box 7.11
Management of insider information related to regular information

MAR requires the issuer to disclose to the public, as soon as possible, insider information relating directly or indirectly to it or to a financial instrument issued by it, in order to prevent insider trading and misleading investors. Where the issuer, or a person acting on its behalf or for its benefit, identifies insider information, the issuer, or a person acting on its behalf or to its benefit, prepares an insider list of persons who have access to the insider information and disclose the insider information publicly through appropriate channels as soon as possible.

Subject to certain conditions, MAR provides for the possibility, at the issuer's own risk, to delay the public disclosure of insider information in order to protect the issuer's legitimate interests. According to Article 17(4) of MAR, public disclosure of insider information may be delayed if immediate disclosure is likely to prejudice the legitimate interests of the issuer, it is unlikely that the delay misleads the public and the issuer can ensure that the information is kept confidential. The issuer shall, promptly after the public disclosure of insider information, notify the MNB that it has delayed the public disclosure of insider information and explain in writing how the conditions set out in Article 17(4) of MAR, listed above, have been satisfied.

It should be emphasised that, even when preparing interim or year-end financial reports, the issuer should assess on an ongoing basis whether any insider information can be identified in connection with the reports being prepared.

Should it be the case, the information should be treated as such, i.e. to be disclosed "as soon as practicable" or, if the conditions of Article 17(4) MAR are met, delaying the public disclosure of insider information.

While typically the publication of reports is scheduled in advance according to the issuer's corporate event calendar, this scheduled publication does not result in the issuer being exempted from the provisions of Article 17(1) of MAR or, if the conditions therein are met and the issuer chooses to delay the public disclosure of insider information, from the provisions of Article 17(4) of MAR, in respect of reports where insider information is identified.

Accordingly, if an issuer identifies insider information when compiling a report, whether it identifies all or part of the report as such, it must decide whether to disclose the insider information as soon as possible or, if the conditions are met, to delay disclosure of the insider information to the public. In the latter case, the issuer shall, promptly after the public disclosure of insider information, notify the MNB that it has delayed the public disclosure of insider information and the notification shall contain specific information and details as to how the conditions set out in Article 17(4) of MAR have been satisfied.

7.6.3.1 Compliance with the European Single Electronic Format (ESEF)

Among the 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 should be highlighted again this year. The main objective of the ESEF is to provide a common format for the rapid processing, comparison and analysis of data in consolidated financial statements, thereby facilitating fast and informed investor decision-making and increasing market efficiency. Having postponed the implementation by 1 year, the use of ESEF is now mandatory for annual reports for financial years starting on 1 January 2021 and thereafter.

In addition to the above-mentioned benefits of the implementation of ESEF, of the risks associated with the transition the risk of legal regulation should be highlighted. 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.) (MoF Decree) on the detailed rules of the disclosure obligation in relation to publicly traded securities issued on the basis of the Act. Commission Delegated Regulation 2019/815/EU supplementing the Transparency Directive with regard to regulatory technical standards on the specification of a single electronic reporting format (the ESEF Regulation) is the legal act that contains the detailed rules on the ESEF format.

Due to the Hungarian translation and implementation of certain EU legislative acts, it is sometimes not entirely clear what exactly should be included in an annual report in ESEF format. Interpretation is supported by the following tables.

Transparency Directive in English	Transparency Directive in Hungarian	Capital Market Act / MoF Decree	Correct interpretation based on the English text of the Transparency Directive
annual financial report	éves pénzügyi beszámolók	annual report	annual (financial) report
audited financial statements	auditált pénzügyi kimutatások	annual accounts and consolidated annual accounts approved by the issuer's supreme body	audited annual accounts and consolidated annual accounts approved by the issuer's supreme body
management report	vezetőségi beszámoló	management report	annual (business) report (as defined by the Hungarian Accounting Act it)
statements made by the persons responsible within the issuer	a kibocsátón belüli felelős személyek nyilatkozatai	statements made by the issuer	statements made by the persons responsible within the issuer

In view of the foregoing, and also considering that domestic legislation has not made the annual business report prescribed by the accounting legislation part of the annual (financial) report, the annual (financial) report includes the following documents:

1. annual accounts, to be compiled in most cases in accordance with IFRS;

2. Consolidated annual accounts, to be compiled in accordance with IFRS;

3. management report as defined by the MoF Decree;

4. statements made by the persons responsible within the issuer.

For the purposes of ESEF, it is important to note that pursuant to the MoF Decree, the annual (financial) report includes the auditor's report(s) expressing an opinion on the accounts, whereas under the Transparency Directive, the auditor's report(s) is (are) not part of the annual report, but must be disclosed simultaneously with it. The Hungarian legislation distinguishes between the management report and the annual business report: formally, the annual business report is not part of the issuer's annual (financial) report, but it is recommended to make it part of the issuer's annual (financial) report, in line with EU legislation.

