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

2024

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

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

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Pursuant to Act CXXXIX of 2013 on the Magyar Nemzeti Bank, the MNB supervises the financial intermediary system in order to ensure, 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. The MNB has prepared this risk and consumer protection report – which presents the key characteristics and risks of insurance companies, funds, intermediaries, non-banking group entities and markets of capital market participants – consistent with those tasks and in accordance with Article 135 (2) of the MNB Act. 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 about current prudential and consumer protection issues, thereby raising risk awareness and maintaining and strengthening confidence in the financial system. With its regulatory activities aimed at identifying and mitigating risks, as well as its awareness-raising and educational activities and its work to promote the development of Hungarian financial literacy, the Magyar Nemzeti Bank intends to ensure that appropriate information is available to stakeholders for decisions affecting financial institutions and products, thus strengthening the stability of the financial system as a whole.

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

The data used in this report and the analyses based on them typically pertain to the reference date 31.12.2023. Data with diverging frequencies are updated differently, and therefore the horizon of the analyses may also differ in some cases.

The report was approved by the Financial Stability Council and it was approved for publication by Dr. Csaba Kandrács, Deputy Governor.

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Executive summary

The disinflation that started after the inflation peak in January 2023 continued in early 2024 in Hungary. Employment in the national economy remains at historically high levels. Real wages have been on the rise again since September 2023. With inflation easing and energy prices moderating and in parallel with the end of the tightening cycle of the world's leading central banks, investor sentiment turned positive, overall, in 2023.

The risk-free yield curve of the Hungarian forint has undergone significant changes in recent years: After 2020, which was still characterised by a low yield environment, yield spreads moved upwards in 2021 and peaked at the end of 2022 Q3. In 2023, the yield curve shifted downwards and became flat across the entire time horizon. In 2024 Q1, the downward trend came to a halt and the curve started to rise again, although it did not reach the level of 2022.

By the end of 2023, the gross wealth of households, including financial assets and housing, exceeded HUF 153,000 billion, an increase of 8.5 per cent compared to the previous year. The growth of assets significantly exceeded the 5.5 per cent annual inflation rate at the end of 2023. Overall, Hungarian households appear to prefer government bonds and cash compared to other EU nations while investing less in shares, deposits, life insurance and pension funds.

In 2023 the **insurance** sector's gross premium written grew by 5.6 per cent to HUF 1,509 billion, reaching HUF 1,647 billion including the premiums earned of branches. Non-life premiums increased by 14.5 per cent year on year, more than one and a half times the average for 2014–2022, while life premiums fell by 6.3 per cent due to the decline in single premium products, falling short of even the 2021 level. The growth of the non-life sector was driven by the personal property, casco and MTPL sectors. The sectoral combined ratio for non-life insurance decreased compared to 2022, which was a boom year due to drought losses. The combined ratio of MTPL within non-life products fell from 95.7 per cent to 92.8 per cent. The value of the total fixed assets of domestic insurers increased by 18.8 per cent in 2023 following a decline of 8.8 per cent in 2022, and this increase was positive in real terms. As in the previous year, the profitability of the insurance sector deteriorated further in 2023, mainly due to the impact of the surtax levied on the sector. The sector-wide return on equity (ROE) fell from 9.5 per cent to 5.4 per cent, which is still positive from a stability perspective. At the end of 2023, the sectoral capital adequacy ratio was 195 per cent, which, once again, is almost double the level required by law.

The **voluntary pension fund** sector achieved an average net return of 21.2 per cent in 2023, weighted by closing assets; accordingly, the positive investment result and positive cash flow pushed individual accounts to a record level of HUF 1,939 billion. The amount of membership fees and tax allowances also increased to a record HUF 146.4 billion, while payments in 2023 were even higher than in 2022 (+9.4 per cent). The operating result turned into a surplus in 2023; accordingly, sector-wide loss absorbency remained adequate. Despite the positive developments, the medium- and long-term risks have not diminished as the ageing of the membership and the slow decline in membership numbers have also continued. Looking at the composition of the membership, institutional reform is urgently needed to reach the under-40 age group. For the pension fund sector to play its role in society effectively and to maintain it in the long term, it needs to be able to attract people under 40 to a significantly greater extent than two decades ago, when it was more successful in attracting young adults. The incentive and service delivery system and the participation process need to be reconsidered as part of the urgent institutional reform.

The contributions credited to the individual accounts of **health and mutual aid funds** (HUF 85.1 billion) rose by 22.4 per cent, while benefit payments (HUF 81.7 billion) increased by 25.7 per cent (HUF 16.7 billion) compared to 2022. At 89.9 per cent, the largest share of payments continues to be for the purchase of health services, medicines and medical equipment. The number of members continued to grow and now exceeds the number of voluntary pension funds. In 2023, the sector of health and mutual aid funds achieved an operating surplus, with an adequate level of reserves.

In 2023, a new element was added to the supervisory toolkit: mystery shopping aimed at market monitoring. This supervisory tool is a specific form of mystery shopping, which is in fact a trial visit to the supervised institutions without the conclusion of a contract. With this new tool, it is possible to map the activities of market players more quickly, efficiently and in large volumes. The MNB first applied the new methodology of mystery shopping at the end of 2023 and then during the March 2024 home insurance campaign. The methodology proved successful, creating an almost immediate opportunity for the MNB to intervene in the home insurance campaign.

From a consumer protection perspective, the importance of electronic communication has increased in recent years, which is why the MNB set the assessment of the adequacy of electronic communication between insurers and customers as a priority target area for 2023.

In order to ensure transparency of the costs associated with life insurance products with savings element, the total cost indicator (TCI) is of particular importance. Thanks to the measures taken by the MNB over the past 8 years, the TCI values have fallen significantly, ranging between 1.79 per cent and 6.88 per cent in 2023.

In the **intermediaries** market, the concentration – which has been observed for years, but with different dynamics – continued, but the decline in the insurance intermediaries market continues to be no obstacle to a visible increase in performance in terms of number and value of contracts. For financial market intermediaries, 2023 saw a dramatic decline in retail lending, especially in the case of mortgage intermediation.

The total assets of **financial enterprises not belonging to a banking group** continued to rise in 2023.

Compliance with the statutory initial capital requirement prescribed from the end of 2023 was closely monitored and supervised by the MNB, and no operating licence was revoked for non-compliance with the statutory requirement; thus compliance in the sector is considered successful.

External funding for the sector continued to grow at a steady pace, albeit slower than last year. At 39 per cent, the share of funding from credit institutions (domestic and foreign) remains high, including a considerable increase in foreign funds. The capital adequacy of financial firms increased from 16 per cent to 17 per cent in 2023, but is still below the previous level of 20 per cent. In addition to the share of equity, the volume of equity also increased significantly, mainly due to a capital injection and to a lesser extent to profitable management.

In 2023 receivables from customers continued to grow; however, the rate of the growth (3 per cent) was below the value recorded in 2022 (15 per cent). The increase in credit and loan operations and in the volume of financial leasing contributed to the 2023 increase in the stock of loans, while factoring (current and work-out) and other receivables decreased.

In the capital markets, **investment service providers** realised a total capital market turnover of HUF 1,151.2 thousand billion: the 62.1 per cent increase is mainly due to the dynamics of derivatives turnover. The turnover of the Budapest Stock Exchange exhibited a sharp decline in 2023, primarily driven by the performance of the derivatives market. The composition of the top three most traded stocks remained unchanged. The high concentration of the equity market moderated, reflecting a fall in blue chip turnover on the one hand and an increase in small cap turnover on the other. In 2023, the stock of client securities expanded dynamically by around 29.6 per cent. Investment firms, which are well capitalised, posted a profit after tax of EUR 56.6 billion, up nearly 10 per cent on the previous year.

The HUF 19,401 billion in assets under management by **investment fund managers** is 47.5 per cent higher than in the previous year. The dynamic growth can be essentially attributed the surge in the net asset value of investment funds, which reached HUF 14,632 billion mainly due to capital inflows into bond and money market funds. The stock of public real estate funds increased by 20.1 per cent to HUF 1,921 billion, while the share of liquid assets and real estate remained practically unchanged. In line with the growth in assets under management, the profit after tax of investment fund managers increased one and a half times.

In accordance with the objectives set out in the MNB's supervisory strategy, the supervision of **capital market consumer protection** focused on ensuring transparent and easy-to-understand information on the provision of investment services and the financial instruments sold, and on ensuring practices that result in the recommendation of capital market investments that suit the needs and objectives of clients.

As regards **issuer supervision**, in 2023 the central bank concluded 4 targeted IFRS investigations of public offer issuers and 1 targeted investigation on regular and extraordinary disclosures. The MNB issued 33 decisions in 2023 in the context of issuer supervision, including 11 decisions imposing fines, and imposed supervisory fines of around HUF 150 million[1] in total.

In 2023, the MNB commenced 20 and closed 16 **market surveillance procedures** concerning market abuse; moreover, it commenced 17 market surveillance procedures on suspicion of unauthorised, i.e. unlicensed or unreported activities, and closed 20 market surveillance procedures of this type. In 2023, the MNB imposed a total of HUF 2.38 billion market surveillance fines in the framework of market surveillance procedures.

[1] A market surveillance fine of HUF 85 million imposed in the course of a targeted inspection against a public issuer of securities was taken into consideration in the sanctions imposed in the framework of issuer supervision.

1 Macroeconomic environment and developments in household savings

1.1 INTERNATIONAL AND NATIONAL MACROECONOMIC TRENDS

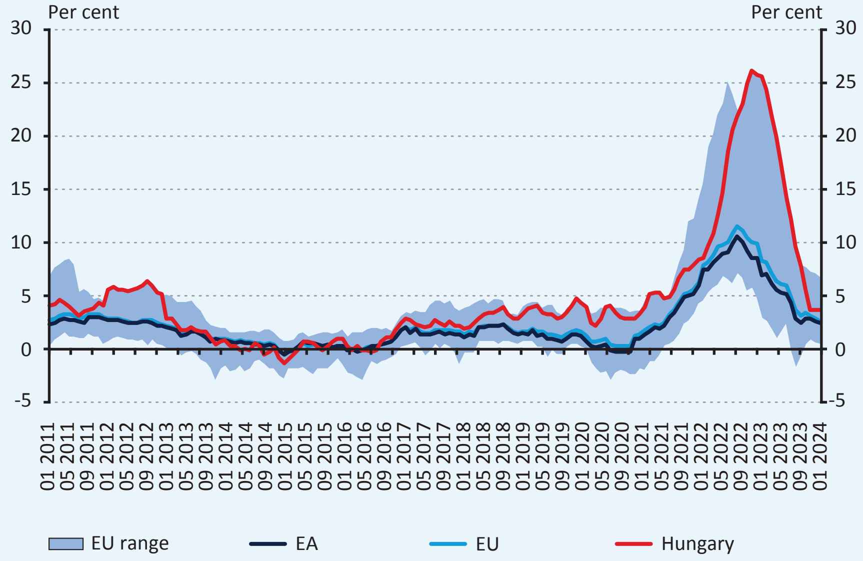
1.1.1 Successful disinflation after inflation peaked in January 2023

In the last quarter, European disinflation, which has been in progress since November 2022, decelerated. Inflation in the euro area eased to 2.4 percent in November 2023, and then ranged between 2.4 and 3 percent throughout the following months. The recent deceleration in disinflation was mainly due to the wearing off of base effects that pushed down energy price inflation until November. Disinflation continued in the last quarter for industrial goods and food, but the moderation in the price dynamics of market services stopped and has remained unchanged at 4.0 percent since November. Inflation rose in 10 of the 27 EU Member States compared to February, and core inflation was higher than the rate of increase in the overall consumer basket in 21 Member States. This indicates that inflation trends have not fully normalised yet after the successive waves of inflation in recent years. Disinflation continued in the countries of the region. In Slovakia and Poland, the Harmonised Index of Consumer Prices for March dropped to 2.7 percent, while in the Czechia it remained at its February level of 2.2 percent.

Geopolitical conflicts are a risk for commodity price developments. The route of sea freight from China has become significantly longer in the back of the attacks by Yemen's Houthi rebels in the Red Sea, more than doubling the cost of sea freight from China since December. Geopolitical conflicts have also contributed to the gradual increase in Brent crude oil prices since December. In the period between October 2023 and February 2024 gas prices declined. Contributing factors included the high filling rates of European gas storage facilities, a mild winter, low residential consumption and reduced demand for gas from the European industry fighting an economic downturn.

The disinflation that started after the inflation peak in January 2023 continued in early 2024 in Hungary (Chart 1.1). Since January 2024, the consumer price index has resided within the central bank's tolerance band, easing to 3.6 percent year on year in March. The broadly perceivable deceleration in price dynamics reflects a combination of disciplined monetary policy, government measures to strengthen competition, subdued demand, base effects and a significantly lower external cost environment than in the previous years. Disinflation in market services continued, but monthly repricing is still higher than the historical average, also supported by the retrospective repricing of banking and telecoms services. Subdued food price changes are supported by declining global food commodity prices, as well as government measures intended to generate stronger competition. Core inflation and annualised indicators, which capture more persistent inflation trends, also declined.

Chart 1.1
Annual change of the Harmonised Index of Consumer Prices, HICP



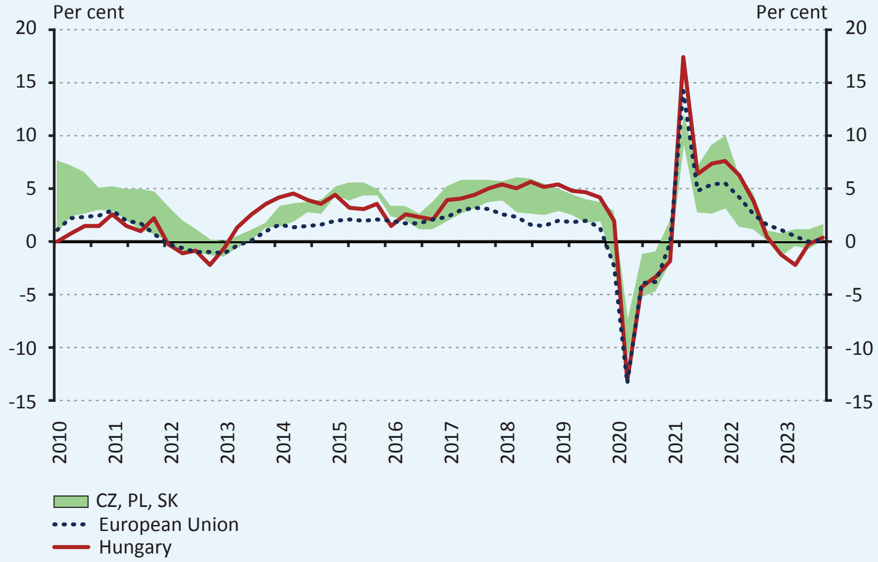
Source: Eurostat

1.1.2 Growth may resume this year after inflation moderates

The short-term growth outlook in Europe remains subject to downside risks, exacerbated by the generally tense geopolitical situation. In 2023 Q4 the EU economy expanded by 0.2 percent year on year. The subdued growth was mainly due to uncertain consumer sentiment and the lingering effects of the previous energy crisis. GDP in Germany, Hungary's main trading partner, contracted by 0.2 percent on an annual basis. Over the same period, US GDP grew by 3.1 percent year on year, while China recorded 5.2 percent annual growth. In China, a decline in the real estate sector and fragile consumer confidence continue to dampen domestic demand as the government takes measures to support growth. Among the countries in the region, GDP also grew in Poland (+1.7 percent), Slovakia (+1.3 percent), Romania (+3.0 percent) and the Czech Republic (+0.2 percent) in 2023 Q4.

In 2023 Q4, domestic economic output stagnated (Chart 1.2). As disinflation continued and real wage dynamics turned positive, unlike in previous quarters, household consumption started to increase from the end of the year. Investment declined less than in previous quarters, primarily supported by rising public development projects. Corporate investment continued to decrease, with a decline in volumes recorded in sectors producing for both the domestic and export markets. Agriculture saw significantly higher output last year after the drought in 2022, dampening the contraction in GDP. Last year, domestic exports increased somewhat, while imports declined as domestic demand dropped, resulting in net exports' positive contribution to growth in 2023.

Chart 1.2
Annual change of GDP



Note: Based on seasonally and calendar adjusted data.

Source: Eurostat

Following the downturn in 2023, a slow recovery started in early 2024, with domestic growth likely to pick up in the second half of the year. In 2024, as inflation moderates, real wages continue to rise and confidence improves, domestic demand may expand again. Export performance is affected by forces acting in opposite directions. The prolonged weak European economic activity may restrain domestic exports, but ongoing and newly announced significant capacity expansions are gradually boosting exports.

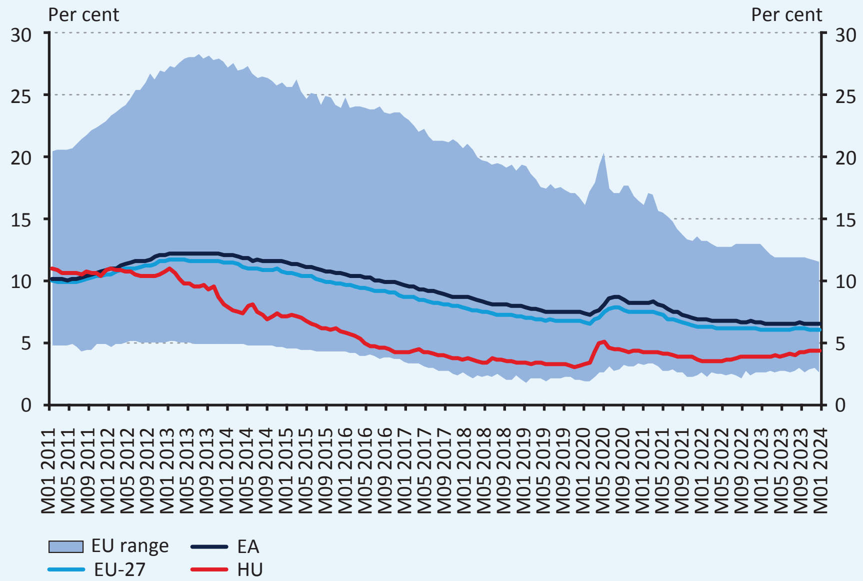
According to preliminary data, in 2023 the current account balance turned into a surplus of 0.2 percent of GDP, after a deficit of 8.4 percent in 2022. In parallel, the net lending derived from real economy figures accounted for 1.2 percent of GDP. The 8-percentage-point improvement in the current account balance throughout 2023 was driven by an increase in the trade balance. The steady, significant rise in the goods balance can be mainly attributed to the decline in energy prices and the contraction in domestic demand. The other component of the trade balance, the surplus of the balance of services as a percentage of GDP, remained stable, overall. The improvement in the indicators was somewhat restrained by the fact that interest expenditures and the rising profits of foreign companies both increased the deficit on the income balance. The surplus on the transfer balance was subdued at less than 1 percent of GDP, despite EU transfers received in 2023 Q4. The general government's accrual-based deficit was 6.7 percent of GDP in 2023. The high inflation environment over the past two years has led to a significant increase in the interest expenditure of the government, which will continue to place a heavy burden on the budget this year.

1.1.3 Even with full employment, the tightness of the domestic labour market is easing

The Hungarian labour market has proved resilient in the crises of recent years, but there are signs of a modest adjustment to the slowdown in the economy. Employment in the national economy remains at historically high levels. The number of unemployed persons has been gradually rising over the last period. The unemployment rate rose slightly to 4.6 percent by February 2024, which is still favourable by international standards. However, the labour market tightness is easing. The number of employed and unemployed persons has risen simultaneously over the last five quarters, i.e. the labour force has increased. At the same time, demand for labour has declined: the number of vacancies has fallen in recent quarters and the number of hours worked per person also declined in 2023 Q4.

The EU labour market is characterised by heterogeneity. In Spain and Greece, unemployment rates remained in double digits, while in Czechia the share of unemployed within the economically active population stood at only 2.6 per cent of the active population in February 2024. In the same month, the unemployment rate in the euro area averaged 6.5 per cent (Chart 1.3).

Chart 1.3
Unemployment rates in the European Union



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

Real wages have been on the rise again since September 2023. Inflation, which was still high in the first half of 2023, offset strong wage dynamics, with nominal wages rising by 14.3 per cent for the year as a whole, while real wages fell by 2.9 per cent in the national economy. Real earnings rose again from September 2023, in line with disinflation.

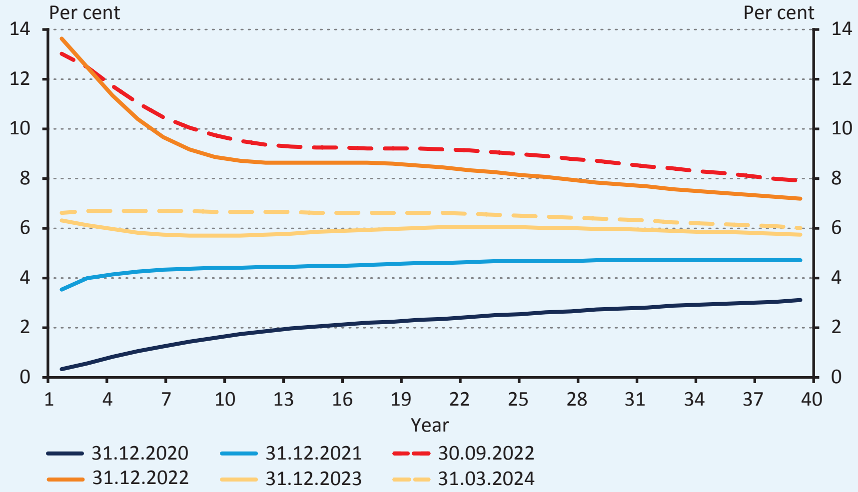
The slow pick-up in economic activity slowly may determine labour market developments this year. In view of the slow recovery in economic output, we do not expect a significant increase in employment, while the unemployment rate may start to decline from the second half of the year.

1.1.4 Improved yield environment in 2023

A key risk for the Hungarian insurance sector is the rising yield environment due to macroeconomic developments. On the one hand, it causes the depreciation of insurance assets of which the revaluation of fixed-income securities was the main factor affecting the Solvency II (S2) balance sheet of the institutions. At the sector level, a large proportion of insurers' non-unit-linked assets was directly invested in government bonds, which can have a significant impact on individual institutions. The considerable yield change was also reflected on the liabilities side. A rise in the risk-free yield curve (Risk Free Rate – RFR), which is a key determinant for reserve calculation, may reduce the S2 provisions of the institutions through the discount effect. With the decline in provisions, total liabilities decrease, thus increasing the eligible regulatory capital of insurers, which in itself can have a positive effect on capital adequacy.

The Hungarian forint's RFR has undergone significant changes in recent years: in 2020, the yield environment was still low, but in 2021 it started to move upwards, peaking by the end of 2022 Q3. In 2023, it shifted downwards over the entire time horizon, while the inversion of the curve decreased significantly, i.e. it became flat. In 2024 Q1, the downward trend came to a halt and the curve started to rise again, although it did not reach the level of 2022.

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



Source: EIOPA

The calculation of the RFR is based on government bond yields with a maturity of 1 to 15 years, given that they meet the deep, liquid and transparent criteria expected of them. From this last observation point, an extrapolation to the ultimate forward rate (UFR) is used to calculate the curve. The value of the ultimate forward rate is influenced by two factors: the inflation targets of central banks and real interest rates. As a result, the ultimate forward rate of the forint remained 4.5 per cent in 2023, but is expected to fall to 4.35 per cent from 2024 and 4.2 per cent from 2025.

1.1.5 Changes in the sovereign debt market

With inflation easing and energy prices moderating and in parallel with the end of the tightening cycle of the world's leading central banks, investor sentiment turned positive, overall, in 2023. However, in addition to the considerable market uncertainty caused by the war between Russia and Ukraine, the turbulence in the US and European banking sectors in March and the conflict in Gaza in the autumn temporarily increased risks and hence, financing costs, to a significant extent. The peaking of the interest rate paths of the world's leading central banks, expectations of protracted, elevated interest rates, and quantitative tightening programmes pushed up both short and long yields significantly for most of the year. However, in the final months of the year, rapid disinflation led to a significant increase in expectations of future interest rate cuts, which caused a sharp fall in yields in developed economies. The German 1-year government bond yield rose by 60 basis points in one year, while the 10-year yield fell by 55 basis points. Among US Treasury yields, the 1-year yield is up 10 basis points, while the 10-year yield remained broadly unchanged. Long-term government bond yields declined significantly in the region, with Hungarian yields falling by 750 basis points at 1-year maturity and 320 basis points at 10-year maturity. The moderation in yields was supported by the normalisation of the monetary policy of the Magyar Nemzeti Bank, followed by a prudent easing of monetary conditions, with the central bank cutting the effective interest rate by a total of 725 basis points from May to the end of the year. Secondary market government bond flows in 2023 continued to increase year-on-year, with market liquidity improving overall during the year and remaining above the historical average for most of the period. The average daily turnover was around HUF 430 billion, with most of the trading taking place at maturities longer than 5 years, but the turnover of 1–3-year securities also increased significantly, while the turnover of 3–5 year securities decreased somewhat compared to the previous year. As regards government securities holdings by held by the major sectors, during 2023, households increased their holdings of HUF-denominated government securities by HUF 1,694 billion, while non-resident investors increased their holdings by HUF 1,522 billion and domestic banks reduced their holdings by HUF 819 billion.

1.2 CHANGES IN HOUSEHOLD SAVINGS

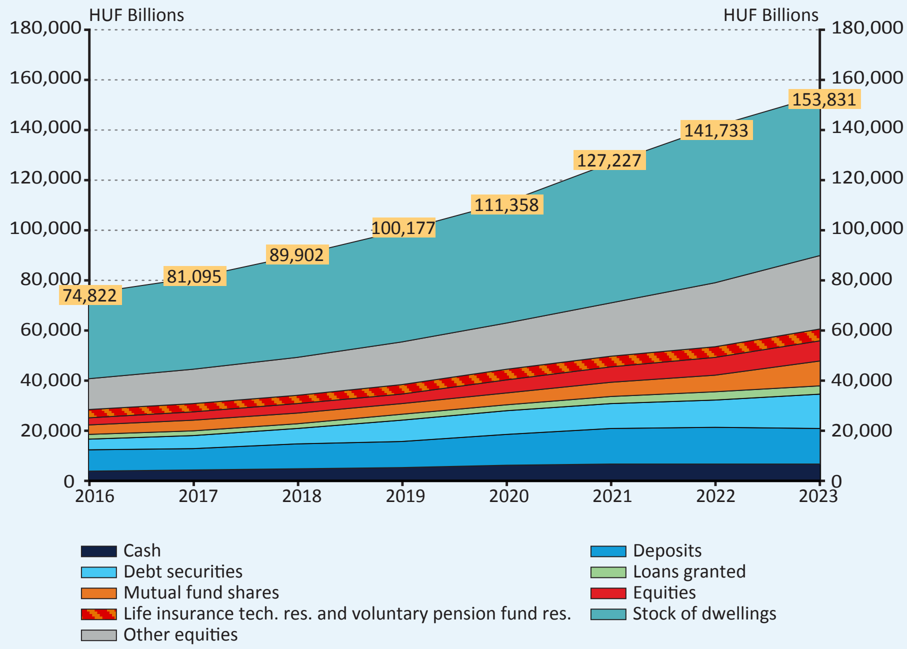
1.2.1 In 2023, life insurance and pension fund reserves increased significantly

By the end of 2023, the gross wealth of households, including financial assets and housing, exceeded HUF 153,000 billion, an increase of 8.5 per cent compared to the previous year (Chart 1.5). The growth of assets exceeded the 5.5 per cent inflation rate significantly at the end of 2023. In the past year, investment fund shares, debt securities, technical and fund reserves and the rising value of equity holdings contributed the most to the growth in wealth (with a total of HUF 11,564 billion, they accounted for 95.6 per cent of the total increment).

The most dynamic growth was recorded in investment fund shares (45 per cent), but debt securities (28 per cent), insurance technical reserves and fund reserves (17 per cent) and equities (15 per cent) also grew above average. For these asset classes, the increments were driven by price increases in addition to purchases, as yields fell and equity prices rose. At the same time, housing growth was below average and cash and deposits fell.

Premium income decreased for life insurance reserves and increased for voluntary fund reserves compared to the previous year. At the same time, the level of premium and commission reserves increased significantly due to income from investment activities and revaluation gains. The increment deriving from revaluation gains exceeded HUF 510 billion, historically the highest annual revaluation for these assets, and broadly covered the revaluation losses in 2022. As a result of the stock increase, the share of the asset category in total household wealth increased to 3.1 per cent, while its share in financial wealth remained 5.3 per cent.

Chart 1.5
Changes in gross household wealth



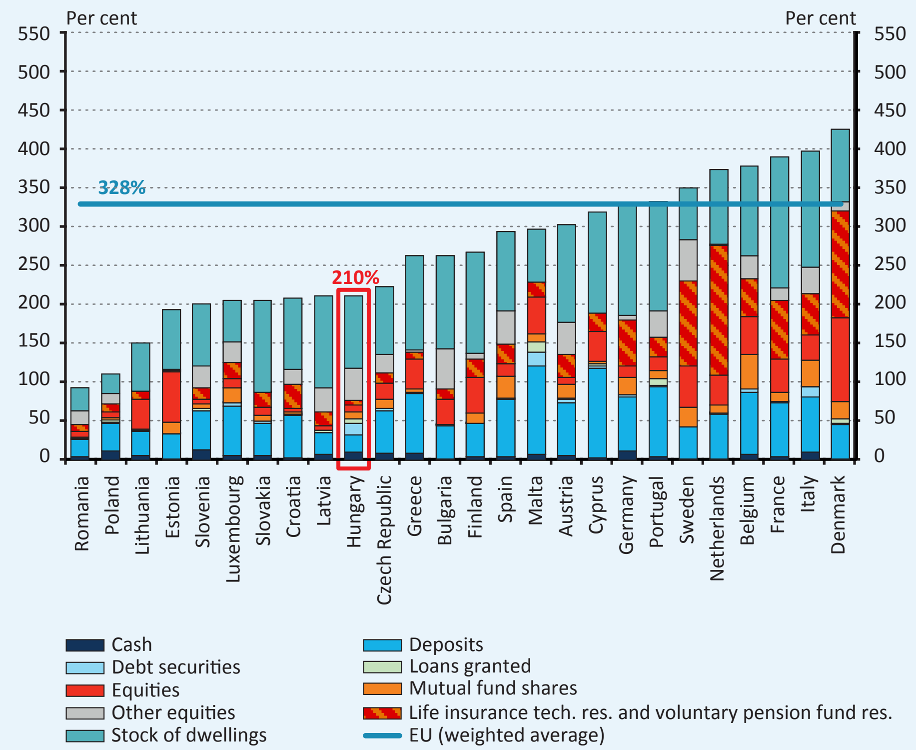
Note: Housing stock data for 2022 and 2023, MNB estimates

Source: HCSO, MNB

1.2.2 Hungarian households prefer cash and government bonds compared to other EU Member States

The gross wealth of Hungarian households, including financial assets and housing, amounted to 210 per cent of GDP at the end of 2022 (Chart 1.6), and hence, Hungary is in the middle third of the European Union Member States according to Eurostat data. Average gross household wealth in the EU, calculated as the GDP-weighted average of the Member States, was 328 per cent, which represents a sharp decline compared to the 355 per cent recorded in 2021. The decrease was mainly due to revaluation losses on financial assets, caused by rising yields and falling equity prices. The average gross household wealth of the countries in the region (Czechia, Poland and Slovakia) was 150 per cent of GDP; therefore, household wealth is higher as a share of GDP in Hungary than in countries with similar levels of development, according to statistical data. At the same time, Western European countries (e.g. Denmark, Italy, France, Belgium) continued to have significant surpluses compared to the Visegrád countries, with these four countries having the highest values in the EU at the end of 2021, an average surplus of 393 per cent. In terms of GDP shares for each category, Hungary ranked second to Malta for debt securities (mainly sovereign debt instruments). It was also among the leaders in holding cash and other equities. Domestic households ranked in the middle in terms of investment fund shares (ranked 16th) and housing (14th). In contrast, Hungary was at the bottom of the league in deposits, insurance technical provisions, voluntary pension fund reserves and equities (ranked 26th, 25th and 21st in 2022, respectively, out of the 26 countries reviewed). At the stock level, Hungarian households appear to prefer government bonds and cash, overall, compared to other EU Member States while investing less in shares, deposits, life insurance and pension funds.

Chart 1.6
Gross wealth of EU households as a percentage of GDP at the end of 2022



Note: Housing stock data for 2021

Source: Eurostat

2 The insurance market and its risks

2.1 OVERALL PICTURE OF THE MARKET

2.1.1 Growing market size

The number of institutions in the Hungarian insurance sector decreased significantly in 2023 (Table 2.1). While there had been 33 supervised insurance companies[2] and insurance associations in 2022, by the end of 2023 the number dropped to 27 after the closure of six small associations. In terms of institutional form, 21 institutions operate on the market as join-stock companies, 2 as large associations and 4 as small associations. There are also 12 insurance branch offices in Hungary (the number of which decreased by one); in their case, the MNB has competence only with respect to consumer protection. Due to their size and activities, 1 joint-stock company and 4 small insurance associations are not covered by Solvency II (S2). Regarding the insurance segment, of the 22 institutions covered by S2 there were 4 life, 9 non-life and 9 composite insurers.

In 2023, with a 5.6 per cent year-on-year increase, sectoral premium income amounted to HUF 1,509 billion, of which the non-life segment accounted for 62 per cent and the life segment for 38 per cent. Non-life premiums increased by 14.5 per cent year on year, more than one and a half times the average for 2014–22, while life premiums dropped by 6.3 per cent, falling short of even the 2021 level. This is in line with an inflation report by the European Insurance and Occupational Pensions Authority (EIOPA), which stresses that new sales have also fallen significantly at EU level, due to inflation and the ensuing weakening of purchasing power. Taking into account the Hungarian branch offices of insurers with a registered office abroad, the premium income of the insurance sector amounted to HUF 1,647 billion. The share of branches in total premium income (8.4 per cent in 2023) increased by 0.8 percentage points relative to the year before.

Compared to the previous year, in 2023 the growth in the number of policies (+1.1 per cent) was significantly lower, again, than the growth in premiums. Life insurance decreased by 0.1 per cent, while non-life insurance increased by 1.3 per cent over the year.

Profitability at sector level fell sharply, with a profit after tax of HUF 22 billion, down 60 per cent on the previous year. The P&L dynamics was significantly influenced by the fact that the 2022 base would have been HUF 45 billion higher, overall, due to the surtax, while the current year by more than HUF 80 billion. The sector-wide return on equity (ROE) stood at 5.4 per cent (9.5 per cent in 2022), which continues to paint a positive picture for the insurance sector as a whole. Although it falls somewhat short of the fair and competitive target of 10 to 15 per cent set in the "10-year future of the insurance sector in 7 points" (FIS), if calculated without the surtax, it would be far higher than the target value.

[2] Table 2.1 does not include one supervised institution not covered by S2

Table 2.1
Key figures of the insurance sector

	2022	2023		
	Total	By institutions type		Total
Number of institutions*	32	Total S2 insurers	22 –	26 ↓
		Life	4 –	
		Non-life	9 –	
		Composite	9 –	
		Small insurance union	4 ↓	
	Total	**Life segment**	**Non-life segment**	**Total**
Gross written premium (HUF billions) *(including branch offices)*	*1,427.9 (1,546.0)*	570.5 ↓ (614.1)	938.0 ↑ (1,032.8)	1,508.5 ↑ (1,646.9)
Number of contracts (thousand pcs) *(number of contracts per capita) ***	14,818 (1.53)	2,275 ↓	12,702 ↑	14,977 ↑ (1.56)
Technical provision S2 (HUF billions)	2,162.6	2,116 ↑	367 ↑	2,483.4 ↑
Balance sheet total (HUF billions)	3,367.1			3,729.0 ↑
Eligible own funds (HUF billions)	632.4			769.0 ↑
Capitalisation level (per cent)	172			195 ↑
Profit after tax (HUF billions)	35.8			22.0 ↓
Return on equity (ROE)	9.5%			5.4% ↓
Return on solvency capital (S2-ROE) ***	5.7%			2.9% ↓

Notes:
** Does not include one supervised plc outside the scope of S2.*
*** For per capita insurance policies we calculated with the total population indicated on the HCSO's website.*
**** The S2-ROE index compares profit after tax to the available capital under Solvency II.*
Source: MNB

Table 2.2
Key data of small insurance associations

	Small insurance unions		
	2021	2022	2023 *
Number of institutions	10	10 –	4 ↓
Gross written premium (HUF millions)	747	763 ↑	-
Number of contracts - also shorter than 1 year (pcs)	2,272	1,798 ↓	-
Return on equity (ROE)	12.5%	-28.6% ↓	-

Notes:
** Annual data for small insurance associations for 2023 are not yet available.*
Source: MNB

2.1.2 Market not yet set on a convergence path

The MNB published the FIS in February 2018. The points of the publication set out trends and targets for converging to mature markets, which can also serve as a sector-wide strategic plan and guidance for market players. As in previous years, this publication also shows the evolution of the FIS target figures by the 10-year targets and by the projected paths (summarised in the table below).[3]

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

Table 2.3
Target values and actual data of the insurance sector

Objectives to be achieved	Target variable	2016 actual data	2023 target / optimal value	2023 actual data
1. Wide-ranging self-provision More savings, greater security	Life insurance and voluntary pension fund contracts/economically active persons	54% 2.46 million pieces	71% 3.3 million pieces	47% 2.32 million pieces
	Ratio of reserves as a percentage of GDP (life technical reserve + voluntary pension fund individual accounts)	8.7% 3,054 HUF Bn	9.4% 5,132 HUF Bn	5.8% 4,372 HUF Bn
2. Market size convergence Back to the forefront of the region	Penetration (gross written premium/GDP)	2.5% 889 HUF Bn	2.9% 1,526 HUF Bn	2.0% 1,509 HUF Bn
3. Competitive market Increasing competition	Share of TOP5	60% HHI 8.9%	56% HHI 8.6%	63% HHI 10%
4. Efficient sales Half of sales over an innovative channel	Ratio of innovative channels	37%	50% above	41% (2022)
5. Economies of scale Institutions operating more cost efficiently with dropping margins	ACR values of UL contracts	0.53 - 9.97%	0.5-5.75% steadily	1.8% - 6.9%
	Non-life combined ratio (net of tax)	81%	85-90% steadily	81%
	Cost ratio	30%	20-30% steadily	31% (2022)
6. Fair and competitive profitability Long-term confidence and stability	ROE	ROE 20% S2 ROE 11%	ROE: 10-15% steadily	ROE 5% S2 ROE 3%
7. Well-capitalised insurers Safe and prudent operation	Capitalisation level	215%	>150% steadily	195%

Note: The values linked to objectives 1 and 2 were evaluated relative to trends projected in the publication.
Source: MNB

The coverage of life insurance and voluntary pension contracts fell by 0.9 percentage points (to 46.7 per cent) in 2023: the number of contracts fell by 0.4 per cent, while the number of economically active persons rose by 1.4 per cent during the year. The lag behind the convergence path projected in the FIS worsened further as the reaching of potential savers remained unsuccessful; moreover, neither the capital market downturn of 2022 nor the still high short-term yields supported an increase in the long-term savings coverage.

With a moderate additional decline in the number of contracts, life insurance and voluntary pension fund reserves together increased by 15.2 per cent (HUF 575 billion), and voluntary pension fund returns turned positive in 2023. The trend was driven by a rise in the prices of the underlying assets, with equities correcting compared to a year earlier and bonds in the asset portfolios appreciating as a result of the fall in yields. In addition, both sectors were characterised by positive cash-flows, with both contributions and payouts increasing in the case of funds, while both premiums and the volume of services decreased in the case of life insurance products. Of the three scenarios presented in the FIS, only the originally defined figure for the inflation-adjusted path is exceeded by self-provision savings, which, by the end of 2023 grew to 5.8 per cent of GDP from 5.7 per cent. The stagnation of the indicator is due to a significant combined increase in nominal GDP and reserves in 2023.

Insurance premiums grew again in 2023 (5.6 per cent): once again, they only exceeded the inflation-adjusted path of the three projected growth scenarios over the period, but lagging behind the empirical trend and the upward penetration trend originally projected. At the same time, the GDP penetration rate fell further to 2.0 per cent from 2.15 per cent in 2022, again driven by a significant increase in GDP at current prices in 2023. The indicator was 0.19 percentage point above the inflation-adjusted trend in the FIS, 0.27 percentage points below the empirical trend projected for 2022 and 0.74 percentage points below the upward penetration trend.

After an additional increase of 2 percentage points, the share of the 5 largest market players (TOP5) exceeded the projected path by 7 percentage points in 2023. The Herfindahl-Hirschman Index (HHI) also rose by 0.3 percentage points, moving away from the projected path of a steady decline.

The share of innovative channels[4] in the composition of insurers' sales channels stood at 41 per cent in 2022. Compared to the 36 per cent in 2021, the gaining ground of direct and online sales is striking. However, the sector is still far from the 50 per cent target projected in the FIS. Despite this positive change, incentives to use these channels more actively still appear insufficient.

Compared to the previous year, the TCI values of the unit-linked contracts[5] covered by MNB Recommendation No 8/2016 exceeded the limits required by the MNB in some cases.

The sectoral combined ratio for non-life insurance decreased compared to 2022, which was a boom year due to drought losses. This is in line with the slight downward trend after 2013, broken only by the modest increase recorded in some years; consequently, the 2023 indicator value for the sector as a whole is the same as in 2016 and significantly below the target range set in the FIS.

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

The profitability of the sector was 5 per cent in 2023, which implied a return on equity (ROE) well below the target range (10–15 per cent). Profit after tax was down 60 per cent year on year due to the surtax levied on the sector, but most institutions were profitable nevertheless. There is still no sign of a significant decline in the value when the calculation excludes the surtax, and no sign of a move towards the target range at sector level.

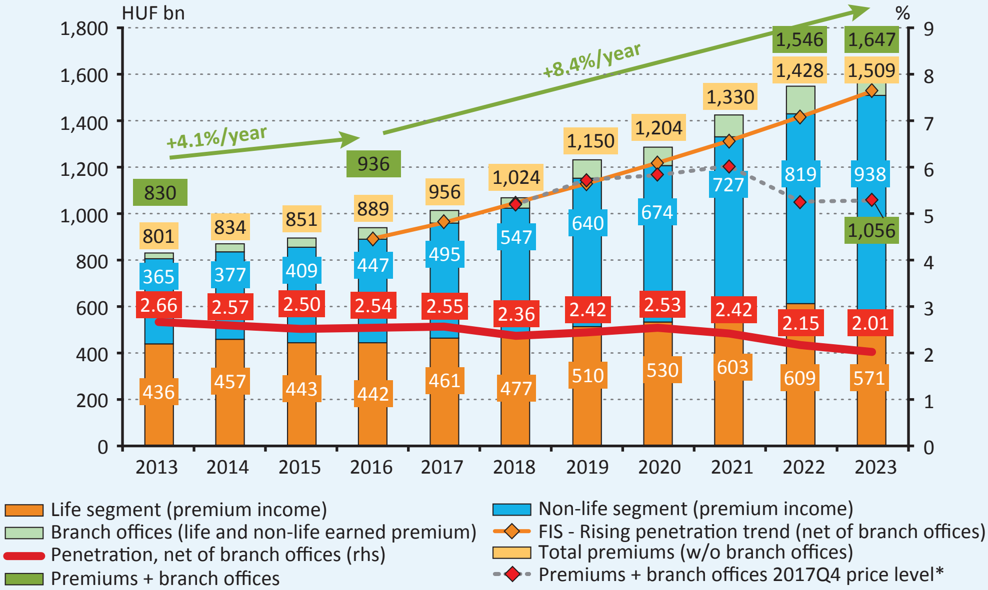
As in previous years, the target of over 150 per cent for the sectoral Solvency II ratio was met. Half of the institutions had capital ratios above 200 per cent, and each of the institutions individually met the 150 per cent target by the end of 2023. A sustained high level of capital adequacy of institutions provides the basis for safe and prudent operation of the sector.

2.1.3 Premium income approached the HUF 1,526 billion projected in the MNB's FIS

The total premium income of insurers in 2023 was HUF 1,509 billion, an increase of 5.6 per cent (HUF 81 billion) compared to 2022, which means that the real value of premium income stagnated. Premium income was HUF 571 billion in the life segment and HUF 938 billion in the non-life segment. The life segment declined by 6.3 per cent, overall, as a result of a 10.2 per cent increase in regular premium life insurance and a 35.2 per cent decrease in single and top-up premiums. This is in line with the inflation report of EIOPA, which stresses that new sales have also fallen significantly at EU level, due to inflation and the ensuing weakening of purchasing power. The non-life segment grew by 14.5 per cent, with premium income from household property insurance contributing 17.3 per cent and MTPL 11.5 per cent. As a result, the sector is close to the HUF 1,526 billion upward penetration trend projected in the FIS for 2026. As the growth of the sector lagged behind the growth of the economy as a whole, insurance penetration, which continued to decline, decreased from 2.15 per cent in 2022 to 2.0 per cent in 2023, further away from the MNB's target. Real premium growth and an increase in penetration are expected in the following years, due to the impact of protracted inflation escalation. Premium income including branch offices also increased dynamically to HUF 1,647 billion.

[4] Innovative channels: bank insurance, direct sales, online mediation.
[5] Of term policies, this includes those with a 10, 15 and 20-year duration, of permanent policies, those with a duration of 15 and 20 years.

Chart 2.1
Gross premium written and penetration in the insurance sector



Note: Gross premium income in the life and non-life segments, and gross premium earned for branch offices. The sectoral total of gross premium income, shown in the yellow rectangle in the figure, does not include the value of the gross premium income of branch offices.