The same discrepancy and inaccurate translation between the English and Hungarian versions of the ESEF Regulation can be observed as in the Transparency Directive. Accordingly, taking this into account, it can be concluded that under the ESEF Regulation, issuers are required to prepare their full annual (financial) report in XHTML eye-readable form in any internet browser, which means that all the documents listed above must be included in a single XHTML file. However, under the ESEF Regulation, the data included in the consolidated annual accounts must be marked up using the extensible business reporting language (XBRL) and embedded in the XHTML documents using InLine XBRL technology. The taxonomy to be used for XBRL tagging is based on the IFRS Taxonomy issued by the IFRS Foundation, supplemented by the ESEF taxonomy prepared by the European Securities and Markets Authority (ESMA) and, where applicable, by the taxonomy extended by the issuer according to the rules set out in the ESEF Regulation.

Under the ESEF Regulation, the Inline XBRL Instance document (an XHTML file containing the XBRL tagging) and its XBRL extension taxonomy files (the taxonomy elements created by the issuer; the presentation linkbase, which groups the taxonomy elements; the calculation linkbase, which expresses the arithmetic relationships between the taxonomy elements); the label linkbase, which describes the meaning of each taxonomy element; the definition linkbase, which provides the dimensional validity of the resulting XBRL instance document relative to the extending taxonomy) are submitted in a single reporting package, which contains the XBRL taxonomy files in a batch format according to the taxonomy package specification.

This means that an issuer that does not have a subsidiary and therefore does not prepare consolidated annual accounts will publish its annual (financial) report in a single XHTML file containing all the documents listed above but the consolidated annual accounts.

Issuer that also prepare consolidated annual accounts will compress into a single ZIP file a single XHTML file containing all the documents in the list above, including the XBRL tags of the consolidated annual accounts, and the XBRL extension taxonomy files detailed earlier. In addition to the ESEF Regulation, the "ESEF Reporting Manual" issued by ESMA provides further guidance on the technical implementation of this.

The Hungarian regulation prescribes the issuance of an auditor's report on the compliance of financial statements with the ESEF Regulation for financial years starting from 1 January 2022. Considering that it is practicable and expected that the auditor's report should identify the annual (financial) reports available in digital format in a unique way (e.g. by HASH code), the auditor's report should not be part of the annual (financial) report in ESEF format, but should be disclosed at the same time as part of the same publication.

In the period of preparing for ESEF, the MNB held a number of technical consultations for issuers requesting this, mainly to assist issuers in interpreting the above legal requirements.

Box 7.12
Crowdfunding

Regulation (EU) 2020/1503 of the European Parliament and of the Council of 7 October 2020 on European crowdfunding service providers for business, and amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937 entered into force on 10 November 2021. It should be noted that the Regulation contains several provisions that authorise the European Commission to adopt regulatory technical standards (RTS), the drafts of which have been completed only by the end of 2021. In order to ensure that market participants can obtain authorisation until the end of the transitional period specified in Article 48 of the Regulation, i.e. 10 November 2022, the MNB conducts the authorisation of crowdfunding service providers based on the Regulation and the draft RTS.

Crowdfunding services may only be provided by legal persons that are established in the Union, if they hold the licence specified in the Regulation. The MNB's authorisation is not required for the establishment of a legal person that wishes to provide these services, but crowdfunding activities cannot be started without authorisation.

Services that may be rendered by crowdfunding service providers

Pursuant to the Regulation crowdfunding service comprises the matching of business funding interests of investors and project owners through the use of a crowdfunding platform, and it may consist of any of the following activities:

- the facilitation of granting of loans;
- the placing without a firm commitment basis of transferable securities and admitted instruments for crowdfunding purposes issued by project owners or a special purpose vehicle, and the reception and transmission of client orders, in relation to those transferable securities and admitted instruments for crowdfunding purpose.

Pursuant to the Regulation, crowdfunding service providers are legal persons rendering crowdfunding services, and accordingly, crowdfunding service providers must provide at least one of the aforementioned services.

The rendering of the following service is not mandatory for the crowdfunding service providers, but optionally they may also apply for an authorisation for these services as well.

- individual portfolio management of loans: the allocation by the crowdfunding service provider of a pre-determined amount of funds of an investor, which is an original lender, to one or multiple crowdfunding projects on its crowdfunding platform in accordance with an individual mandate given by the investor on a discretionary investor-by-investor basis;
- safe custody of assets: such services may only be rendered if the applicant as well is authorised to render such services as a certified custodian licensed in accordance with Directive 2013/36/EU or 2014/65/EU; if this is not the case, it shall mandate a third party;
- provision of payment services: it may only provide such services, if the applicant as well qualifies as a payment service provider in accordance with the provisions of Directive (EU) 2015/2366; if this is not the case, it shall mandate a third party;
- use of special purpose vehicles for the provision of crowdfunding services;
- loan assessment;
- determines the price of a crowdfunding offer;
- operating a bulletin board;
- establish and operate a contingency fund.

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