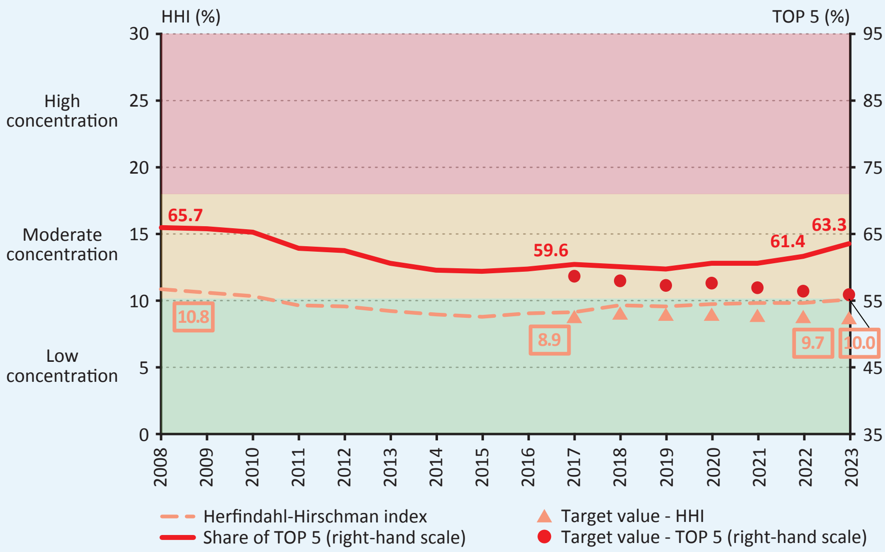
** adjusted by the consumer price index*

Source: HCSO, MNB

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

The share of the top 5 market players (TOP5) increased by 1.9 percentage points further in 2023, reaching 63.3 per cent, and the HHI increased from 9.7 per cent in 2022 to 10.0 per cent in 2023 (Chart 2.2). The TOP5 remains the same insurers, but two insurers have switched places. Concentration indicators were determined by the market penetration of the TOP5 players. Both concentration indicators continued to outperform the concentration paths projected in the FIS substantially and, as a result of the 2023 changes, they moved further away from the target values.

Chart 2.2
Share of the 5 largest insurers (TOP5) and the Herfindahl-Hirschman Index (HHI) of the entire sector based on gross premium written



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

Source: MNB

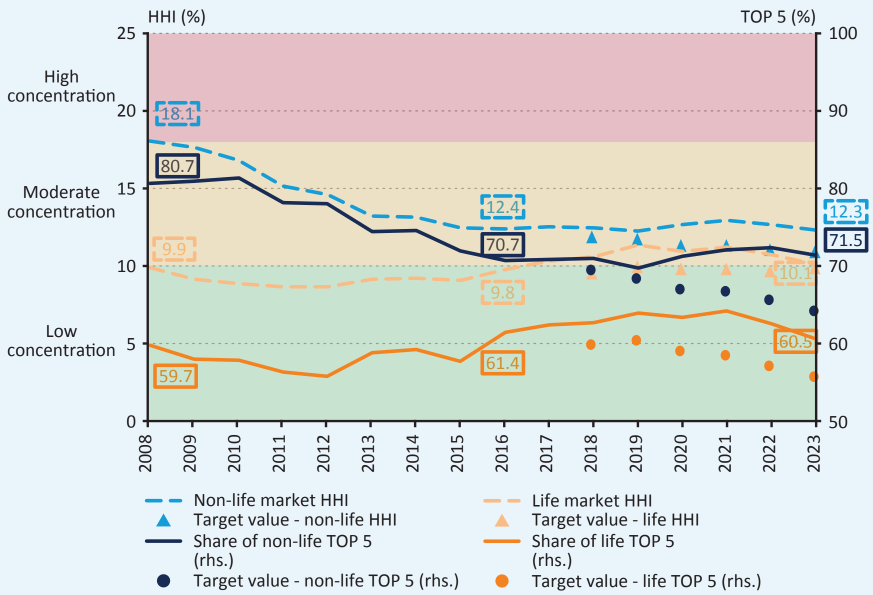
2.1.5 Concentrations have fallen in both the life and non-life segments

Compared to the increase in the HHI indicator for the whole market, both life and non-life indicators decreased in 2023 (Chart 2.3). The share of the 5 largest institutions in the life sector decreased by 2.0 percentage points and the HHI by 0.6 percentage points. The change reflects a drastic contraction in the otherwise relatively concentrated single/top-up premium market, which has led to a significant change in the scope of the top 5 insurers and the shares of the individual players in terms of exposure.

Compared to the previous year, the market weight of the 5 largest non-life insurers decreased by 1.1 percentage points in 2023, while the HHI decreased by 0.3 percentage points. The scope of the TOP5 institutions has not changed; the change is due to the market penetration of smaller institutions.

The concentration ratios of individual segments exceeded the figures of the life and non-life paths projected in the FIS. The FIS expected a continued increase in competition, and although the shifts in 2023 brought the values closer to the targets in both segments, they are still far from the targets, and the decline in the life segment is more a result of a one-off effect in the single premium market.

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



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

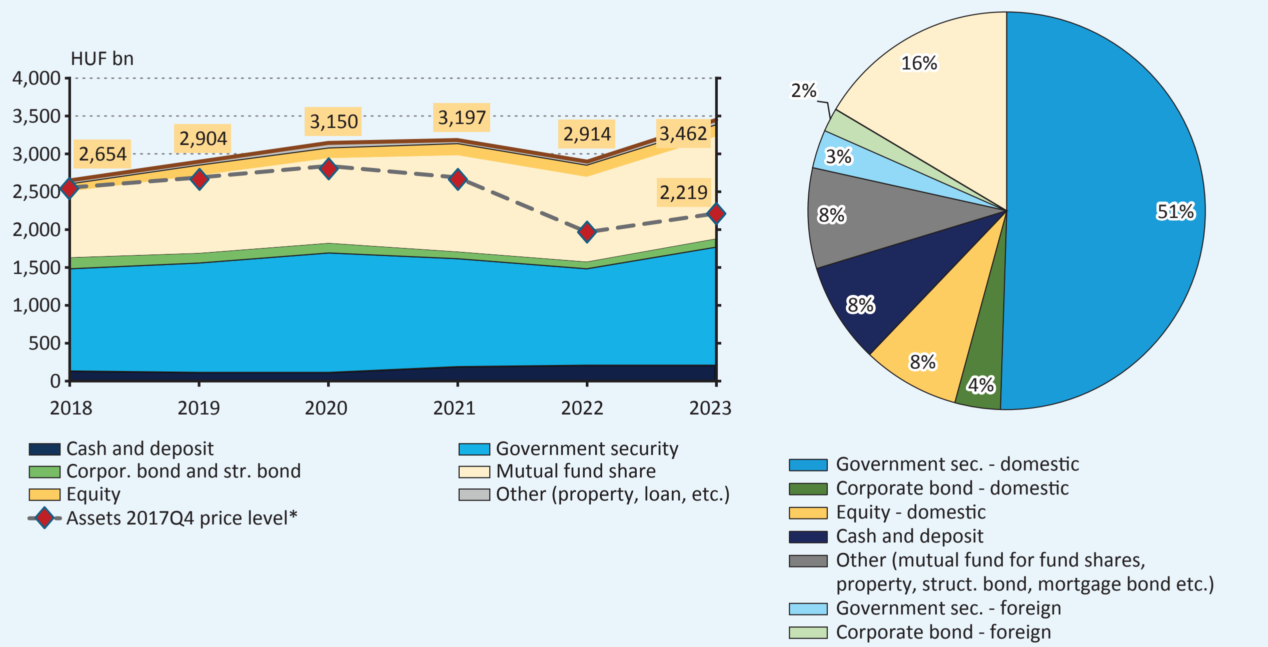
2.1.6 Significant wealth growth, 79 per cent of investments are domestic

The value of the total fixed assets of domestic insurers increased by 18.8 per cent in 2023 following a decline of 8.8 per cent in 2022, and – compared to the negative trend observed in 2021 and 2022 – this increase was positive in real terms.

Total assets amounted to HUF 3,462 billion, of which 50.3 per cent was backed by unit-linked life insurance reserves, while the remainder was made up of instruments underlying traditional life insurance and non-life insurance, as well as the institutions' own assets. Lower-risk, conservative assets (government bonds, cash and deposits) accounted for 51.5 per cent of insurers' total assets. This rate is 0.5 percentage points higher than in 2022. The remaining assets were mostly made up of investment fund shares, equities and corporate bonds (including structured bonds), of which investment fund shares had the largest share, accounting for 39 per cent of total assets at the end of 2023. Domestic assets make up 79 per cent of investments.

The classification of these indirect investments by underlying assets reveals that foreign equities make up the largest portion of the HUF 1,354 billion portfolio. The investment composition that emerges from the decomposition of indirect assets is shown in detail in the diagram on the right-hand side of Chart 2.4.

Chart 2.4
Asset composition of domestic insurance companies and its distribution by investment fund share

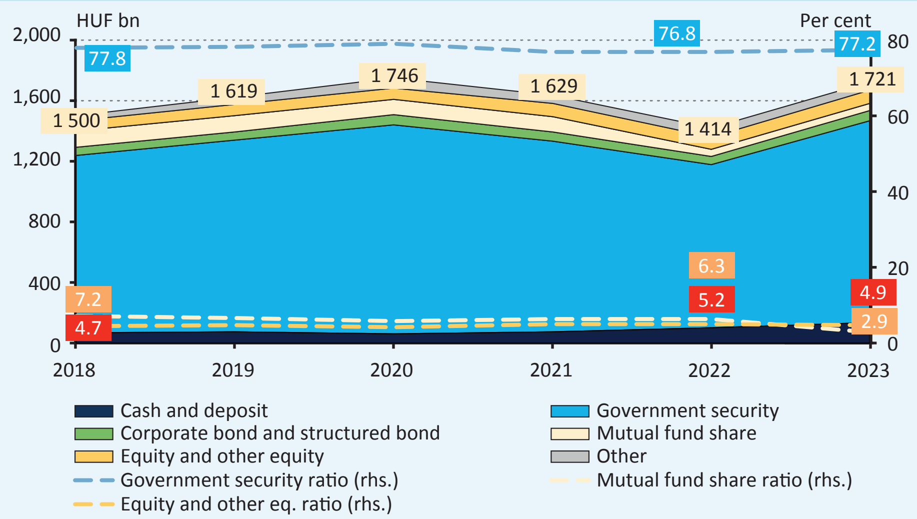


** adjusted by the consumer price index*
Source: MNB

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

For investments underlying non-unit-linked reserves, there was a shift towards lower-risk assets (government bonds, cash and bank deposits). The combined share of these assets rose to 85.2 per cent, up from 83 per cent in the previous year. The share of government bonds was 77.2 per cent, which is still outstanding by European standards.

Chart 2.5
Changes in the composition of assets underlying the non-unit-linked reserves



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

2.2 LIFE SEGMENT

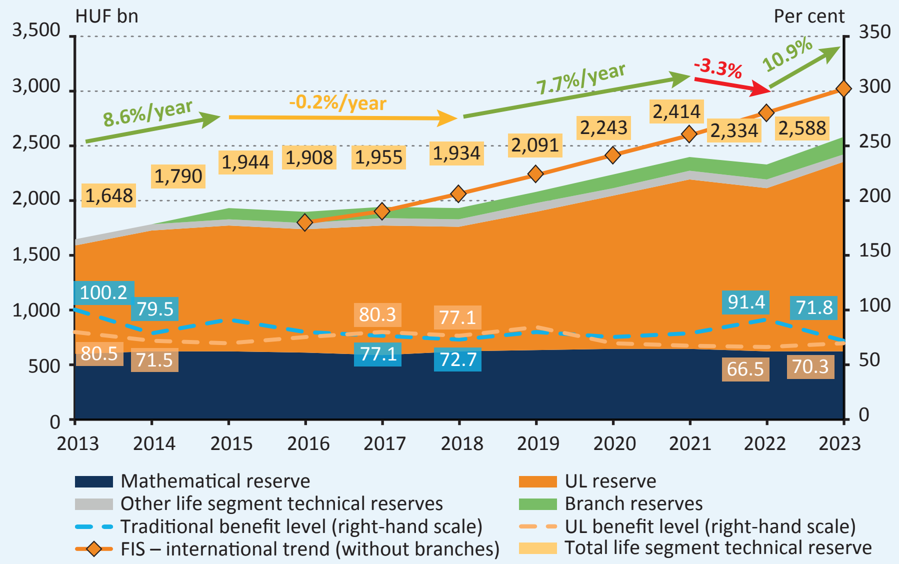
2.2.1 Increase in the reserves of unit-linked portfolios

The amount of technical provisions in the life segment amounted to HUF 2,433 billion by the end of 2023 (HUF 2,588 billion including branch offices), representing a 10.6 per cent year-on-year decline (10.9 per cent including branch offices). In particular, the reserves for unit-linked products, which accounted for a significant part of life segment reserves, increased by HUF 239 billion, that is, by 16 per cent. The mathematical provisions for traditional life insurance also increased, albeit to a much lesser degree (by HUF 596 million, 0.1 per cent).

In the two large groups of investment-based life insurance, i.e. for unit-linked and traditional products, cash inflows typically exceeded payouts over the past period. The benefit level of unit-linked products increased somewhat compared to the previous year, to 64.7 per cent in the year under review, the ratio of the life segment's benefit level to premiums. At the same time, traditional life insurance is characterised by a higher benefit level of 78 per cent, down 15 percentage points on the previous year, reaching the average level of the previous year. Premiums received for traditional products decreased sharply, while benefit payments show a market-consistent payout volume, thus reflecting the average benefit level seen in previous years.

Considering the above, life insurance reserves were positively affected by the fact that the cash inflows during the year exceeded payouts (change due to transactions), while the continuing, overall increase in life insurance premium reserves was attributable to appreciation effects. Unit-linked premiums are stagnating compared to the previous year, while premiums from traditional life policies decreased significantly. The turbulence in the capital markets primarily affects – either adversely or favourably – the value of the savings of customers with unit-linked products, in particular. In the latter case, there is a risk that negative returns in a given year may increase the number of surrenders, while a positive return situation may have a moderating effect. Such risk is lower if the clientele with this type of insurance is sufficiently informed and takes into account the expected market correction when making a decision instead of immediate loss realisation. The MNB monitors surrenders on a monthly basis. 2023 saw a decline, both in number and value.

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

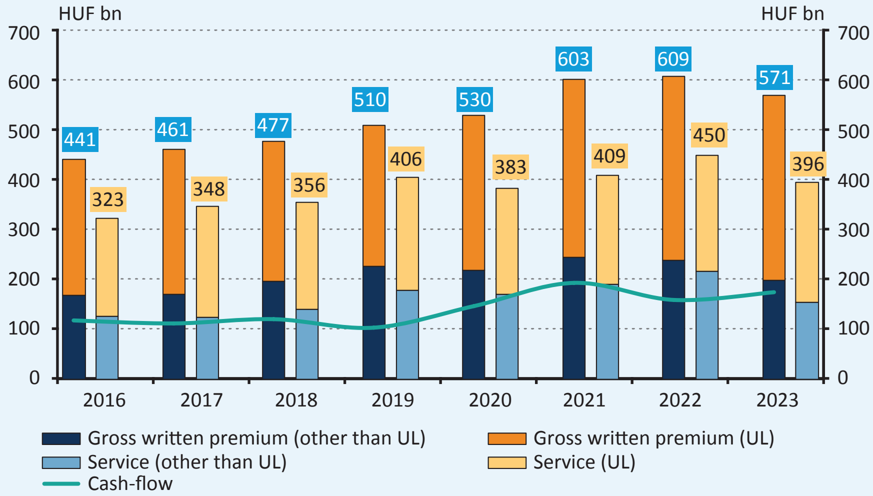


Note: From 2016, the benefit level (claim payment until 2015) is the ratio of the claim charges compared to gross premiums. When calculating the benefit level, the gross premium of branch offices has not been taken into consideration. The total value of the life insurance reserve, which is shown in the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

Source: MNB

In recent years, life insurance premiums exceeded benefit payments each year, resulting in a consistently positive net cash flow balance for life insurers. Net cash flow remained stable at HUF 100 billion until 2019, then fluctuated in the period of 2020–2022 before it rose again to HUF 175 billion in 2023. The decline in premiums compared to the previous year was more than offset by a decrease in benefit payments; this caused the net cash flow to rise again. The net cash flow balance of traditional life insurance was HUF 43 billion, while the benefit level stood at 78 per cent. As in previous years, the net cash flow balance of unit-linked life insurance was positive in 2023, with premiums exceeding payments by HUF 130 billion, bringing the benefit level to 64.7 per cent. However, premium income exceeded benefit payments, overall; therefore, the net cash flow balance remains stable.

Chart 2.7
Cash flows in the life segment



Source: MNB

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

Currently, the risk-free yield curve is declining, especially for spot yields with shorter time horizons, but it still exerts a significant discount effect. The considerable yield change was also reflected on the liabilities side. A rise in the risk-free yield curve, which is a key determinant for reserve calculation, may reduce the institutions' S2 technical provisions through the discount effect and thus, it exerts a direct impact on the solvency ratio.

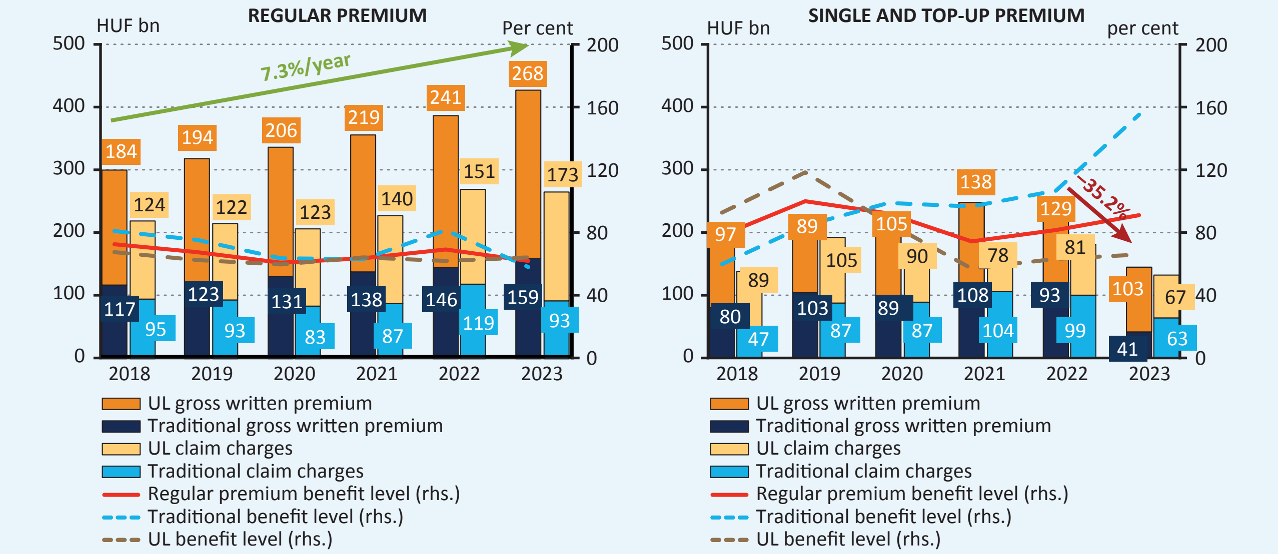
2.2.2 Regular premiums up, single premiums down further

In 2023, the premium income of the life insurance segment amounted to HUF 571 billion, of which 74 per cent came from regular premiums and the rest from single and top-up payments. Gross premiums in life insurance products have been on an upward trend since 2016, but a more modest decline in premiums can be observed in 2023. The past year saw a decline, overall (6.2 per cent on an annual basis).

Revenues from regular and single premiums changed to various degrees relative to the preceding year, especially because of the faltering sale of declining single-premium policies. Premium income from regular premiums continued to grow dynamically (11.2 per cent higher than in the previous year). Single and top-up premiums, on the other hand, fell further from an unusually high base in 2021, by 35.3 per cent compared to 2022. The drop in single premiums was in line with the decline in the growth of single premium products. The insurance surtax levied on the insurance sector appears to have hit mainly single-premium policies whose cost structure was less able to absorb the additional tax burden. By contrast, top-up premium payments decrease significantly only from 2021. Premium income from regular premium policies increased in both main product ranges (unit-linked and traditional).

In the regular-premium unit-linked segment, benefit payments increased in proportion to premiums, leaving the benefit level essentially unchanged (64.4 per cent). For traditional products, however, benefit payments in 2023 are back to their pre-2022 peak (58.3 per cent). As regards single-premium policies, the decrease in premium income had an immediate impact on the benefit level, which increased in both the unit-linked and the traditional segments compared to the previous year, and was above 150 per cent for traditional products.

Chart 2.8
Developments in premiums, claims and benefit levels* for life products, by frequency of premium payment

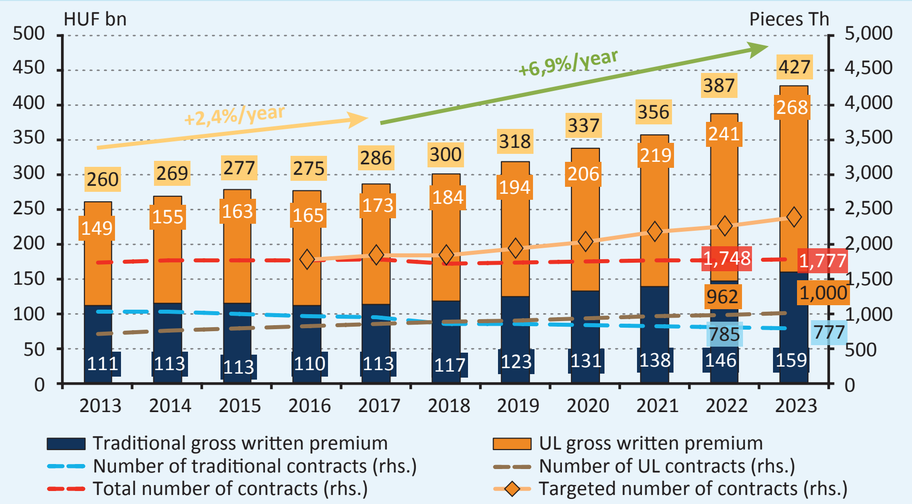


*Note: *Benefit level is the ratio of claims payments to gross premiums.*
Source: MNB

2.2.3 Steadily growing regular premiums portfolio

The vast majority of life insurance policies were still in the regular premium portfolio where the sectoral premium income continued the growth trend of the preceding years in 2023, and exceeded the previous year-end figure by 10 per cent, equalling HUF 427 billion.

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



Note: "Total number of contracts" excludes premium-free contracts and group life, accident and health insurance contracts.
Source: MNB

The increase in regular premium income was largely attributable to unit-linked products. Premium income increased for untied unit-linked products, which account for a large part of the regular segment, while the portfolio stagnated. The role of unit-linked pension insurance products was also considerable: similar to recent years, the portfolio grew dynamically.

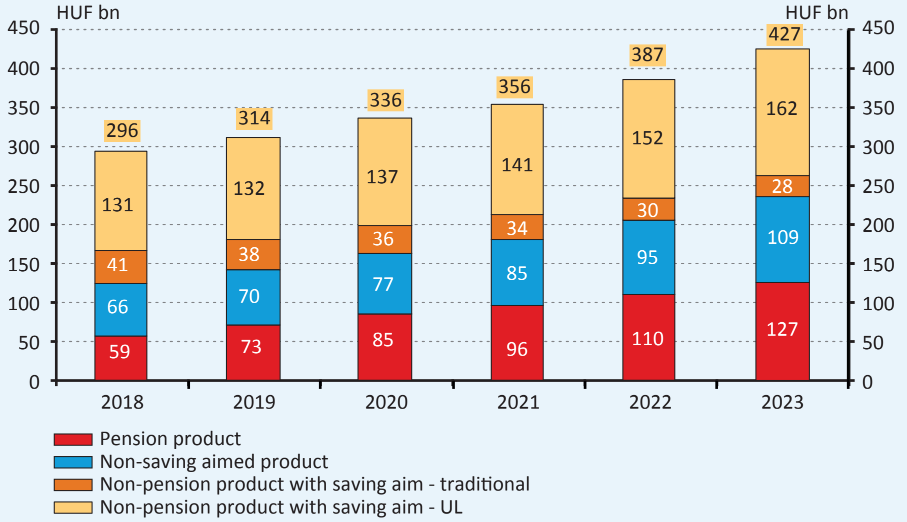
Regarding traditional life products with regular premiums, premium income for life insurance products with savings element in case of mixed (profit participants) life insurance decreased in the untied portfolio, slightly offset by the premium growth for pension savings of a traditional structure.

In terms of number of contracts, the portfolio of regular-premium life insurance policies stagnated, with a total of 1,777,000 contracts in 2023 (excluding premium-free, suspended contracts). Unit-linked policies were the most dominant followed by death benefit and savings products in the range of traditional products. For group life insurance policies, analyses based on the number of contracts were not suitable to identify an increase in the portfolio. Overall, however, the upward trend projected in the FIS did not materialise, the number of regular-premium policies reached 79 per cent of the target figure.

2.2.4 Strengthening pension and risk life insurance

Premiums from regular-premium life insurance had been growing at a slow, steady pace (6 to 9 per cent) since 2017, and exceeded HUF 427 billion in 2023. The growth in premium income continued to be driven primarily by unit-linked pension insurance, while the premiums due on term life insurance also increased. Premium income from non-pension type savings had been growing slowly and steadily for years, with the declining premium income from the maturing traditional savings portfolio being firmly compensated – and significantly exceeded – by the rising premium income of unit-linked policies.

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



Source: MNB

In 2023, the number of regular premium pension insurance policies approximated 490,000, of which 77 per cent were unit-linked. The evolution of gross premiums written for regular premium pension insurance is in line with the composition and evolution of the portfolio, with an increase of 16 per cent in terms of portfolio premiums in the year under review, while the number of contracts shows an increase of 8 per cent from 2022 to 2023.

In the year under review, HUF 115 billion of premiums were collected on the growing unit-linked pension insurance portfolio. Growth in the segment of traditional pension insurance with a regular premium remained well below that of the unit-linked portfolio and had slowed significantly since 2019 before it increased slightly from 2022 to 2023 (by 1.5 per cent).

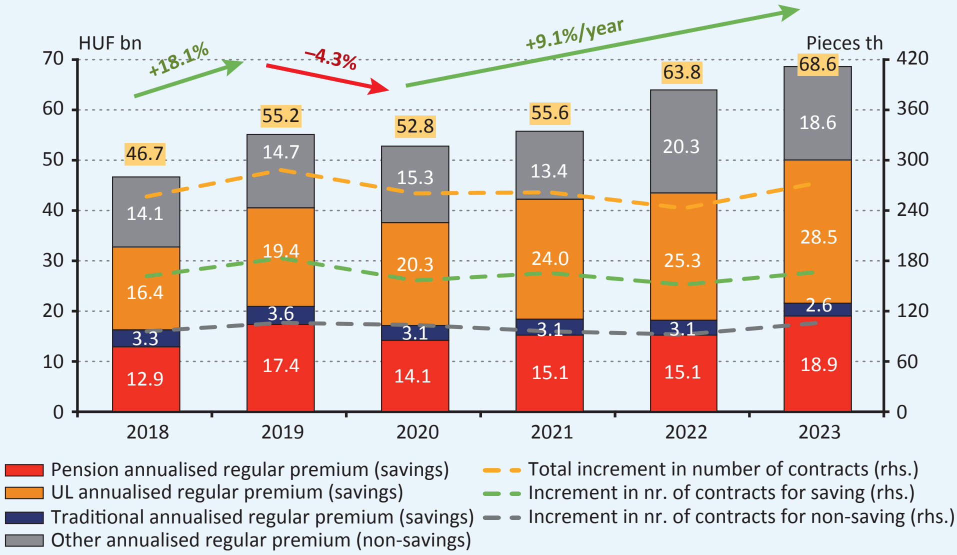
There are 12 institutions and 1 branch office active in the pension insurance market, of which 2 offer traditional products only, 3 have only unit-linked products, and the branch office sells pension insurance only in a unit-linked structure.

2.2.5 Increasing increment in regular premium life insurance

In the life segment, premiums earned on the increment in the regular premium policies rose by 7.5 per cent compared to the previous year. The increase is primarily related to unit-linked contracts, which account for 41 per cent of the premium on the increment of the segment. In terms of number of contracts, the increment increased by 12 per cent in 2023 compared to the previous year.

As in recent years, unit-linked and pension insurance products continued to be popular, and accounted for 69 per cent of the life segment's total premiums in 2023. With regard to savings-oriented UL products, premiums earned on the segment's increment were also higher compared to the previous year (by HUF 3.2 billion); indeed, the increment in this product group is remarkable, considering the volatile increment observed in previous years. Premium earned on the increment in traditional products shows an oscillating pattern, but pension products appear to be the main drivers of the growth in premium.

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



Note: "Other" comprises the following insurance products: death, annuity, group, health, payment protection insurance products with death cover
Source: MNB

2.2.6 Decrease in single and top-up premiums

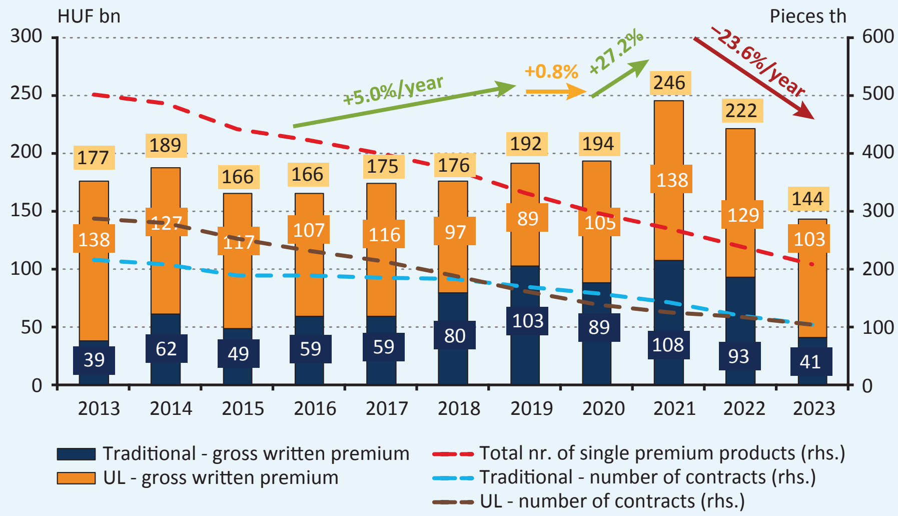
In terms of single and top-up premiums, there was a 19.5 per cent decline in 2023 compared to 2022 and a 23.6 per cent decline compared to 2021. One of the main factors influencing the decline is the imposition of a surcharge on the insurance sector, which had a negative impact on lump-sum property transaction insurance, and decelerated the sales dynamics of these products significantly.

Premium income is at an absolute trough when looking back over the last 10 years (Chart 2.12). Of the HUF 144 billion top-up and single premiums paid at sector level, HUF 103 billion (71 per cent) is related to unit-linked products only. Benefit payments exhibit a mixed picture, with unit-linked products having a 65 per cent benefit payment rate, while traditional products have a 153 per cent payment rate. The benefit level aptly illustrates the specificities of the business: the tendency of traditional products with a high benefit level to wear off, and the consistent practice of following the indicators of regular premium contracts for unit-linked products.

Gross premiums written in 2023 for single-premium life insurance amounted to HUF 56 billion, a decline of 51 per cent compared to the end of 2022. 58 per cent of the single premium income was generated by the traditional non-pension type portfolio, while 35 per cent was earned from non-pension type unit-linked contracts.

The number of single-premium policies had been on a downward trend for several years, as the loss of portfolio, primarily due to high surrender rates, exceeded new acquisitions. Moreover, sales were hit even harder by the surtax levied on the insurance sector. The single-premium stock represented nearly 210,000 contracts in 2023, 12 per cent less than in 2022. As regards new contracts, the number of single premium life products (20 thousand) is down 33 per cent which, coupled with the loss of 49 thousand contracts, supports the contraction in the portfolio. The abolition of the insurance surtax outlines positive expectations and could strongly improve the recovery in demand for single premium life insurance, thus stabilising the deteriorating portfolio figures.

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



Source: MNB

The MNB is committed to strengthening the insurance sector's ability to deliver customer value and is therefore preparing to introduce a comprehensive regulatory package at product level and across business processes, as the next step in the "ethical life insurance concept", translating supervisory experience into practice and updating it.

2.3 NON-LIFE SEGMENT

2.3.1 Corporate property and travel insurance showed significant premium growth

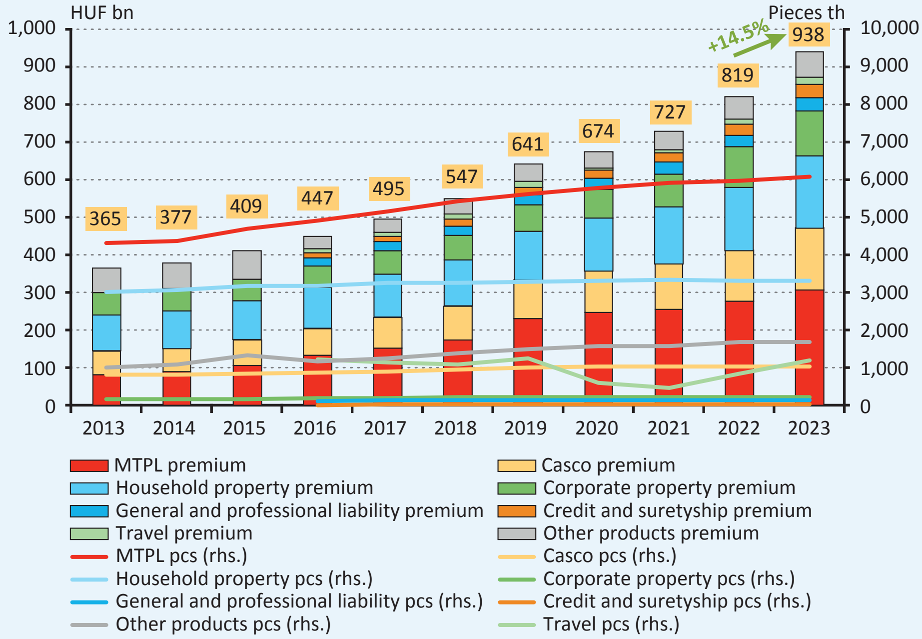
Non-life premium growth had been steady since 2012, its intensity in 2023 was once again higher than the 12.7 per cent recorded in the previous year. The 14.5 per cent growth in 2023 represented an increase of HUF 119 billion in absolute terms, with casco (HUF 28 billion) and personal property (HUF 26 billion) products contributing almost equally. The contribution of corporate assets (EUR 8 billion) was lower, a small increment compared to previous years. The largest growth was recorded for the motor third party liability (MTPL) segment (EUR 32 billion), which translated to an 11.5 per cent increase in premium income for this product type. At the same time, MTPL remained the most important segment, accounting for 32 per cent of the total non-life premium income in 2023, while its portfolio of 6 million contracts represented 44 per cent of the entire non-life insurance segment, although it rose only moderately by 1.6 per cent.

The portfolio of land vehicle casco contracts decreased by an essentially negligible 0.5 per cent in 2023. At the same time, premiums per contract increased by 21.3 per cent, more than double the 9.8 per cent dynamics of MTPL contracts. As a result of the above, the overall premium income of the casco portfolio increased by 20.7 per cent year on year.

Household property insurance premium income grew by 15.4 per cent in 2023, surpassing the 10.0 per cent acceleration in 2022, which was historically the highest in history. As with casco, the number of contracts was marginally up by 0.3 per cent during the year. In corporate property insurance, the number of policies decreased by 1.4 per cent, which contributed to a more moderate growth of 7.7 per cent in premium income in 2023 compared to the previous year.

Other non-life insurance, with the exception of travel insurance, saw a uniformly small decline in the number of contracts (0.2–1.0 per cent), while premium income grew dynamically (15–27 per cent). For travel insurance, the number of policies reached nearly 1.2 million in 2023, a significant increase (41 per cent) compared to the previous year. However, this volume is 60,000 contracts less than the number of policies in the insurance portfolio in 2019, the last year before the coronavirus epidemic.

Chart 2.13
Development of gross written premium and number of contracts of non-life segment by products



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

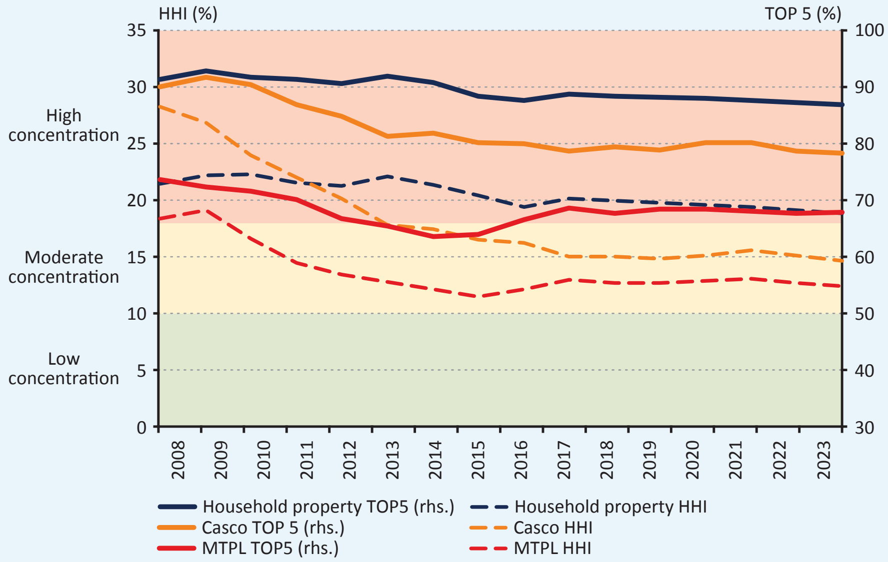
Source: MNB

2.3.2 Concentration in major non-life insurance products remained high

Market concentration in the main non-life product groups continued the slight decline seen in previous years. Both the share of the 5 leading market players (TOP 5) and the Herfindahl-Hirschman Index (HHI) decreased by only a few tenths of percentage points for each product group. The largest concentration decline was observed in casco insurance, where the TOP 5 decreased by 0.5 percentage points and the HHI by 0.3 percentage points. The indicators for the other product groups showed a decline of 0.3 percentage points or less. Despite these changes, concentration remains moderate to high in individual insurance categories. This market structure can ensure high profitability for market players, which can also encourage competition between institutions.

In the case of home insurance, an additional competition driver could be the MNB's announcement of the Certified Consumer-Friendly Home Insurance (MFO), which aims primarily to put the interests of the customer first by setting standardised minimum frameworks. The spread of the MFO criteria could lead to a more uniform product offering, but also to a more comparable product offering, which may foster competition and contribute to the reduction of market concentration. In the case of home insurance, the introduction of the option to cancel the contract in March, outside the anniversary date, has become a competitive factor, creating a campaign situation in the market.

Chart 2.14
Share of the 5 largest insurers (TOP 5) and the Herfindahl-Hirschman Index (HHI) of the entire sector based on gross premium written in the non-life segment, by major products



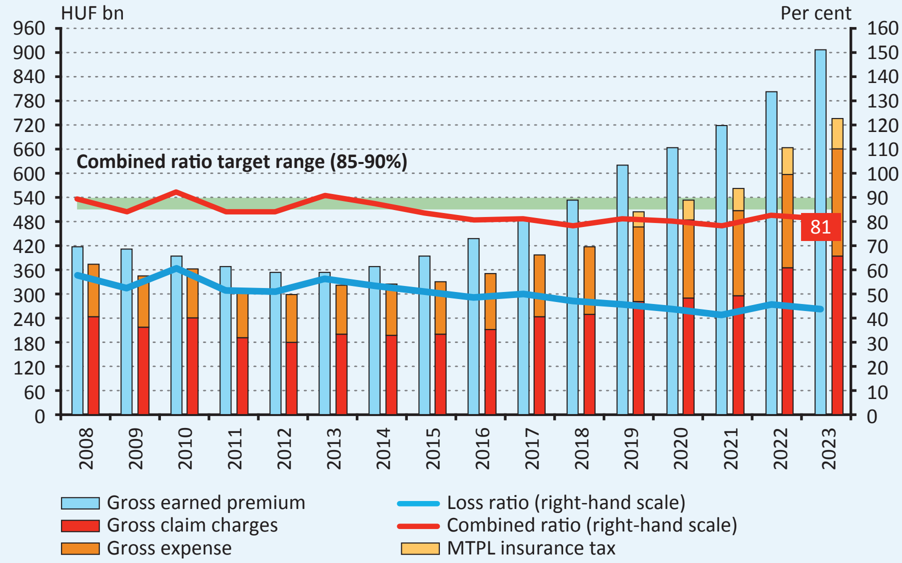
Note: The colour of the background illustrates the strength of concentration under the HHI.
Source: MNB

2.3.3 After going down, the combined ratio is still below the target range in the non-life segment

The combined ratio of the non-life segment decreased from 83 per cent in 2022 to 81 per cent in 2023. The increase in premiums earned only exceeded the increase in claim charges, while it was slightly below the increase in costs and the insurance tax paid on MTPL products. Claims were 8 per cent higher in 2023 than in the previous year, while premiums earned grew by 13 per cent, and as a combined result, the loss ratio dropped (to 41 per cent). However, costs and the insurance tax both increased by 15 per cent each in 2023. The value of the combined ratio is still low, falling short of the 85–90 per cent target range set as ideal in the FIS, while still exceeding the last trough in 2023 (2021: *78 per cent)*.

The more moderate increase in gross claim charges relative to the previous year can be attributed to the moderating inflation trends in the economy. However, the increase in premiums followed the dynamics of the previous year. The concentration of the non-life market left insurers more room to set prudent premium rates for their products. In the absence of excessive competitive pressures, insurers were able to avoid setting lower premiums than necessary for their products in response to rising claim charges.

Chart 2.15
Developments in the non-life combined ratio

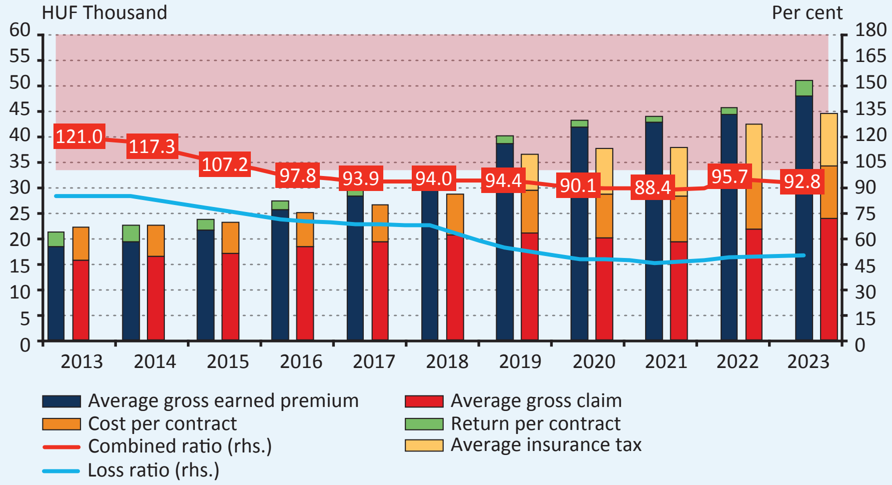


Note: The MTPL insurance tax is calculated from the expenditure data in the profit and loss accounts of insurers.
Source: MNB

2.3.4 Return on MTPL improves – Low claims frequency and high claims inflation

In the post-pandemic vehicle traffic recovery, the number of claims started to increase in 2021 compared to the trough in 2020, and this growth continued, albeit to a lesser extent, in 2022. At the same time, in 2023 the number of claim events declined despite the increase. Chart 2.17 clearly shows that post-pandemic claims frequencies were below the level of 2019. A more significant change can be observed in gross claim per contract, which rose by 12.4 per cent in 2022 and dropped to 10 per cent in 2023, while the same dynamics for gross premiums earned was only 8 per cent. The increase in claim charges was mainly driven by inflation, in particular, rising repair costs, as well as exchange rate changes which were also reflected in the prices of spare parts and international claims. These so-called claim inflationary effects are much larger than the change in the overall consumer basket. Inflation has also increased costs, and a 15 per cent increase in the overall insurance tax has contributed to the increase in total expenditure. Together, these effects led to a higher combined ratio, which rose from 88.4 per cent in 2021 to 95.7 per cent in 2022. However, in 2023 the ratio dropped to 92.8 per cent, which is closer to the 85–90 per cent range indicated as the target range in the FIS. With MTPL products, the increase in claims again could only be reflected in the premiums with a delay as new premiums are calculated in view of past claims experience. Looking ahead, if the market manages to maintain a low claim frequency, the impact of the recently observed claim inflation may be mitigated, which is also supported by the graph of the loss ratios.

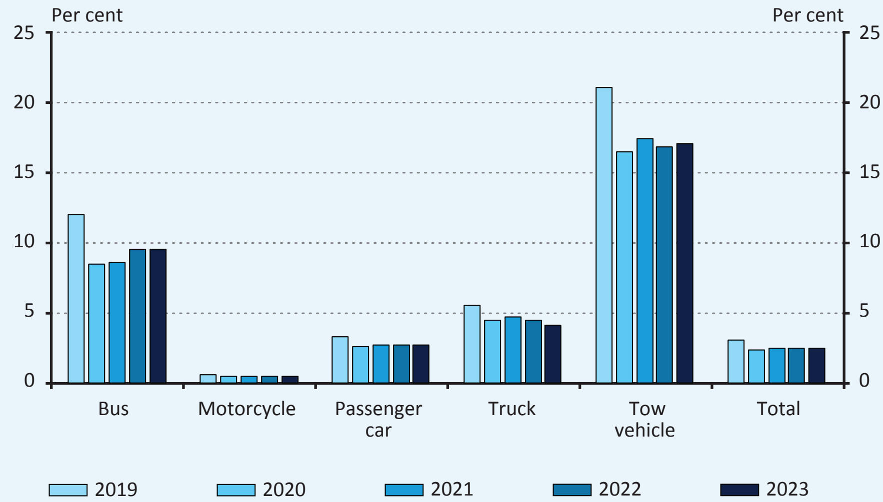
Chart 2.16
Development of combined ratio of motor third-party liability insurance in Hungary



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

Developments in the MTPL market in 2023 should also be reviewed on the basis of claim frequencies[6] and claim charges. Data from the Central MTPL Itemised Database (KKTA) show that the level of claim frequency remained low and still falls short of the higher, pre-pandemic level. Chart 2.17 shows claim frequencies by vehicle type for the period 2019–2023. Although the claim charges for individual claim events increased, especially in the period of 2022–2023 following a sharp increase in the consumer price index, the low claim frequency moderated the increase in premiums. Accordingly, premiums did not have to follow the high level of claims inflation, which is also important for customers in the MTPL market. Apparently, claim frequency was below the 2019 level for each vehicle type, and by 2023 it even declined, albeit slightly, compared to the level of 2022 for the market as a whole, approaching the 2020 low.

Chart 2.17
Claim frequencies of main vehicle types in the MTPL business, 2019–2023



Source: MNB

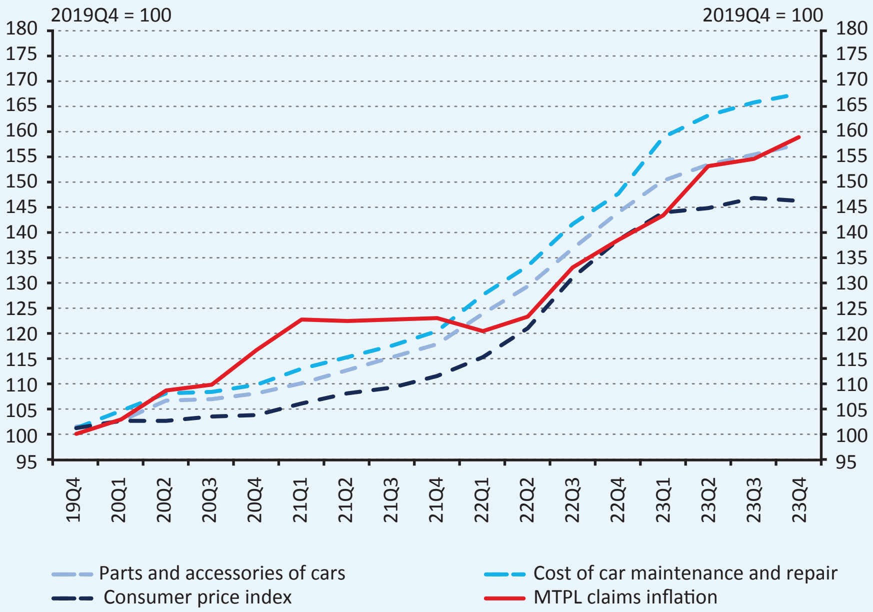
[6] Claim frequency = number of claims in the review period / number of contracts

1.3.5 Claims inflation, growing claim charges in the post-pandemic period

A significant part of MTPL claims is vehicle damage ("tin damage"); therefore, when estimating the level of claims inflation, of the consumer price indices of the HCSO, the indices of the costs, vehicle prices and spare part prices necessary to repair this type of damage should be considered primarily. Unfortunately, in addition to vehicle damage, accidents resulting in severe personal injury are a regular occurrence, and the amount of compensation for these accidents is much higher than for vehicle damage; therefore, even without inflation, the average annual cost of a claim is significantly affected by such injuries. Quarterly developments in claim sizes are shown in Chart 2.19.

Compared to 2019 Q4, there was a sharp increase in 2021 in excess of the listed claims indices, which can be primarily attributed to an increase in the average loss ratio caused by buses in 2021. The inflationary effect has been perceived in claims since 2022 Q1, with claims and the indices described rising sharply together until 2023 Q4. Although the claim charges associated with individual claims followed – especially in the period of 2022–2023 – the sharp increase in the consumer price index, the low frequency of claims restrained the growth in premium needs. Consequently, premiums do not have to follow the high level of claims inflation, which also results in more favourable premium levels for customers.

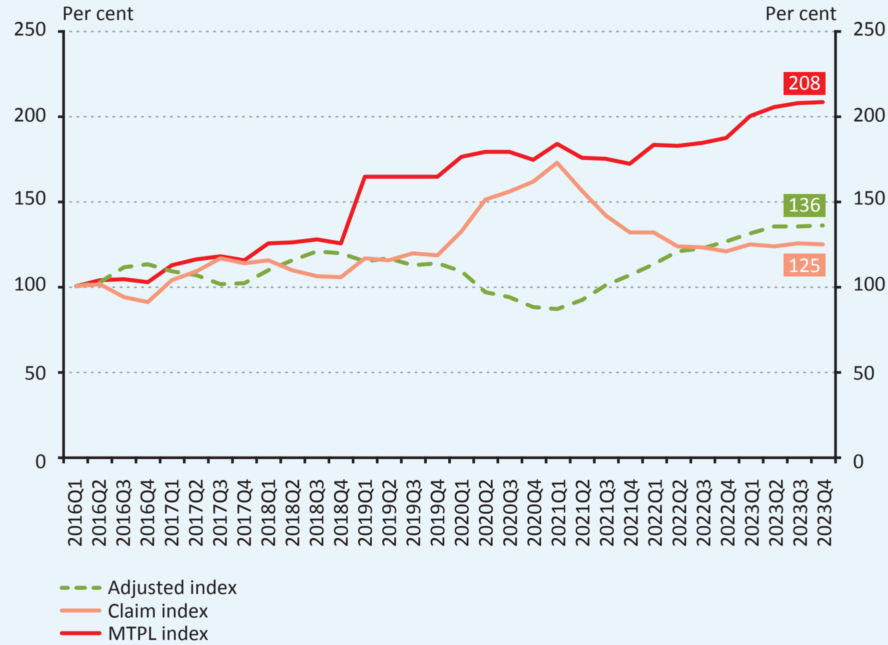
Chart 2.18
MTPL claims inflation with consumer price changes



Note: For claims inflation, the chart shows changes in the value of the moving average per claim.
Source: MNB, HCSO

The MTPL index, which is published regularly on the MNB website, is based on the KKTA which contains all domestic claims and policies data, and therefore provides a complete and up-to-date view of changes in average market premiums. The average premium for normal use passenger cars was HUF 52.9 thousand in 2023 Q4, up 11 per cent year on year, which is reflected in both Budapest and non-Budapest premiums, with a slightly higher increase in Budapest premiums (12 per cent). However, the upward trend in claim charges decelerated significantly, with an annualised increase of only 3 per cent relative to 2022 Q4. The significant increase in claim charges observed earlier was not seen in 2023 due to the continuing low level of claim frequencies. Owing to average premiums – which previously rose slowly – and claim charges – which increased at a faster pace –, compared to the large gap in 2021 Q1, the gap between claims and premiums closed by 2022 before it started to widen again in 2023.

Chart 2.19
Passenger car MTPL index



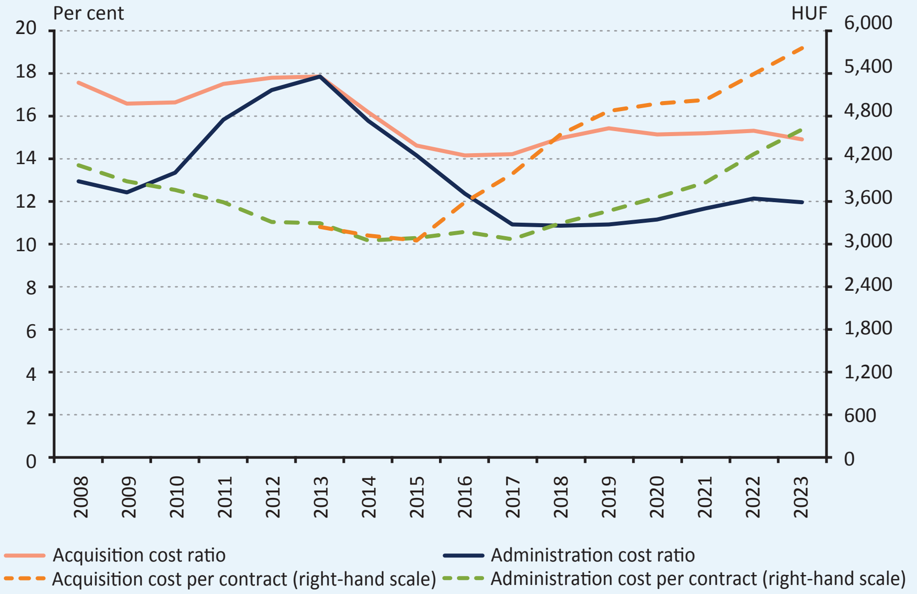
Source: MNB

2.3.6 Stagnating cost ratios in the MTPL market

The cost ratio of the business line[7] has been stagnating in recent years. The size of the expense ratio was in line with the ideal target of below 30 per cent set in the FIS for non-life insurance, and had been below the indicated level since 2015. In 2023, the ratio was 26.8 per cent, 14.9 per cent for acquisition costs and 11.9 per cent for administrative costs. The ratio decreased slightly compared to 2022 (27.4 per cent). Compared to the favourable cost ratios in 2017, a slow rise can be perceived, but the market essentially settled at 27 per cent. Costs per contract have increased steadily compared to 2015, with the increase in administrative costs far outweighing the increase in acquisition costs. The increase in administrative costs also followed, albeit at a lower rate, the growth rate of average gross wages. Administrative cost per contract in 2023 will be HUF 4,603 and the acquisition cost HUF 5,742. While the cost ratio is essentially constant, values per contract are increasing steadily, essentially tracking the increase in premiums. This is only natural, as the premiums charged should also cover the costs incurred.

[7] Cost ratio: the ratio of acquisition and administrative costs to premiums.

Chart 2.20
Developments of the cost ratios of motor third-party liability insurance in Hungary



Source: MNB

Box 2.1
The MNB has published its new home insurance index

Competition for customers in the home insurance market has recently become slack in terms of services and prices. Over four-fifths of premiums are written by only four insurers, which demonstrates the concentration of the market. Meanwhile, premiums increased significantly in 2023, and climate change is causing a growing amount of damage: in the summer of 2023, the globe was hit by storms unprecedented in recent years.

Government Decree No. 25/2023 (II. 1.) on certain contingency rules applicable to property insurance contracts allows for the cancellation of all home insurance contracts free of charge once a year in addition to the insurance anniversary – in March –, which was first possible in 2024. In this context, the Magyar Nemzeti Bank was expected to share publicly with the market more detailed information on home insurance.

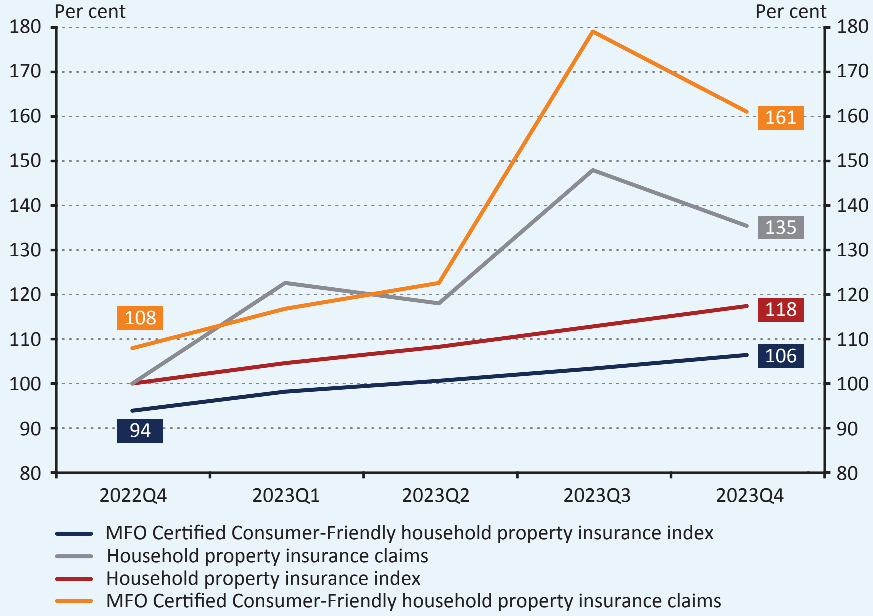
In order to achieve these objectives, starting from 2023 Q4, the MNB added to the time series disclosed on its website[8] a table with additional data on home insurance, including quarterly, aggregate data on the portfolio and on claims for home property insurance, broken down into the categories of home insurance (individual), condominium insurance, household property insurance with credit protection and other household property insurance. Publishing data on individual home insurance policies can benefit both insurers and the wider society.

In addition to the extension of the published time series, the MNB has developed a new Home Insurance Index to be published on a quarterly basis, enhancing the transparency of market developments. The Home Insurance Index also shows the evolution of average market premiums and claim charges in Budapest and the countryside. The MNB will also publish the characteristics of a number of sub-segments – e.g. home insurance, condominium sub-insurance, etc. – for which no information was previously available. The index was first published on 20 March 2024 on the MNB's website[9]. The Home Insurance Index is intended to increase transparency, inform the market and society at large, and stimulate competition.

[8] https://statisztika.mnb.hu/publikacios-temak/felugyeleti-statisztikak/biztositasi-piaci-szervezetek/lakasbiztositas-idosorai
[9] https://statisztika.mnb.hu/sw/static/file/lakasbizt_index_infografika_2023q4.pdf

According to the MNB's index, in 2023, an average home (movable and immovable) insurance policy cost HUF 56 thousand per year. During 2023, premiums increased by 18 per cent; however, the average premium for fully comprehensive MFO policies (covering both movable and immovable property) is 9.5 per cent lower than the average premium for fully comprehensive residential property, while claim charges are 19 per cent higher – providing a higher level of service to customers – and even increased further over the past year. Combining price and service benefits, the customer value represented by MFO products is 31.4 per cent higher.

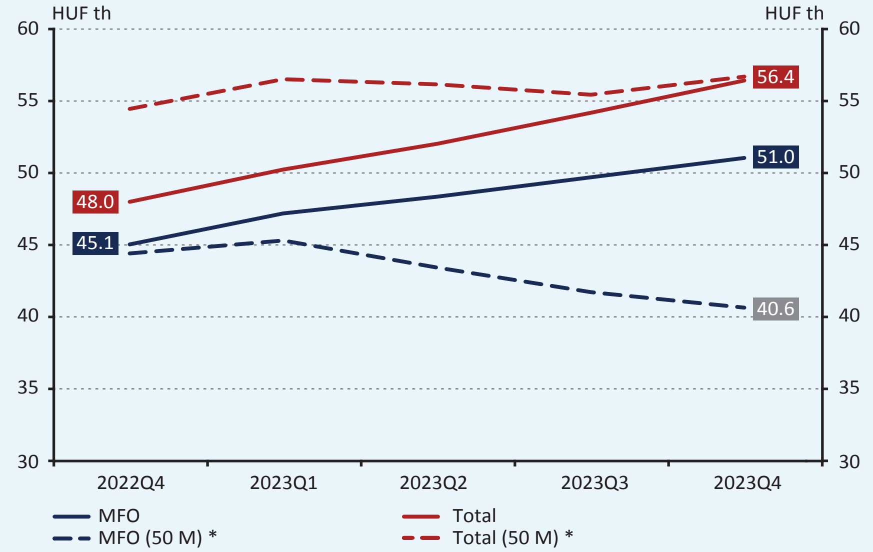
Chart 2.21
MNB Home Insurance Index 2023 Q4



Source: MNB

With the same fixed insurance amount of HUF 50 million, the premiums of the MFO policies were more than HUF 16 thousand lower on average. In addition, MFO premiums decreased over the past year with the same insured amount, while non-MFO products saw an increase.

Chart 2.22
Average premium (HUF) and average premium with a fixed sum insured of HUF 50 million



**for a fixed sum insured of HUF 50 million*

Source: MNB

Box 2.2
DLT Home Insurance Scheme

At the initiative and with the participation of the Magyar Nemzeti Bank, a Distributed Ledger Technology (DLT) was developed, based on blockchain technology, a pioneering development in the field of digital developments, to strengthen the electronic-based relationship between insurers and credit institutions. The mandatory application of the DLT Home Insurance Scheme is not prescribed by law; it was established and is operated voluntarily by the MNB and the affiliated insurers and credit institutions at the suggestion of the Magyar Nemzeti Bank. 11 insurers and 9 credit institutions, both major players in the domestic market, have joined the DLT Home Insurance Scheme, and the range of institutions using its functions continuously becomes complete gradually.

The overall objective of the development of the DLT Home Insurance Scheme is to establish and maintain an up-to-date, uniform register of the eligible collateral behind the mortgage loans associated with residential and condominium properties. It also aims to simplify the process of underwriting home insurance policies, avoiding cases that may require the personal involvement of the client. In addition to the former intentions, the DLT Home Insurance Scheme will provide a modern, secure technological basis for the flow of information between insurers and credit institutions and will create the potential for a substantial improvement in turnaround times and for paperless communication between sectors with a uniform data content. In the DLT Home Insurance Scheme, data reconciliation between insurers and credit institutions takes place on a common platform, which also provides a technological framework for managing and executing cases through a single process, while at the same time providing a way to reduce the administrative burden for customers, insurers and credit institutions alike.

The functional and non-functional requirements of the DLT Home Insurance Scheme have been defined as a result of tripartite consultations with the insurance and credit sectors – the Magyar Nemzeti Bank, the Association of Hungarian Insurers and the Hungarian Banking Association. The participating Magyar Nemzeti Bank and the affiliated insurers and credit institutions operate the DLT Home Insurance Scheme in a common data processing structure, in accordance with the General Data Protection Regulation (GDPR), based on a joint data processing agreement concluded in accordance with legal requirements. The DLT Home Insurance Scheme allows data sharing and queries of the same scope and content as has been done so far between insurers and credit institutions in relation to collateral coverage. Only the insurer(s) and the credit institution(s) that has (have) a live credit coverage endorsement on the insurance policy and hold the written consent of the policyholder may access the data of an insurance contract concerning the property insurance, and the Magyar Nemzeti Bank has no access to this information. In the DLT Home Insurance Scheme, transparency is also guaranteed by technology: all data transmissions and queries between the institutions are logged.

2.4 PROFITABILITY AND CAPITAL POSITION

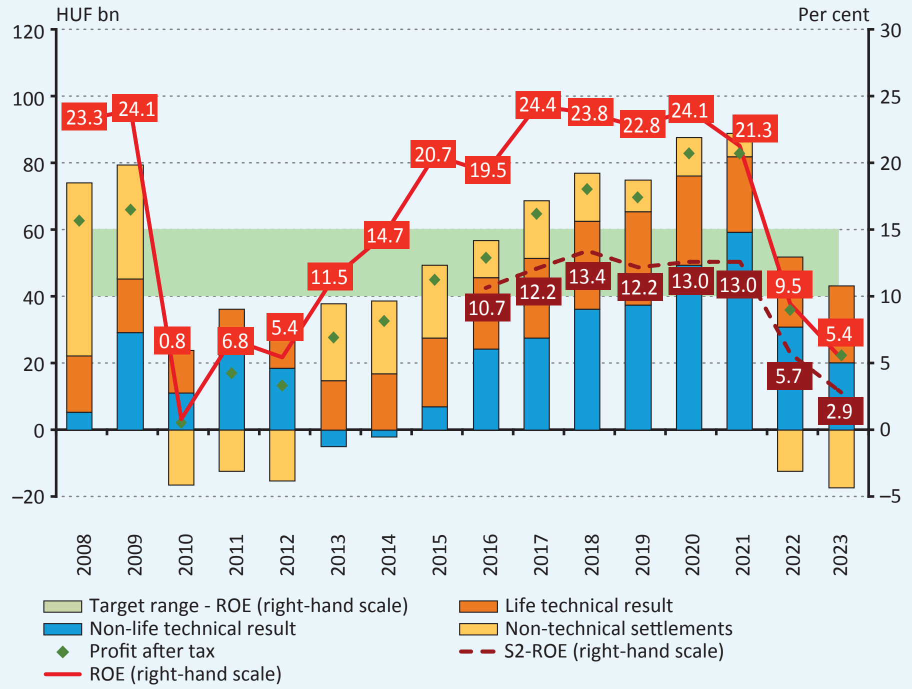
2.4.1 The insurance sector remained profitable

The insurance sector's after-tax profit was still positive in 2023, but continued to decline to HUF 22 billion from HUF 36 billion in 2022. In both years, the decline was due to the levy of a surtax on the insurance sector in 2022; the sector's top tax rates increased further in 2023, increasing the tax burden on institutions even compared to 2022. At the same time, in 2022 the profitability of the sector would have been similar to previous years without the surtax, with a significant improvement in 2023.

In line with the above, the sector's return on equity (ROE) also continued to deteriorate from 9.5 per cent to 5.4 per cent year on year. The indicator was only slightly deteriorated by a moderate increase in equity. Compared to the EU data available in the OECD's statistical database[10], the Hungarian ROE value for 2022 including the surtax would be in the middle range, while the value without the surtax would be in the upper range. Looking at the data for 2010–2022, the long-term average ROE of the Hungarian insurance sector is among the best.

The return on eligible own funds calculated as per Solvency II (S2-ROE) exhibited a co-movement with ROE, falling from 5.7 per cent in 2022 to 2.9 per cent in 2023. For S2-ROE, the increase in own funds by more than one fifth also contributed to the substantial decline in the indicator.

Chart 2.23
Profitability of the Hungarian insurance sector and its composition



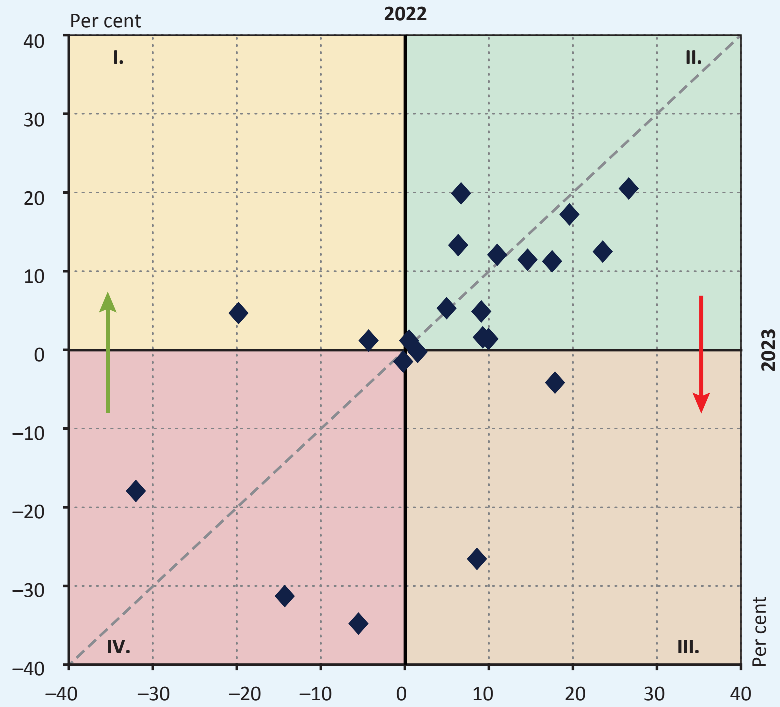
Note: The sector-level ROE values (with the exception of 2023) were calculated on the basis of the annual audited data reporting, where equity does not contain the current year's dividend. For the S2-ROE indicator, the after-tax profit was compared to the eligible own funds.

Source: MNB

Institutional-level ROE results show that 7 market participants were loss-making in 2023 compared to 6 insurers in 2022. Of the latter, 3 deteriorated during the previous year, which may imply a temporary loss-making operation (see field **III** on the relevant chart). Overall, however, the majority of the sector (13 institutions) managed to remain profitable in 2023 despite the adverse conditions of recent years, and 2 institutions turned their profitability into the positive range.

[10] https://stats.0ecd.0rg/# (Insurance Statistics)

Chart 2.24
ROE value of Hungarian insurers



Source: MNB

Box 2.3
IFRS 17

The new International Financial Reporting Standard (IFRS) 17, which replaces IFRS 4 for insurance contracts, became applicable from 1 January 2023. Unlike its predecessor, the new standard sets out a uniform methodology for accounting for the core business of insurers, which is an important step forward in the international comparability of insurers' results and financial position. Although the actual application of IFRS standards in Hungary will only affect a small part of the sector (3 institutions, with premium income of 5 per cent of the sector-wide premium income in 2022), the application of the new standard will affect the operations of most institutions. Twelve insurers (accounting for almost 90 per cent of the total premium income of the sector) are indirectly affected by the application of IFRS 17, as they prepare IFRS reports for the consolidated accounts of their foreign parent companies.

For the three insurers that apply IFRS in preparing their financial statements, 2023 is the first year in which they had to measure their technical provisions, the most significant item on the liabilities side of their balance sheets, in accordance with IFRS 17. On the assets side, fair value was the main valuation principle for the most significant investments, but the new standard also bases the valuation of insurance liabilities on the fair market value, which improves consistency between the valuation of assets and liabilities significantly.

Obviously, the most important question is the numerical impact of IFRS 17 on the equity and profitability of these insurers. The audited figures on financial position and profitability are included for the first time in the annual reports published in 2024, where the insurers concerned provide details of the impact of the adoption of IFRS 17.

Experience so far shows that the application of IFRS 17 strengthens consistency between the valuation used to prepare the financial statements and the calculations (economic balance sheet, capital adequacy calculations) performed to comply with the quantitative requirements of the prudential framework under Solvency II (SII). In their public report on solvency and financial position for the year 2023 under Article 51 of Directive 2009/138/EC (SII Directive), the insurers concerned shall disclose the material differences between the two types of the valuation and the explanation thereof.

In spring 2023, the MNB conducted a survey among twelve insurers that do not apply IFRS in their financial reporting but also produce IFRS data as part of a group. Insurers producing IFRS data perform IFRS 17 reserve calculation in different depths. Most commonly, institutions only transmit the basic data required to their parent company or carry out calculations with considerable simplifications. Insurers typically rely heavily on parent company expertise and systems. In terms of their operations, the most significant impact of IFRS 17 is on IT developments and business planning. The impact on corporate governance and changes in key indicators is less significant, but perceivable at half of the institutions. In terms of dividend payments, responses indicated that two institutions take IFRS profitability into account, but the impact was considered negligible. The introduction of IFRS 17 had a noticeable cost impact for non-IFRS insurers. The cost of the developments related to the new standard varied from institution to institution, ranging from HUF 38 million to HUF 3.6 billion, with the total estimated by the responding insurers at more than HUF 12 billion (based on the 2018-2022 actual and 2023 projected data of 10 insurers).

The MNB examined how the financial position and income statement under IFRS compared to the national accounting balance sheet and profit and loss account for the twelve insurers that have not converted to IFRS but apply the standards for internal purposes. Eleven insurers sent indicative, presumably reliable data for the end of 2022, but it should be stressed that these are unaudited data, and the valuation of institutions under IFRS is often based on significant simplifications. Unsurprisingly, the survey showed that there may be significant differences between the IFRS and domestic accounting balance sheets of insurers, affecting both the asset side (valuation of investments) and the liability side (valuation of technical provisions). On an aggregate level, the application of IFRS would result in a decline on both sides (9.9 per cent decline on the asset side and 12.7 per cent on the liability side), while the impact on equity would be an increase of 16 per cent (HUF 44 billion). On the institution level, it is not clear whether the application of IFRS ultimately leads to an increase or decrease in equity (an increase in 6 cases, nearly the same in 1 case, a decrease in 4 cases), with the difference being examined for 2022, when the effects of the high yield environment and negative capital market returns had a significant impact on IFRS calculations based on economic measurement.

The application of IFRS 17 has no material impact on prudential supervision, and insurers continue to determine their dividend payment intentions based on the capital requirement calculated under the SII framework, available capital and expected capital adequacy. In addition, the first application of IFRS 17 and its impact is also in focus at the European level. EIOPA monitors consistency between the prudential and accounting requirements [SII Directive recitals (46) and (54)]. Following the commencement of the practical application of IFRS 17, EIOPA carried out an analysis based on quantitative data, the results of which were published on 15 April 2024 (EIOPA's report on the implementation & synergies and differences with Solvency II: Report on the implementation of IFRS 17 – Insurance contracts – European Union (europa.eu)[11]).

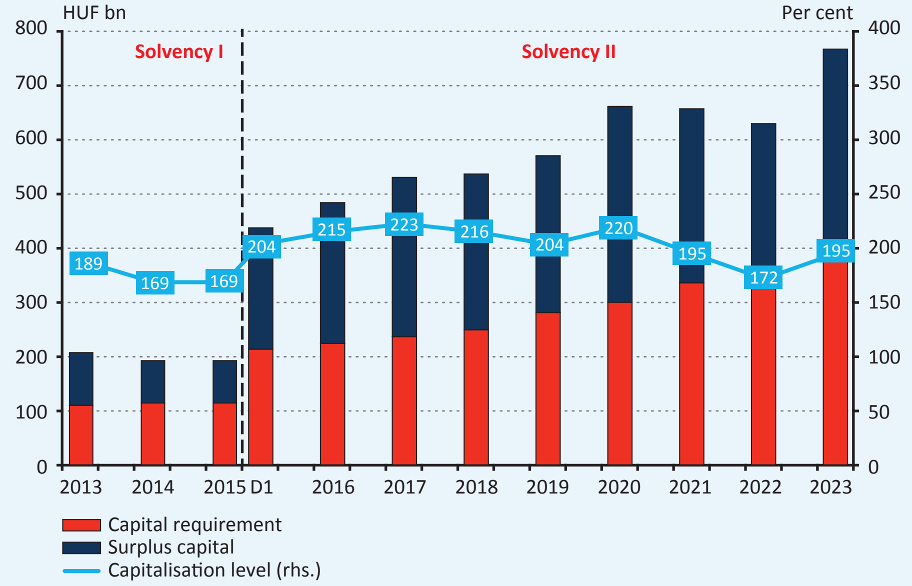
[11] https://www.eiopa.europa.eu/publications/report-implementation-ifrs-17-insurance-contracts_en

2.4.2 Capital adequacy close to 200 per cent again

The capital adequacy of the insurance sector was 195 per cent at the end of 2023, almost double the level required by law. After the negative impact of the significant yield curve increase in 2022, the average capital level of the sector has returned to the 2021 level. The capital-reducing effect of the insurance surtax, also introduced in 2022, is still in place. Without this effect the levels above 200 per cent that had been typical for most of the post-2016 period could have been reached.

The 23-percentage-point increase in the last one year was mainly due to a rise in available regulatory capital. This was mainly (97 per cent) due to an increase in the revaluation reserve. At the same time, the volume of dividends expected to be paid out in 2023 more than doubled compared to the previous year, but is significantly lower than the dividends paid out in the years before 2022.

Chart 2.25
Capitalisation rate at sector level

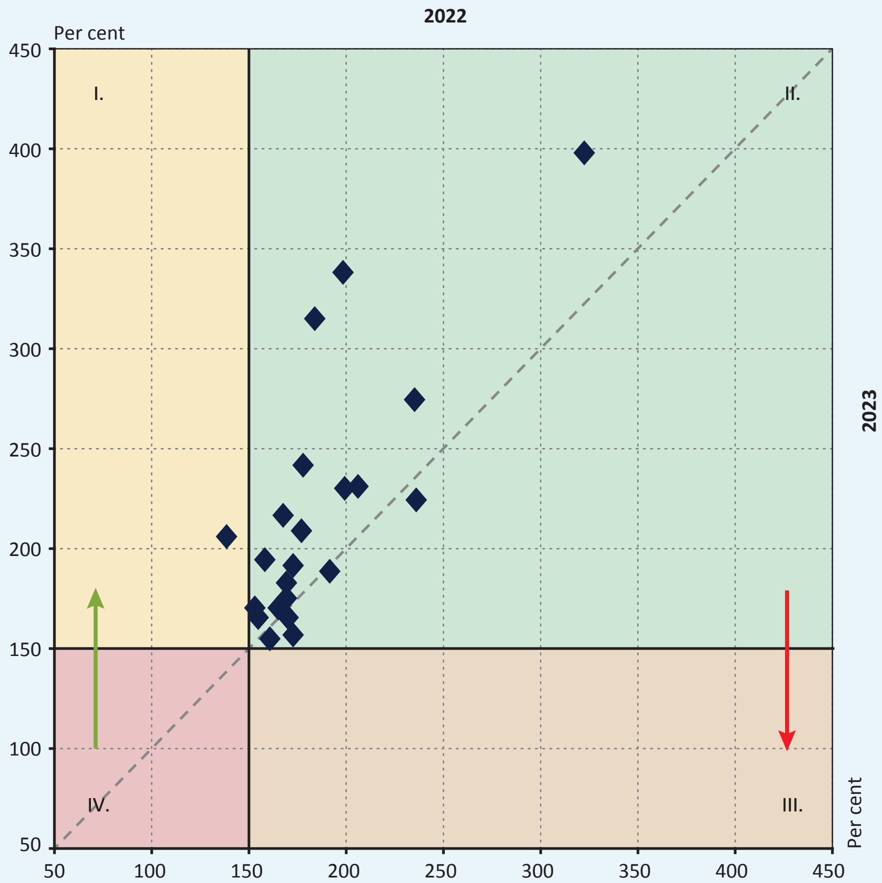


Source: MNB

2.4.3 Insurer capitalisation is also stable at individual level

The unweighted average capital adequacy of insurers was 218 per cent in 2023, with individual values spread around 63 percentage points, one and a half times higher than in the previous year. However, all institutions had a capital ratio above 150 per cent; consequently, they all met the capital adequacy requirements recommended by the MNB's volatility capital buffer. Accordingly, no institution breached the 100 per cent level required by law. Of the 22 insurers, 17 were able to strengthen their capital adequacy further, including the one that was still below 150 per cent in 2022.

Chart 2.26
Individual capitalisation level of insurers



Source: MNB

Box 2.4
Green recommendation for the insurance sector

In December 2023, the MNB issued a recommendation for Hungarian insurers on the identification, management and disclosure of climate change and environmental risks and the integration of environmental sustainability considerations in their business activities. The main objectives of the document are to encourage domestic insurers to take account of environmental factors and risks, to provide guidance on how to achieve sustainable operations and to increase the predictability of legislation, thereby facilitating regulatory compliance.

Climate change and volatile environmental risks pose serious challenges to the entire financial system, and insurance is no different in this regard. As key risk managers in the economy, insurers are already experienced in understanding, measuring and pricing environmental impacts and the risks they carry. However, the nature and severity of environmental risks may change at an accelerating pace due to climate change. For this reason, traditional risk models are less and less able to predict expected claim events with certainty; consequently, insurance risks are expected to increase. In this turbulent period, in line with its supervisory strategy the MNB is supporting domestic financial institutions in implementing the sustainability turnaround and preparing for the risks posed by environmental anomalies. The Recommendation sets out requirements and good practices under four headings.

In addition to identifying the short-, medium- and long-term risks from climate change and environmental degradation (over a time horizon of at least 10 years), it is important for insurers to assess the opportunities that these changes bring in terms of business model and strategy development. In the context of corporate governance, it is important to develop a governance system that takes into account the significant environmental and climate change risks and establishes consistent and well-defined responsibilities within the company and ensures that the management, governance or supervisory body is adequately informed on the issue. In order to be able to assess its exposure to climate change, an insurer should also assess the potential impact of climate change and environmental risks on its own operations, business continuity and availability of services. While European legislation is the main reference for disclosure and reporting obligations, the MNB sets out a number of general requirements in the context of disclosures. The guiding principle of disclosure requirements is that based on reliable data, insurers should publish meaningful and easy-to-understand information for the market.

Currently, Hungarian insurers are preparing a gap analysis in response to the requirements of the Recommendation, which must provide an ambitious but achievable action plan to meet the requirements of the Recommendation. By assessing the action plans together with the institutions, the MNB aims to encourage them to pursue their sustainability efforts, and to closely monitor the domestic insurance sector's environmental risk exposures and resilience to the impacts of climate change.

2.5 RISKS IN THE INSURANCE MARKET

2.5.1 Stability preserved despite the risks

Table 2.4
Risks of the insurance market

Risk category	Risk groups	Risk rating	Risk prospects	Evaluation in words
Business model	Environment Strategy, business plans Profitability	●	↘	Profitability in 2023 was determined by the sectoral extra profit tax and high interest rates: despite the improved insurance technical results, only non-life and own investment returns could turn the sector into a profitable one. The number of unprofitable institutions is 7, without sectoral tax 1. The yield curve on both the short and long sides decreased significantly in 2023. *Improving outlook based on economic forecasts for 2024.*
Corporate governance	Exercise of owner's rights Internal governance Risk assessment system and ORSA Internal control	●	→	Environmental risks are managed with high-quality internal control. Changes in the ownership structure and personnel composition still require special attention. The essential risks were identified, no other significant risks arose in the ORSA reports. Stress tests are mainly integrated into the institutions' risk management system. *Significant organizational and management, key function changes.*
Financial and operational risks	Insurance risk Market risk Credit risk Operational risk Other relevant risks	●	↘	The drop in single and top-up premiums for life is expected to be permanent until 2024 (sectoral tax out of force). The consolidation of the risk-free yield curve continued. MTPL combined ratio indicator is rising, currently 93%. HUF 15 billion higher claim payments for household property insurance due to storm damage. At the sector level, increased home insurance competition may represent a prudential pricing risk. *As inflation moderates and the yield environment improves, the risk may decrease in the future.*

Table 2.4
Risks of the insurance market (continuation)

Risk category	Risk groups	Risk rating	Risk prospects	Evaluation in words
Capital and reserve risks	Capital Reserves			Capital adequacy at the sector level is 195%, in no case below 150%. Capital adequacy improved, as the impact of the extension of the sectoral tax was compensated by the impact of the declining yield environment. *Non-life insurance reserves are increasing annually, further growth is expected due to claims inflation, the risk inherent in this offsets the improvement of the capital position, so stagnation is expected at a moderate level.*
Market entry risk	Products Customers			According to Ethical concept 2 analyses, the customer value of some UL life insurance products is low. EIOPA warning on credit protection insurance. *Topic examination of credit protection insurance provided through the banking channel. According to the KID scenarios, the collection of products with low customer value at the market level, calling on the relevant institutions for a POG-based review and ACR reduction.*

Legend:

Degree of risks — *high* — *significant* — *moderate* — *low*

Direction of risks — *increasing* — *stagnant* — *decreasing*

Source: MNB

In 2023 annual inflation was 17.6 per cent on average. Within the change in the CPI, once again, the price of food and household energy increased the most.

The MNB defined a fair and competitive level of profitability in the FIS as a sustainable sector-wide return on equity (ROE) of 10 to 15 per cent. The sector-wide return on equity (ROE) was 5.4 per cent. After a strong year for the insurance sector in 2021, the surtax levied on the sector changed the income position of insurers substantially in 2022 and 2023. After a profit after tax of more than HUF 80 billion in 2021, the sector realised a profit of only HUF 36 billion in 2022 and HUF 22 billion in 2023. Despite the decline, the majority of the institutions remained profitable, and the profitability of the sector without the surtax would remain well above target.

Environmental risks in the sector are managed through high-quality internal, shareholder's and governance controls. Prudent shareholder's governance and control are in place to support the safe operation of the institutions, but changes in the ownership structure and in management and key functions will continue to demand particular attention. The insurers have identified material risks, and no other material risks have been identified in the own risk and solvency capital assessment reports that are part of the risk management system. Stress tests are now firmly embedded in the institutions' risk management systems. In respect of the quality of the internal control system, supervisory inspections identified specific risks and errors in internal regulations and controls. The MNB expects the significant risk level to change in the short term, with a stagnant risk outlook.

For life insurance products, the market was still characterised by a decline in single and top-up premiums in 2023, which is expected to be present until 2024 (end of the surtax). The monitoring of monthly data indicates that the level of surrenders was not particularly high last year, but the fall in single and top-up premiums means that the growth in new policies decelerated relative to previous years. Consolidation of the risk-free yield curve continued throughout 2023, with the year-end yield curve almost horizontal and the inverted form essentially eliminated. The MTPL combined ratio stood at 93 per cent, rising but not reaching 100 per cent. The tax and surtax should increase the value, but this was partly offset by the high yields achievable in 2022 and 2023. In household property insurance, storm damage resulted in total claims payments HUF 15 billion higher, which is a surge compared to recent years, but even so, the loss ratio did not increase significantly. With the first home insurance campaign now over, increased competition in home insurance may pose a prudential pricing risk for insurers if smaller institutions have built up larger portfolios with inadequate premium cover. The relevant backtesting and the impact thereof will be measurable in the second half of the year. The sector's non-life P&L was negative, with different results for institutions. With the moderation of inflation claims inflation may come to a halt and as the yield environment improves, risks may become less severe in the future.

Capitalisation at sector level was 195 per cent, in no case below 150 per cent. Both the own funds requirement and the available capital increased, and a dividend of HUF 34 billion is planned for the next 12 months. Capital adequacy improved, as the impact of the extension of the surtax was offset by the effect of the declining yield environment; provided that the yield environment continues to moderate, risk is expected to decrease. Non-life insurance reserves are increasing year on year, with further growth expected due to claims inflation, the risk of which offsets the improvement in the capital position; consequently, stagnation at a moderate level is expected.

According to the analyses produced by the MNB in 2023, the low customer value of some UL life insurance products, i.e. the unfavourable price-to-value ratio of insurance, poses a consumer protection risk. The MNB aims to increase the customer value of insurance, which is one of the key elements of the Ethical 2.0 regulatory package, an enhanced version of the ethical life insurance concept developed in 2015.

The 2023 analyses also included the inspection of Key Information Documents (KID) scenarios. The inspection found that, for a significant number of product–asset fund combinations, the expected return on investment is negative even for a moderate scenario for the recommended life insurance holding period. The MNB's long-term minimum requirement is to preserve the real value of investments and to avoid the effects of inflation. To this end, the MNB pays particular attention to filtering out products with low customer value in the life insurance market. In addition to providing additional services, reducing costs is another way to increase customer value. In 2023, the main focus of MNB inspections was to examine the justification for the 1.5 per cent additional cost deducted above the TCI limits, and the fulfilment of the most common justification for the higher return potential of UL life insurance policies, with the aim of reducing costs for product-asset fund combinations where the promise of higher returns is not fulfilled.

In 2022, EIOPA issued a warning to insurers and banks on consumer protection issues related to the sale of credit protection insurance products. In the warning, EIOPA called on insurers and banks to take steps to fully comply with the Insurance Distribution Directive (IDD), including product oversight and governance (POG) requirements, and to take action to address high remuneration issues and prevent harmful conflicts of interest.

Group credit protection insurance sold through banking channels were subject to a comprehensive inspection by the MNB in 2023 and are subject to a thematic inspection in 2024. The focus is on the compliance of insurance products with POG requirements.

3 The funds market and its risks

3.1 OVERALL PICTURE OF THE MARKET

3.1.1 The funds market remains stable due to strong returns and income, but declining and ageing pension fund membership is a key risk

The number of **voluntary pension fund** members has been falling steadily for 15 years. At the end of 2023, 1.1 million members had voluntary pension savings, 0.3 million fewer than at the peak in 2008. The average age of the membership is increasing, and the low level of pension savings per capita – partly due to the high proportion of non-paying, passive members – means that there is little income supplement over and above the public pension.

The main reason for these trends is the failure of supplementary pension products to appeal to the younger generation. Looking at the age composition of voluntary pension funds, it can be seen that voluntary pension fund membership was much more popular among the under-45 generation in 2002 than in 2022: while 677,000 persons in this age group were members in 2002, membership amounted to only 412,000 in 2022. Membership is not an attractive option for young people today, and their failure to join contributes to the ageing of the membership at a higher rate than society as a whole, and the concentration of wealth at older pension fund members is even more drastic than the concentration of members in the older generation.

Reform is needed to ensure the long-term viability of pension funds, which also play an important role in financing the capital market, by creating conditions that will attract younger generations to join.

In 2023, the positive investment result and the positive cash flow boosted the voluntary pension fund sector's individual accounts to an all-time high of HUF 1,939 billion, an increase of 21.4 per cent relative to the end of the previous year. Due to the impact of the price increase of investment instruments, in 2023 the investment gain was triple the investment loss in 2022 (in nominal terms).

In 2023, payouts were even higher than in 2022 (+9.4 per cent), realised mainly in the first half of the year. The membership is extremely sensitive to annual returns, despite the fact that voluntary pension funds are built on long-term commitment and their performance should be evaluated over a 20–30 year time horizon. This was demonstrated by the increased outflows following the communication of negative voluntary pension fund returns in 2022. At the same time, the weaker investment performance in some years was not only corrected but outstripped significantly by the positive performance in subsequent years. Accordingly, instead of making a rash, hasty decision, pension fund members should wait for the return adjustment that is likely to occur. After weak returns in 2022, weighted by closing assets, voluntary pension funds achieved a net return of 21.2 per cent on average in 2023, which is an outstanding performance and significantly above the inflation rate. The 21.2 per cent rate of return is nearly 5 percentage points above the best return performance in the past decade and a half (2009: a net return of 16.3 per cent). The 10-year average net return (weighted by closing assets) is 5.6 per cent and accordingly, the funds were able to outperform inflation over this period by an annual average of about 0.7 percentage points. The 15-year average net return (weighted by closing assets) of the sector's players, which looks back even further and thus gives an even more reliable picture, is close to 7 per cent. As a result, the real rate of return over the same period was 2.3 per cent.

The total amount of contributions credited to the individual accounts of voluntary pension funds and tax credits transferred from the tax authority amounted to HUF 146.4 billion, which is 10.0 per cent more than in 2022 and the highest amount ever. In 2023, the amount of individual contributions (HUF 85.6 billion) increased by 6.7 per cent, employer contributions (HUF 42.7 billion) increased by 15.3 per cent and the amount transferred by the NAV (National Tax and Customs Administration) (HUF 18.1 billion) increased by 14.6 per cent compared to 2022.

The number of institutions in the voluntary pension fund sector fell to 28 due to the merger of one institution and the liquidation of another, while the number of members at the end of 2023 was 1 million 73 thousand, 1.7 per cent (nearly 19 thousand) less than at the end of 2022. The number of members decreased in all quarters of 2023. The share of payers among the members reached its highest value in 2023 Q4 (51.8 per cent), 0.6 percentage points lower than in the same period in 2022, breaking the upward trend of the last 3 years. The average age of members continued to rise, from 48 in 2020 to 48.4 in 2021 and 48.7 in 2022. Therefore, priority continued to be given to membership recruitment and reaching out to younger generations and non-paying members in order to activate them.

In 2023, voluntary pension funds achieved an operating profit of HUF 1.7 billion, an improvement of HUF 2.3 billion compared to the previous year. 22 out of 28 institutions were profitable. This is also due to the outstanding investment results, as high yields allowed for a higher deduction of unpaid uniform membership fees from non-paying members. This amounted to HUF 2.1 billion at sector level. By the end of 2023, the sector-level reserves of voluntary pension funds available for operating purposes increased by 21.4 per cent to HUF 19 billion compared to the end of the previous year, and the sector's reserve level was adequate.

The number of institutions in the sector of **health and mutual aid funds** remained unchanged in 2023. Although the amount of contributions paid to the individual accounts was exceeded by the amount of benefit payments, the investment result of the institutions and the amount of tax credits claimed were able to offset this effect, thus increasing the balance of individual accounts.

Revenues credited to the individual accounts of health and mutual aid funds (HUF 85.1 billion) increased significantly by 22.4 per cent in 2023 compared to 2022. After a 19.0 per cent increase, member contributions amounted to HUF 61.8 billion. Employer contributions amounted to HUF 9.0 billion, 10.4 per cent higher than in 2022. The amount transferred by the tax authority (HUF 14.3 billion) rose by 51.5 per cent compared to 2022.

The sector of health and mutual aid funds has surpassed the voluntary pension fund sector in terms of number of customers as early as 2023 Q1, due to the trend growth in the number of members. At the end of 2023, the number of members was 1 million 124 thousand, 5.2 per cent (55,804 persons) more than at the end of 2022. Although membership growth has been unbroken for the fourth consecutive year, the increase in 2023 is considered to be outstanding. The share of non-payers at the end of 2023 was 62.0 per cent, 1.7 percentage points lower than in 2022 Q4. Although the number of paying members has increased over the last 3 years, the proportion of non-paying members is still extremely high.

The benefit payments of health and mutual aid funds (HUF 81.7 billion) increased by 25.7 per cent (HUF 16.7 billion) compared to the previous year. The largest share of payments continues to be for the purchase of medicines, special formulae and preventive vitamins, with a share of 39.0 per cent.

Health and mutual aid funds realised an operating surplus again in 2023 – HUF 1.4 billion –, which is HUF 0.74 billion higher than a year earlier. Only 2 out of 16 institutions were loss-making on an annual basis. The deduction of from the return of non-payers (nearly HUF 500 million) was an important contributor, but even without it, the operating surplus is still significant. The operating reserve increased to HUF 6.9 billion, an increment of 28.3 per cent compared to the end-2022 figures, and almost double the increment of the previous year.

Table 3.1
Key data of the voluntary pension funds sector

	Pension funds		Health and mutual aid funds	
	2022	2023	2022	2023
Number of institutions (pcs)	30	28 ↓	16	16 –
Number of members (thousand persons)	1,092	1,073 ↓	1,068	1,124 ↑
Number of members paying membership fee (thousand persons | %)	573 | 52.4%	556 | 51.8% ↓	387 | 36.3%	427 | 38.0% ↑
Total funds portfolio (HUF billions)	1,615	1,960 ↑	79	91 ↑
Of this: Coverage reserve (HUF billions)	*1,598*	*1,939* ↑	*73*	*84* ↑
Asset value per contract (HUF thousands)	1,463	1,807 ↑	64	75 ↑
Membership fee payments (HUF billions)	123	134 ↑	64	76 ↑
Of this: Membership fee payments allocable to coverage reserve (HUF billions)	*117*	*128* ↑	*60*	*71* ↑
Claimed tax credit (HUF billions)	16	18 ↑	9	14 ↑
Payments against the coverage reserve (HUF billions)	127	139 ↑	65	83 ↑
Operating profit/loss (HUF billions)	-0.58	1.71 ↑	0.61	1.42 ↑
Reserves for operational purposes (HUF billions)	15.6	19.0 ↑	5.4	6.9 ↑

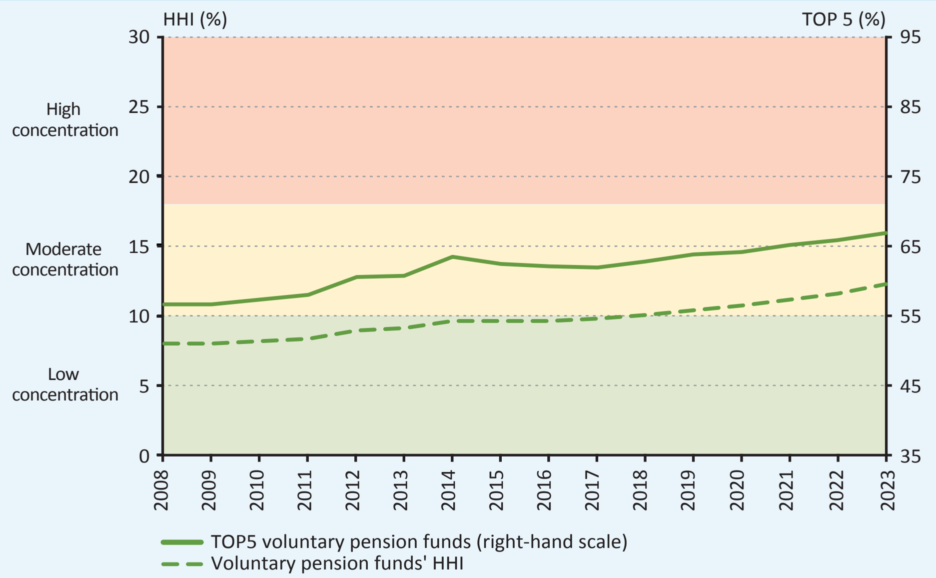
Source: MNB

3.2 VOLUNTARY PENSION FUNDS

3.2.1 Moderate but increasing concentration in the sector of pension funds

In the sector of voluntary pension funds, the number of institutions dropped to 28 in 2023, following the merger of one institution and the liquidation of another. Decisions to cease the operation were driven by factors related to economies of scale, efficiency and business models. As a result of these, the Herfindahl-Hirschman Index (HHI), a measure of market concentration based on the contributions paid, increased in 2023 (Chart 3.1). The market share of the 5 largest funds (in terms of the contributions paid) also increased relative to 2022. An analysis of the concentration of contributions shows that 66.8 per cent of the sum of individual members' contributions and employer contributions paid to the voluntary pension funds sector were made by the 5 largest institutions.

Chart 3.1
Developments in voluntary pension fund concentration



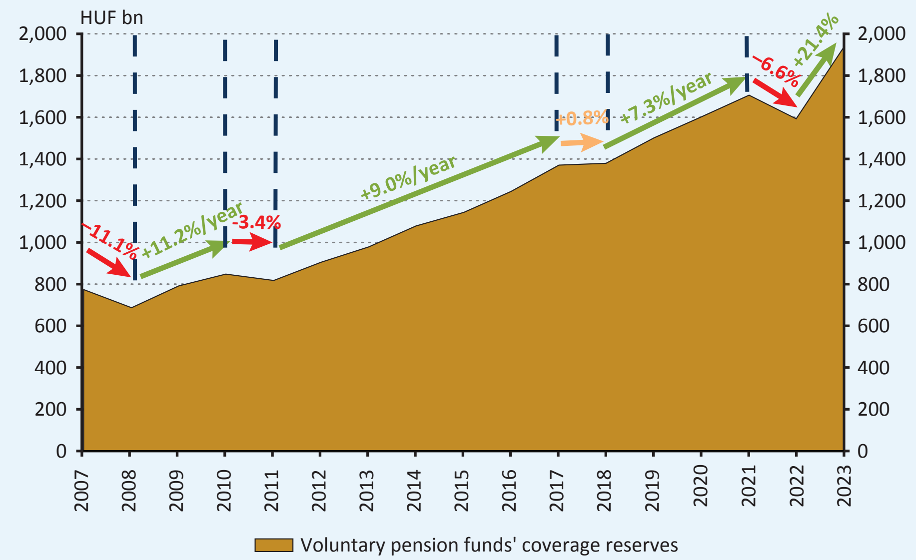
Note: The colour of the background illustrates the strength of concentration under the HHI. Contrary to the practice of previous years, this year quarterly data were used only in respect of 2023. Figures from previous years were updated with the annual audited data. For this reason, the chart may differ from those published in previous years.

Source: MNB

3.2.2 Significant asset growth at voluntary pension funds

At the end of 2023, the individual accounts of voluntary pension funds stood at HUF 1,939 billion, 21.4 per cent higher than at the end of the previous year (HUF 1,598 billion). The increase was mainly due to the significant investment result on the individual accounts (HUF 335.7 billion) and the smaller but positive cash flow. The amount on the individual accounts reflects a strong bounce back: the decline recorded in 2022 was surpassed three times by the investment gain (in nominal terms) in 2023 due to the impact of the increase in the price of investment assets. The correction was driven by the fall in bond market yields and the price increase in equity markets.

Chart 3.2
Developments in the individual accounts of voluntary pension funds



Source: MNB

3.2.3 Significant wealth growth, 71 per cent of investments are domestic

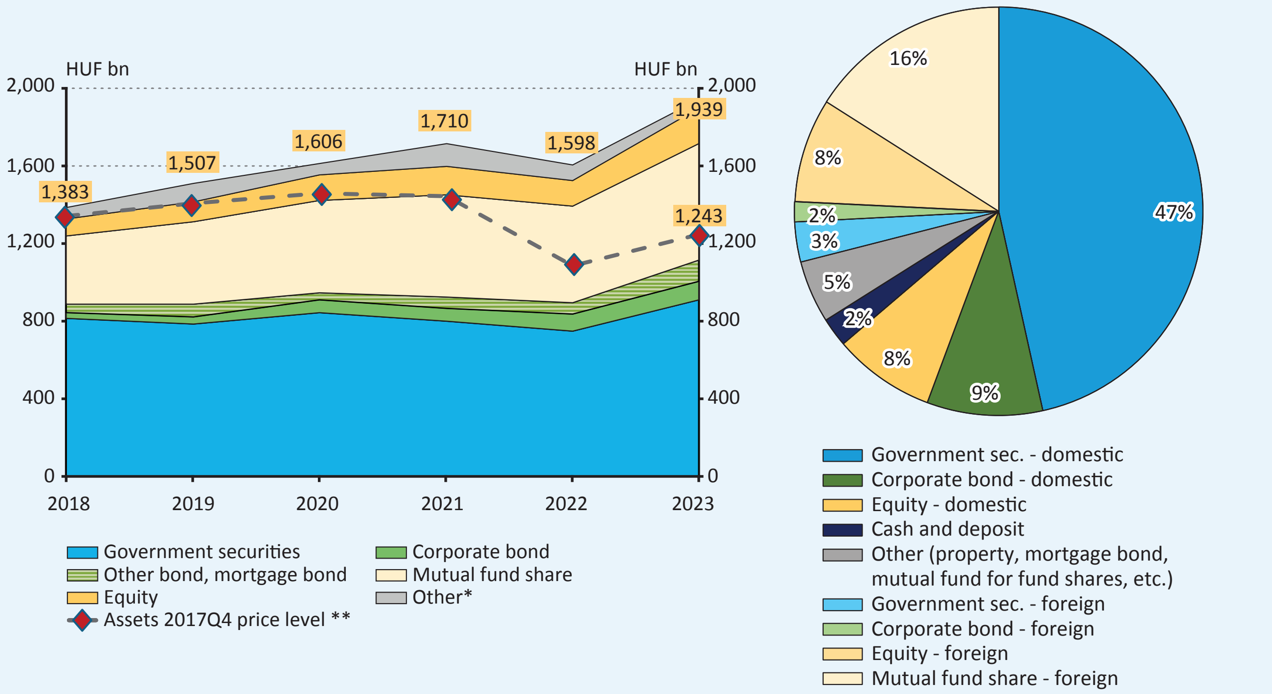
After the trend of steady growth seen in the previous years, the value of individual accounts started to decline in 2022 Q1, reaching its annual trough – which was even lower than the value at the end of 2020 – in 2022 Q3. The market correction started in 2022 Q4 and continued in 2023, and by the end of the year, the sectoral level of the reserve requirement not only reached the end-2021 level, but exceeded it considerably, reaching a new record level close to HUF 2,000 billion. Contrary to the negative trend observed in 2021 and 2022, this increase was positive in real terms.

Hungarian government bond investments continued to account for the largest share of voluntary pension funds' savings. The direct exposure of Hungarian government bond investments decreased slightly (45.8 per cent) compared to the end-2022 level (46.3 per cent). In contrast, the share of direct equity investment rose by a little over 1 percentage point compared to the end of the previous year. At the end of 2023, total exposure equalled 9.4 per cent of which 6.4 per cent consisted of domestic exposures, and 3 per cent comprised foreign equities. The ratio of investment fund shares remained largely unchanged; it increased from 31.0 per cent at the end of 2022 to 31.1 per cent. Of this, domestic investment fund shares accounted for 19.9 per cent and foreign investment fund shares for 11.2 per cent.

The classification of indirect investments by underlying instrument shows that foreign investment fund shares make up the majority (52 per cent) of the HUF 603 billion portfolio at the end of 2023. Equity investments account for a further 22 per cent of indirect investments, which, taking into account diversification objectives, largely consist of foreign equities. 7 per cent of indirect investments (HUF 43 billion) were held in foreign government securities. Within the holdings of investment fund shares, the share of foreign instruments is 78 per cent. The breakdown of indirect investments indicates that 71 per cent of the investments behind individual accounts are domestic instruments.

The investment composition emerging from the decomposition of indirect investments Is shown in detail in the diagram on the right-hand side of Chart 3.3.

Chart 3.3
Distribution of voluntary pension funds' investments by asset groups with the decomposition of investment fund shares



*Note: *"Other" includes: bank accounts, fixed deposits, forward contracts, direct real estate investments, equity loans, other securities listed on stock exchange or other regulated markets, receivables from securities lending transactions and net value of receivables and payables from securities transactions. ** Adjusted by the consumer price index*

Source: MNB

3.2.4 Changes in legislation affecting funds' investments

The operation of funds applying an optional portfolio scheme (VPR) is made easier and their decision-making is made simpler and faster now that the board of directors is authorised to decide on changes to the optional portfolio regulations instead of the general meeting. However, the decision on the adoption or termination of the VPR and its continuation after a suspension of its operation remains the exclusive competence of the general meeting, and can be taken by fund members directly or through their delegate at a meeting of the supreme body. The prior opinion of the Audit Committee is also required for the adoption, modification, suspension, subsequent continuation or termination of the optional portfolio regulations.

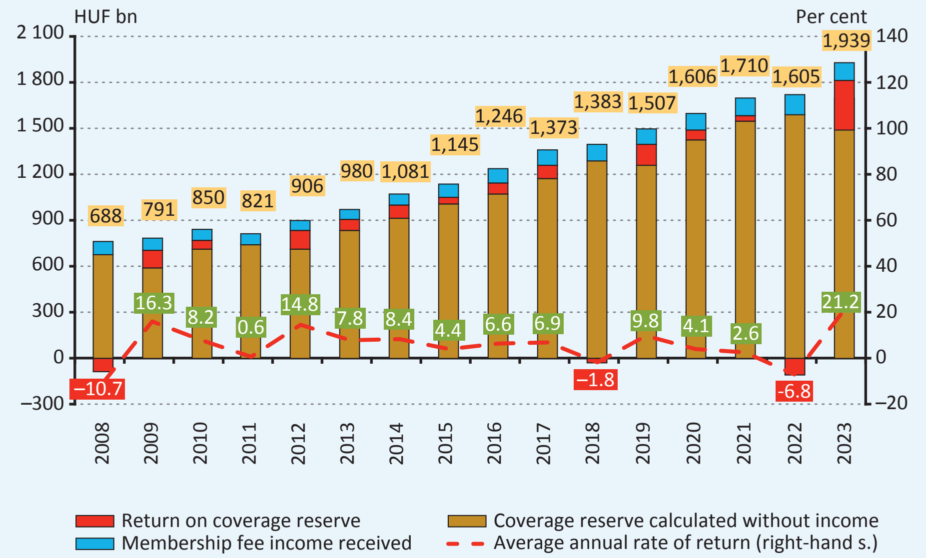
The amendment to the Government Decree on Investments of Voluntary Pension Funds replaces the previous requirement for an asset management and asset valuation policy with a requirement for detailed procedural rules on the management of own assets in the investment policy. The investment policy should include, as a new element, the principles and methodology (asset valuation policy) to be applied in the valuation of the assets, as agreed with the depositary. Instead of upon the purchase of investment instruments or at least the last day of the month in which the investment is purchased, it requires depositary information to be provided on each working day.

3.2.5 Outstanding returns for voluntary pension funds

Weighted by closing assets, voluntary pension funds achieved a net return of 21.2 per cent on average in 2023, which is an outstanding performance and significantly above the inflation rate. The 21.2 per cent rate of return is nearly 5 percentage points above the best return performance in the past decade and a half (2009: a net return of 16.3 per cent). Typically, mixed (classic, balanced) and higher equity, growth portfolios with longer maturity bonds achieved higher returns, while most of the safer, e.g. money market, risk-averse portfolios closed with a somewhat more modest – but still outstanding – performance. Since the year-on-year inflation rate[12] was 5.5 per cent in December 2023, this means that the real return realised by voluntary pension funds was 14.9 per cent last year.

From 2025, in addition to the annual, ten-year and fifteen-year rates of return, funds also calculate the twenty-year value, which is published on the MNB's website after verification.

Chart 3.4
Developments in voluntary pension funds' individual accounts, membership fee income, volume of yields and net annual average rate of return



Source: MNB

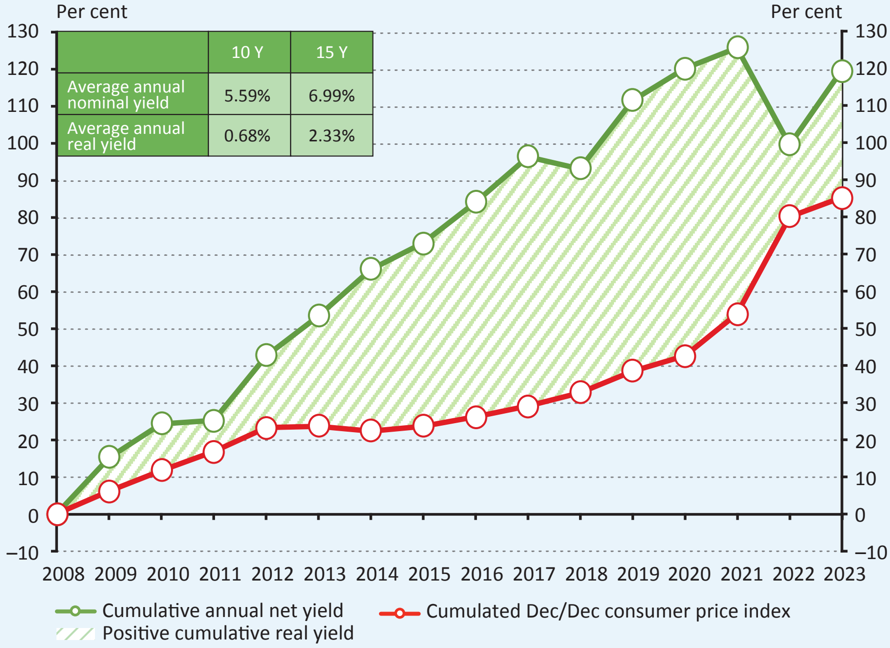
3.2.6 Long-term nominal and real returns in the positive range, low cost level

The 10-year average net return (weighted by closing assets) is 5.6 per cent and accordingly, the funds were able to outperform inflation over this period by an annual average of about 0.7 percentage points. The 15-year average net return (weighted by closing assets) of the sector's players, which looks back even further, is close to 7 per cent. As a result, the real rate of return over the same period was 2.3 per cent.

In consideration of the investment performance of voluntary funds, their low annual operating and other charges (fees) of less than 1 per cent, and the 20 per cent tax allowance on contributions, voluntary funds remain a competitive form of self-provision in the market for retirement savings products.

[12] The December/December inflation rate expresses the annual change in the price level between the end of the year preceding the year under review and the end of the year under review; therefore, this value is used to calculate the real return, against which the annual return of the funds should be compared.

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



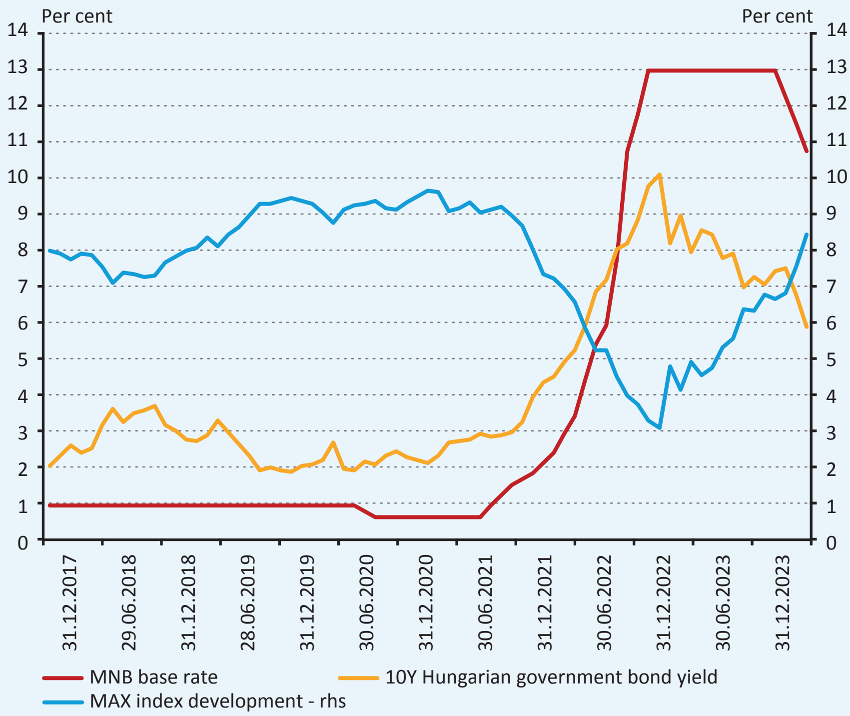
	10 Y	15 Y
Average annual nominal yield	5.59%	6.99%
Average annual real yield	0.68%	2.33%

Source: MNB

Box 3.1
Outstanding pension fund investment results and the trends behind them

At the beginning of 2023, looking at the 2022 returns, many fund members may have wondered what happened and, even more importantly, what will happen to their voluntary pension savings. In the very tense period of late 2022 and early 2023, articles and discussions appeared on economic portals about the outlook for 2023 and about how to achieve a return on investments of around 20 per cent in 2023 with acceptable risk. For nearly two-thirds of pension fund members, fund investments generated a net return of over 20 per cent in 2023, with more than 95 per cent of members earning an annual return on their pension savings of over 15 per cent. Weighted by assets, the sector-wide average return was 21.2 per cent in 2023. After 2008 or 2018, customers with up to 25–30 years of pension fund savings were reassured once again in 2023 that switching portfolios or funds or exiting their funds was not an economically rational decision in years such as 2022. These events have once again highlighted the need to take a long-term view when investing in pension funds. Instead of drawing far-reaching conclusions from one year's unfavourable – or even favourable – annual returns, one should always look at a longer period (5, 10 or even more years). It also confirmed the assumption made by the MNB when communicating the 2022 returns based on the experience of previous periods, that in the case of funds' pension savings, the unfavourable investment performance of a given year was usually offset by periods generating favourable returns. For both the MNB and the funds, an important communication task during this period was to reassure fund members and to draw attention to the fact that it is not advisable to make a major decision on long-term savings based on the investment performance of a single year alone. In order to understand what happened in 2023 with fund investments and why the annual returns turned out to be so high, it is worth briefly reviewing the developments in the securities market. Government securities account for a significant share of pension fund investments: more than half. Developments in government bond prices has a significant impact on fund yields.

Chart 3.6
The MNB's base rate, 10-year Hungarian government bond benchmark yield and MAX index, 2018–2023

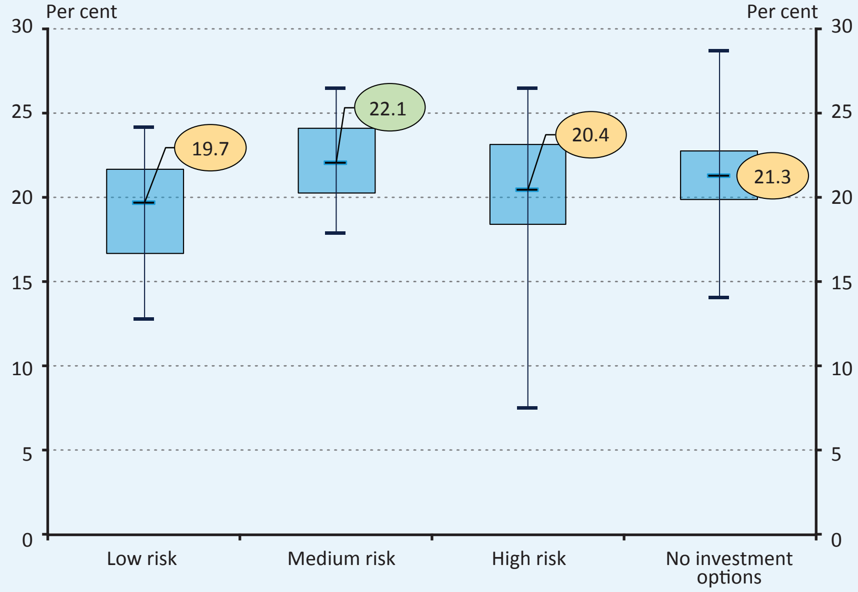


Source: MNB, ÁKK

From mid-2021, government bond yields started to rise, leading to a decline in the market value of government bond portfolios. This process lasted until 2022 Q4. The decline in government bond prices is indicated by the decline in the MAX index, which represents the performance of government bonds with a maturity of less than 365 days, to minus 16.05 percent in 2022. This has contributed significantly to the fact that pension fund returns were overwhelmingly negative in 2022. The 10-year government bond yield reached 10 per cent in October 2022. The improving macroeconomic outlook led to a decline in bond yields, and the MAX index, which indicates the change in exchange rates, has turned positive. The change in the MAX index was 26.8 per cent in 2023. As a result of these developments, the majority of lower and more moderate risk portfolios (e.g. classic and balanced), which predominantly hold longer maturities of government bonds (over one year), have achieved returns above 20 per cent.

In addition to government bonds, equity investments are also dominant in fund investments, especially in higher-risk, dynamic growth portfolios. Among the investments of the voluntary pension fund sector, direct equity exposure was 9.4 per cent at the end of 2023, but the majority of indirect investment instruments are mutual funds investing in equities. 2022 was also a negative year for equity investment, with the BUX index performing minus 13.66 per cent and the CETOP20 index minus 21.46 per cent; indeed, even the major global equity indices performed negatively in 2022. In 2023, however, there was also a significant correction in equity markets, which contributed to the positive performance of pension fund returns. It is worth noting, however, that the extent of the stock market correction varied across regions or sectors. This may have led to some of the riskier portfolios in 2023 achieving annual returns significantly below the sector's average. Overall, however, the strong fund returns in 2023 not only compensated for the poor investment performance in 2022, but also contributed significantly to the long-term performance of the funds. Breaking down the 10-year average net rate of return of 5.6 per cent for the sector for the period 2014–2023 into two parts, thanks to the return performance in 2023 the average annual return for the period 2022–2023 was 6.6 per cent, which is outperforms the average annual return of 5.4 per cent for the period 2014–2021.

Chart 3.7
Net return on different risk optional portfolios and non-optional portfolios of funds in 2023

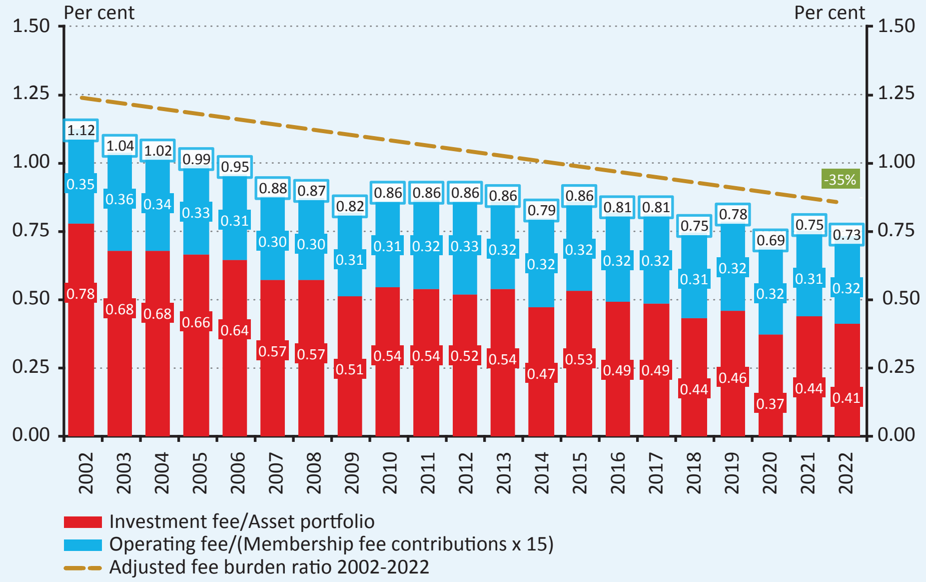


Source: MNB

Besides investment performance, it is also worth looking at the evolution of pension fund costs, as it is costs, alongside returns, that can have the greatest impact on clients' decisions and, at the same time, on the cost efficiency and sustainability of institutions. The MNB publishes several cost indicators in order to ensure the transparency of the fund's costs and to provide members with adequate information, such as the calculation and publication of the charge ratios from the data of the funds' annual report each year. The adjusted charge ratio was 0.73 per cent in 2022 (0.75 per cent in 2021), a 2-basis-point decline compared to 2021. The ratio of voluntary pension funds' contributions deducted for operation relative to the total contributions paid decreased by 9.2 per cent in the period of 2002–2022. In 2022, the ratio of charges deducted from contributions for operating and liquidity purposes to total contributions did not change significantly; it increased somewhat. The increase is due to the fact that, in view of the economic difficulties in 2022 some funds decided to change their contribution rates or, in the case of funds applying contribution brackets, their bracket limits.

The difference between the investment performance achieved by funds and the benchmark return of a portfolio may have a significant impact on the charge ratio. Generally speaking, under a success fee scheme, if the return realised by the fund exceeds the benchmark return, the trustee partner will be entitled to a success fee. In the extremely volatile market environment of 2022, trustees sought to maximise returns by underweighting or overweighting individual investment vehicles relative to the targets set out in the investment policies. In 2022, the returns achieved by trustees exceeded, on average, the benchmark index set out in the funds' investment policy more so than in the previous year. Even so, the changes in sovereign debt and equity markets have led to negative returns for all but a few fund portfolios in 2022. Several funds have entered into contracts with the trustee where the success fee is paid on the condition of achieving a positive return in addition to exceeding the benchmark return. For this reason, we can assume that the size of the success fees paid was smaller than in 2021.

Chart 3.8
Developments in the adjusted charge ratio, 2002–2022

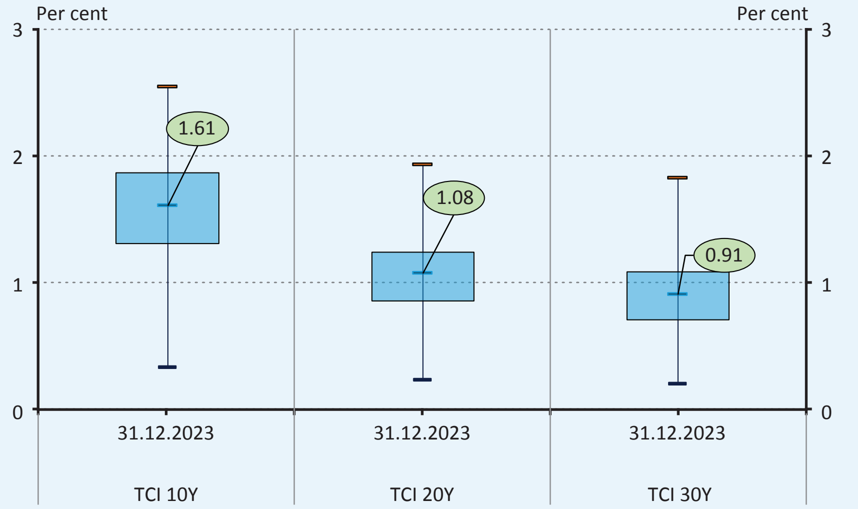


Source: MNB

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

In 2023, the 10-year median TCI_{PF} was 1.61 per cent, the 20-year median TCI_{PF} was 1.08 per cent, and the 30-year median TCI_{PF} was 0.91 per cent. There were no significant changes in the TCI_{PF} values at sector level compared to the previous year. The 10-year median TCI_{PF} value increased by 1 basis point, the 20-year median TCI_{PF} value increased by 2 basis points, and the 30-year median TCI_{PF} value increased by 4 basis points. Funds' cost ratios also confirm that voluntary pension funds are a cost-effective long-term investment even when compared to other financial products.

Chart 3.9
TCI values of the sector of voluntary pension funds (2023)

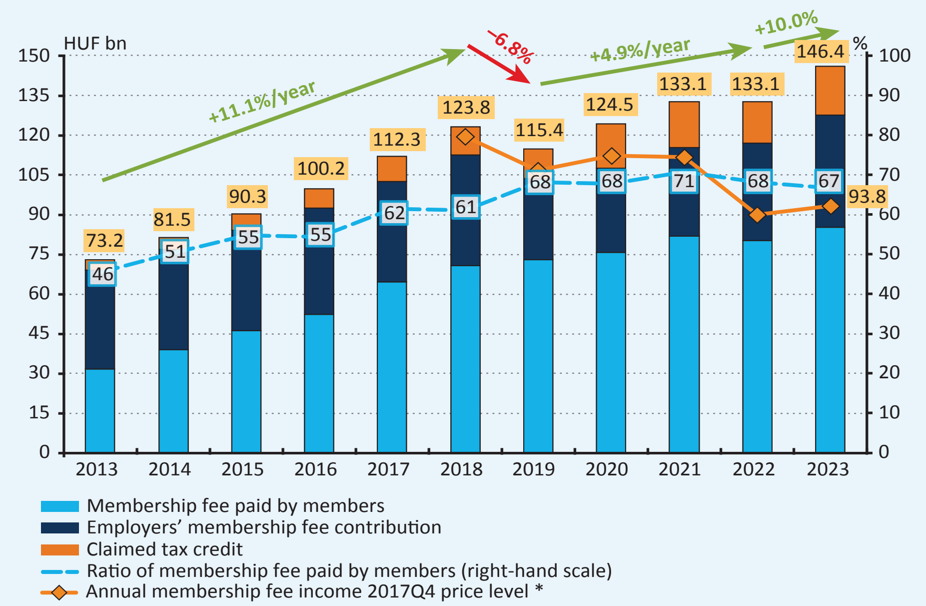


Source: MNB

3.2.7 Significant increase in revenues affecting the individual accounts

The total amount of contributions credited to the individual accounts of voluntary pension funds and tax credits transferred from the tax authority amounted to HUF 146.4 billion, which is 10.0 per cent more than in 2022 and the highest amount ever (Chart 3.10), resulting in a moderate increase in contributions in real terms, as well. In 2023, the amount of individual contributions (HUF 85.6 billion) increased by 6.7 per cent, employer contributions (HUF 42.7 billion) increased by 15.3 per cent and the amount transferred by the NAV (National Tax and Customs Administration) (HUF 18.1 billion) increased by 14.6 per cent compared to 2022. The tax credit of up to 20 per cent of individual and employer contributions was not fully used, or part of it was claimed by members for their health and mutual aid funds. The amount of tax credits accounted for 13.5 per cent of the contributions in 2023. Members cut back their contributions slightly during the exceptional global market conditions of 2022, but performed strongly in 2023. Also positive is the significant increase in the amount of employer contributions, which is a sign of employers' commitment to the fund system. Furthermore, the indirect effect of wage increases may also be behind this process, as employer contributions are often linked to a percentage of employees' wages. Individual contributions continued to dominate the inflow, accounting for 66.7 per cent of the annual income from contributions. However, employer contributions remain important because they are stable due to contractual commitment, while individual contributions are more likely to fall in a year that proves to be more difficult for the economy.

Chart 3.10
Member contributions credited to the individual accounts of voluntary pension funds, broken down by payers



** adjusted by the consumer price index*

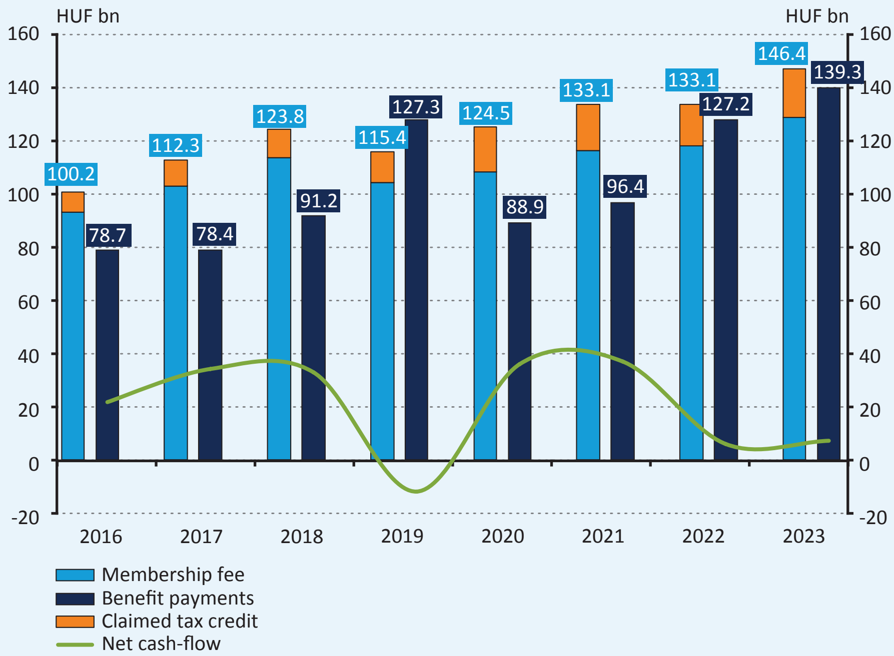
Source: MNB

An analysis of the cash flows of voluntary pension funds shows that since 2016, there has been only one occasion (in 2019) when the annual cash flow at sector level was negative, mainly due to higher payouts owing to negative returns in 2018 and a decrease in member contributions compared to the previous year. With the exception of 2019, voluntary pension funds have recorded a revenue surplus for the last 8 years; thus, in the long run, individual negative swings smooth out. However, it should also be noted that in 2022 and 2023, without the amount of tax refunds, the sector's cash flow would have been negative due to the significant increase in payouts.

The large payouts in 2022 were presumably caused by the exceptional global market environment and the resulting higher cost of living. In 2023, the negative voluntary pension fund returns in 2022 and the subsequent intermediation of returns resulted in even higher payouts (+9.4 per cent) than in 2022, mainly in the first half of the year. This shows that membership is highly sensitive to developments in annual returns, despite the fact that voluntary pension funds are built on long-term commitment, and their performance should be evaluated over a 20–30 year time horizon.

Based on past experience, the poorer investment performance in some years will not only be corrected by positive results in subsequent years, but will be significantly exceeded; consequently, it is not worth making a reckless, hasty decision; those who can would be better off waiting for the correction in returns that is very likely to occur. Due to the high yields in 2023, lower outflows are expected in 2024, but the MNB will continue to monitor, on a monthly basis, the cash flows of institutions and the potential risks arising from them.

Chart 3.11
Cash flows of voluntary pension funds



Source: MNB

3.2.8 Declining membership, moving away from the target

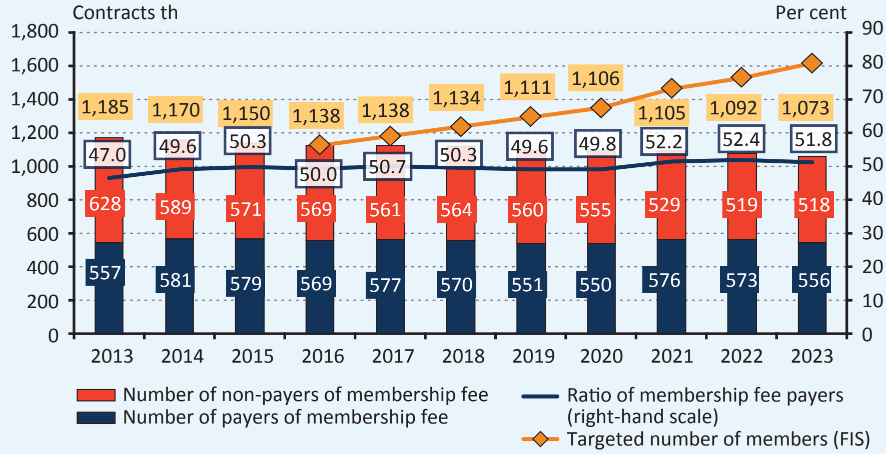
At the end of 2023, the number of voluntary pension fund members was 1 million 73 thousand, 1.7 per cent (nearly 19 thousand) less than at the end of 2022. The number of members decreased in all quarters of 2023, but at a decelerating rate: in the first quarter by 8.1 thousand persons, and in the fourth quarter only by 1.1 thousand persons. The share of payers among the members stood at 51.8 per cent at the end of 2023, 0.6 percentage points lower than in the same period in 2022, breaking the upward trend of the last 3 years.

Membership in the voluntary pension fund sector peaked in 2008 and has been declining slightly but steadily since then. It indicates a growing drift away from the path that is considered ideal, as presented in the FIS with an outlook on self-provision.

In 2023, 26,183 new members joined voluntary pension funds, but this could not offset, inter alia, the number of beneficiaries (23,783); deceased members (3,195); leavers (17,235) and members excluded for not paying contributions (361), and as a result, membership decreased by almost 19 thousand. Three quarters of the new entrants (19,628 members) were enrolled by client recruiters. The trend in the number of new members is positive in itself, but to maintain and increase the number of members, a larger number of new members is needed. The average age of membership was 48 years in 2020, 48.4 years in 2021 and 48.7 years in 2022, which means that attempts to stop the increase in the average age of membership did not succeed. The institutions need to reach out to the age groups below 35 in order to stop the rising trend in the age of membership and to keep it at a constant level.

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

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



Source: MNB

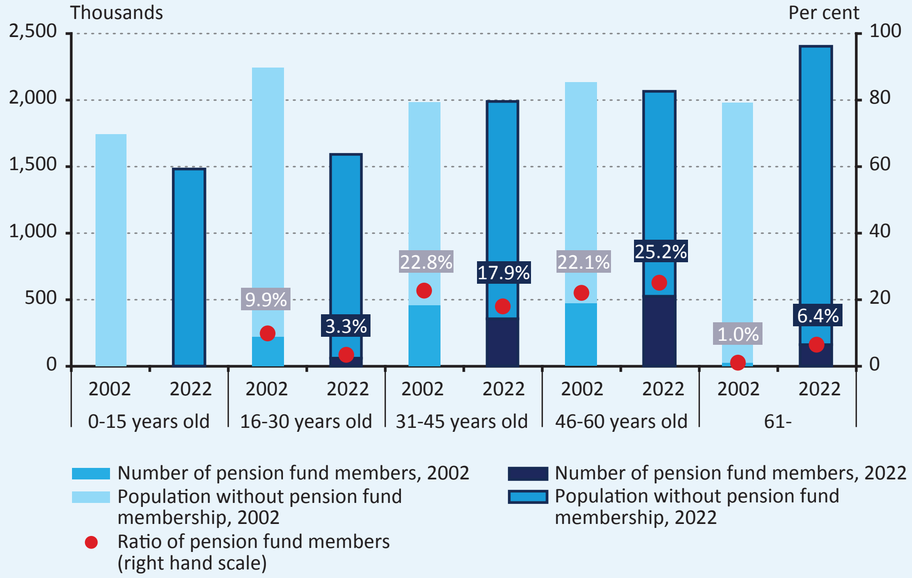
The ratio of payers declined in 2023, a phenomenon unprecedented on an annual basis since 2019, and is still considered low, posing a risk to the long-term viability of the funds. The business model for voluntary funds is that operating expenses should be covered by a share of the costs deducted from members' contributions, which can be supplemented by donations for operating purposes. In the case of non-paying members, from the date of the beginning of the default in payment of the contribution, the applicable legislation enables the fund to reduce the member's return on the investment of their individual account by an amount equal to the share of the current standard contribution of the fund dedicated to operating and liquidity purposes, but not exceeding the amount of the return, and to credit this amount to the operating or liquidity fund. Not all funds take advantage of this option, but most do, and it is an important source of their operating income. According to Section 14 (6) of Act XCVI of 1993 of 1 September 2023 on Voluntary Mutual Insurance Funds (Insurance Fund Act), "The amount of yield reduction due to membership fee arrears may not exceed the amount of yield earned over the period quarterly corresponding to the frequency of withholding – quarterly, semi-annual or annual – (hereinafter: reference period), and the amount corresponding to 5 per cent of the minimum wage in effect on the first day of the reference year for the period corresponding to the selected frequency of withholding equal to the share of the membership fee applicable to the operating and liquidity reserves. If the yield for the quarter, half-year or year in question is less than the amount the fund can deduct, the fund shall not be entitled to claim the difference against the return for the previous quarter, half-year or year. In the case of a semi-annual withholding frequency, the deduction of the yield due to membership fee arrears is made after the second and fourth quarterly yield crediting, against the yield credited to the member's individual account in the current semester. If the fund is unable to claim a deduction for unpaid membership fees from its income for the quarter, half-year or year in question, the fund may claim a deduction for unpaid membership fees from its income for a maximum of one calendar year following the period in question. In the case of a deduction for membership fee arrears, the deduction for the current period may be claimed first, followed by the deduction for the previous period." If the fund wishes to make use of the possibility of deducting the yield from the yield for the period following the period in question due to membership fee arrears, the fund must amend its statutes in accordance with the amended legal provisions. In order to protect the members of the fund, the MNB requires funds wishing to apply the deduction of income for membership fee arrears to lay down in their statutes the rules on the deduction of income for membership fee arrears, including the applicable procedures, legal effects and processes, in a clear, unambiguous and transparent manner. In addition, the MNB recommends that, for the lack of a yield in the current period, funds should not apply several instalments for the deduction due to membership arrears in the period opening after the current period and ending at the end of the following calendar year, and that they should deduct the amount at the earliest possible period of the periods corresponding to the frequency of the fund's membership payments.

Box 3.2
Low coverage, ageing membership

Between 2002 and 2022, the number of voluntary pension fund members fell by 6.7 per cent. According to HCSO data, Hungary's population aged 16 or above – i.e. the age group eligible to become a fund member – decreased by 3.3 per cent over the same period. Due to a larger decline in membership, the share of members to the total population is half a percentage point lower than in 2002 (13.5 per cent), i.e. the penetration of this type of institution has deteriorated somewhat.

Over 20 years, the average age of Hungary's population has increased by 3.6 years (to 43.0 years), with a more significant increase of 7.0 years (to 48.7 years) for voluntary pension fund membership. In terms of specific age groups, it can be seen that the number of the youngest members aged 16–30 in 2022 (53 thousand) represents only 24 per cent of the number of members in 2002, and their share in the age group (3.3 per cent) is only one third of that in 2002. There was also a decline in the number and share of middle-aged fund members in terms of employment, i.e. those aged 31–45 (21 per cent and 5.0 percentage points, respectively), but this was smaller than for the younger generation aged 16–30. For these two age groups, reaching the 2002 membership rate in 2022 would have required 104 thousand more 16–30 year-old members and 99 thousand more 31–45 year-old members.

Chart 3.13
Distribution of specific age groups of the population by voluntary pension fund membership (2002, 2022)



Source: HCSO, MNB

However, there was an increase among older workers aged 46–60 and members aged 61 or above who are close to retirement (and also, many retirement-age persons in 2022). Of the latter two age groups, the most marked increase was for older members aged 61 and above, whose share within the population of the same age increased by 5.4 percentage points and their number by 7.6 times during the course of 20 years. The most populous age group of members in 2022 was the 46–60 age group once again, accounting for 48 per cent of the membership, up 7.6 percentage points from 20 years earlier. The number of members in this age group was 11 per cent higher than in 2002, and their share within the corresponding age group in the population as a whole has increased by 3.2 percentage points over two decades. If people aged 61 or above was also included, the two age groups would account for 62 per cent of the membership of voluntary pension funds, 20 percentage points more than 20 years ago.

In terms of accumulated assets, at the end of 2022, the share of members aged 46–60 was 53 per cent, 24 per cent for those aged 61 or above and 21 per cent for those aged 31–45. Not surprisingly, in terms of wealth, the combined share of older (46–60 years) and pre-retirement (61+) members (78 per cent) is even more significant relative to the distribution of membership. Per capita wealth was close to HUF 1.5 million, with the two younger age groups accumulating less (HUF 325 thousand and HUF 949 thousand on average) and the two older ones accumulating more (HUF 1.6 million and HUF 2.5 million) by the end of 2022.

The age group under 16 is also worth a look in terms of the succession of the funds sector. We expect that this generation will be most likely to show similar attitudes towards pension fund membership to those closest to them, aged 16–30; thus the popularity of fund membership may be subdued among them. Furthermore, the population size of the age group 15 and under (nearly 1.5 million) is low: it is 6.7 per cent below the second smallest group (16–30 year olds), and this is not a positive trend for the succession of membership.

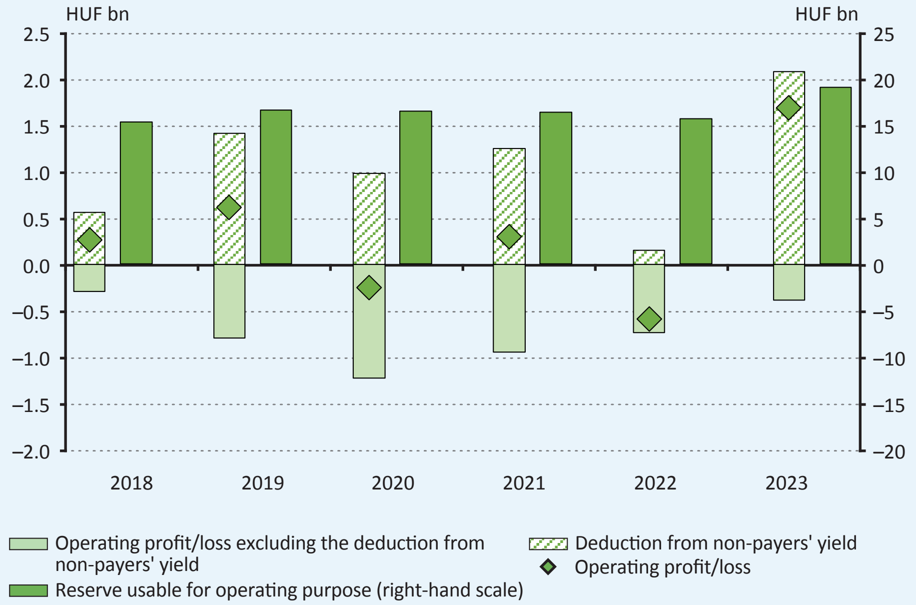
The number of members of voluntary pension funds increased by 24 per cent between 2002 and 2008 to 1 million 355 thousand, based on year-end data for the past two decades. The increase may have been driven by the more tax-efficient benefits-in-kind (Cafeteria), which enabled employees to claim voluntary pension fund contributions. The ratio of members to the total population aged 16 and above rose from 13.0 per cent to 16.1 per cent over these years. The number of members of voluntary pension funds has been steadily declining since 2008, partly as a result of the reduction or abolition of the tax advantage of Cafeteria benefits over wages. At the end of 2023, the number of voluntary pension fund members was 1 million 73 thousand, 21 per cent less than at its peak in 2008. The ratio of members to the total population aged 16 and above fell by 2.6 percentage points to 13.5 per cent between 2008 and 2022 (the same age population fell by 3.7 per cent over the same period).

The above trends suggest that reform is needed to maintain the long-term viability of the sector, which should create the right conditions to properly attract younger generations to become members.

3.2.9 Operating P&L turns into profits after last year's loss

In 2023, voluntary pension funds achieved an operating profit of HUF 1.7 billion, an improvement of HUF 2.3 billion compared to the previous year. 22 out of 28 institutions were profitable. This is due to the fact that high yields allowed for a higher deduction of uniform membership fee arrears from non-paying members, which amounted to HUF 2.1 billion at sector level. The dividend received was on par with the dividend received in 2022 (HUF 0.9 billion). Funds with a negative operating income in the longer term need to reconsider their operational characteristics (more specific targeting of non-payers, transformation of the operating cost model). The MNB places particular emphasis on monitoring the operational situation of funds, both in the course of ongoing supervision and inspections. If, due to persistent operating losses or other reasons, funds' operating reserves approach or fall below the prudential minimum, the MNB can take or takes various measures (for example, holding a prudential meeting; requesting an action plan; requiring an operation-liquidity report; launching a targeted inspection) with regard to the institutions concerned. By the end of 2023, the reserve base of voluntary pension funds for operating purposes increased by 21.4 per cent to HUF 19 billion at sector level; consequently, the level of reserves remains adequate compared to the end of the previous year.

Chart 3.14
Developments in the operating P&L of voluntary pension funds



Source: MNB

Box 3.3
Experience to date with the application of the PEPP Regulation

In the context of the Capital Markets Union, the European Commission is giving priority and attention to the "Pan-European Personal Pension Product" (PEPP), a long-term savings product that can be distributed in the single EU market and carried across Member States. One of the objectives of the PEPP is to reduce the fragmentation of the market for complementary personal pension products observed at international level. While in some Member States there are sufficient personal pension savings options available, in others there is no broad market for these financial products, limiting the choice for some consumers. According to the European Commission, the fragmented personal pension savings market means that competition between providers is not efficient enough, with some consumers having less access to better quality and lower cost products. The new product is expected to allow PEPP providers to maximise the benefits of risk diversification, innovation and economies of scale. A further problem that PEPP needs to address is that the availability and portability of personal pension products between Member States is limited due to the limited cross-border activity of service providers.

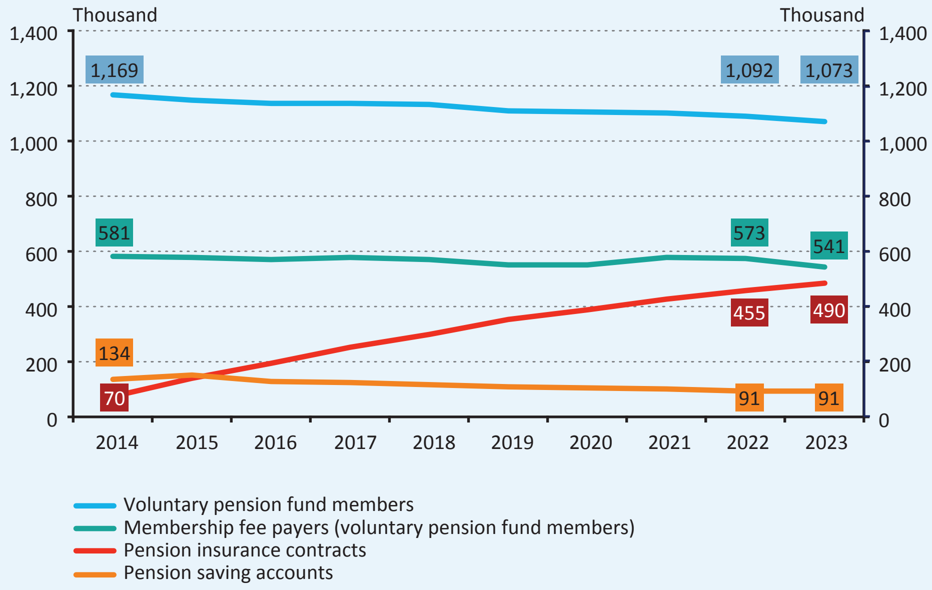
Regulation (EU) 2019/1238 of the European Parliament and of the Council on a pan-European Personal Pension Product (PEPP Regulation) was published on 25 July 2019 and entered into force on 14 August 2019. The PEPP Regulation became applicable from 12 months of the announcement of the related additional secondary regulation[13], i.e. from 22 March 2022, after which date service providers may apply for the registration of PEPPs with the competent national authority. Based on the experience of the past two years, there is no significant interest in PEPP in terms of the potential range of service providers. In September 2022, FINAX, o.c.p., a.s., based in Slovakia, became the first and so far only PEPP provider in the EU market. In addition to Slovakia, FINAX sells PEPP in Czechia, Croatia and Poland, but FINAX PEPP is not available in Hungary at the time of the preparation of this report.

[13] COMMISSION DELEGATED REGULATION (EU) 2021/473 of 18 December 2020 supplementing Regulation (EU) 2019/1238 of the European Parliament and of the Council with regard to regulatory technical standards specifying the requirements on information documents, on the costs and fees included in the cost cap and on risk-mitigation techniques for the pan-European Personal Pension Product

From the point of view of service providers, the conditions set out in the regulation are barriers to the spread of the product. According to the PEPP Regulation, PEPP providers may offer PEPP savers up to six investment options, one of which shall be a “Basic PEPP”. The Basic PEPP must provide a guarantee on the capital, which shall be due at the start of the decumulation phase and during the decumulation phase, or a risk-mitigation technique consistent with the objective. According to the PEPP Regulation, all PEPP investment opportunities must use appropriate risk mitigation techniques. According to the secondary legislation, the risk mitigation technique should be designed with the objective of outperforming the annual rate of inflation with a probability of at least 80 per cent over a 40-year accumulation phase. The regulation also stipulates that the costs and charges associated with the Basic PEPP cannot exceed 1 per cent of the accumulated capital each year. The cost cap should be reviewed by the legislator every two years, starting in 2024. Apparently, service providers do not see a business potential in a PEPP product that meets the requirements of the PEPP Regulation and the secondary legislation.

In addition to promoting a capital markets union, the European legislators’ objective in creating the PEPP was to increase the number of people with personal pension savings by expanding the supply side. However, the low penetration of pension products based on capital market investments is not a supply-side problem, but a demand-side problem, as domestic experience also shows. Among pension savings products, pension insurance has been the leading product in the life insurance sector since the introduction of the tax credit for contributions in 2014. However, the number of pension fund members has declined slightly over the last 10 years, and the role of the pension savings account is marginal, as it has not become a mass product. In addition to the domestic supplementary pension products, PEPP would be another product on the supply side. In order to increase penetration, we believe that the demand-side problem needs to be addressed, which can be solved by improving the financial literacy and awareness of the population, developing existing products, strengthening their marketing and making them more widely known, an effective public incentive system and strengthening employee/employer engagement.

Chart 3.15
Contract number of supplementary pension products



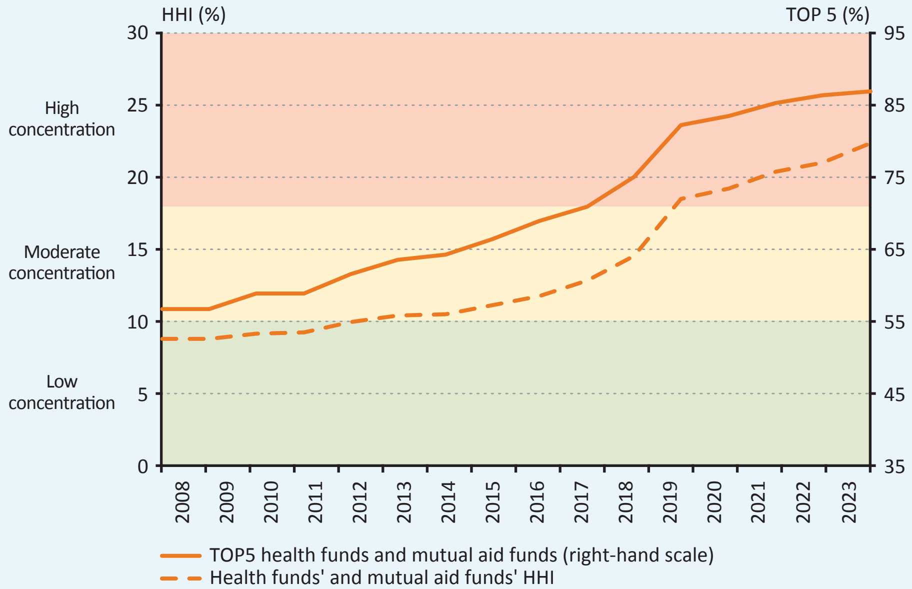
Source: MNB

3.3 HEALTH AND MUTUAL AID FUNDS

3.3.1 Concentration levels continued to rise

The level of concentration in the sector of health and mutual aid funds continued to increase. An analysis of the concentration of contributions shows that 87.1 per cent of the sum of members' contributions and employer contributions paid to health and mutual aid funds were made by the 5 largest (in terms of contributions) institutions. Health and mutual aid funds, which are at least medium-sized, have a national coverage and are typically supported by banking and insurance institutions, find it difficult to compete with smaller institutions in terms of the quality of services and the additional conveniences they offer (e.g. innovative health fund card solutions, apps, discounts in private health care institutions). Smaller institutions, typically employer-based, have a more limited capacity to innovate, but can compete with larger institutions in terms of costs and certain features of services (e.g. easier personal administration).

Chart 3.16
Developments in the concentration of health and mutual aid funds



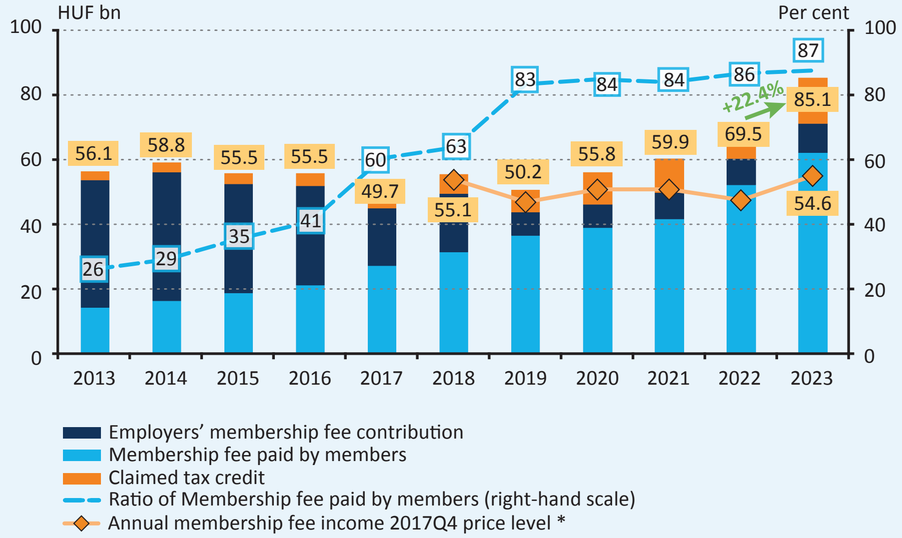
Note: The colour of the background illustrates the strength of concentration under the HHI. Contrary to the practice of previous years, this year quarterly data were used only in respect of 2023. Figures from previous years were updated with the annual audited data. For this reason, the chart may differ from those published in previous years.

Source: MNB

3.3.2 Payments peak in the health and mutual aid funds sector

Revenues credited to the individual accounts of health and mutual aid funds (HUF 85.1 billion) increased significantly by 22.4 per cent in 2023 compared to 2022, demonstrating an increase in the real value of contributions. After a 19.0 per cent increase, member contributions amounted to HUF 61.8 billion. Employer contributions amounted to HUF 9.0 billion, 10.4 per cent higher than in 2022. The amount transferred by the tax authority (HUF 14.3 billion) rose by 51.5 per cent. Membership dues and tax credits for 2023 were significantly higher than in some years of the past decade. Individual contributions at the sector level were more than four times the amount of a decade ago, and were rising steadily. Compared to 2013, the shares of individual and employer contributions in the sector reversed, with strong emphasis on individual contributions from members. The uneven distribution of contributions between quarters during the year continued to be typical, a considerable part of the contributions paid concentrated in the last quarter (seasonality), also as a result of funds' campaigns. Almost half of individual contributions are paid in the last quarter to health and mutual aid funds, while employer contributions are less volatile in each quarter. In 2023, the tax credit for personal and employer contributions amounted to 19.0 per cent of contributions.

Chart 3.17
Member contributions credited to the individual accounts of health and mutual aid funds, broken down by payers

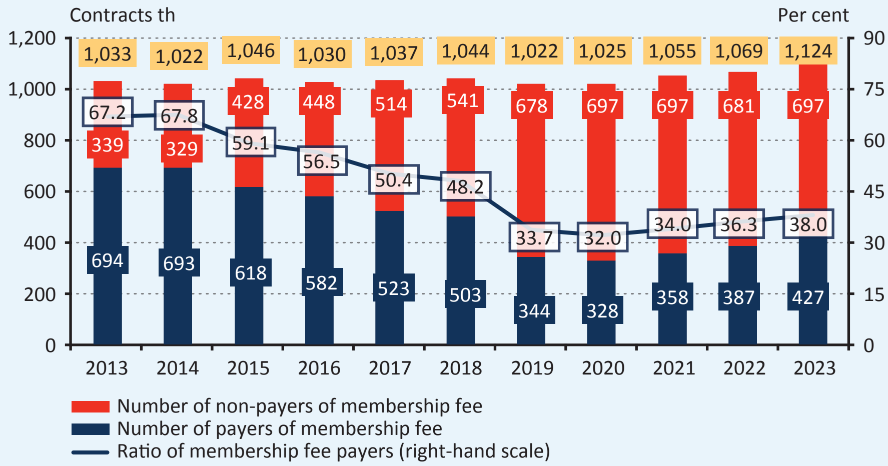


** adjusted by the consumer price index*
Source: MNB

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

Exceeding the number of members in the voluntary pension funds sector, at 1 million 124 thousand, the number of members in the health and mutual aid funds sector was up 5.2 per cent (55,804 persons) at the end of 2023 compared to the end of 2022. Although membership growth has been unbroken for the fourth consecutive year, the increase in 2023 is considered to be outstanding. The number of new entrants (82,128 persons) is a third more than in the previous year. Two thirds of the new members were enrolled by client recruiters. The number of members exiting (16,385) increased by 4.2 per cent and the number of deaths (5,963) by 25.5 per cent compared to 2022. The share of contribution payers at the end of 2023 was 38.0 per cent, 1.7 percentage points higher than in 2022 Q4. Thanks to the employer contribution rate of 74 per cent, at the end of 2013 67.2 per cent of the membership were statutory contributors, but by 2023 this value dropped to 38 per cent, with an employer contribution rate of 13 per cent. Although the willingness to pay membership fees has increased over the last 3 years, the proportion of non-paying members is still extremely high. The statutes of each fund determine the consequences of non-payment (e.g. exclusion or deduction from the return the portion that can be spent on operations and liquidity).

Chart 3.18
Changes in the number of the paying members of health and mutual aid funds



Source: MNB

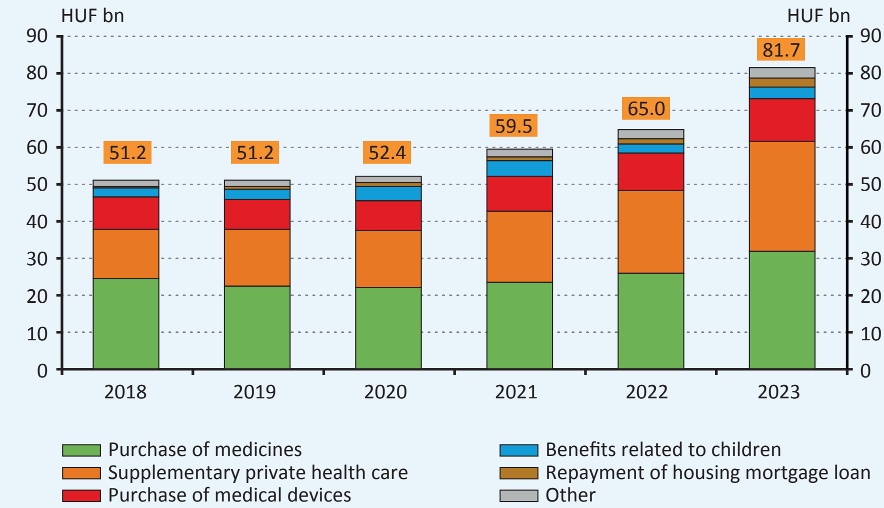
3.3.4 Soaring benefit payments by health and mutual aid funds

The bulk of the voluntary health care financing subsystems is made up of the health-related expenditure of health and mutual aid funds. Benefit payments (HUF 81.7 billion) increased by 25.7 per cent (HUF 16.7 billion) compared to the previous year. The largest share of payments continues to be for the purchase of medicines, special formulae and preventive vitamins, with a share of 39.0 per cent. This value, however, is 0.5 percentage points lower than in 2022. This is followed by the financing of health services (e.g. dentistry, diagnostic imaging) with an increase of 1.7 percentage points and a share of 36.4 per cent, and by the financing of the purchase price of medical aids with a decline of 1.2 percentage points and a share of 14.5 per cent.

The ratio of spending on child-related benefits decreased by 0.2 percentage points to 3.9 per cent, mainly due to a decline in the share of birth-related benefits, which dominate the group. The share of the amounts paid out to support residential mortgage loan repayments rose from 2.2 per cent to 2.7 per cent in 2023, after a 50.5 per cent increase in the payout amount.

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

Chart 3.19
Evolution of health and mutual aid funds' services

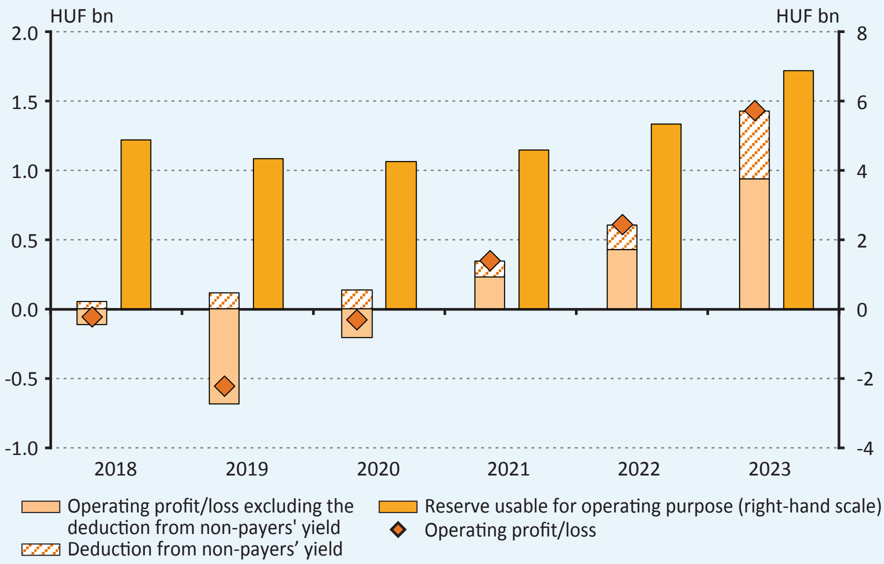


Source: MNB

3.3.5 Health and mutual aid funds generated operating profit again

Health and mutual aid funds realised an operating surplus again in 2023 – HUF 1.4 billion –, which is HUF 0.74 billion higher than a year earlier. Only 2 out of 16 institutions were loss-making on an annual basis. The deduction of from the return of non-payers (nearly HUF 500 million) was an important contributor, but even without it, the operating surplus is still significant. After repeated growth, the operating reserve increased to HUF 6.9 billion, an increment of 28.3 per cent compared to the end-2022 figures, and almost double the increment of the previous year. Funds with a negative operating income in the longer term need to reconsider their operational characteristics (more specific targeting of non-payers, transformation of the operating cost model). If, due to persistent operating losses or other reasons, funds' operating reserves approach or fall below the prudential minimum, the MNB can take or takes various measures (prudential meeting; requesting an action plan; requiring an operation-liquidity report; launching a targeted investigation) with regard to the institutions concerned. By building up adequate operating reserves, funds can ensure the conditions for their operation and continuity of operations in the event of an adverse period.

Chart 3.20
Developments in the operating P&L of voluntary health and mutual aid funds



Source: MNB

3.4 RISKS IN THE FUNDS MARKET

3.4.1 2023, the year of the correction, resulted in reduced risks

Table 3.2
Risks in the funds market

Risk category	Risk groups	Risk rating	Risk prospects	Evaluation in words
Business model	Environment Strategy, business plans Sustainability of operation	🟠	↘	Operating profit and adequate loss-absorbing capacity in both sectors, however, due to the significantly increased cost of living in the recent period, there is still a risk of a decrease in the willingness to save. Several institutions lacked a comprehensive *strategy to increase and rejuvenate their membership.* *Improving environmental outlook based on economic forecasts.*
Corporate governance	Exercise of owner's rights Internal governance Risk management system Internal control	🟡	→	The internal risk management system of the voluntary fund sectors must be strengthened. It is necessary to deepen the activities of the control committees and to monitor the activities of the asset managers more closely. *The risk is not expected to decrease in the short term.*
Financial and operational risks	Insurance risk Investment risk of operational and liquidity reserve Operational risk	🟠	↘	Inflows are at their peak. The increased outflow trend since 2022 started to decrease in the second half of last year, but outflow still significantly exceeded the outflow seen in recent years. According to supervisory examinations, operational risks arose in several cases (related to IT, accounting, data provision, member settlements). *The outflow level of previous years is not expected to return in the short term, but the outflow rate is expected to decrease in 2024 due to the outstanding returns in 2023.*
Sustainability and reserve risk	Coverage reserve investment risk Capital Operating and liquidity reserve	🟡	→	The coverage reserve increased due to a positive cash flow balance and outstanding yield. Adequate operating and liquidity reserve at sector level. *Sustainability risk is expected to decrease as a result of the legislative amendment related to deduction of yield realised on the savings of non paying members, but problems related to this may still arise at smaller institutions.*
Market entry risk	Products Customers	🟢	→	Voluntary funds products are cost-effective, and the number of complaints is low. The 2023 yield significantly improved the funds' reputation. *The attractiveness of voluntary funds may increase due to a positive yield and decreasing inflationary pressure.*

Legend:
Degree of risks — *high* 🔴 *significant* 🟠 *moderate* 🟡 *low* 🟢
Direction of risks — *increasing* ↑ *stagnant* → *decreasing* ↓

Source: MNB

Both sectors are profitable and have adequate loss-absorbing capacity, but there is still a risk of a decline in the propensity to save, given the recent sharp rise in the cost of living. There were risks to the sustainability of the business model at some – typically smaller – institutions with an employer background. High non-payment rates continued to pose operational risks. Based on economic forecasts for 2024, we expect an improving outlook.

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

There are still weaknesses related to the internal control systems, the audit activities of the audit committees are not always well documented and internal audit findings are not always followed up on an ongoing basis. The control of outsourced activities is not always comprehensive. The quality of internal control at a significant number of funds still needs to be improved. Given the recent volatile periods, there is a need for closer monitoring of the activities of the trustees of funds. We do not expect the risks to fade in the short term.

The amount of contributions credited to the individual accounts of voluntary pension funds was extremely high in 2023, exceeding even the 2022 peak. Although the trend of increased outflows since 2022 started to decline in the second half of last year, outflows still substantially exceeded the corresponding figures of recent years. Due to high yields in 2023, lower outflows are expected in 2024. In several cases, operational risks were identified in relation to IT, accounting, data reporting and member accounts.

In 2023, the positive investment result and the positive cash flow boosted the voluntary pension fund sector's individual accounts to an all-time high of HUF 1,939 billion, an increase of 21.4 per cent year on year. The decline recorded in 2022 was surpassed three times by the investment gain (in nominal terms) in 2023 due to the impact of the increase in the price of investment assets. The revaluation or appreciation was driven by the fall in yields and the rise in the price of investment assets. After weak returns in 2022, weighted by closing assets, voluntary pension funds achieved a net return of 21.2 per cent on average in 2023, which is an outstanding performance and significantly above the inflation rate. The 10-year average net return (weighted by closing assets) is 5.6 per cent and accordingly, the funds were able to outperform inflation over this period by an annual average of about 0.7 percentage points. The 15-year average net return (weighted by closing assets) of the sector's players, which looks back even further and thus gives an even more reliable picture, is close to 7 per cent. As a result, the real rate of return over the same period was 2.3 per cent.

Funds' products are cost-effective and the number of complaints is low. The 2023 return has significantly improved the reputation of funds. Positive yields and falling inflationary pressures may increase the appeal of funds.

4 Consumer protection risks in the insurance and funds market

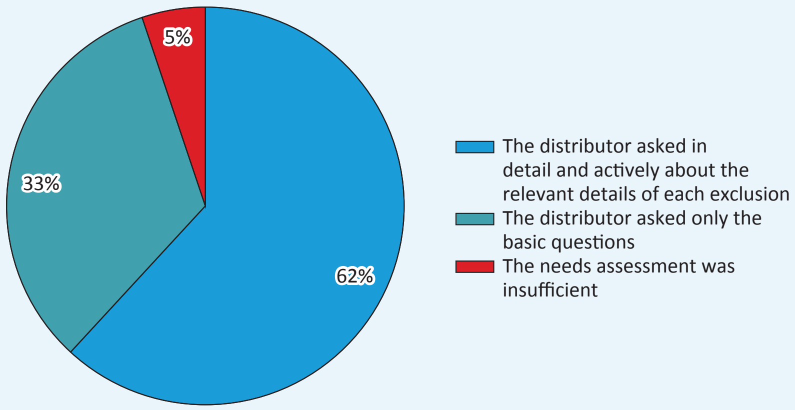
4.1 EXPANDING CONSUMER PROTECTION TOOLKIT

4.1.1 The MNB's new mystery shopping methodology has worked in the live environment

As part of its ongoing supervision, the MNB conducted 97 mystery purchases for market monitoring purposes with the involvement of an external market research firm, using the mystery shopping methodology provided by EIOPA in August 2023. This tool enables the MNB to assess market practice (especially in areas that are more difficult to monitor from a distance) and the experience gained in this monitoring can provide a basis for further actions in its surveillance practice. In total, the programme mapped the sales practices of six insurers and four intermediaries. The mystery shopping exercises were based on the first home insurance campaign in March 2024, during which the MNB assessed the sales practices of insurers in general, with a particular focus on the information provided in relation to the Certified Consumer-friendly Home Insurance (MFO) product. From the mystery shopping carried out during the home insurance campaign, the MNB gained important insights that were already used during the campaign to improve information and sales processes.

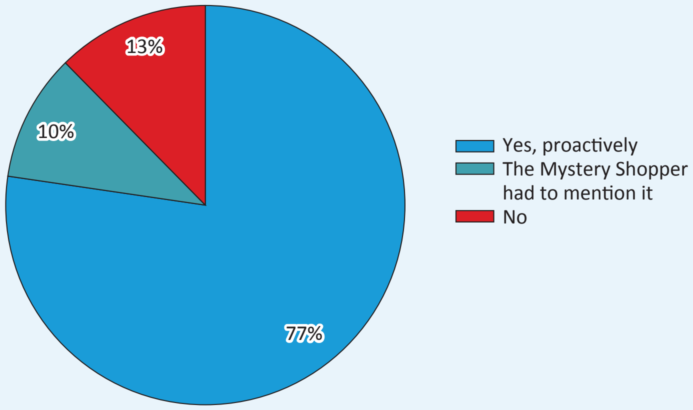
The experience of the mystery shopping shows that 62 per cent of the demand and needs assessments were sufficiently detailed. The distributors proactively assessed the needs of customers in 77 per cent of the mystery shopping, including additional needs of the mystery shoppers for various endorsements.

Chart 4.1
Demands and needs assessment I.
Did the adviser properly assess the property to be insured and the needs of the mystery shopper?



Source: MNB

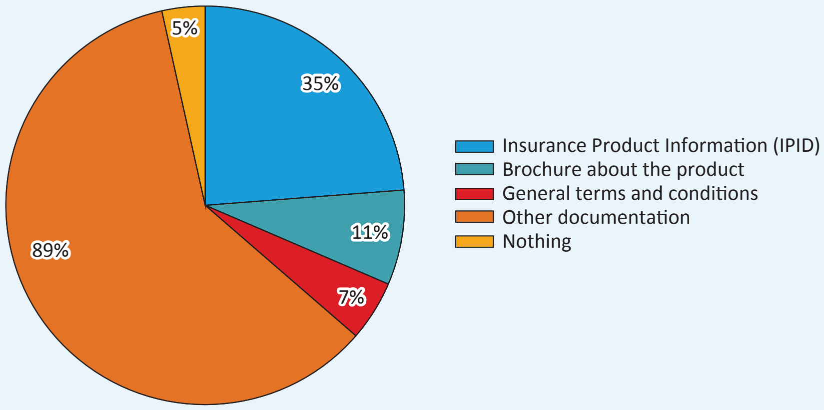
Chart 4.2
Demands and needs assessment II.
Did the advisor ask whether the mystery shopper needed any additional elements in the insurance?



Source: MNB

Among the documents that must be handed over in order to comply with the obligation to provide information under Act LXXXVIII of 2014 on the Business of Insurance (Insurance Act), the document most frequently handed over to mystery shoppers – in 35 per cent of the visits – was the insurance product information document (IPID). It was an important finding that only 7 per cent of the transactions received some form of general terms of contract for the underlying home insurance product. In most cases – 89 per cent of the visits – the distributor provided the customer with documents other than the above, the most common being a premium calculation and the demand and needs analysis form. Overall, the rate of disclosure of the documents to be provided under the law was unsatisfactory during the mystery shopping exercise.

Chart 4.3
Assessment of product recommendation practices
What documents were handed over during the mystery shopping visits (more than one answer per mystery shopping was possible)



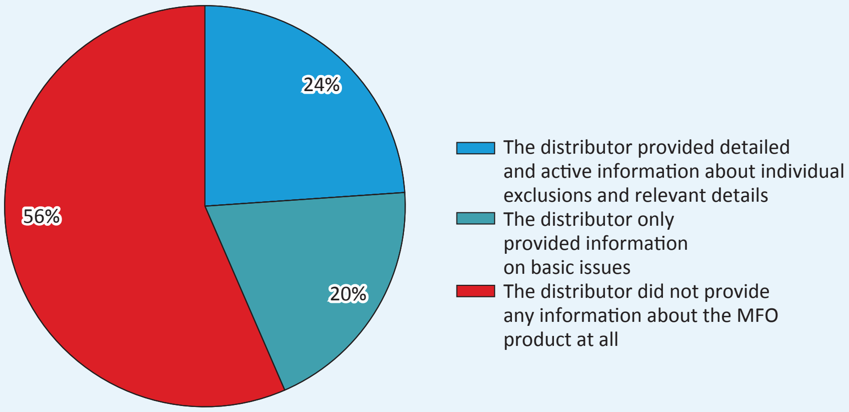
Source: MNB

During the mystery shopping visits, typically more than one product was recommended by the distributors, most often – in about 33 per cent of the cases – two products were offered, typically one non-MFO product and one MFO product, given that insurers typically have two home insurance products. There were some cases where four or more products were reported by the mystery shoppers as being recommended, but in these cases different packages of one product were considered as separate products. During the campaign, 93 per cent of the mystery shoppers was given a specific suggestion for a product that would suit their needs, and in the majority of cases – almost 60 per cent of the visits – they were informed about the product in terms of covers, exclusions and claims settlement features. No specific product recommendation was made in four cases only, three of which were due to unsuccessful mystery shopping visit, and in one case the mystery shopper was redirected to the online platform by the adviser after the mystery shopper asked a specific question about how to make an offer.

The network of insurance agents did not recommend MFO

The results of the mystery shopping show that in the institutions concerned, the distributors typically did not mention the MFO products in the information, and only included them in the information if the mystery shopper was specifically interested in the MFO product.

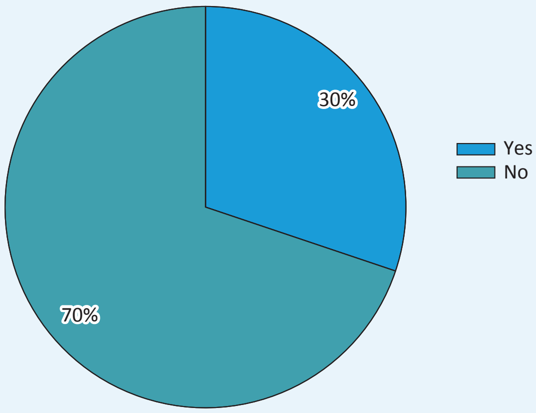
Chart 4.4
Assessment of information on MFO products
Did the mystery shopper receive information or explanations about MFO products without having to ask?



Source: MNB

When MFO products were mentioned in any way during the provision of information, 70 per cent of the distributors did not recommend them.

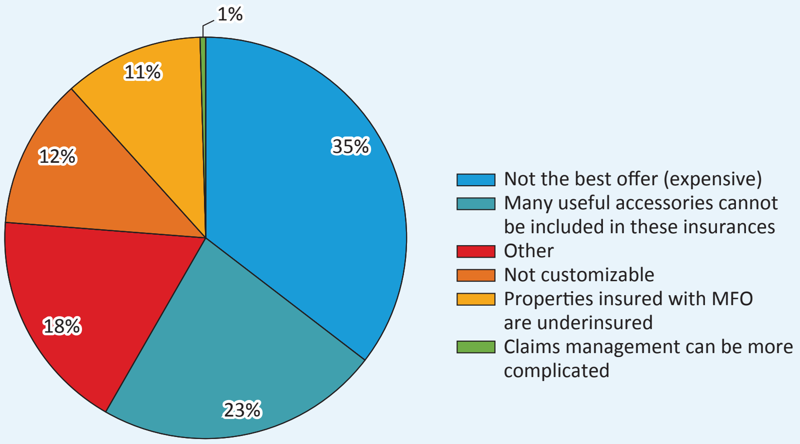
Chart 4.5
MFO product recommendation assessment
Did the advisors specifically recommend the purchase of the MFO product? (Where the products offered included MFO)



Source: MNB

Where an MFO product was included in the offered products, the distributors did not recommend the purchase of the MFO product in more than two thirds (70 per cent) of the cases. The main reason for this was that the distributors considered MFO products to be particularly expensive. The results of the online calculations carried out by the MNB refute this, as indeed, when the premium for a traditional – non-MFO – home insurance policy was calculated taking into account the same service content as the MFO products, MFO premiums were usually more favourable. Another typical argument against MFO products was the claim by distributors that many useful endorsements cannot be incorporated into MFO products. MFO's basic package is a comprehensive package of covers; accordingly, many covers that are only available as an endorsement to a non-MFO home insurance policy are part of the basic package with MFO products. It is important to note, however, that under the MFO terms and conditions, it is up to the individual insurers to make available any additional cover they consider important in their MFO product.At many insurers, the number of endorsements available for MFO products is much lower than the number of endorsements available for non-MFO products.

Chart 4.6
Reasons against MFO during a mystery shopping
What reasons/arguments did the adviser use for not recommending the MFO product?



Source: MNB

Overall, the mystery shopping exercise showed that, although most of the information provided during the campaign was preceded by adequate demand and needs assessments, the written information was not always complete and adequate. Experience with the MFO shows that distributors are not sufficiently competent in the terms and conditions of the MFO; consequently, education on this will be essential in the coming period to ensure that consumer-friendly products are broadly available to customers. This exercise enabled the MNB to apply the new mystery shopping methodology effectively in the context of the programme carried out during the home insurance campaign, the results of which will be used to improve the information process in the coming period along the lines of the risks identified.

Box 4.1
Pilot exercise of the new mystery shopping methodology

In 2022, the MNB successfully applied for a Technical Support Requests-TSI project of the European Commission's Directorate General for Structural Reform (DG Reform), which was a tripartite cooperation, with the EU Commission as the financier, EIOPA as the technical facilitator and the MNB as the beneficiary of the project. One of the topics of the DG Reform project was the development of a methodology for supervisory mystery shopping, in consideration of the fact that, according to the MNB's experience, the EU requirements on information, advice and conflicts of interest introduced in the insurance sector in recent years have not eliminated the so-called "point-of-sales" risks yet, and the number of complaints and reports related to sales remains high. Mystery shopping can be used for a number of supervisory purposes, such as analysing market practices (setting up a kind of "diagnosis"), identifying risks, monitoring and detecting actual infringements.

The DG Reform project developed a new methodology for conducting (mainly for monitoring purposes) mystery shopping visits, which was tested in a Pilot exercise in November and December 2023 with the involvement of an external contractor. The Pilot exercise focused on 3 main products: (1) insurance-based investment products, (2) home insurance and (3) travel insurance. The mystery shopping exercises, which took place in the second half of 2023, included both face-to-face and online shopping, and covered several insurers and different sales channels.

1) In the case of insurance-based investment products (IBIP), the appointed external facilitator carried out a total of 90 face-to-face visits involving 5 companies and different distribution channels. The exercise focused primarily on assessing the distributors ' pre-contractual demand and needs assessment and advisory practices (including, in particular, the identification of sustainability preferences and explanations on sustainability issues in general).

   The results of the IBIP mystery shopping visits suggest that intermediaries and insurers most often (77 per cent of the time) failed to provide consumers with adequate explanations of sustainability features (e.g. which environmental or social objectives the product supports / does not violate, or which major adverse impacts it avoids[14]) and often (43 per cent of the time) failed to assess sustainability needs even when customers explicitly indicated that they were interested in such a product. Only 13 per cent of customers without sustainability needs received such a product recommendation. Distributors typically (88 per cent) assess clients' investment objectives, but their assessment of risk appetite, loss tolerance and insurance protection needs is often insufficient. They are also careful to draw attention to the risks of terminating an investment before maturity. As regards information, it is common for it to be provided verbally without showing the relevant document, but the majority of mystery shoppers (66 per cent) indicated that they received detailed information on costs spontaneously (without any specific enquiry).

2) For home insurance, the DG Reform Pilot included 120 face-to-face visits to 9 insurers and intermediaries (including brokers, tied agents and direct distributors of insurers). The main focus in these cases was on MFO, within which the exercise assessed the extent to which the identification of needs and the subsequent recommendation of different products (including MFO) were satisfactory.

   The visits showed that mandatory pre-contractual information is not provided in many cases, with only 54 per cent of mystery shoppers receiving a product brochure, 22 per cent receiving general terms of contract, and 13 per cent not receiving any written customer information, despite the legal obligation to provide these documents before signing a contract. Customers typically (77 per cent) received documents by e-mail. A significant proportion of mystery shoppers (88 per cent) reported that the distributor had properly assessed their needs and proactively asked them questions about endorsements. Almost half of the customers received more than one product recommendation, but in many cases (38 per cent) the advisers did not compare the products offered. MFO products were mentioned with an adequate explanation or a cursory mention in only one third of the cases and accordingly, the majority of mystery shoppers (63 per cent) had never heard of MFO products.

3) The mystery shopping for travel insurance consisted of 40 face-to-face visits (mainly to travel agencies) and 60 online purchases (with a particular focus on comparison sites). The online research assessed the rankings displayed on comparison websites and the way in which product features and, in particular, the exclusions used were presented to consumers before sale.

[14] EBA, EIOPA, ESMA, 2023: INVESTMENTS, LOANS, INSURANCE OR PENSIONS WITH A SUSTAINABLE FOCUS (https://www.eba.europa.eu/sites/default/ files/2023-12/b7109f03-89ab-4b9a-a0al-0a0c6ead267c/HU.pdf

During the face-to-face visits to travel agencies, many distributors (58 per cent) did not properly assess customers' insurance needs, and many customers (36 per cent) did not receive customer information documents. Cancellation cover and related exclusions were explained in most cases (75 per cent), but health cover was explained only 69 per cent of the time and baggage cover only 59 per cent of the time. Online shoppers found IPID documents easy to find in general (96 per cent), most of the time (84 per cent) in less than 4 clicks. The ranking of comparison sites was not consistent in pilot practice, as they contained different products, prices and rankings for the same needs. Experience shows that the majority of customers (58 per cent) did not find a way or contact details to receive the results of the comparison by email.

4.1.2 Legislative proposal package on the amendment of EU rules on the protection of retail investors

The Commission published its legislative proposal on the EU's Retail Investment Strategy (RIS) on 24 May 2023[15], with the explicit objective of putting the interests of consumers at the heart of retail investment and ensuring that retail investors receive the same level of protection and treatment regardless of the investment products or distribution channels they choose.

The legislative package is part of the Commission's 2020 Capital Markets Union Action Plan, one of the three main objectives of which was to make the EU an even safer place for citizens to invest in the long term. The proposal also aims to encourage participation in EU capital markets, channel private finance into the economy and support the green and digital transition. The rules on investor protection are currently determined by sector-specific rules, which may vary from one financial instrument to another, but may result in different levels of investor protection. The new legislative package therefore aims to establish a coherent regulatory framework, and to this end the proposal revises and amends the rules laid down in the Markets in Financial Instruments Directive (MiFID II), the Insurance Distribution Directive (IDD), the Directive on Undertakings for Collective Investment in Transferable Securities (UCITS) and the Alternative Investment Fund Directive, the Directive on Fund Managers (AIFMD), the Insurance and Reinsurance Directive (Solvency II) and the Regulation on Packaged Retail Investment Products and Insurance-Based Investment Products (PRIIPs).

The legislative package contains a broad range of proposals on the following topics: Improving retail investor information, which would also be better adapted to the digital age and investors' growing sustainability preferences. Increasing the transparency and comparability of costs and ensuring that the products offered provide real value for money to retail investors. The proposal emphasises the need to address potential conflicts of interest in the marketing of investment products and to introduce stricter rules and greater transparency in the use of incentives/rewards and to maintain a high level of professionalism among financial advisors. The Commission also intends to introduce rules concerning the responsibility for marketing communications and advertising (including in social media).

[15] https://finance.ec.europa.eu/publications/retail-investment-strategy_en

4.1.3 Electronic communication

In 2023, a particular focus was placed on examining electronic communication between insurers and consumers. The MNB's inspections found that insurers do not always fulfil their contractual obligations to provide information to consumers. The MNB requires insurers to give due priority to electronic communication with consumers, which may boost consumer confidence in electronic transactions and simplify and facilitate transactions for both parties.

Generally speaking, consumers can get a discount on their premiums by opting for e-commerce, but consumers should check their online account regularly as specified in the insurance contract. If they do not view the documents uploaded to their online account, they may not be able to enforce their contract amendment needs in time or may incur premium arrears.

The MNB considers it good practice for the insurer to send an electronic information letter to the user of the customer portal or to the electronic mail address declared by the user, after documents that are capable of triggering legal effects have been posted on the customer portal, informing the user that a document has been placed on the portal. If insurers receive feedback that the electronic notification is undeliverable, the MNB considers it a good practice for them to try, at least once, to contact the customer by other means (e.g. phone, SMS, letter) in the case of documents that may trigger a legal effect (e.g. premium notice, cancellation notice). The MNB does not consider it a good practice for intermediaries, such as a broker, to generate an e-mail address upon the customer's registration on the insurer's customer portal if it is not directly linked to the customer's primary e-mail address. The use of an intermediary's e-mail address upon registration to the customer portal is only acceptable if the client has the choice to register with his/her own or the intermediary's electronic address, he/she has been duly and verifiably informed of this choice in advance and has clearly expressed this choice in a declaration.

Box 4.2
Heat map of the risks and phenomena affecting consumers

For the year 2023, the MNB has again prepared a heat map showing the risks and phenomena affecting consumers in the Hungarian insurance market. A heat map is an informative way of showing how a given phenomenon affects consumers, whether it is harmful or beneficial to them. The map also indicates whether the risk or phenomenon affects a smaller or larger number of consumers.

In 2023, the average inflation rate was 17.6 per cent[16], which may have resulted in underinsurance again, due to the possibility of insurers' neglecting to adjust insurance amounts and consumers cancelling existing insurance products and postponing the purchase of planned insurance products in order to maintain their financial position. From a climate risk perspective, extreme weather events resulting from climate change may cause increasingly frequent and large-scale damages to consumer-owned properties.

In February 2023, legislation was adopted to reform the regulation of home insurance, requiring lenders to demonstrate the use of the MNB's MFO calculator when providing personalised information on mortgage loans, and a new re-contracting option was introduced, as in the case of open-end insurance, in addition to the normal cancellation option at the policy anniversary date, customers are granted a no-cost cancellation period in March of the year. This means that there will be fierce competition between insurers for consumers every March. In 2023, two new MFO applications have been positively assessed by the MNB and accordingly, 13 out of 14 insurers in the home insurance sector have now obtained MFO certification. Consequently, almost the whole insurance market – 98 per cent of the market in terms of market share – is committed to a consumer-friendly approach.

[16] https://www.mnb.hu/letoltes/gyorselemzes-az-inflacio-alakulasarol-hu-2023-december-en.pdf

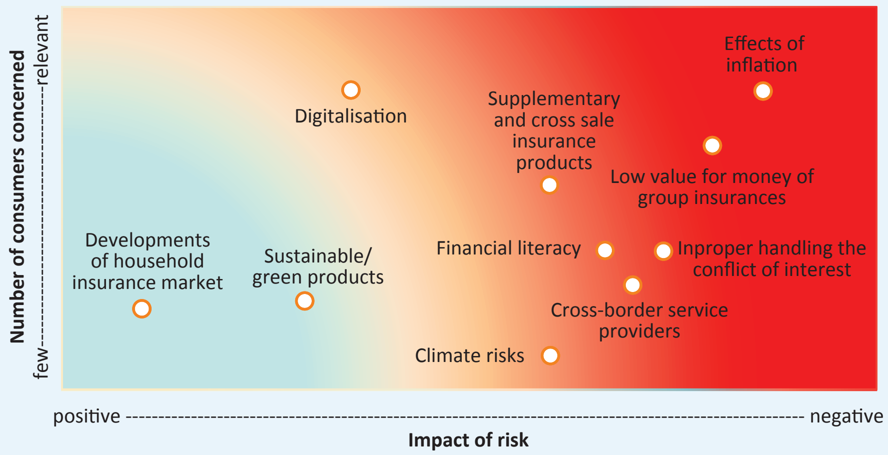
In line with EU experience, concerns have been raised about the adequacy of group insurance products. The MNB has also observed that consumers were not always aware of the covers and exclusions linked to the insurance products they bought, and that for this type of product, the commission rates charged for sales were very high and therefore, these factors may lead to low customer value. Biased sales due to high commissions and sales outside the target market remain a problem for consumers. Complementary and cross-sold insurance products, such as extended warranties, can carry serious consumer risks given that the product is usually sold to consumers by various commercial entities without professional training in insurance, in a way that may not be in line with consumer needs.

Adequate information and financial awareness are essential for consumers to make optimal financial decisions; the lack of these two items may have an adverse impact on consumers' financial well-being, and this phenomenon is also evident in the Hungarian market. Digitalisation has made information available to consumers quickly and almost completely, which supports and helps them to be informed, but it is important that service providers also keep in mind the consumer segment that is less comfortable in the digital world to ensure that they do not experience any disadvantages because of the lack of their digital experience.

The number of service providers operating cross-border in Hungary is constantly increasing, which has the positive effect of stimulating competition in the insurance market, but at the same time, this may sometimes pose risks to Hungarian consumers, especially given the difficulties of keeping contact with cross-border service providers. Based on the MNB's inspection experience, these service providers did not respond to consumers' complaints in several cases, or responded beyond the 30-day statutory time limit, and the possibility to complain orally was not always provided.

Consumers are increasingly open to and interested in sustainable investments. The regulation of sustainable, "green" products is a major focus both in the EU and domestic markets, helping consumers to avoid the phenomenon and risk of "greenwashing".

Chart 4.7
Heat map of the risks affecting Hungarian consumers



Source: MNB

4.1.4 In focus: complaints handling

Following the adoption of legislation on complaints handling in the financial sector in 2010, the handling of complaints by insurers and pension funds has undergone significant changes. The major shortcomings of the initial periods are now absent or significantly reduced. In addition to legal compliance, institutions are increasingly striving for customer-friendly solutions. In addition to market competition, the MNB has always placed great emphasis on the regular monitoring of complaints handling practices.

A significant proportion of the complaints received by insurers concern the service provided by insurers, including the amount of compensation and information on the amount of compensation. Similar to the provisions already laid down in Act LXII of 2009 on Compulsory Motor Third Party Liability Insurance (MTPL Act), the 2021 amendment of the Insurance Act sets out clear rules on the time limit and the depth of information that insurers must provide following the submission of a claim, regarding the basis on which the amount of compensation was determined or the claim was rejected. This information puts the injured party in a position to judge whether the insurer has acted in accordance with the terms of the contract.

With regard to property damage, if the policyholder is not insured for new value, the question arises as to what extent the insurer has taken into account the depreciation, what method it has used to calculate it and whether it has provided the policyholder with adequate information. In the case of compulsory motor third party liability insurance, a significant number of disputes and complaints arise from the fact that insurers do not pay the full price of new parts installed in a vehicle, but discount them according to the age of the vehicle in order to ensure that their value corresponds to the condition at the time of the accident. For example, if a damaged part is replaced by a new part, the insurer will not reimburse the bill in full because of the depreciation.

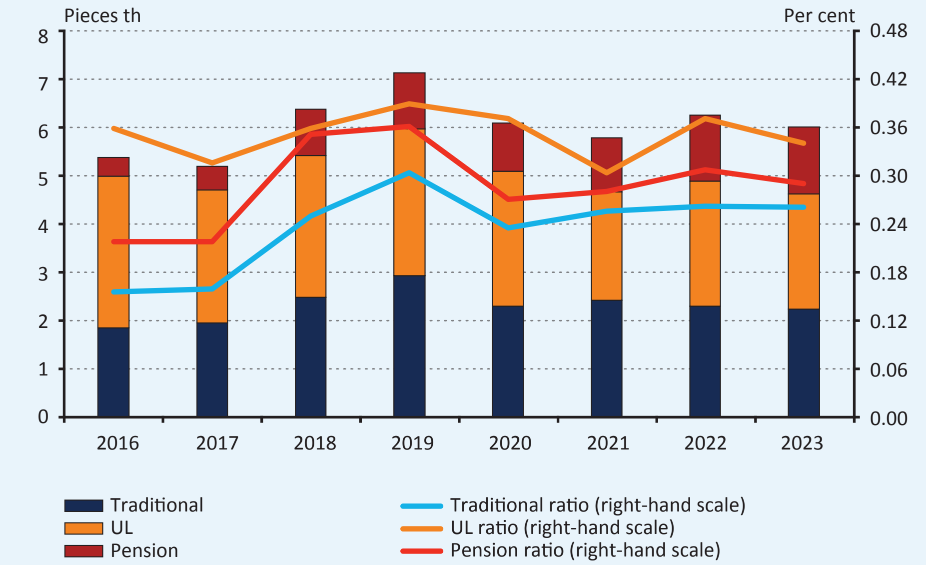
The number of complaints from group insurance policyholders in the consumer protection control procedures initiated at the request of the MNB is increasing, and group insurance is increasingly becoming a focus of the MNB.

In the year 2023, the MNB continued to receive a small number of applications for consumer protection procedures in the money market sector, and the experience gained from the comprehensive inspections shows that the sector is functioning well from a consumer protection perspective, as a result of the customer-friendly attitude of the money market institutions and the detailed regulation of the sector.

4.1.4.1 Moderate decline in life insurance complaints statistics

Unit-linked life insurance continues to be the most popular product in the savings-oriented life insurance market. The popularity of unit-linked insurance is due to the fact that it offers a similar service to mixed (profit participation) life insurance in the event of death, while also offering an investment option similar to mutual funds. Given the complexity of the product, which is difficult for consumers to understand, the information provided at the time of contracting is of paramount importance. Despite the fact that both domestic legislation and EU regulation are constantly striving to ensure that customers have a realistic picture of the specifics of the product they are buying before contract conclusion, experience shows that in many cases they only become aware of the obligations of their contract after it has been signed, several years later. However, it is very difficult to identify subsequently the specific information the customer received before the contract was concluded. In addition to the complexity of the products, the situation is not made easier by the fact that contracts are typically medium to long-term. These timeframes are difficult to predict for consumers; however, there are significant costs associated with withdrawing from a contract before its expiry.

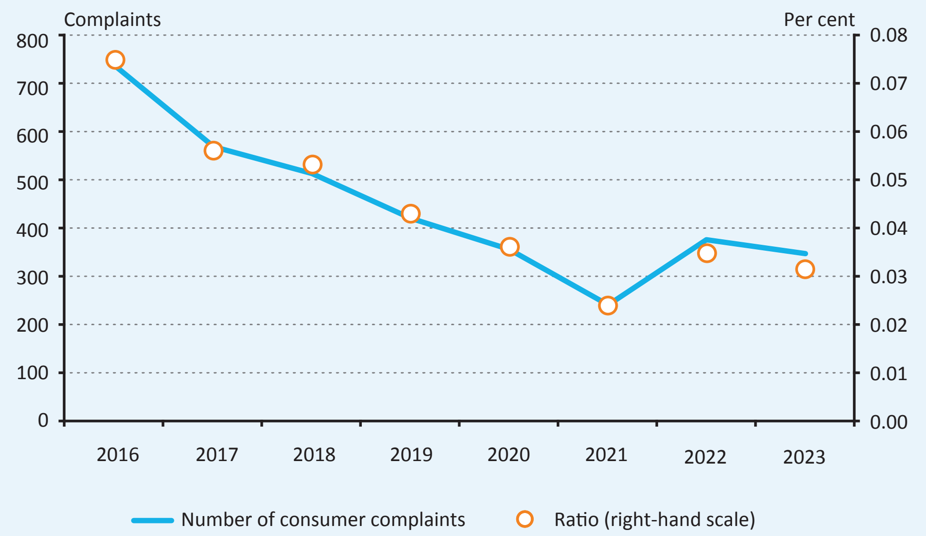
Chart 4.8
Number and ratio of life insurance complaints within the portfolio



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

Unit-linked insurance is a focus of the MNB in all respects, both in terms of comprehensive inspections and complaints. Complaints statistics for unit-linked insurance showed an improvement following the ethical concept launched in 2016, but given that the full risk of investments is borne by the policyholders, this positive trend faltered in 2022 due to the adverse economic environment and lower-than-expected investment results. However, the 2023 figures show a modest improvement again, with the number of complaints about unit-linked products falling by 8.9 per cent. The number of complaints about the provision of pre-contractual information on unit-linked products and the ratio of complaints to total unit-linked contracts (unit complaints ratio) also decreased (Chart 4.9).

Chart 4.9
Number of consumer complaints related to the provision of pre-contractual information and relative to intermediaries, and the ratio of complaints to the number of consumer contracts for unit-linked life insurance and unit-linked pension insurance

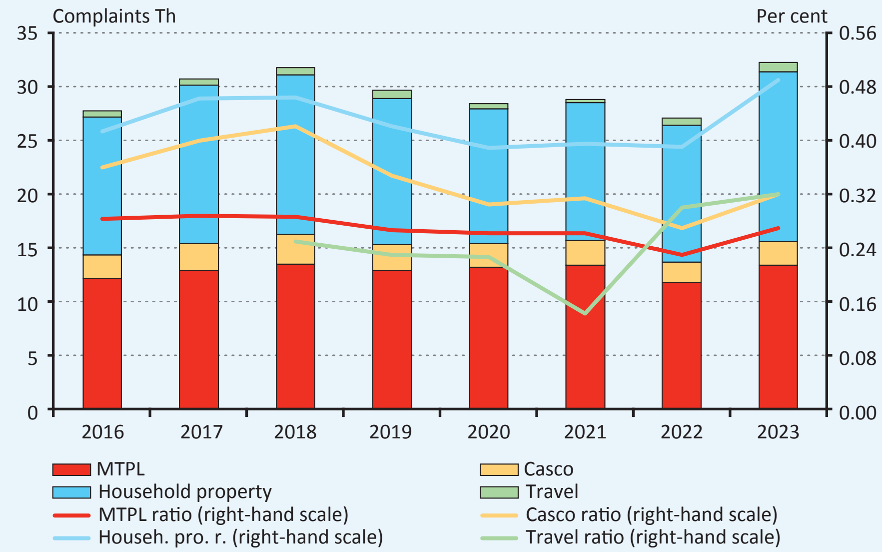


Source: MNB

4.1.4.2 The decline in the number of complaints in non-life insurance has halted

In non-life insurance, the positive trends in the number and ratio of complaints seen in previous years have faltered. The most striking change is in the area of personal property insurance, where the number of complaints per policy started to increase markedly after stagnating in the previous year. Extreme weather in 2023 is likely to play a significant role in this. Storms across the country have caused severe damage, which has overstretched the capacity of insurers to settle claims, causing delays in claims settlement procedures. Complaint rates also increased for MTPL, casco and travel insurance, albeit more moderately than for personal property insurance. Despite temporary declines, a positive change is expected in the complaints ratio as a result of the 2021 legislative amendment concerning claims settlement and the MNB's ongoing review of customer-friendly solutions to make claims settlement more efficient and simpler. In addition to administrative measures, guidelines, recommendations and management circulars are also working towards making insurers' practices more customer-friendly even beyond legal compliance.

Chart 4.10
Number and ratio of non-life insurance complaints



Source: MNB

4.1.4.3 Distribution of the number of complaints concerning life and non-life insurance by subject of complaint

In order to show the ratio of complaints registered by insurers by type of complaint, complaints have been classified into a number of categories. The category of insufficient information includes complaints concerning the pre-contractual period, the term of the contract, the termination of the contract and intermediaries, i.e. cases where the complaint primarily objects to the insurer's provision of incomplete, incorrect or otherwise inadequate information about the product and the risks thereof, the additional costs to the customer or any other factor that may be relevant to the customer. This also includes complaints relating to the period after the conclusion of the contract (but before the termination of the contract) and complaints relating to inadequate information at the time of termination of the contract or in relation to the terminated contract. This category also includes complaints about tied insurance intermediaries (other than complaints arising from financial fraud).

The category of claims handling includes complaints about delays in the handling of claims, the rejection of a claim that the client considers to be well-founded, or disputes over the amount of compensation.

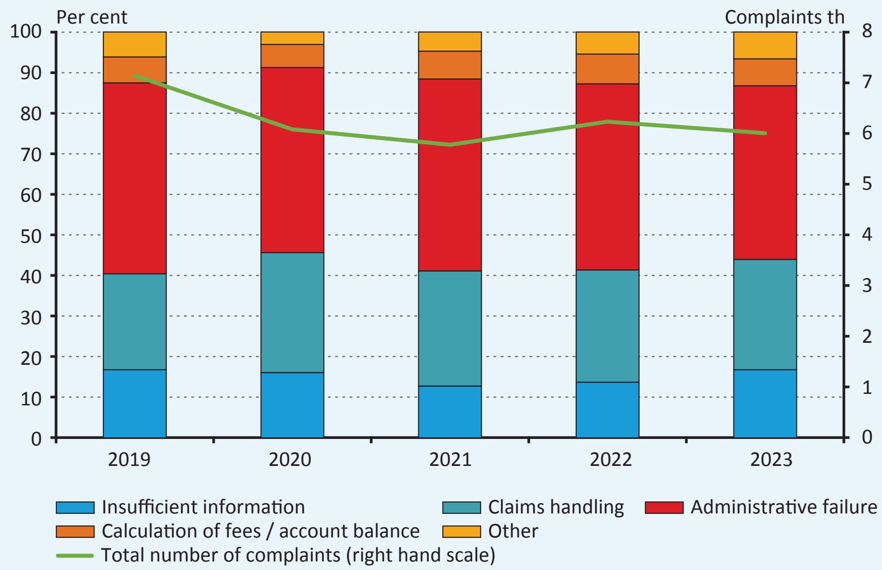
Administrative deficiencies include complaints about the general operation and administration of the insurer, errors in the accounting background to ensure reliable and up-to-date records, complaints about errors in case management and administration (incorrect supporting documents, lost claims, mailing errors, failure to send mandatory notifications, etc.), as well as attitude towards customers, rude service, unavailability of agents, slow administration, failure to respond to complaints, etc.

Complaints about premium calculations and account balances include complaints about the incorrect calculation of premiums, and complaints that any statement provided to the consumer contradicts any other statement or other evidence.

Any other complaints that do not fall into the above categories are covered under "Other", including unauthorised activity, IT system failure and financial fraud.

For life and non-life insurance, complaints typically arise for other reasons. For life insurance, the largest ratio of complaints, 43 per cent in 2023, was related to administrative shortcomings, 27 per cent was related to the payment of benefits and 17 per cent was due to deficiencies in the provision of information. Complaints about premium calculation/account balances and the "Other" category each accounts for 7 per cent of all complaints.

Chart 4.11
Distribution of complaints concerning life insurance by subject of complaint

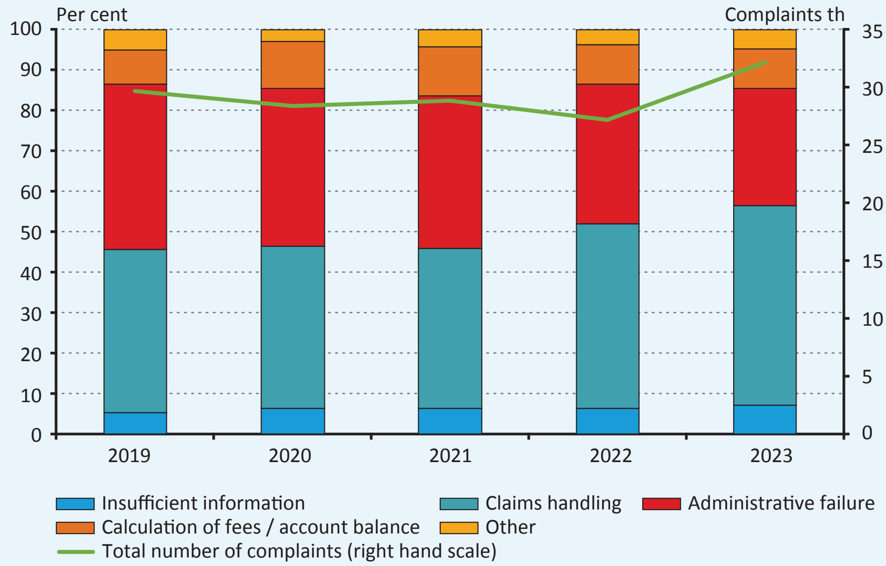


Note: Traditional and UL insurance including pension insurance.
Left axis: ratio of complaints by subject to total number of complaints.
Right axis: total number of complaints

Source: MNB

Unlike in life insurance, claims management in non-life insurance is the area where most objections are raised by customers. In 2023, almost half of the complaints, 49 per cent, objected to delays in compensation, the rejection of a claim or the amount of compensation. Complaints about administrative shortcomings only came next at 29 per cent. Complaints about premium calculation and account balances also represent a significant share (10 per cent). The percentage of complaints about information provision is 7 per cent, while "other" complaints account for 5 per cent.

Chart 4.12
Distribution of complaints concerning non-life insurance by subject of complaint



Note: Household property, MTPL, Casco, Passenger insurance
Left axis: ratio of complaints by subject to total number of complaints
Right axis: total number of complaints
Source: MNB

4.2 LIFE INSURANCE

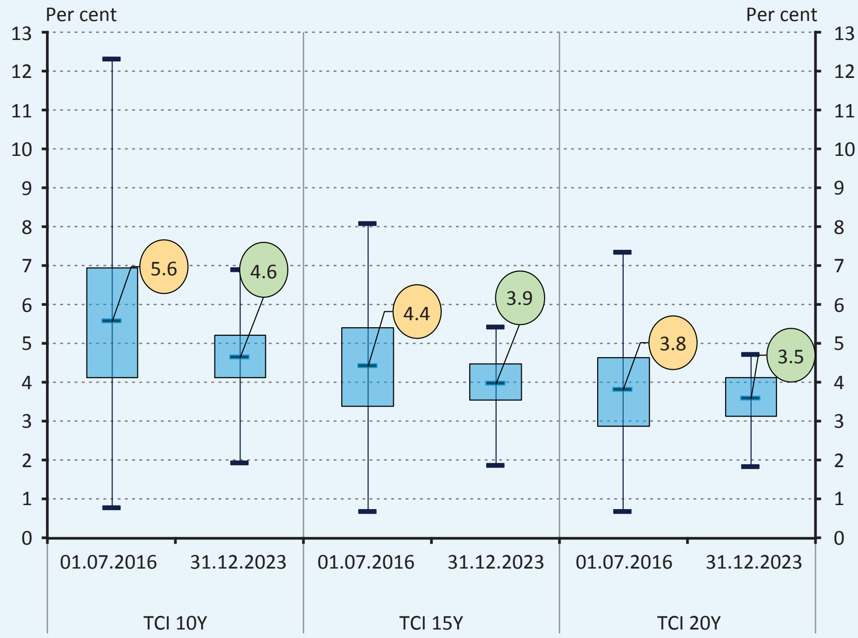
4.2.1 Total cost indicator (TCI)

4.2.1.1 Stable cost levels in unit-linked insurance, effective ethical concept elements

The total cost indicator (TCI), which expresses the cost of life insurances with savings element as a percentage, had been in use on the insurance market for more than 10 years, since 2010, with the aim of enabling the comparison of the cost level of individual products and increasing transparency. In order to achieve this objective, the calculation of the TCI was initially introduced in the market as self-regulation, partly based on a centralised method in the form of self-regulation. Subsequently, from 1 January 2016 the MNB regulated the method to be applied as part of the Ethical Regulation Package (allocation limits, TCI calculation method, other directives for unit-linked and pension insurance). The provisions cover all life insurance products with savings element, including (products with profit participation) and unit-linked life insurance products and pension insurance. For the latter two product groups, the MNB set maturity-specific expectations for the maximum value of the TCI. Compliance with the TCI limits has a key role to play in the cost regulation of life insurances with savings element as it had the effect of removing products with an extremely high TCI that had been offered on the market before the ethical regulation.

With the disappearance of massively expensive products, the dispersion and the average of TCIs also decreased. In mid-2016, the TCI indicators ranged between 0.6 per cent and 12.3 per cent, while the range limits changed to 1.79 per cent and 6.88 per cent in 2023, and the median decreased in all categories. The bulk of the process took place in 2017, after the MNB recommendation on pension insurance was issued and product developments were completed. The use of the TCI has increased transparency which, together with the MNB recommendations, led to a significant reduction in the cost of life insurance products. The figure below shows the TCIs of UL term life insurance policies with a regular premium.

Chart 4.13
Change in TCI values



Source: MNB

In 2015, the MNB developed the concept of ethical life insurance as set out in its earlier supervisory strategy to restore and strengthen trust and to promote transparency along the lines of the principle of fair treatment.

The elements implementing the objectives of the concept (tightened investment rules, cost transparency, stronger cost control) had been phased in from 2016, and the MNB requires compliance with the related requirements from 1 January 2017.

In order to boost customers' confidence in insurance products and thereby build stable portfolios with long maturities, the MNB established, inter alia, its expectations concerning products, sales and investments in its "unit-linked recommendation", i.e. MNB recommendation No 8/2016 (VI. 30.) on the application of the prudential and consumer protection principles related to unit-linked life insurances. The recommendation also defines an expectation for the maximum TCI of unit-linked life insurance policies of different maturities, which play a key role in the cost regulation of life insurances with savings element.

As a result of compliance with the TCI limit, the fall in TCIs was spectacular, which has stabilised at current levels in recent years. While in mid-2016 TCIs ranged from 0.6 per cent to 12.3 per cent, by 2023 the spread shrank to the range between 1.79 per cent and 6.88 per cent, mainly due to the discontinuation of sales of products with extremely high TCIs.

At the end of 2023, the average TCI value also decreased compared to 2016, but in this case the contraction is much smaller, showing that even in 2016 only a small number of products caused outliers.

The MNB continuously monitors whether the TCI values of insurance policies meet the requirements of the unit-linked recommendation. In 2023, three insurers deviated from the recommended limits. The MNB has sent a management letter to insurers calling on them to comply with the TCI limit requirements, which has led to two insurers reducing their asset management costs to comply with the MNB's recommendation. In the case of regular-premium unit-linked life insurance policies distributed by the insurer with a maturity of at least 10 years, in its unit-linked recommendation the MNB requires the TCI value linked to the product and calculated in accordance with the TCI Decree not to exceed 4.25 per cent per asset fund for policies with a 10-year maturity, or 4.25 per cent plus 1.5 percentage points, that is, 5.75 per cent in justified cases (e.g. higher potential return). According to TCI data as at 31 December 2023, there was an insurer with a TCI value of more than 5.75 per cent, offering a product with a 10-year maturity and a TCI value of 6.88 per cent. The third insurer is currently conducting a product review, which may lead to cost reductions and the maintenance of the recommended TCI.

4.2.1.2 Rising yield environment boosts the TCI value

Compared to 2022, TCI values show stability in 2023, primarily due to the measures taken by insurers to compensate for the rising yield environment (cost structure changes, introduction of new products). The current method used to calculate the TCI has to take into account risk-free rates of return as the TCI is in fact the potential loss of return on a given product compared to the risk-free rate of return at the time of calculation, so even under unvarying product conditions, the TCIs calculated will change simply because of the changes in the risk-free rates of return. The methodology takes into consideration the cost level of each asset fund, but the return effects are achieved only by applying the risk-free rate of return uniformly to all asset funds. Therefore, in addition to streamlining their costs, insurance companies have restructured the cost structure of their existing products (by adjusting their initial costs, recurring costs, maintenance costs and investment costs) in order to comply with the TCI limits.

The high yield environment generated a change of 0.3–0.6 percentage points in the TCI compared to the previous period. This aptly illustrates the products' feature where a high initial cost deduction and a high return environment can lead to clients realising a higher loss of return, especially in the short and medium term. Insurers review TCIs every year and update them by 1 July of the same year; moreover, they are required to send the updated values to the MNB within 15 days of the calculation being completed. If the costs related to the products and investments change and necessitate a modification of the TCIs during the year, insurers recalculate the TCIs without delay. TCIs are published by insurers on their own websites and are also available on the websites of the MNB and the Association of Hungarian Insurers (MABISZ).

On the MNB's website (www.tkm.mnb.hu), consumers have an opportunity to compare the costs of different life and pension insurance products, which helps them choose the savings product that best suits their needs and in order to make a more informed and substantiated decision. A product range that is easier to compare can also stimulate competition in the market.

Data are uploaded and updated in the TCI comparison application by the insurers.

4.2.2 Provision of sustainability information in the insurance sector

The transition to a more sustainable economy is key to ensuring the long-term competitiveness of the EU economy. One of key instrument is the EU Sustainable Finance Disclosure Regulation (SFDR), which has the primary objective of making the environmental, social and governance risk objectives of investment products more transparent to (end) investors.

From August 2022, product manufacturers are required to take sustainability into account in the design and approval of products, as well as in the testing and back-testing thereof. As part of the DG REFORM project benefiting the MNB, EIOPA has carried out an analysis of insurance-based investment products (IBIPs) falling under Article 8 or 9 of the SFDR offered in Hungary in 2023. According to the survey, nine insurers offer IBIPs with sustainability features in the Hungarian market, and of the 528 investment options identified on the market, only three qualify as Article 9 investment options, which are the strongest sustainability-focused ("dark green") products. In contrast, Article 8 investment options, which represent a more moderate level of sustainability ("light green products"), are more common. A total of 93 investment options were classified into this category. Accordingly, the prevailing trend in the Hungarian market is to offer investment opportunities without sustainability features, i.e. most investment opportunities are classified as Article 6 investments (432 out of 528).

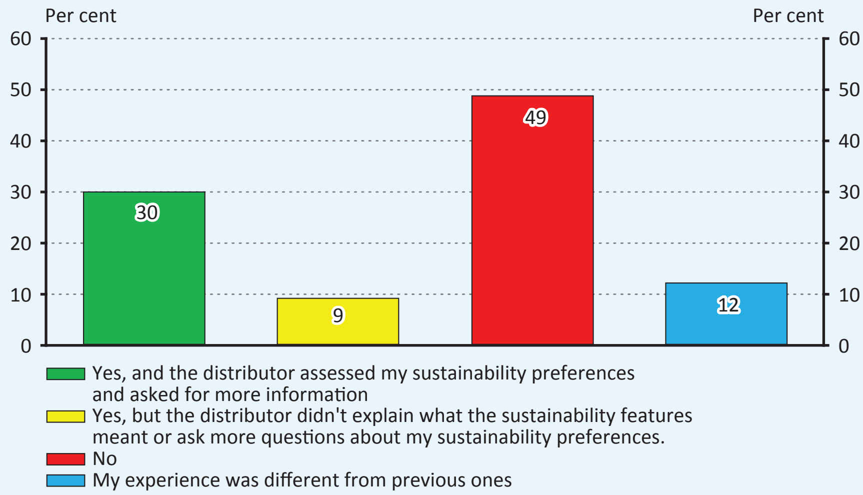
In 2023 the MNB examined the sustainability disclosure of the asset funds and investment policies of thirteen insurers. This clearly showed a cautious approach by the market, the reason for which is to avoid "greenwashing", i.e. misleading information. According to the MNB's inspections conducted under its ongoing supervision, 89 per cent of insurers meet their sustainability disclosure obligations, but only 47 per cent of the asset funds met all criteria. 8.7 per cent of all asset funds – 66 in total – take sustainability criteria into consideration.

From August 2022, insurance distributors are required to assess customers' sustainability preferences before recommending insurance products.

In 2023, also in the framework of the DG Reform project, the MNB carried out mystery shopping in order to map the practices of the insurance sector in the area of unit-linked life insurance products applied during the sector's sustainability-related suitability assessment and product disclosures (for more details, see Box 4.1 of this report). The overall market picture shows that the mandatory assessment of customers' sustainability preferences is highly haphazard, indicating that sellers perceive the obligation to provide information as a legal obligation in many cases, and do not understand its true importance.

During the mystery shopping, the MNB found that only 39 per cent of customers were asked about their sustainability preferences, 30 per cent of which were asked in depth about the different elements of sustainable finance, while 9 per cent were asked only general and superficial questions about sustainability needs. The proportion of mystery shoppers (49 per cent, N=69) whose sustainability preferences were not measured at all was very high. Sometimes, even when explicitly asked, clients were told that this was a new area of investment and that there was little experience of a product with such features.

Chart 4.14
MNB mystery shopping 2023
Answers to "Did the agent assess your sustainability needs?"



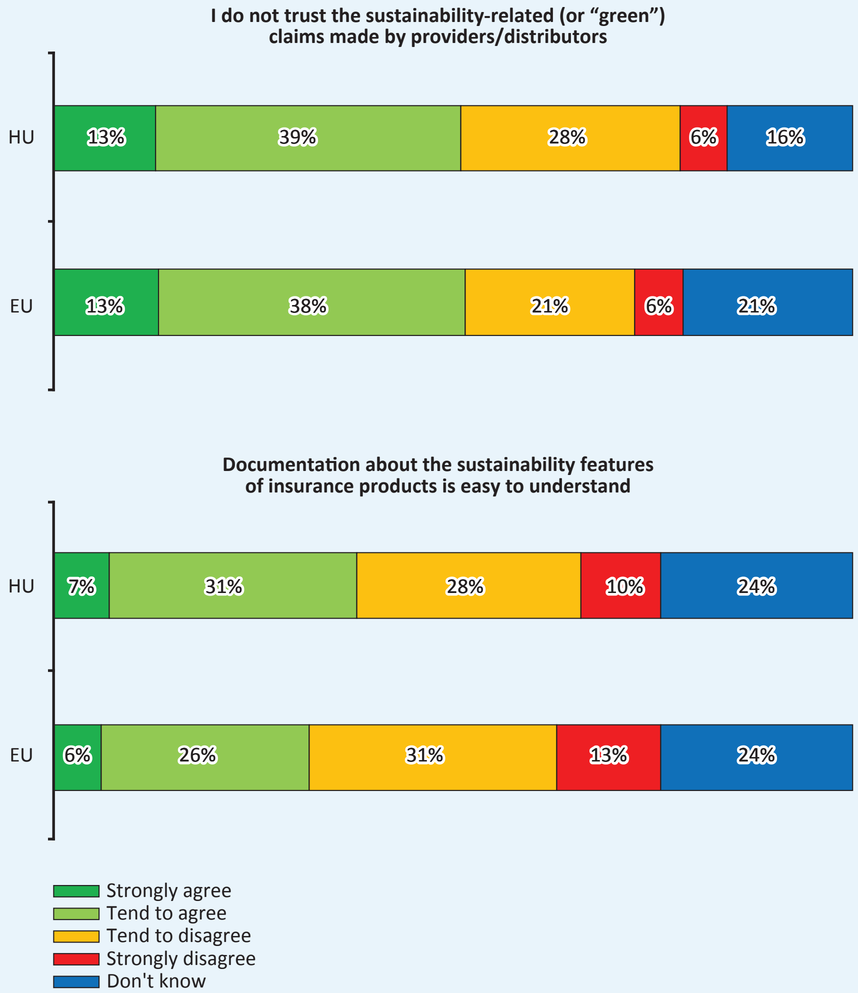
Source: MNB

The results of a Eurobarometer survey carried out by EIOPA confirmed that consumers are increasingly interested in insurance products that are considered sustainable. The number of EU consumers who have heard of sustainable or "green" products increased from 25 per cent in 2022 to 32 per cent in 2023, accompanied by a 17 per cent increase in Hungarian consumers' awareness of sustainable products, one of the largest increases[17].

EIOPA's survey[18] also revealed that consumers still have reservations about the "green" claims made by service providers: 51 per cent of EU consumers and 52 per cent of Hungarian consumers do not fully trust the sustainability information provided by service providers. Moreover, 38 per cent of domestic consumers feel that sustainability information is too complicated, which is slightly better than the corresponding value of EU consumers (44 per cent). (Chart 4.15)

[17] EIOPA Consumer Trends Report 2023: https://www.eiopa.europa.eu/publications/consumer-trends-report-2023_en
[18] https://www.eiopa.europa.eu/document/download/b64423cd-2afb-434d-8f46-d3c7ac057028_en?filename=fl_Insurance%20Trends_fact_HU_en.pdf

Chart 4.15
Consumer trends in the insurance and pension markets, Eurobarometer Flash Report 2023, answers to question 14



Note: Target population: EU citizens 18+, (EU27 – 26,168 interviews, HU – 1,065 interviews) 19.07.2023 – 27.07.2023

Source: https://www.eiopa.europa.eu/document/download/b64423cd-2afb-434d-8f46-d3c7ac057028_en?filename=fl_Insurance%20Trends_fact_HU_en.pdf

4.3 NON-LIFE INSURANCE

4.3.1 Active preparation months, getting ready for the first home insurance campaign

The home insurance campaign was initiated by the legislator to stimulate competition, the rules of which entered into force on 30 April 2023 under Government Decree No. 25/2023 (II. 1.) on certain emergency rules applicable to property insurance contracts ("Decree"). The provisions laid down in the Decree have been incorporated into the Insurance Act from the beginning of 2024.

The MNB took an active role in preparing the first home insurance campaign period in conjunction with the legislator. At the request of the legislator, the MNB has prepared an information sample letter which, under the Regulation, insurers are mandatorily required to send to consumers before the home insurance campaign. In developing the content of the sample letter, the MNB took into account the professional comments of the legislator, market participants and the Association of Hungarian Insurers (MABISZ), and incorporated them into the final text of the sample letter, which was issued in the form of a management circular.

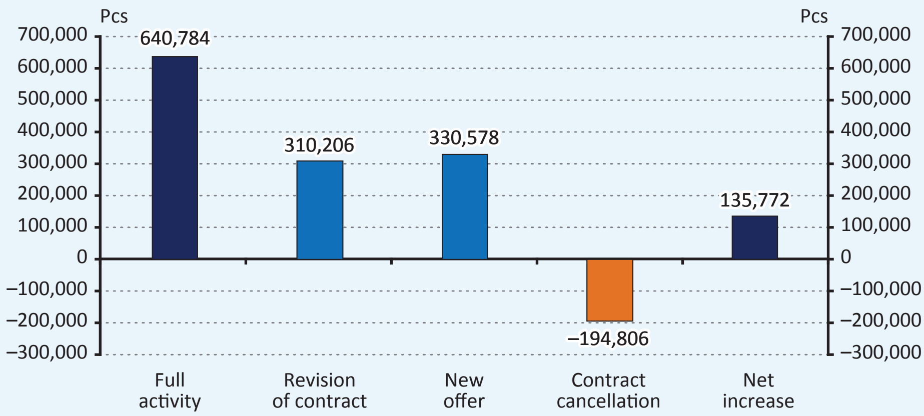
The MNB has successfully assessed the home insurance market in the period preceding the campaign, and the activity of the various market players in preparing for the campaign. In doing so, it has indicated to the institutions that active participation in the home insurance campaign is a socially beneficial activity in terms of promoting financial awareness among consumers. The MNB has developed an efficient monitoring system to ensure the effectiveness of the campaign. The main purpose of the monitoring system is to track the sales practices of individual insurers during the active period of the campaign and to provide feedback on the depth of the content of the information provided. The MNB's new tools enabled the supervisory authority to react to any inappropriate practices identified during the campaign.

During the preparatory months, the MNB also assessed the level of consumer knowledge about the Certified Consumer Friendly Home Insurance (MFO) through a targeted market research. The results of the research showed that most consumers do not have sufficient knowledge about MFOs; consequently, it may be necessary to expand this knowledge. The MNB prepared the home insurance campaign with active marketing communications, using the results of this research. Education was identified as the main objective of the marketing communication activities planned for the different communication channels, which included deepening insights into the MFO and informing the public about the opportunities offered by the home insurance campaign ("kick-off"). The MNB's marketing communication tools included, among others, professional articles, professional interviews and television advertisements in order to contribute to the success of the first home insurance campaign, complementing the marketing activities of market players and the legislator.

Box 4.3
The first home insurance campaign was a bigger success than expected

The first home insurance campaign was more successful than expected: 19.4 per cent of the 3.307 million home insurance policies moved (641,000 policies in total). The percentage of customers switching insurers was 5.9 per cent during the campaign, representing 195,000 offers. 9.4 per cent of all home insurance policies – more than 310,000 policies – were revised during the campaign period. As a result of the first home insurance campaign, the home insurance market grew by 4.1 per cent, with nearly 136 thousand contracts.

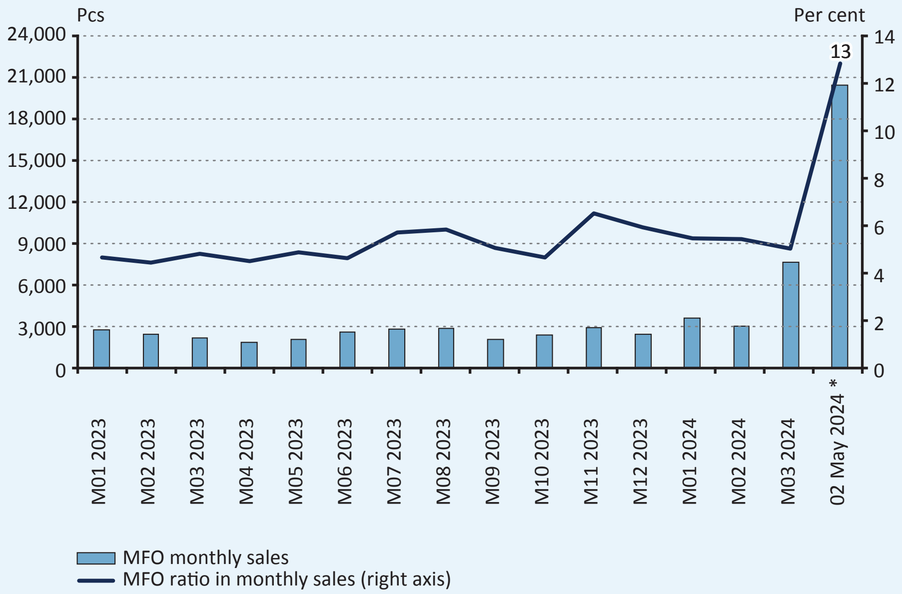
Chart 4.16
Impact of the campaign on new home insurance offers and contract review activity (units)



Source: MNB

Doubling the share of MFO in new sales

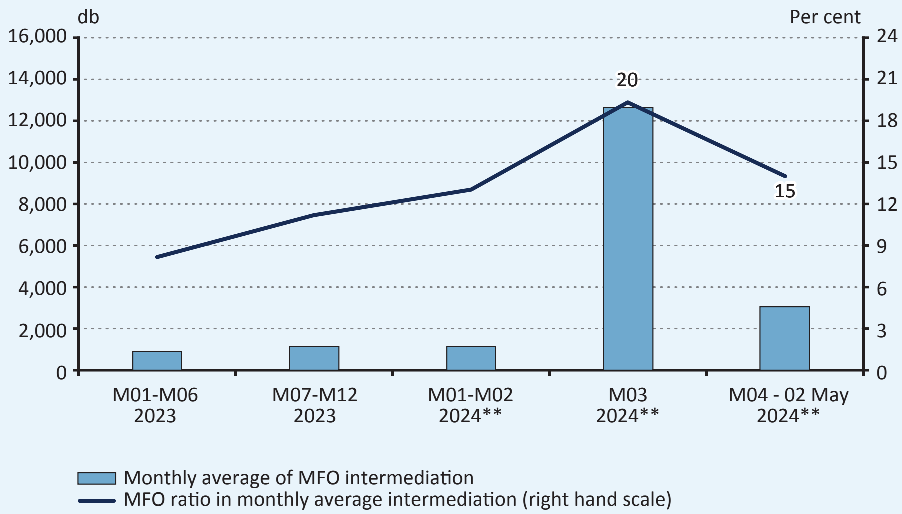
Chart 4.17
Monthly MFO increment data



** Number of policies resulting from the offers received by 2 May 2024 under the campaign as at 7 May 2024.*
Source: MNB

During the campaign, the share of MFOs in newly sold contracts increased significantly, reaching 13 per cent of the total.

Chart 4.18
Average monthly MFO sales and ratio, brokers and multiple agents



***Ratios for 2024 show data from the 12 intermediaries subject to a reporting obligation in relation to the campaign*
Source: MNB

Box 4.4
Useful help from the insurance product information document

Brokers and multiple agents achieved an even higher MFO ratio, with the MFO rate for brokered deals reaching 20 per cent.

The IDD[19] requires non-life insurance product developers to produce a standardised insurance product information document. The Directive and its implementing regulation on the insurance product information document[20], as well as Act LXXXVIII of 2014 on the Business of Insurance, specify the form and content of the insurance product information document.

The MNB had reviewed the insurance product information documents of the largest stock of home insurance policies of 14 insurers selling home insurance products before the launch of the home insurance campaign on 1 March 2024.

Based on the results, the MNB warned insurers to avoid the use of terms that are common in the financial sector but unfamiliar to the average consumer without explanation, and to avoid quoting legislation verbatim.

It is important that the text is properly structured, because unstructured text is much more difficult to understand. Insurers are also expected to list the main insurance risks clearly and to make an effort to present exclusions and exemptions as comprehensively as possible. Exclusions and exemptions which, in the experience of insurers, are the most common grounds for rejecting claims should always be included in the insurance product information document. Exclusions and exemptions which are not listed must be clearly indicated by reference to the relevant clauses of the contract terms. The MNB also pointed out that product information document should only contain the most necessary information to avoid information overload. However, the insurer is required to indicate precisely where the full information on the product is available and to provide an electronic link to it.

Experience has shown that, despite some minor shortcomings, the product information documents meet the basic requirements in terms of form and content, and are suitable for helping customers to review the content of contracts.

4.3.2 Extended warranty contracts on the MNB's radar screen

Within the non-life insurance sector, among the products sold by Hungarian-based insurers the market is dominated by the quantity of extended warranty policies, followed by MTPL and home insurance products. Given the wide range of consumers affected, inadequate demand and needs assessments may pose serious consumer protection risks; therefore, in order to prevent such a risk the MNB prioritises the monitoring of the provision of prior information before the conclusion of the extended warranty contract.

For this reason, the MNB has recently inspected the extended warranty contracts available on the market. In the experience of the supervisory authority, this is an area less affected by consumer complaints, overall, the main reason being that the majority of extended warranty contracts are single-premium contracts; consequently, there are no problems with contract maintenance or the non-payment of premium. The lower number of complaints is also due to the fact that the majority of product defects occur in the first half of the warranty period when the defect is covered by the statutory manufacturer's warranty rather than the extended warranty.

The sale of most of these products is linked to the purchase of the product, which is why intermediaries are the traders and thus exempt from certain public law requirements applicable to insurance intermediaries under the IDD rules. However, this legal ambiguity means that, when selling, the customer may have to rely on technical insurance information provided

[19] Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast)
[20] Commission Implementing Regulation (EU) 2017/1469 of 11 August 2017 laying down a standardised presentation format for the insurance product information document

by less knowledgeable traders. In this case, the insurer entrusts the sale of the extended warranty insurance to a person who may be less familiar with the legislation on insurance, the obligations arising from it and the terms and conditions of the contract. Therefore, both the insurer and the consumer are protected if the product is sold under close control, as it is the principal who is liable for the professional errors of the seller. Therefore, the MNB considers it important to examine how the insurer acted before the introduction of the product. It is through the product development and management processes that the insurer has the primary ability to influence the sales process, by precisely defining the target market and customer needs. Annual reviews should always assess the impact of any changes in sectoral legislation in terms of product structure, sales and target market. The processes described above must be kept under close control to ensure that consumers' rights are not violated. Given that the complaints register may not be a complete record of all problems related to the extended warranty, it is advisable for insurers to regularly collect information from the distributors and claims assessors on their experience with the insurance, in addition to the complaints register.

In the extended warranty sales process, particular emphasis should be placed on assessing consumer needs, which should always be explored in detail. It can make the needs assessment process easier and more cost-effective if the insurer prepares a form and provides it to the sales force. Clients are more likely to enter into a contract if they have the relevant legal knowledge. Accordingly, both parties may benefit from the seller explaining to the customer the main elements of the law applicable to the warranty.

Elements of the information provision obligation of ancillary insurance intermediaries:

1. Insurance intermediaries are required to provide the customer with clear, accurate, comprehensible, unambiguous, straightforward, not misleading, fair, detailed and free of charge written information in Hungarian, in good time and in a verifiable and identifiable manner, before the conclusion of the insurance contract, on the name and address of the principal insurer.

2. It is essential to take the client's needs and requirements into account before concluding the contract.

3. A mandatory element of the pre-contractual information for insurance contracts is the insurance product information document (IPID), which summarises the essence of the product in a maximum of three pages. Its content must not be in conflict with the general terms and conditions. It highlights the main features of the insurance, such as when the insurer will pay, or when it will not pay because the event is not an insured event. The insurance product information document must be given to the customer before the contract is concluded.

4. The trader must act honestly, fairly, professionally and in the best interests of the customer, which also means providing the customer with professionally sound information in response to his or her questions.

5. Advertising for insurance products must be clear, accurate, understandable, unambiguous, not misleading and fair.

6. The seller is required to keep the insurance secrets related to the insurance contract (name, address, other personal data necessary for the conclusion of the contract).

7. The contact details of the authorities must be indicated, together with information on how to lodge a complaint, the method to do so, the procedure to be followed and to which supervisory authority or arbitration body to lodge a complaint.

8. If the insurance product is an addition to a product or service that is not insurance, the insurance intermediary must provide information on the possibility of buying the good or service separately, the content of the different elements and their separate costs and charges.

In the context of the insurance market for extended warranty contracts, it should be noted that recent experience shows that in this area, as well, players have appeared who provide insurance services in the context of cross-border activity. The supervision of these service providers is made more difficult by the fact that, from a prudential point of view – i.e. for POG rules – the "home" supervisory authority is entitled to supervise their activities, whereas for consumer protection rules, the "host" supervisor proceeds, i.e. the supervisor of the country where the service is provided. This requires close cooperation between national supervisory authorities, as sales can be effectively controlled through the POG processes. The MNB has published a technical article on the most important information and potential risks for consumers related to extended warranty contracts[21].

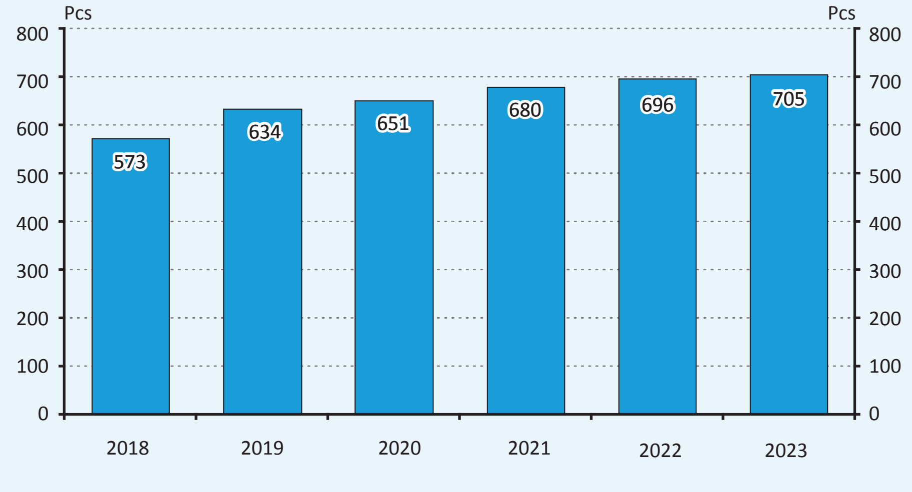
4.4 PARTICULAR FOCUS ON THE SUPERVISION OF INSTITUTIONS PROVIDING CROSS-BORDER SERVICES IN HUNGARY

In addition to supervising domestic institutions, the MNB also monitors the activities of service providers operating in the framework of cross-border services in Hungary and, although its supervisory powers against cross-border firms are limited, the MNB will take resolute action if it detects infringements, information or other deficiencies affecting Hungarian consumers.

4.4.1 Experiences with cross-border service providers – complaints handling problems

In December 2023, 705 insurance undertakings were entitled to provide cross-border services in Hungary. The MNB pays special attention to cross-border service providers, which is essential in view of the fact that their number is growing year after year, and they are active players in the insurance market. They are active in a wide range of services, including (but not limited to) fire and property damage insurance, unit-linked insurance, medical expenses insurance, extended warranty insurance, credit and liability insurance and assistance services.

Chart 4.19
Changes in the number of insurers providing cross-border services



Source: MNB

The MNB also pays particular attention to consumer complaints about cross-border service providers. In several cases, the MNB received notifications from customers that raised suspicion of breach of consumer protection provisions, and started investigating them in a consumer protection procedure initiated by the consumer's request or, where appropriate, in a targeted consumer protection inspection. If an insurer operating cross-border services in Hungary and established in another Member State violates the provisions in force in Hungary concerning cross-border services, or if the MNB detects

[21] https://www.mnb.hu/letoltes/szucsne-dr-janvari-erika-ezt-kell-tudni-a-kiterjesztett-garancia-biztositasrol.pdf

deficiencies in its operation, the MNB shall require the insurer to remedy the irregular situation. In 2023, the Supervisory Authority carried out targeted consumer protection inspections at three cross-border service providers.

Among the breaches of complaints handling practices identified during the inspections, the most serious problem was the failure to respond to complaints received within the 30-day time limit. One service provider regularly responded to complaints from customers well beyond the legal deadline. Considering the seriousness of the infringement and the future protection of consumers' interests, in this case the MNB issued an interim injunction to the cross-border insurer, even before the inspection was closed, requiring it to discontinue its infringing conduct and comply with its legal obligations at all times.

One institution was found to have failed to receive oral complaints from Hungarian customers in an office open to customers or at its headquarters, and to publish its complaints handling policy on its website. The MNB considers it a bad practice for an institution to operate in Hungary and provide services to Hungarian consumers, but not to provide the opportunity to lodge a complaint orally in Hungarian. The MNB expects institutions operating in Hungary to provide oral and written communication channels in the official language of the country to their customers, and to make all mandatory information required by law available to them, either in the premises open for receiving customers in person or on the online interface, the institution's website.

4.4.2 Uncertainty caused by protracted winding-up proceedings at a cross-border insurer

NOVIS insurance undertaking, based in Slovakia, has been closely monitored by the MNB for several years, and in recent years, in order to protect the interests of Hungarian customers, the MNB has used its host country powers concerning public interest and consumer protection to launch several inspections and prohibit the distribution of all of the company's domestic life insurance policies, preventing the company from increasing its domestic customer base further.

In June 2023, the Slovak supervisory authority (NBS) revoked the licence of NOVIS Insurance Company and initiated winding-up proceedings against the insurer. However, according to NBS, the decision to revoke the licence does not imply the immediate termination of existing insurance contracts with the Insurer, and until the winding-up proceedings are commenced, the rights and obligations of the policyholders remain unchanged; accordingly, they are entitled to have insurance cover and pay for insurance benefits and other claims under the terms of their contracts.

In view of the protracted court proceedings on the appointment of a liquidator, which have been going on for several months, the MNB has also drawn the attention of domestic customers in its notices to the need to keep themselves informed about the situation of the insurer, and to review the general terms and conditions of the contract, either with an independent expert or a legal adviser, and to assess the possibilities of a potential suspension of regular premium payments (e.g. suspension of premium payments if the contract allows it, or apply premium-free reduction, or waiver of premiums) and termination of the contract before maturity. In the case of early termination (surrender) of life insurance policies with a savings element, or premium-free surrender (where the contract can be maintained with a lower sum assured by stopping further premium payments), the amount returned may differ from the value of the service projected when the contract was concluded, or in the case of pension insurance, any previously claimed tax credit must be repaid increased by a 20-per cent interest if the contract is terminated before maturity, prior to the order of liquidation. The MNB has also stated in its communications that, in its view, it is worth analysing all options to deal with the current uncertain situation, including the consequences indicated above, and to decide on the future of the insurance contract within the framework afforded by the contract.

4.5 INTERNATIONAL UPDATES

4.5.1 Report on the costs and past performance of retail investment products in the EU

EIOPA has prepared and published its 2023 report on the costs and past performance of retail investment products under its remit (EIOPA's Costs and Past Performance Report December 2023[22]). The report analyses the costs of insurance and pension products in 2022 and the returns they have offered over the past few years, based on a sample of more than 1,000 investment products from 173 insurers, over 200 individual pension products and 1,400 occupational pension funds.

The changed macroeconomic environment in 2022 (high inflation and rising interest rates) had an impact on overall market returns and the outlook for the underlying assets of investment products in general. Unit-linked and hybrid products reported negative returns in 2022, with a performance of –11.5 per cent (–18.9 per cent in real terms) and –4.7 per cent (–12.7 per cent in real terms), respectively. While products based on profit-sharing showed a positive nominal return of 1.35 per cent, when inflation and costs are considered, they still had a negative real return of –7.2 per cent.

The performance of insurance-based investment products (IBIPs) differed in function of risk rating, recommended holding period and premium payment frequency: higher risk categories had worse net returns in 2022 than the products in lower risk categories. According to the report, IBIP costs were stable but relatively high on average. Profit-sharing products continued to maintain their cost advantage (1.5-per cent drop in yields) over unit-linked or hybrid products (2.1-per cent drop in yields), even though the latter two categories saw a moderate decline in costs.

Both supply and demand for sustainable products grew rapidly, and these products continued to be cheaper than non-sustainable products, while showing no significant difference in market performance.

Individual pension products largely followed the trends observed for insurance-based investment products. Due to the financial market stress, without guarantees, personal pension products achieved negative returns on average in 2022. Personal pension products such as unit-linked products had a loss of 14.1 per cent, while personal pension products such as profit-sharing products had a small positive return of 0.7 per cent.

4.5.2 EIOPA Consumer Trends Report[23]

As in previous years, EIOPA has prepared a report on consumer trends, which this year again consists of a textual report and a heat map, as well as the aggregated results of the Eurobarometer survey. This year's report focused on the negative effects of inflation, Value for Money (VfM) risks, and digital and other insurance sales practices.

Inflationary trends and rising interest rates had a negative impact mainly on the (real) returns of insurance-based investment products and pension products, resulting in fewer customers buying products and more customers cancelling existing contracts, increasing the risk of a lack of insurance protection/savings. According to EIOPA's Eurobarometer 2023 survey, EU consumers' financial confidence in their retirement decreased overall (by 3 per cent) between June 2022 and July 2023.

A new theme in the report highlights the phenomenon of (vulnerable) consumer groups not receiving adequate services and/or fair treatment because of some of their special but non-dominant personal characteristics. In particular, the Eurobarometer survey revealed a persistent gender gap in insurance and pension access, leading female EU consumers being 10 percentage point less financially confident about retirement than men, and consumers belonging to a minority group also have poorer access to insurance and pension products/services. Younger consumers may also face greater risk due to a lack of financial literacy, while older consumers struggle with digital illiteracy. Financial exclusion and/or unfair treatment of individual consumers often results from the failure of producers to take into account different consumer characteristics in the way products are designed or distributed. The report also highlights the need for greater focus by

[22] https://www.eiopa.europa.eu/publications/eiopas-costs-and-past-performance-report-december-2023_en
[23] https://www.eiopa.europa.eu/publications/consumer-trends-report-2023_en

supervisory authorities and clear expectations in the insurance and pensions sectors on consumer diversity, fair treatment and inclusiveness[24].

The risks associated with value for money for insurance products were confirmed by EIOPA's Eurobarometer 2023: Unit-linked life insurance and other insurance-based investment products are reported to be highly complex, difficult to understand, high cost and often poorly performing. Digital distribution of insurance services has increased, assisted by technologies such as text analysis, natural language processing and machine learning. These technologies can facilitate document management, consumer access, fraud prevention and cross-selling. Selling through price comparison sites can also have benefits for both consumers and services, but there are also risks, such as inappropriate timing and form of information provision, aggressive sales tactics and dark-patterns.

Personal Pension Products (PPPs) continue to vary widely across Member States, and the different product characteristics pose regulatory and supervisory challenges. The number of pension products is growing slightly but steadily across Member States, partly as a result of tax benefits.

The 2023 report also includes a new section on the following recurring consumer risks:

(1) Increased consumer interest and awareness in insurance and pension products with sustainability features and an improvement in the supply of these products, which has, however, increased the risk of greenwashing;

(2) Deficiencies in demand and needs assessment, poor consumer information and advice in the identification of sustainability preferences, and conflicts of interest due to inducements; (3) Protection gaps due to increasing natural disasters (Nat-Cat) and systemic events; (4) Risks in the design and cross-selling practices of credit protection products.

[24] Diversity, Equity And Inclusion (DE&I)

5 Intermediaries and their risks[25]

5.1 INSURANCE INTERMEDIARIES

5.1.1 Falling number, rising revenues

The number of licensed insurance intermediaries continued to decrease in 2023, showing a trend decline over the last 4 years with varying dynamics. In the year under review, the rate of decline was 5.3 per cent (Table 5.1). The continued decline is still typically due to the need to comply with regulatory requirements, which have not changed much in recent years but are still very demanding essentially, and to the impact on intermediaries of measures affecting the insurance sector as a result of economic and war situation. For these reasons, portfolio transfers remain a popular option for institutions that would prefer to continue their activities as part of an institution with a larger apparatus, but without the administrative burden. As in the previous year, despite the decrease in the number of institutions, the amount of commission or remuneration on insurance sales increased by 9.9 per cent in 2023.

Table 5.1
Key data of insurance intermediaries

	Insurance itermediary	
	2022	2023
Number of institutions*	378	**358** ↓
Broker	*339*	*322*
Multiple agent	*39*	*36*
Number of natural persons (persons)	11,935	**11,493** ↓
Commission income (HUF billions)	111.7	**122.8** ↑

Note: The number of insurance intermediary institutions includes institutions registered as insurance intermediaries that conduct insurance intermediary activities as their principal activity, as well as institutions registered under other principal activities that also engage in insurance mediation.

Source: MNB

5.1.2 The non-life branch is the engine of growth

As regards brokered insurance products, the picture is as mixed in 2023 as it was in 2022. The increasing number of non-life insurance contracts brokered is in contrast with the contraction in life insurance sales, with the difference that not only the premiums but also the value of the consideration received for brokered life insurance contracts declined in the past year compared to the previous year (Table 5.2).

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

Table 5.2
Sales data of insurance intermediaries

		Value of contracts HUF billions		Number of contracts pcs		Commission income HUF billions	
		2022	2023	2022	2023	2022	2023
Non-life insurance segment		195.3	**246.6**	2,468 111	**2,680 474**	81.0	**95.2**
Compulsory motor third-party liability insurance		98.7	115.6	1,540 064	1,643 091	20.3	22.9
Home insurance		6.1	7.8	114 761	122 503	9.1	10.3
Casco motor liability insurance		38.2	52.0	203 289	229 905	13.9	16.7
Corporate and institutional property insurance		33.9	48.2	48 566	46 716	23.9	29.5
Travel insurance		4.4	6.0	365 460	495 099	1.6	2.3
Other non-life insurance		14.0	17.0	195 971	143 160	12.1	13.5
Life insurance segment		47.8	**32.2**	115 138	**75 475**	30.3	**27.6**
Risk (death) life insurance [Traditional life insurance before 2023]		3.6	3.9	60,350	21,102	6.0	4.3
Life insurance with saving aim		43.1	27.3	53,643	53,508	19.9	21.8
of this	Unit-linked life insurance	38.8	24.5	46,275	46,723	17.0	18.8
	Traditional life insurance	4.3	2.8	7,368	6,785	2.9	3.0
Other life insurance		1.0	1.1	1 145	865	4.4	1.5

Source: MNB

Compared to 2022, the number of non-life insurance contracts brokered grew by 8.6 per cent, while their premiums rose by 26.3 per cent. Commissions for brokerage amounted to 17.6 per cent.

The travel insurance category was the most dynamic in the non-life segment, with the growth in travel demand continuing unabated in 2023, based on the premiums and number of travel insurance policies brokered. With a 37.5 per cent increase in the premiums of brokered policies, the number of contracts sold increased by 35.5 per cent, which means that almost 500,000 customers secured their travel through intermediaries, exceeding the nearly 450,000 contracts before the pandemic. Motor insurance continued its upward trend, with 6.7 per cent and 13.1 per cent more MTPL and casco policies taken out, respectively, which is only partly explained by the nearly 100,000 more vehicles in circulation compared to the end of 2022. The increase may also be due to the mobilising effect of nominal premium differentials on customers, which increased against the backdrop of rising average premiums (+9.8 per cent and +20.4 per cent, respectively).

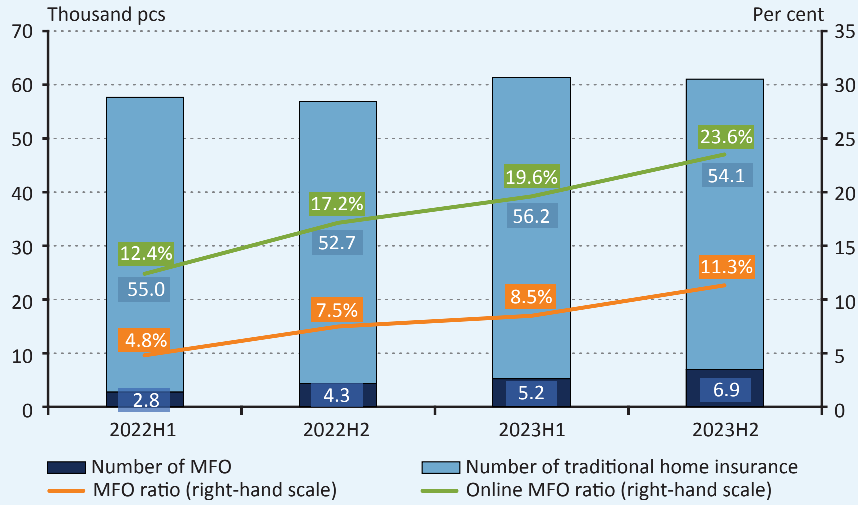
Corporate insurance, the biggest driver of revenue, continued to grow by 42.0 per cent, but – similar to the previous year – the number of contracts fell. Average brokered premiums rose by 47.7 per cent, reflecting the impact of inflation and the efforts of intermediaries to reduce the phenomenon of under-insurance, which the MNB had previously drawn to the attention of stakeholders in a circular. This product category could be next year's winner as a result of the home insurance campaign to be launched from 2024.

The number of brokered term life insurance policies fell dramatically, to a third, but this did not mean a fall in premiums, as average premiums per policy more than tripled to HUF 183,000. Brokered premiums for life insurance products with savings element also fell significantly by 36.7 per cent, while the number of policies brokered remained stagnant and the incentives paid out by insurers increased by 9.6 per cent. This is due to the fact that both the number and the brokered portfolio premiums of life insurance products with a recurring premium – which offer higher incentives in magnitude – increased, while the volume of sales of single-premium products, which can compete with capital market products, including government bonds that sometimes guarantee above-inflation yields, fell by more than 75 per cent and the brokered premiums by 66.7 per cent.

5.1.2.1 Dynamically growing MFO intermediation

There is no significant change in the volume of home insurances brokered compared to the previous year, with brokers selling 6.7 per cent more home insurance in 2023 (Chart 5.1). At the same time, the sales of MFO products showed a sharp increase, with 71.3 per cent more consumer-friendly home insurance products sold by intermediaries compared to 2022, accounting for more than 10 per cent of total sales. The rate of change is not as dynamic in the online space: where customers reach the contracting stage without face-to-face advice, the increase is 45.9 per cent; at the same time, at 23.6 per cent they are almost twice as likely to choose the MFO product. The high ratio of MFO to the total brokered portfolio can be attributed to the fact that policyholders who buy insurance online typically look for the most suitable insurance for standard properties and risks; therefore, the MFO product is optimised for their needs.

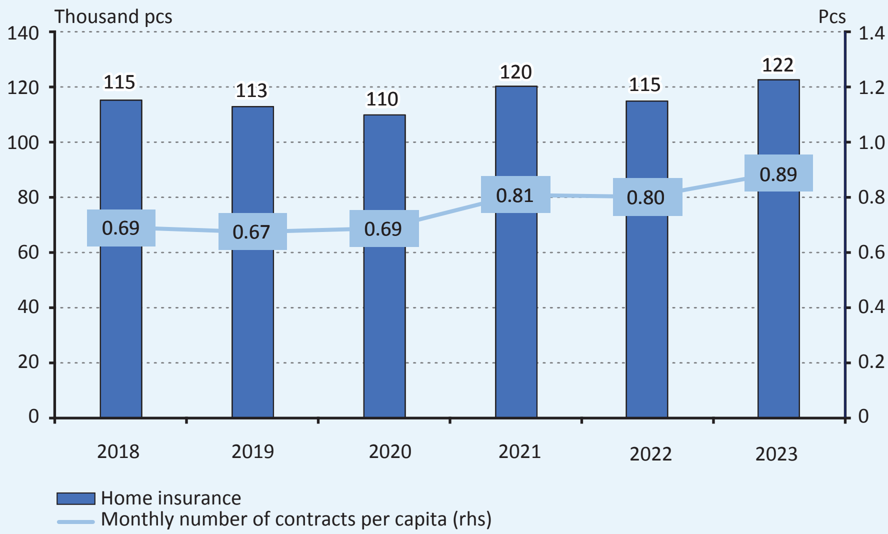
Chart 5.1
Changes in home insurance sold by brokers and multiple agents



Source: MNB

There is no trend increase in the number of home insurance policies sold by intermediaries (Chart 5.2). On a per capita basis, a significant reserve in sales volume can be identified, given that although their ratio is increasing year after year, the number of home insurance policies per capita is less than one per month.

Chart 5.2
Number of home insurance policies brokered per intermediary

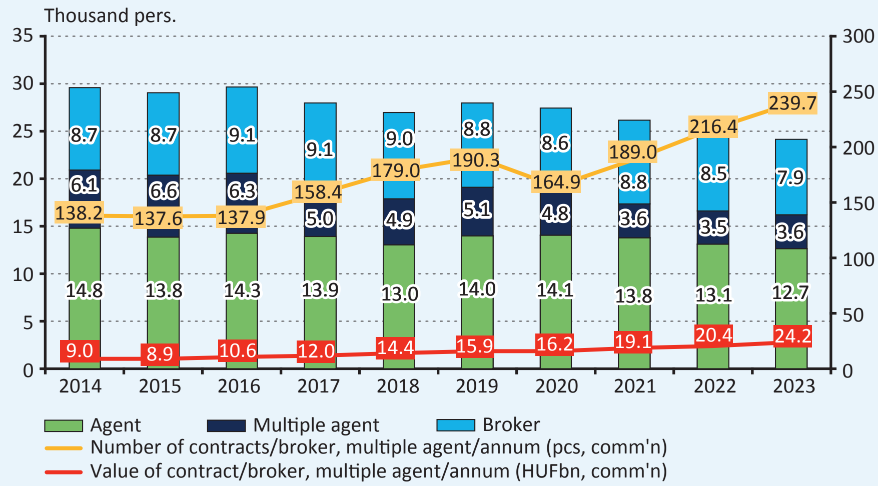


Source: MNB

5.1.3 Trend decline: one thousand persons per year

In 2023, the trend of falling numbers of natural persons working as insurance intermediaries continued. Over the past 3 years, the number of registered intermediaries has decreased by about 1,000 per year (Chart 5.3); consequently, at the end of 2023, the MNB's register showed a 3.7 per cent decline in the number of registered intermediaries compared to the previous year. The number of insurance tied agents decreased by 3.6 per cent, corresponding to the overall population, while the number of brokers dropped by 6.2 per cent, which can be largely attributed to a change in the business model of a single broker. The number of multiple agents has stabilised at around 3,500 over the last three years.

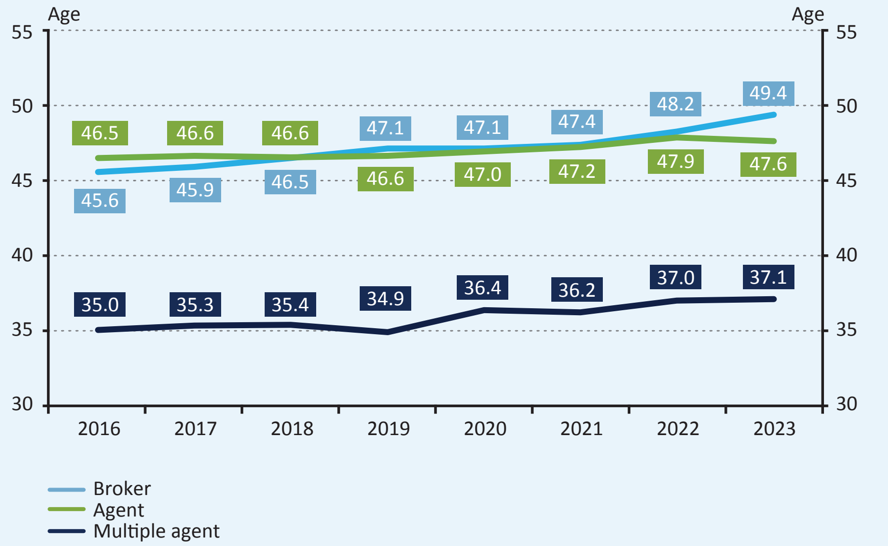
Chart 5.3
Changes in the number of natural persons acting as insurance intermediaries



Source: MNB

An ageing society also poses challenges to the participants of the economy, the impact of which can also be perceived in the insurance intermediary market (Chart 5.4). While the entry requirements in terms of staff and facilities are the same for the different types of intermediaries, the available data demonstrate that different types of intermediaries have different ways of attracting potential and retaining active employees. The dynamics of the change in average age varies significantly across different intermediate categories. The average age of multiple agents is traditionally lower, as a strong focus is placed on targeting young persons and career starters; that notwithstanding, the average age has increased by two years over the past seven years. The best response to the challenge was given by insurance tied agents, where the average age of agents has increased by one year over seven years, while the average age of brokers has increased by four years over the same period. In order to avoid this phenomenon, brokers are paying particular attention to retaining staff members. Data suggest that their efforts are successful, but in order to reduce or stop the ageing dynamics, it may be necessary to reconsider business operating models and make the brokerage profession more attractive to young people.

Chart 5.4
Changes in the average age of natural persons acting as insurance intermediaries

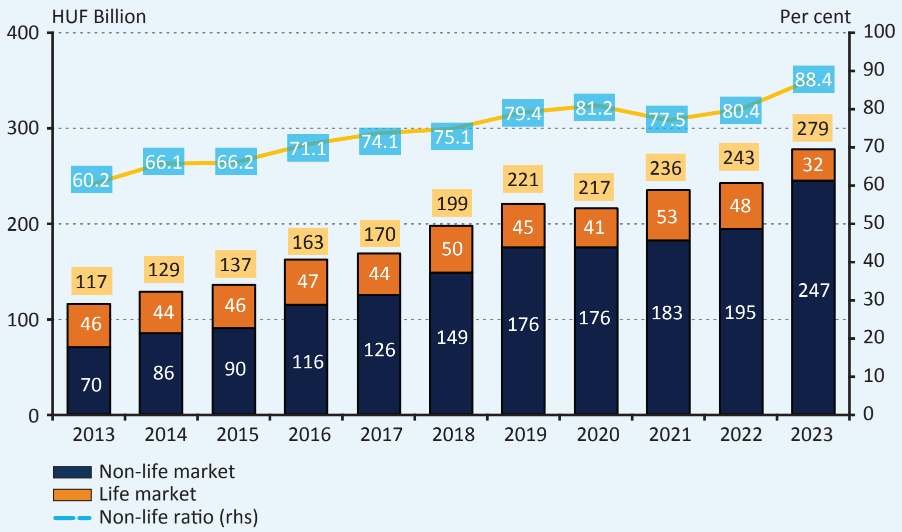


Source: MNB

5.1.4 Skyrocketing non-life ratio, historic low for life

The total value of brokered contracts equalled HUF 279 billion in 2023, 14.7 per cent higher than in 2022. The share of non-life insurance continued to grow, reaching 88.4 per cent in 2023. This increase in the gap is also due to the further decline observed in the life branch. In the life segment, the total amount of brokered contracts decreased by 32.5 per cent, while that of the brokered non-life insurance contracts rose by 26.2 per cent. The decline in life contract value is mainly due to a 36.7 per cent drop in policies of life insurances with savings element. In the non-life segment, the value of brokered business and institutional property insurance increased by 42.0 per cent, while the number of policies decreased by 3.8 per cent, and the value of casco insurance rose by 36.2 per cent, while the number of policies increased by 13.1 per cent, mainly due to the impact of inflation on casco premiums.

Chart 5.5
Changes in insurance premiums on contracts mediated by brokers and multiple agents

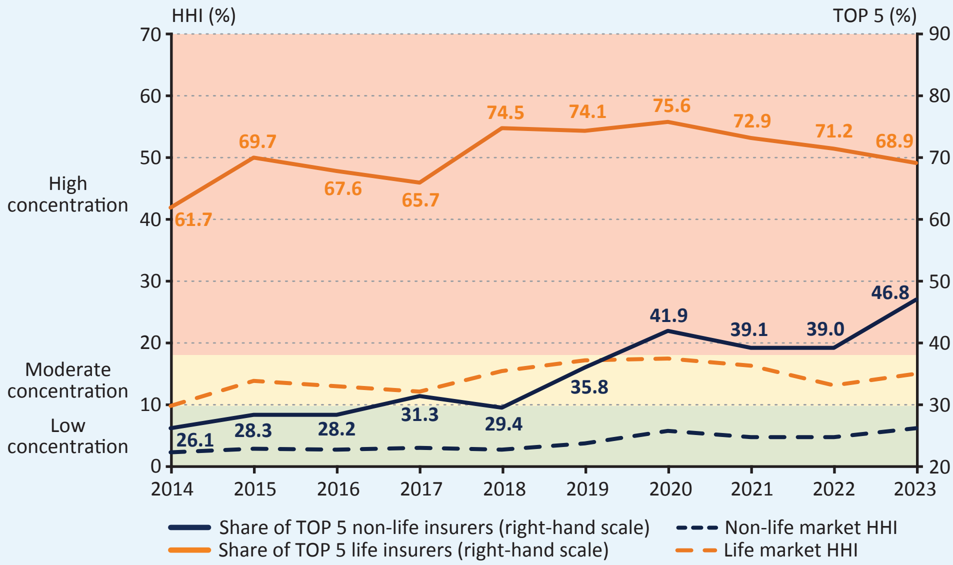


Source: MNB

5.1.5 Increasing concentration in both segments

After the decline recorded previously, in 2023 market concentration increased in terms of gross premiums brokered and total premiums in both the life and non-life segments (Chart 5.6). In the life sector, the Herfindahl-Hirschman Index (HHI) increased from 13.0 per cent to 14.9 per cent, indicating a moderate concentration of the market, while the TOP5 share dropped from 71.2 per cent to 68.9 per cent, which is still considered high. Both concentration indicators increased in the non-life segment. After two years of decline, the HHI index, which traditionally shows a low concentration of non-life market intermediaries, rose to 6.1 per cent, and the TOP5's share rose to 46.8 per cent.

Chart 5.6
Share of TOP5 independent insurance intermediaries and the Herfindahl-Hirschman index based on gross premiums written and portfolio premiums by segment

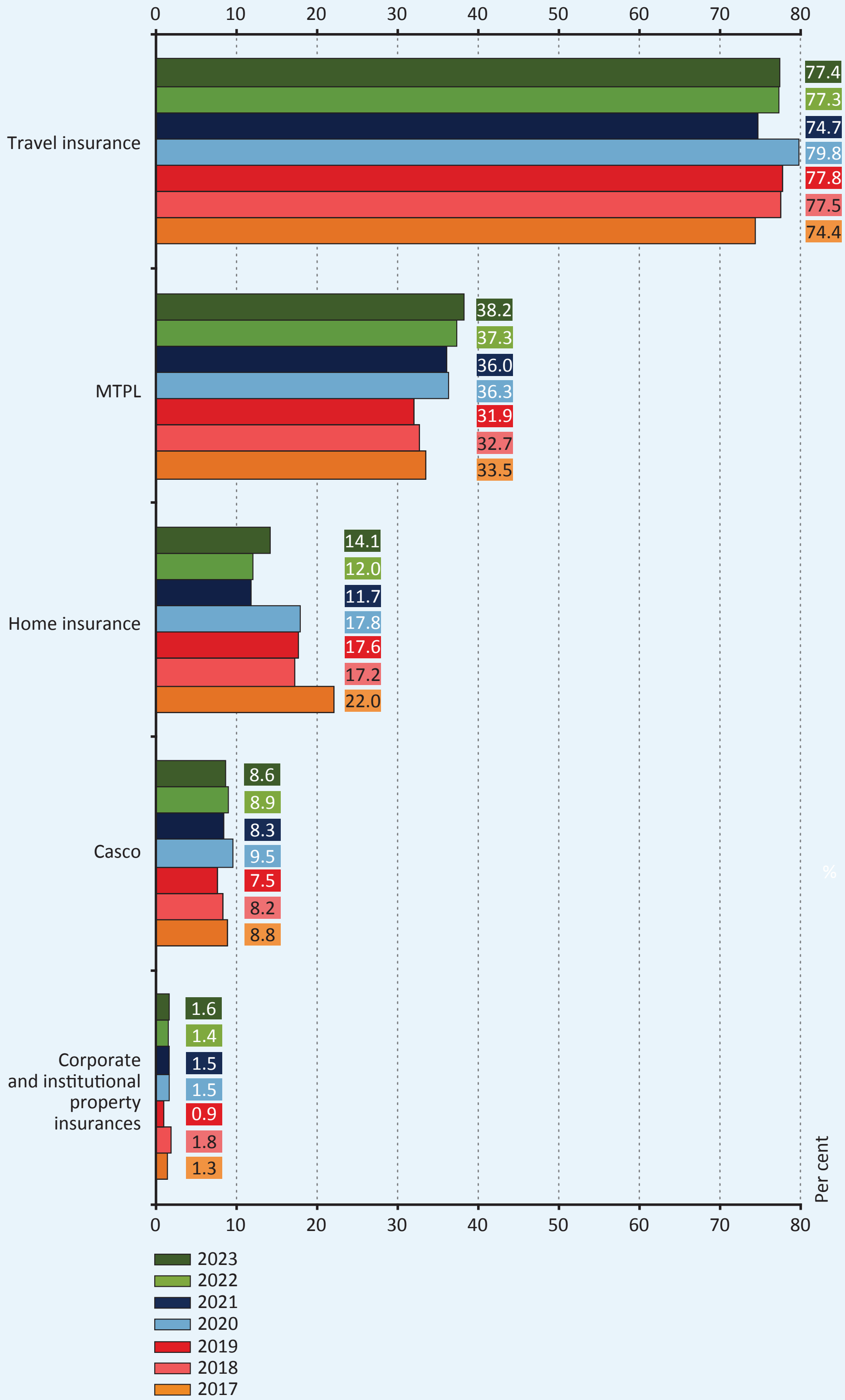


Source: MNB

5.1.6 Untapped online potential in several business lines

The share of e-sales has stagnated in recent years and the intermediary market is still awaiting digital developments; consequently, electronic sales (without the assistance of a sales agent) typically continue to show strong results in product categories that are easily comparable, easy to calculate or highly price-sensitive. In 2023, growth was observed in all product categories, but the rate of increase was not significant, and there was no change in the product categories that are most prominent for online sales. Despite the fact that, according to the data presented in Table 5.1.2, the fastest growing product in 2023 (35.5 per cent growth) was travel insurance; purely electronically mediated contracts grew by only 0.1 percentage point. Such dynamic growth and minimal change in electronic penetration demonstrates that travel insurance has likely approached or reached its potential for electronic sales. This contrasts with motor insurance, where only one third of the MTPL policies, which are mostly sold electronically, are sold without the assistance of an agent. The untapped growth potential in e-commerce, which has been there for years, remained unchanged in 2023, but with the number of natural persons acting as intermediaries declining, the opportunities to exploit them – and hence, digital developments – cannot be postponed for long. (Chart 5.7)

Chart 5.7
Ratio of non-life insurance contracts brokered electronically (by number of contract, as a percentage of total brokered contracts)



Source: MNB

5.2 MONEY MARKET INTERMEDIARIES

5.2.1 Additional concentration in the money market intermediary sector as well

The number of institutions in the money market decreased by 6.4 per cent in 2023, mainly driven by a 6.4 per cent decline in the number of multiple agents, a phenomenon that can be attributed to the decision of institutions with marginal sales to surrender their licences. Overall, however, the current players in the intermediary market are proving to be crisis-proof. At the same time, it remains important to note that if retail lending continues to decline in the longer term, financial intermediaries – typically active in retail lending – will need to adapt. One possible way to adapt is to enter other markets (e.g. insurance intermediaries). The number of natural persons fell by 8.4 per cent in 2023 as a result of the abovementioned licence surrenders by smaller operators and the profile-cleanup measures applied to inactive intermediaries. The 18.1 per cent sharp decline in commission income was driven by a drastic fall in mortgage lending and personal loans. (Table 5.3)

Table 5.3
Key data of independent money market intermediaries

	Financial market intermediary	
	2022	2023
Number of institutions	483	**452**
Broker	*17*	*17*
Multiple agent	*326*	*305*
Multiple special intermediary	*4*	*4*
Hire purchase intermediary	*136*	*126*
Number of natural persons (persons)	6,516	**5,968**
Commission income (HUF billions)	21.0	**17.2**

Note: The number of independent money market intermediaries includes institutions registered as money market intermediaries and carrying out money market intermediation as their principal activity, as well as institutions registered as money market intermediaries that carry out money market intermediation as their principal activity. Consumer loan intermediaries are not required to provide data. Natural persons may act both as money market intermediaries and insurance intermediaries.

Source: MNB

5.2.2 Drastic fall in retail lending

The year 2023 resulted in a decline in all main product categories of retail credit and lending to households. The value of retail credit and loan contracts fell by 32.3 per cent, overall, the number of contracts sold dropped by 24.0 per cent and commission income by 22.0 per cent compared to 2022. As in 2022, among retail loans the most striking decline was recorded for mortgage loans, where the value of contracts fell by 34.1 per cent, the number of contracts by 35.4 per cent and the amount of commission income by 23.9 per cent. Volatile economic conditions, higher lending rates, high home prices and the tightening of the Home Purchase Subsidy Scheme for Families (HPS) have all played a role in the drastic fall in mortgage lending. The 28.2 per cent drop in the number of personal loans sold was also noteworthy, accompanied by a 33.4 per cent fall in the value of contracts and a 24.9 per cent contraction in commission income. In the corporate credit, lending and financial leasing category, the value of contracts rose by 7.5 per cent, while the number of contracts sold fell by 2.9 per cent and commission income by 17.1 per cent. (Table 5.4)

Table 5.4
Sales data of independent money market intermediaries

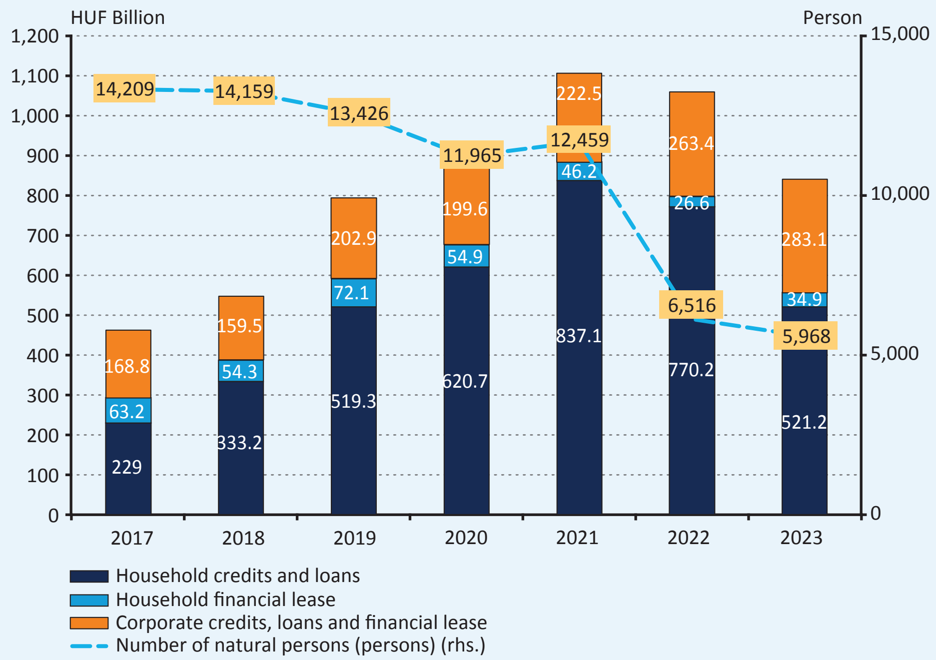
	Value of contracts HUF billions		Number of contracts pcs		Commission income HUF billions	
	2022	2023	2022	2023	2022	2023
Corporate credits, loans and financial lease	263.4	**283.1**	19,351	**18,797**	3.5	**2.9**
Total household credits and loans	770.2	**521.2**	158,697	**120,635**	14.7	**11.5**
of this: Mortgage	*569.3*	*375.4*	*37,159*	*24,009*	*9.5*	*7.2*
Motor vehicle	*0.5*	*0.3*	*146*	*93*	*0.02*	*0.0*
Personal loans	*128.5*	*85.6*	*19,349*	*13,894*	*2.5*	*1.9*
Other	*71.9*	*59.8*	*102,043*	*82,639*	*2.7*	*2.4*
Total household financial lease	26.6	**34.9**	6,538	**7,429**	0.6	**0.4**
of this: Real property	*3.3*	*1.4*	*246*	*90*	*0.1*	*0.0*
Motor vehicle	*23.3*	*33.6*	*6,273*	*7,324*	*0.5*	*0.4*
Other	*0.0*	*0.0*	*19*	*15*	*0.0*	*0.0*

Source: MNB

5.2.3 Retail lending by intermediaries at 2019 levels

The number of natural persons acting as intermediaries in 2023 was down 8.4 per cent year on year. The steady growth observed in retail lending from 2017 came to a halt in 2022, followed by an additional sharp decline in 2023. Compared to the peak in 2021, the value of contracts fell by 37.7 per cent, which means that in 2023, the value of retail credit and lending to households dropped to 2019 levels. Again, economic conditions, such as falling real wages, high interest rates and hence, faltering lending, are behind this phenomenon. However, the value of contracts mediated to the corporate segment has been steadily increasing since 2020, rising by a further 7.6 per cent to HUF 283.1 billion compared to 2022. The value of mediated retail financial leasing contracts rose by 31.2 per cent year on year, but looking back to 2017, it is still far below the results of previous years. The dynamic growth in the sale of retail home savings contracts is remarkable, with the number of contracts mediated in 2023 more than five and a half times higher than in the previous year.

Chart 5.8
Number of financial market intermediaries and amount of mediated credits and leases



Source: MNB

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

6.1 MARKET PRESENCE

To assess the risks of financial enterprises not belonging to a banking group, i.e., those not subject to consolidated supervision, the data of the last 5 years were used, of which data for the period of 2019–2022 are based on the annual audited disclosure, and the latest, 2023 data are preliminary[26]. For the assessment of the real risks to the sector, the MNB did not include data from two specific financial enterprises not belonging to a banking group not engaged in the general business of financial enterprises in order to eliminate distorting effects, except for the data in table 6.1.

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

	2019	2020	2021	2022	2023
Balance sheet total of financial entrerprises not belonging to a banking group (HUF billion)	1,505	1,581	1,735	1,960	2,087
Number of financial enterprises not belonging to a banking group	223	225	226	222	223
Number of financial enterprises not belonging to a banking group that did not provide audited data in the examined period	5	3	2	4	-

Note: The table shows the actual data of financial enterprises not belonging to a banking group that submitted data to the MNB in the relevant period.
Source: MNB

The number of financial enterprises not belonging to a banking group has remained close to the same level over the last 5 years, but there have been small positive and negative shifts in the number of institutions over the year, affecting the developments in the number of players in the segment.

In 2023, 1 financial enterprise not belonging to a banking group was granted the licence necessary to operate by the MNB, and 1 institution had its operating licence returned as a result of the decision and initiative of the owners. The MNB revoked the operating licence of 3 financial enterprises not belonging to a banking group due to non-compliance with personal and material conditions, failure to provide regular data supplies to the MNB, unwillingness to cooperate with the Supervisory Authority, and the risks and concerns identified in relation to prudent operation.

Compliance with the statutory initial capital requirement prescribed from the end of 2023 was closely monitored and supervised by the MNB, and no operating licence was revoked for non-compliance with the statutory requirement. No sector-wide risks were identified in 2023 in relation to changes in the number of institutions in the sector.

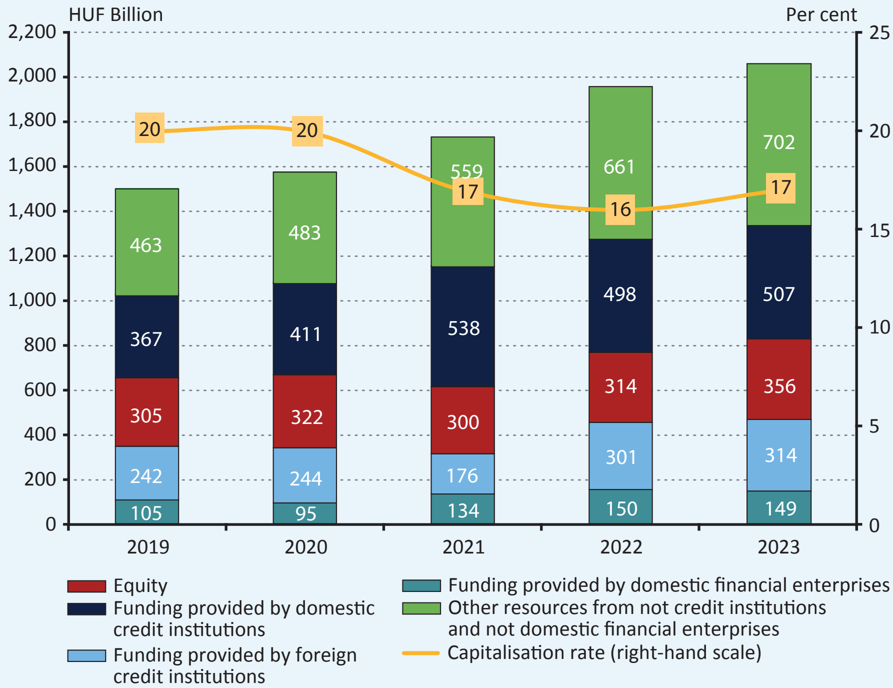
Changes in the regulatory environment of financial enterprises not belonging to a banking group had a negative impact on the profit and profitability of the institutions under review; nonetheless, the balance sheet total of financial enterprises not belonging to a banking group increased by 6.4 per cent in 2023 relative to the previous year, and its amount exceeded HUF 2,000 billion. The steady growth of the sector is evidenced by the increase in the balance sheet total of the last 5 years, which continued in 2023.

[26] The difference compared to the 2023 report is that in 2023, the audited data for 31 December 2022 were not available, whereas this report already includes the audited data for 2022.

6.2 FURTHER INCREASE IN CAPITAL INJECTIONS

In 2023, the growth in the external funding of the sector continued, but at a significantly lower rate than in the previous year. At 39 per cent, the share of funding from credit institutions (domestic and foreign) remains high, including a considerable increase in foreign funds. In terms of volume, after the category of other resources from not credit institutions and not domestic financial enterprises, the source of domestic credit institutions continues to dominate, although it did not reach the 2021 level with an increase of less than 2 per cent. Foreign credit institutions account for only 62 per cent of domestic credit institutions in terms of source volume, but at 4.4 per cent, their growth is higher; this growth, however, is significantly below the previous year's level of 71 per cent. Financing between financial enterprises not belonging to a banking group practically remained constant.

Chart 6.1
Capitalisation of financial enterprises not belonging to a banking group



Source: MNB

MFB Magyar Fejlesztési Bank Zrt. continues to be the largest financier of financial enterprises not belonging to a banking group among domestic credit institutions, followed by Eximbank Zrt. and MBH Bank Nyrt. MFB Magyar Fejlesztési Bank Zrt. increased its credit portfolio in the sector by 1.1 per cent, which is far below the 19 per cent growth in 2022, while Eximbank Zrt., which is significantly smaller in volume, increased its participation in the financing of financial enterprises not belonging to a banking group by a more significant 16 per cent.

There was no significant change in the activities of larger institutions with a balance sheet total above HUF 10 billion that received funding from domestic credit institutions; they were still mostly engaged in credit and loan operations. Concentration remains high, with almost 80 per cent of domestic credit institution financing concentrated in 10 per cent of financial enterprises not belonging to a banking group in 2023. Funding provided by foreign credit institutions, which increased to a lesser extent than last year, remains concentrated in a few foreign-owned enterprises, typically engaged in car leasing activities.

The capitalisation rate of financial enterprises not belonging to a banking group increased from 16 per cent to 17 per cent in 2023, but is still below the previous level of 20 per cent. In addition to the share of equity, the volume of equity also increased significantly, mainly due to a capital injection and to a lesser extent to profitable management.

As a result of the legal provision on increasing initial capital by the end of the year – compliance with this requirement can be considered successful for the sector as a whole –, equity increased by 13 per cent, while external funding increased by only 4 per cent. Within equity, subscribed capital, which is also included in initial capital, increased by 10 per cent due to among others the reinvestment of dividends, while retained earnings rose by 42.7 per cent, boosted by the reallocation from tied-up reserves; however, profit after tax for 2023 decreased by more than 10 per cent compared to 2022 (the latter is not included in initial capital).

In terms of their number, 29 per cent of financial enterprises not belonging to a banking group (65 enterprises) had an equity capital in excess of HUF 1 billion, while 3 per cent (7 enterprises) had an equity capital of less than HUF 100 million.

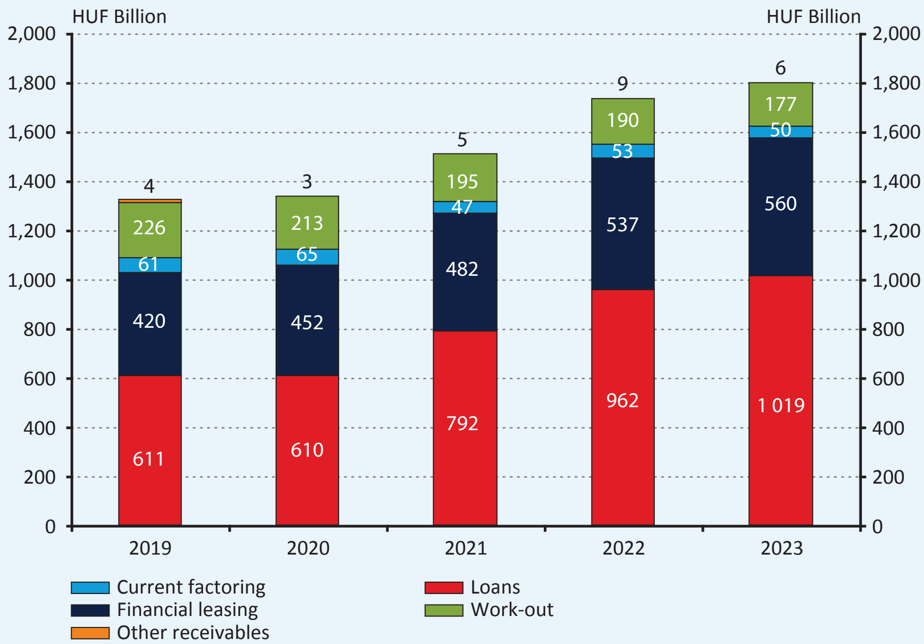
Approached from a different perspective (this type of categorisation is not shown in Chart 6.1), shareholder loans show an increase, but funding from affiliated companies fell significantly in 2023. Surpassing the growth recorded in the previous year, equity financing in the form of shareholder loans grew by 4.1 per cent, which, combined with the owners' capital injections, indicates a stable ownership background in the sector.

Despite the declining profitability, increasing external borrowing and capital injections show that investing in financial enterprises remains attractive.

6.3 MODERATELY GROWING PORTFOLIO OF RECEIVABLES

In 2023, 121 financial enterprises not belonging to a banking group were able to increase their receivables from customers compared to 2022, of which 8 institutions recorded an increase of more than HUF 5 billion. Typically, these enterprises are engaged in credit and loan operations and financial leases as their main activity.

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



Source: MNB

The change in the gross receivables of the institutions under review was far more moderate in 2023 (3 per cent) than the annual growth recorded for 2022 (15 per cent).

The increase in the volume of loans and financial leasing contributed to the 2023 increase in receivables, while factoring (current and work-out) and other receivables decreased. The decline in the work-out portfolio indicates that the receivable packages that can be acquired through purchases do not compensate for the decline in repayments and other entitlements in the debt management market.

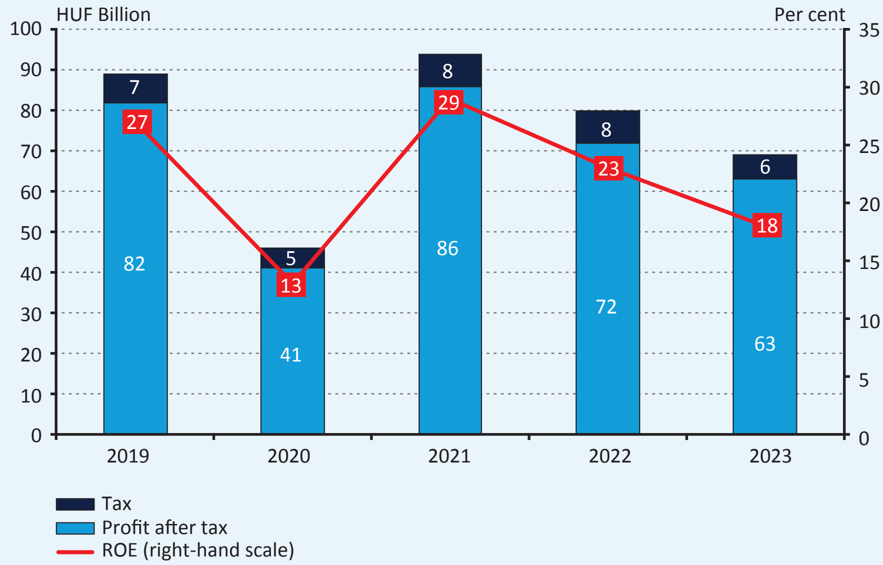
For the last 5 years, the volume of financial leasing has exhibited steady growth, as did loan portfolio, except in 2020 when it practically stagnated.

Credit and loan operations continued to be the principal activity of financial enterprises not belonging to a banking group, which accounted for 56 per cent of gross receivables, followed by financial lease with 31 per cent, work-out with 10 per cent and current factoring with 3 per cent. As in the previous period, the receivables of financial enterprises not belonging to a banking group remained highly concentrated. 15 per cent of the institutions held 66 per cent of the total receivables.

6.4 DROP IN PROFITABILITY

In the course of 2023, more than 85 per cent of the sector of financial enterprises not belonging to a banking group operated profitably, but the sector-wide after-tax profit was below both the 2021 and 2022 after-tax profit volumes.

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



Source: MNB

In 2023, financial enterprises not belonging to a banking group with a profit of HUF 1 billion or more carried out lending, leasing and factoring operations. Of the top 6 financial enterprises not belonging to a banking group with the largest decline in profit after tax (in excess of HUF 1 billion), 3 continued to generate profit; however, together they recorded more than HUF 27 billion less profit after tax than in 2022.

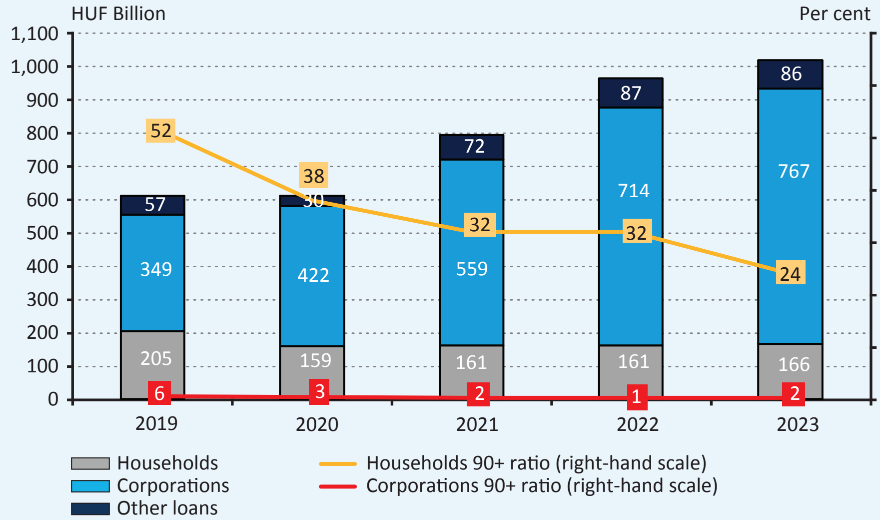
However, the positive shift in the distribution of profitability is evidenced by the fact that while in 2022 a total of 181 financial enterprises not belonging to a banking group managed to realise profit after tax, in 2023 191 of them recorded a profit according to preliminary data. Meanwhile, the number of institutions generating an after-tax loss dropped to 30 from 39.

The decline is partly due to the surtax levied on financial enterprises and the extra profit tax, the latter of which for the year 2023 was mostly due in three equal instalments in June, October and December. Despite the decline in profitability, there was a steady, stronger increase in the shareholder's equity of financial enterprises, partly due to changes in the regulatory environment. ROE is also on a downward trend, due to a decline in profitability and a stronger increase in equity.

6.5 CAUTIOUS GROWTH IN CORPORATE LENDING

In 2023 credit portfolio grew by 6 per cent. Corporate lending continues to be the main driver of growth among the enterprises under review. In 2023 the number of financial enterprises not belonging to a banking group engaged in lending activities did not decrease, despite the fact that by the end of the year, among financial enterprises already operating or under authorisation on 31 December 2019 the Act on Credit Institutions and Financial Enterprises required a higher minimum initial capital level for those with a lending licence than for financial enterprises engaged in other activities.

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



Source: MNB

In 2023 the number of financial enterprises not belonging to a banking group with a credit portfolio of HUF 10 billion or more continued to increase; while based on audited data, in 2022 25 financial enterprises not belonging to a banking group had a portfolio of over HUF 10 billion, 27 such financial enterprises not belonging to a banking group operated in 2023. Among these institutions, there were 3 financial enterprises not belonging to a banking group in 2023 that did not have a credit portfolio of HUF 10 billion or more in 2022. For all 3 institutions, corporate loans dominate the portfolio.

The portfolio of 90+ loans reflects an improvement in the performance of the portfolio over the 5 years under review.

Changing from 749,643 to 749,591, the number of loan contracts managed by the institutions under review did not change significantly, with loan contracts concluded with households still accounting for the vast majority, of which loans covered by pledged collateral represent 50 per cent, while the number of corporate loan contracts – in contrast with the amount of corporate loans – accounts for only 3 per cent. This reflects the high exposure of corporate credit per customer on the one hand, and the consumer protection risk of the retail loan portfolio on the other.

Looking at the corporate credit portfolio, there was a 7 per cent increase in 2023 compared to the audited data at the end of 2022. The increase is reflected both in the number of institutions with a corporate loan portfolio of HUF 10 billion or more (21 financial enterprises not belonging to a banking group in 2022 versus 23 in 2023) and in the ratio of their corporate credit portfolio to total corporate credit (81 per cent in 2022 versus 83 per cent in 2023). In 2023 6 financial institutions were able to increase their corporate credit portfolio by HUF 5 billion or more, 3 of which are mainly intermediaries for micro, small and medium-sized enterprises.

As regards loans to households, financial enterprises not belonging to a banking group recorded an increase, albeit small, in 2023 in their receivables portfolio compared to the trend of the previous year. The increment amounted to 3 per cent, even though one institution operating in the household sector returned its operating licence during the year and its portfolio was sold outside of the scope of the institutions under review. The primary source of the increase was the growth in the loan portfolio of institutions providing payday loans and pledged collateral loans.

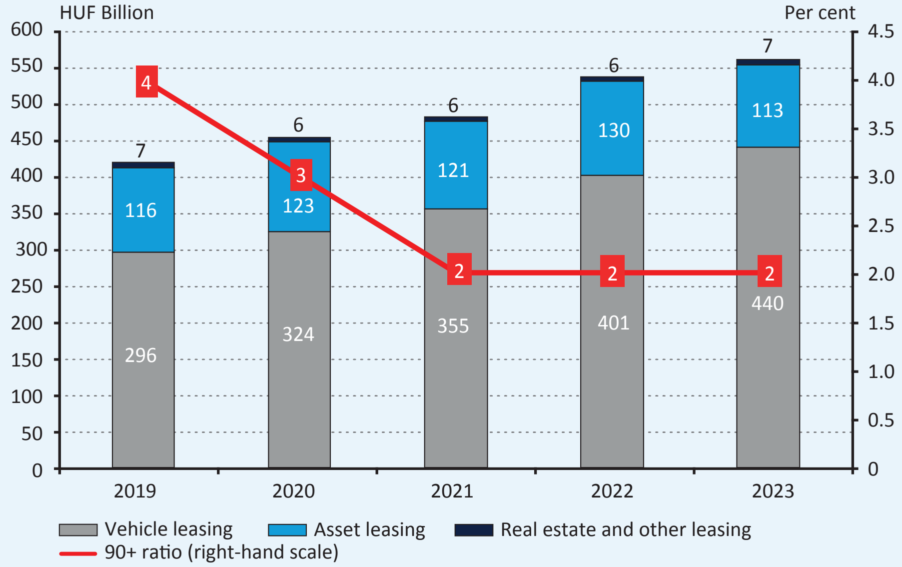
In addition to growth, the household sector was also characterised by an improvement in portfolio quality in 2023, also primarily due to an improvement in the portfolio of institutions providing payday loans as a result of portfolio clean-up. The high level of concentration continued in 2023, with 2 financial enterprises not belonging to a banking group reporting, as in the previous year, loans to households above HUF 10 billion, accounting for 67 per cent of the sector's household loan portfolio. Both institutions also use significant amounts of refinancing from credit institutions to continue their activities. Within the household portfolio, 7 financial enterprises not belonging to a banking group signed 10,000 or more contracts in 2023, these institutions provide pay-day loans and pledged collateral loans.

The receivables of financial enterprises not belonging to a banking group providing pledged collateral loans was on a steady upward trend following a slight decline in 2019. In 2021, the portfolio of pledged collateral managed by financial enterprises not belonging to a banking group increased significantly as a result of a realignment in the financial market in 2021, but the market showed an upswing in 2022 and 2023. Although in 2021, the portfolio of pledged collateral loans decreased for more than 40 per cent of the financial enterprises not belonging to a banking group providing such loans, by the end of 2022 and 2023, the stock of receivables of all operating financial enterprises not belonging to a banking group providing pledged collateral exhibited an increase. In 2023, the portfolio growth of the 4 largest financial enterprises not belonging to a banking group engaged in pledged collateral lending accounted for around 80 per cent of the total increment in pledged collateral loans; accordingly, in respect of pledged collateral loans the market remains concentrated.

6.6 FURTHER GROWTH IN THE LEASE MARKET

The quality of the leasing portfolio managed by financial enterprises not belonging to a banking group remains excellent. Despite an overall increase of 8 per cent in the 90+ days overdue portfolio in 2023 compared to the previous year, the overdue portfolio accounted for only 2 per cent of the total portfolio in 2023; accordingly, the risk of default in the sector remains low.

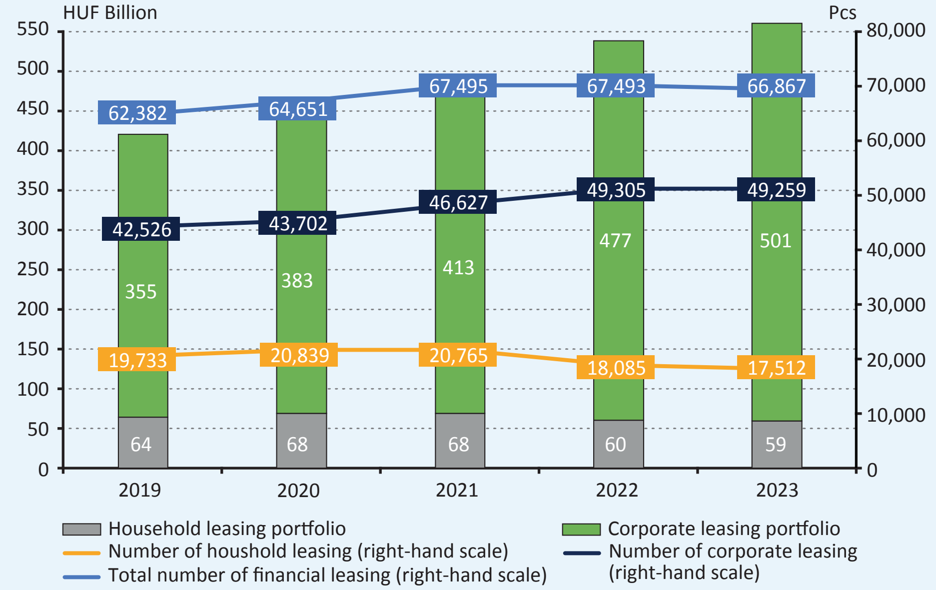
Chart 6.5
Composition of the financial leasing portfolio of financial enterprises not belonging to a banking group



Source: MNB

The total leasing portfolio managed by the institutions under review was able to grow by 4 per cent in 2023 year on year, even when the growth of the asset leasing portfolio of the institutions under review came to a halt in 2023 and declined to an even lower level than in 2019, which translates to a 13 per cent decline compared to the previous year. In contrast, the vehicle leasing portfolio grew by 9.7 per cent in 2023 compared to the previous year; therefore, the growth trend of the vehicle leasing portfolio continued in 2023 similarly as in previous years. In terms of the distribution of the portfolio, asset leasing accounted for 20 per cent of the total portfolio under management in 2023, and vehicle leasing for 79 per cent of the total portfolio. The distribution of leasing activity by type of leasing in the period under review shows that the leasing activity of financial enterprises not belonging to a banking group is increasingly shifting towards vehicles, while the leasing of production tools, machinery and equipment is becoming less and less common in the institutions under review; the asset leasing portfolio shows a declining trend within the total portfolio.

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



Source: MNB

The leasing portfolio managed by financial enterprises not belonging to a banking group has grown at an annual rate of 12 per cent on average over the last 4 years. This growth decelerated to 4 per cent in 2023. The number of leasing contracts managed by the institutions under review decreased minimally in 2023 after a near-stagnation trend in 2022, which strengthened the upward trend in the average value of leasing contracts further. The average size of leasing transactions was HUF 7.1 million in 2021, HUF 7.9 million in 2022 and HUF 8.3 million in 2023. Due to the fact that a significant part of the leasing portfolio managed by financial enterprises not belonging to a banking group (89.5 per cent) is linked to the corporate sector and only 10.5 per cent to the household segment, the average lease size is more representative of corporate leasing transactions. The 8 per cent deceleration in the growth of leasing volume in 2023 compared to the average of previous years indicates thoughtful demand both from corporations and households in the leasing market.

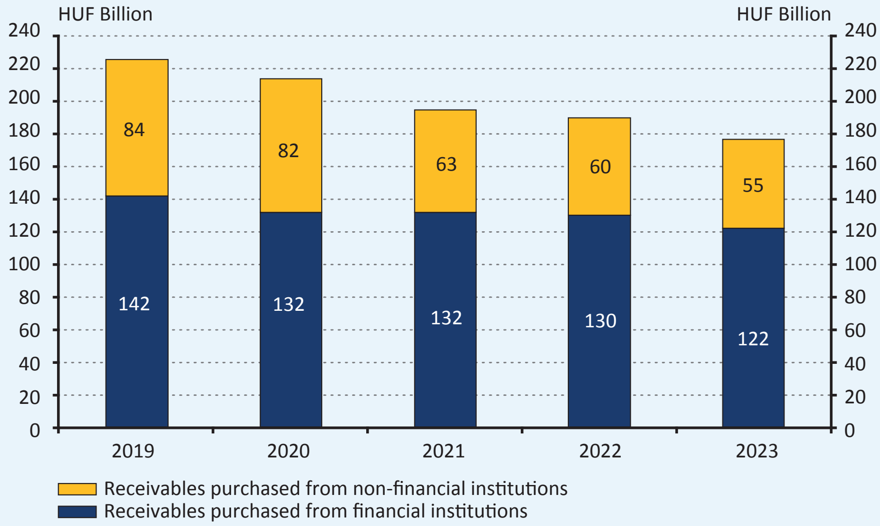
6.7 PORTFOLIO PURCHASED FOR DEBT MANAGEMENT CONTINUED TO FALL

In 2023, the value of the work-out portfolio managed by financial enterprises not belonging to a banking group decreased by 6.5 per cent compared to the previous year. Portfolios purchased from financial institutions and non-financial institutions both declined, by 5.9 per cent and 7.8 per cent, respectively.

In 2023, 10 financial enterprises not belonging to a banking group with work-out portfolios reported an increase of close to or above HUF 1 billion, which means that the number of such enterprises nearly doubled by 2023 compared to 6 such institutions in 2022. Receivables purchased from financial institutions were typically of higher amounts; they are still dominant but declining, with a minimal decrease in the share of receivables by number of contracts compared to 2022, accounting for 44.4 per cent of total receivables and 69 per cent of the book value of the portfolio. It can therefore be concluded that, in terms of number of contracts, more than half of the portfolio purchased for debt management comprises – rather than loans purchased from financial institutions – receivables purchased from non-financial institutions, the exposure of which is lower.

The value of receivables from retail mortgage loans backed by real estate purchased from financial institutions decreased by 19.23 per cent, and the number of these contracts decreased by 1.7 per cent compared to 2022, reflecting an improvement in the efficiency of debt management and the lower exposure of the mortgage loan portfolio offered for sale by financial institutions compared to previous periods, mainly as a result of the collection strategy of financial institutions. Portfolio swaps between financial enterprises not belonging to a banking group also fell by 7.8 per cent in 2023.

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



Source: MNB

The receivables purchased in 2023 by financial enterprises not belonging to a banking group engaged in work-out could not compensate for the fall in transactions resulting from management, which also fell. The additional, 4.8 per cent decline in the volume of repayments compared to the 20-per cent decline in 2022 (relative to 2021) is more of a stagnation. Financial enterprises not belonging to a banking group, whose main profile is debt purchase, tended to use less financing from credit institutions and relied more heavily on their own sources or funding from their owners. According to the relevant 2023 data, the after-tax profit of financial enterprises not belonging to a banking group engaged in debt purchase fell by 17.4 per cent compared to 2022, but since this is concentrated in the drastic fall in the profit of a single financial enterprises not belonging to a banking group due to the payment of the extra profit tax, the year-on-year decline cannot be considered a general, sector-wide phenomenon.

6.8 CONSUMER PROTECTION, FOCUS ON CONTINUOUS SUPERVISION

Following its practice of previous periods, in addition to prudent operations the MNB paid special attention to the enforcement of legal provisions and MNB recommendations on consumer protection in 2023 and monitored domestic economic developments and the effects of legislative changes.

For financial enterprises not belonging to a banking group, ongoing, supportive communication is of paramount importance, given that numerous institutions face challenges due to underdeveloped infrastructure, with 51 per cent employing 1 to 5 persons while having a significant amount of customer receivables.

In 2023, the MNB continued to pay special attention to the consumer-friendly behaviour of financial enterprises not belonging to a banking group in the framework of its ongoing supervisory activities, for example, through requests for statements, data requests and analyses.

In 2023, financial enterprises not belonging to a banking group providing small loans, debt managers and institutions engaged in pledged collateral loans provided the MNB with the most work to do in consumer protection inspections.

The MNB also intends to protect the interests of consumers who, for whatever reason, such as payment difficulties, can no longer use the lending services of financial enterprises not belonging to a banking group, and whose previous credit debt has been assigned to a debt management institution. The MNB monitors the activities of financial enterprises not belonging to a banking group as part of its ongoing supervision to ensure that consumers receive the information they need from the enterprises to resolve their payment difficulties. The MNB promotes the implementation of fair service provider conduct by issuing several recommendations and pays special attention to the sale of small loans combined with home services and of pledged collateral loans, which are typically used by consumers facing liquidity problems and payment difficulties.

In order to fulfil its tasks related to consumer protection, in addition to checking the documents provided during the authorisation procedures and conducting inspections, the MNB also examines the advertisements, websites and other media appearances of the supervised institutions as part of its ongoing supervision, and takes the necessary measures – and did so in 2023, as well – based on the signals and requests received and the information available during the supervision.

As part of its ongoing supervisory activities, the MNB has regularly used the instrument of a management letter and a consumer protection warning in cases where it has identified practices that may be harmful to consumers' interests or potentially violate the MNB's recommendations.

As in previous years, in the debt management sector, the MNB continued to focus on investigating consumer requests concerning the conduct of financial enterprises not belonging to a banking group involved in the purchase and management of overdue debts – primarily objecting to the handling of consumer complaints –, and on the licensing procedures of companies planning to start operation in this sector.

In response to requests, the MNB typically launched investigations into the complaint handling and customer information practices of financial enterprises not belonging to a banking group, and received several customer notifications acting upon which it instructed financial enterprises not belonging to a banking group to comply with the provisions of Recommendation No 9/2020 (VII. 14.) on the application of consumer protection principles and Recommendation No 2/2019 (II. 13.) on consumer debt management.

In 2023, the MNB continued to conduct several prudential inspections, including consumer protection aspects, in which it checked compliance with the rules on the methodology for calculating the APR and the maximum APR, as well as the practice of providing information before the conclusion of a loan contract.

7 The capital market and its risks

With a stable institutional background, domestic capital market turnover, client securities managed by investment service providers and investment funds continued to grow. The number of investment service providers active in the domestic capital market fell by 1 to 30 in 2023. The HUF 62,654 billion client securities portfolio managed by investment service providers at the end of 2023 – HUF 53,147 billion for credit institutions and HUF 9,507 billion for investment firms – was 29.6 per cent higher than the previous year's figure of HUF 48,340 billion. The stock of client securities accounts held by investment service providers was also dynamic, with the 2023 stock showing an 8 per cent increase compared to the previous year. Investment service providers – credit institutions providing investment services and investment firms – realised a total capital market turnover of HUF 1,151.2 billion in 2023, 62.1 per cent higher than the total capital market turnover realised in 2022.

Table 7.1
Key data of investment service providers

Investment service sector	2022			2023		
	Credit institutions	Investment firms	Total	Credit institutions	Investment firms	Total
Number of institutions (pcs)	18	13	31	17	13	30
Customer securities portfolio (HUF billions)	40,593	7,747	48,340	53,147	9,507	62,654
Number of securities accounts managed (thousand pcs)	1,519	413	1,932	1,620	466	2,087
Capital market turnover (HUF billions)	620,692	89,509	710,202	1,065,655	85,520	1,151,175
Profit after tax (HUF millions)		51,541			56,578	
Solvency capital/Capital adequacy ratio (percent)		1,417%			1,484%	

Note: the number of institutions includes institutions subject to partial and other forms of prudential supervision, including branch offices.
Source: MNB

At the end of 2023, assets managed by the 43 supervised investment fund managers amounted to HUF 19,401 billion, representing a 47.5 per cent increase compared to 2022 and reaching a new historic high. The increase can be essentially attributed to the surge in the net asset value of investment funds, but the assets of other managed portfolios also increased, most notably, the assets managed in insurance portfolios. At the end of 2023, the net asset value of investment funds was HUF 14,632 billion, an increase of around 48.2 per cent compared to the corresponding value of the previous year. In line with this, the aggregate profit after tax of investment fund managers also exhibited a dynamic path, reaching HUF 63.3 billion in 2023.

Table 7.2
Key data of investment fund managers

Investment fund management sector	2022	2023
Number of institutions (pcs)	41	43
Number of funds managed (pcs)	698	734
Volume of assets managed (HUF billions)	13,154	19,401
Profit after tax (HUF millions)	41,506	63,268

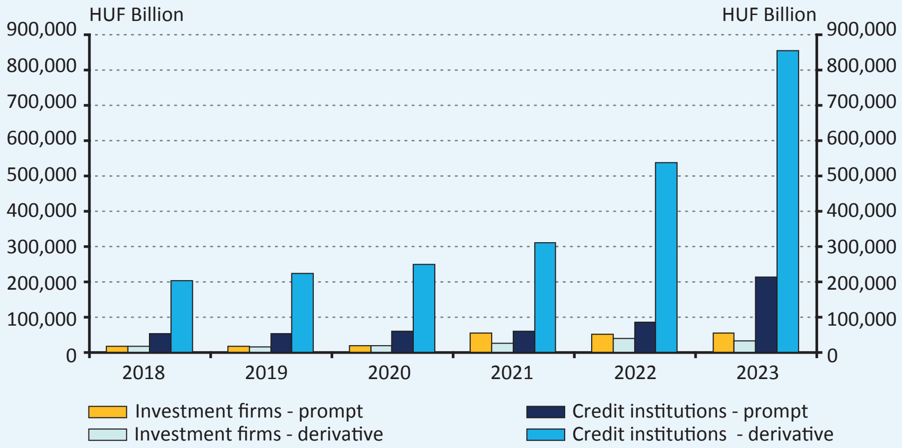
Source: MNB

7.1 INVESTMENT SERVICES MARKET: TURNOVER AND PORTFOLIOS

7.1.1 Capital market turnover continued to grow dynamically in 2023

In 2023, investment service providers – credit institutions providing investment services and investment firms – realised a total capital market turnover of HUF 1,151.2 thousand billion, 62.1 per cent higher than the HUF 710.2 thousand billion total turnover realised in 2022. In 2023, the dynamics of capital market turnover reversed in terms of sectors: while the capital market turnover of credit institutions jumped significantly by 71.7 per cent to HUF 1,065.7 thousand billion, the HUF 85.5 thousand billion capital market turnover of investment firms was 4.5 per cent lower than the 2022 value of HUF 89.5 thousand billion. (Chart 7.1)

Chart 7.1
Developments in capital market turnover



Source: MNB

The surge in the capital market turnover of credit institutions in 2023 is due to the increase in OTC turnover: the spot OTC turnover of credit institutions jumped by 157 per cent to HUF 209.2 thousand billion, while the OTC derivatives turnover of credit institutions rose by 60.3 per cent to HUF 848.7 thousand billion. Credit institutions' spot turnover on the stock exchange increased by 13.1 per cent to HUF 3.3 thousand billion, while the stock exchange derivatives turnover of credit institutions declined: the stock exchange derivatives turnover of HUF 4.4 thousand billion in 2023 is 35.3 per cent below the HUF 6.8 thousand billion in 2022, and in line with the average turnover in the years before the outbreak of COVID-19.

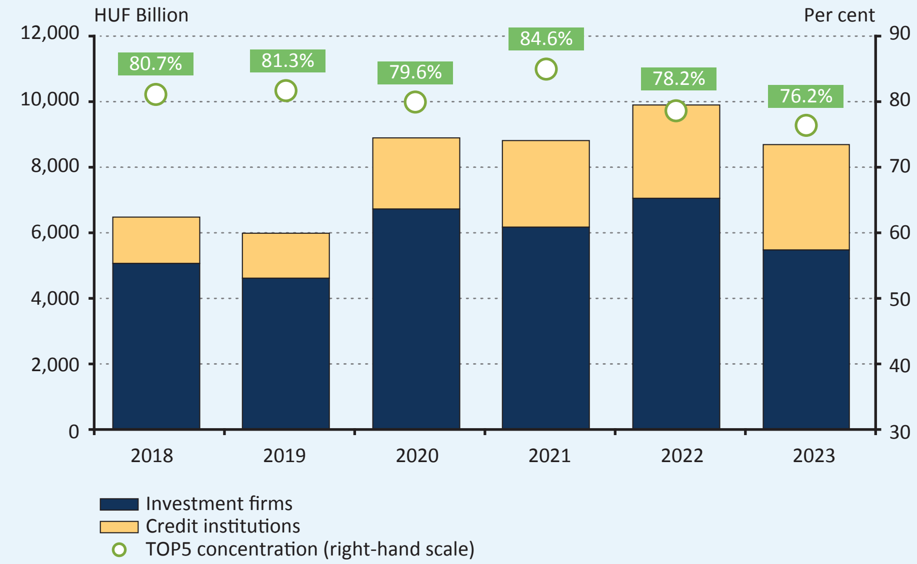
Investment firms' turnover in the capital markets declined in all segments in 2023 except the OTC spot segment. The spot turnover of investment firms on the stock exchange fell by 7.7 per cent to HUF 25.5 thousand billion in 2023. OTC derivatives turnover decreased at a similar pace, falling by 10.5 per cent from HUF 23.9 thousand billion in 2022 to HUF 21.4 thousand billion in 2023. The stock market derivatives turnover of investment firms contracted more drastically, falling by 32.7 per cent to HUF 9.7 thousand billion in 2023. In contrast, the spot OTC turnover of investment firms increased by 23.3 per cent to HUF 28.9 thousand billion in 2023. The non-forwarded and forwarded[27] turnover of investment firms also declined in 2023: non-forwarded turnover decreased by 5.5 per cent to HUF 41.4 thousand billion, while forwarded turnover dropped by 3.5 per cent to HUF 44.1 thousand billion.

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

7.1.2 Stock exchange turnover decreased

Spot stock exchange turnover[28] declined in 2023: the 2023 turnover of HUF 8,670 billion is 12.3 per cent lower than the 2022 turnover of HUF 9,886 billion and is consistent with the figures for 2020 and 2021. The decline can be attributed to the surge in investor activity generated by the outbreak of the Russia–Ukraine war in February 2022, which led to a spike in turnover in 2022 and was offset by lower investor activity in 2023. The decline was present essentially at sector level. The share of investment firms in spot stock exchange turnover fell significantly in 2023 – by around 8.2 percentage points to 62.9 per cent, a historic low –, essentially due to a decline in turnover at the market-leading investment service provider. In 2023, the composition of the top 5 investment service providers with the highest spot stock exchange turnover remained unchanged, with 3 investment firms and 2 credit institutions in the TOP5 in 2023. The concentration of spot stock exchange turnover continued to decrease in 2023, with the share of the five largest investment service providers of spot stock exchange turnover falling by 2 percentage points from 78.2 per cent in 2022 to 76.2 per cent in 2023. (Chart 7.2)

Chart 7.2
Stock exchange prompt capital market: turnover and concentration

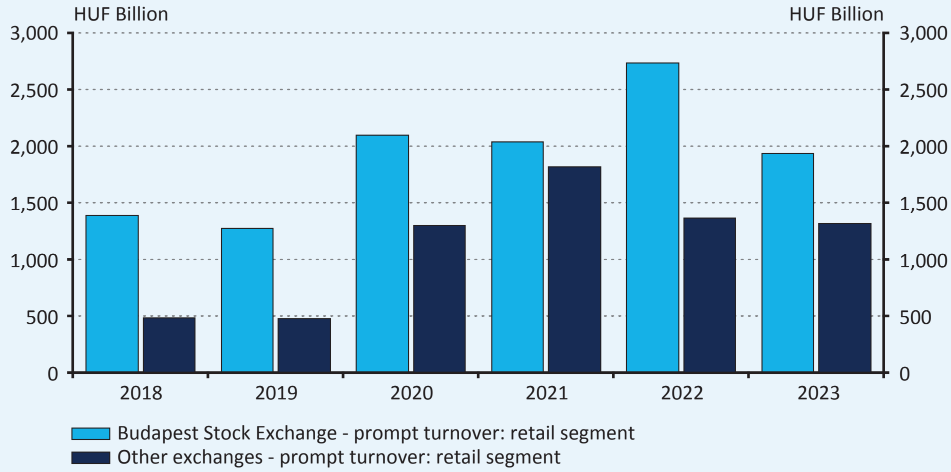


Source: MNB

A decline in spot stock exchange turnover was observed in 2023 for both corporate and retail customers. Spot stock exchange turnover generated by corporate clients decreased by 6.6 per cent to HUF 5,399 billion in 2023. The decline was even more pronounced for retail spot stock exchange turnover, which fell by 20.4 per cent to HUF 3,270 billion in 2023. However, this is still above the levels seen in the years before COVID-19. In 2023, spot retail turnover on domestic stock exchanges decreased by 29.2 per cent to HUF 1,932 billion from HUF 2,729 billion in 2022, while spot retail turnover on foreign stock exchanges decreased at a less dynamic rate: HUF 1,313 billion in 2023 translates to a 3.6 per cent decline compared to the previous year. There was a significant fall in activity for non-residents on the domestic stock exchange in 2023 relative to the previous two years: the HUF 12 billion turnover recorded in 2023 is 93 per cent lower than the HUF 171 billion in 2022 (HUF 294 billion in 2021) and below the HUF 20–30 billion level of previous years. The decline can be essentially attributed to one institution. (Chart 7.3)

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

Chart 7.3
Stock exchange prompt capital market: retail segment



Source: MNB

Non-forwarded derivatives stock exchange turnover[29] decreased by 21.4 per cent in 2023, or around HUF 2,305 billion to HUF 8,464 billion after dynamic growth seen in the previous three years. Concentration of derivatives stock exchange turnover continued to increase in 2023, with the top 5 largest derivatives-trading investment service providers increasing their share from 73.8 per cent in 2022 to 77.7 per cent in 2023 (versus 72.3 per cent in 2021 and 72.7 per cent in 2020). The derivatives stock exchange turnover of credit institutions providing investment services fell by 32.8 per cent to HUF 4,163 billion in 2023 from HUF 6,192 billion in the previous year. The decline is linked to two institutions, while the derivatives stock exchange turnover of investment firms dropped by only 6 per cent year on year to HUF 4,301 billion. Accordingly, the share of investment firms in the derivatives stock exchange turnover increased dynamically in 2023 to 50.8 per cent from 42.5 per cent in 2022, up by around 8.3 percentage points. As in previous years, the composition of the top 5 largest providers of investment services in stock exchange derivatives changed in 2023, with one credit institution and one investment firms dropping out of the top 5 and being replaced by another company. Forwarded derivatives exchange turnover halved in 2023, decreasing from HUF 10,575 billion in 2022 to HUF 5,697 billion in 2023: the forwarded derivatives exchange turnover was essentially attributable to one large foreign-backed investment firm.

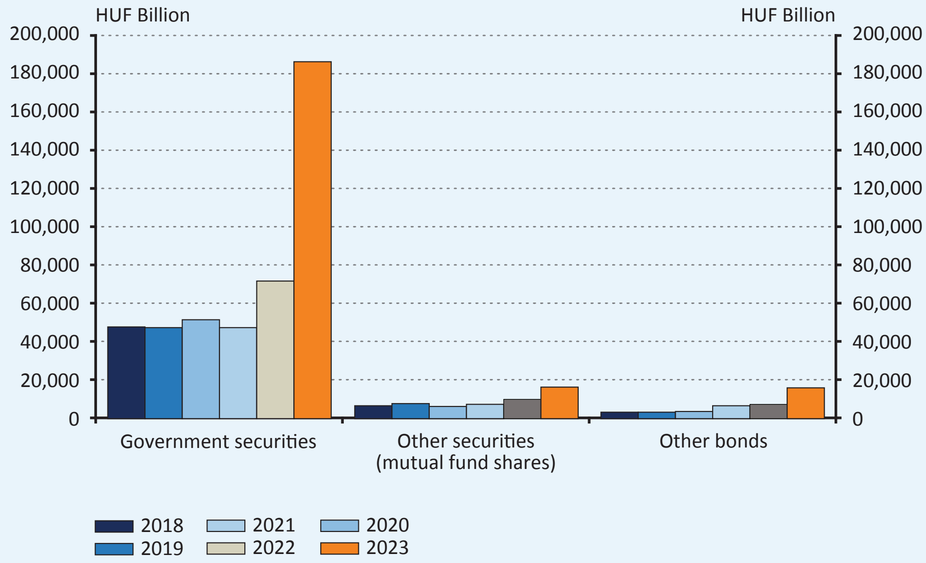
7.1.3 Dynamic growth in the spot OTC capital market turnover of credit institutions

In contrast to previous years, non-forwarded spot OTC capital market turnover realised by investment service providers surged by 144.4 per cent, rising to HUF 218,852 billion in 2023 from HUF 89,538 billion in 2022. The dynamics of turnover can be attributed essentially to the surge in the spot OTC capital market turnover of credit institutions: the spot OTC capital market turnover of credit institutions increased by 150 per cent to HUF 208.655, while the spot OTC capital market turnover of investment firms, HUF 10,197 billion, was 66 per cent higher than in the previous year. Accordingly, the dominance of credit institutions in spot OTC trading continued to grow, and their share of spot OTC trading exceeded 95 per cent. The significant surge in credit institutions was sector-wide and mainly related to the distribution of government bonds. The number of credit institutions active in the OTC spot capital market segment decreased from 16 in 2022 to 14 in 2023, while the number of investment firms decreased from 9 in 2022 to 8 in 2023. In the spot OTC capital market, there was a sharp increase in the turnover of government securities: the OTC turnover of HUF 186,343 billion in 2023 is 159.4 per cent higher than in the previous year, and the increase was present at sector level. There was also a significant increase in the spot OTC turnover of investment fund shares: the value of HUF 16,342 billion in 2023 reflects an increase of 61.5 per cent from HUF 10,118 billion in 2022. The spot OTC market turnover of other bonds also grew dynamically: the turnover of HUF 15,984 billion in 2023 was 123.4 per cent higher than the HUF 7,155 billion recorded in 2022. The concentration of spot OTC capital market turnover continued to increase in 2023, with the top 5 market participants accounting for 77.5 per cent of spot OTC turnover, up by around 4.6 percentage points compared to 2022. The composition of the top

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

5 largest spot OTC investment service providers in 2022 changed by one market player: one investment firm has been replaced by a credit institution, leaving only credit institutions in the top five. (Chart 7.4)

Chart 7.4
Spot OTC turnover by types of securities



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

7.1.4 Strong growth in the holdings of client securities

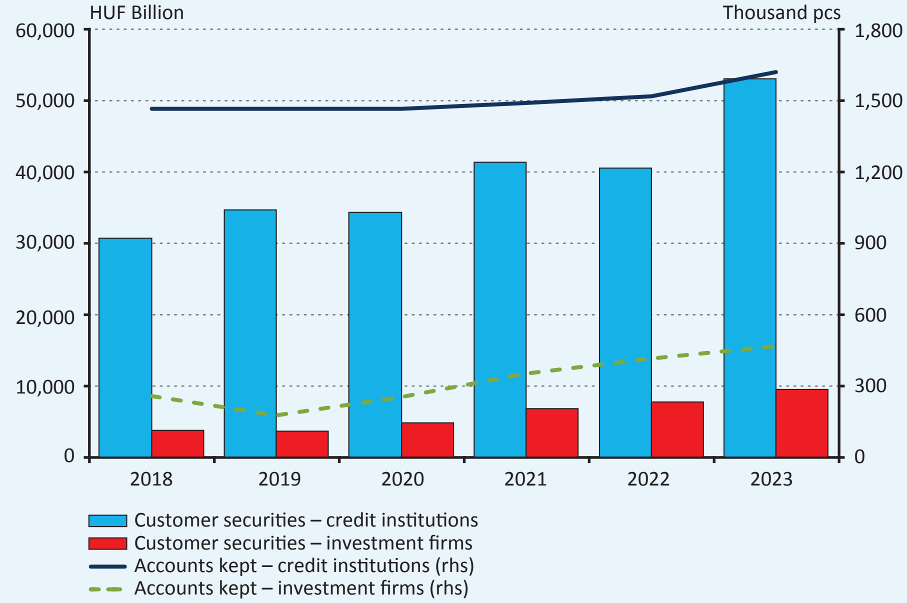
The portfolio of client securities grew dynamically in 2023: the market value of client securities managed by investment service providers rose by HUF 14,314 billion in 2023, reaching HUF 62,654 billion by the end of the year. The growth rate of 29.6 per cent is a historic high, about 6.5 percentage points above the previous peak of 23.1 per cent in 2021. The HUF 53,147 billion in customer securities under management by credit institutions at the end of 2023 represents a 30.9-per cent increase compared to HUF 40,593 billion at the end of 2022 – the increase was present at sector level. The stock of client securities managed by investment firms also increased dynamically: the stock of HUF 9,507 billion managed at the end of 2023 was HUF 1,760 billion higher than the HUF 7,747 billion in 2022 – the dynamic growth can be attributed to the change of client securities of the first and second largest market players.

The holdings of client securities of credit institutions providing investment services grew in all asset classes in 2023. The highest growth rate was observed in corporate bonds: with a portfolio of HUF 4,069 billion at the end of 2023, the segment was up 55 per cent in annual terms. In line with capital market developments, the portfolio of registered shares increased by 20.6 per cent to HUF 16,197 billion in 2023 from HUF 13,430 billion at the end of 2022, while the portfolio of government securities rose by 36.4 per cent from HUF 12,626 billion at the end of 2022 to HUF 17,222 billion in 2023. The dynamics of the stock of investment fund shares held by credit institution also contributed to the growth: the stock of HUF 15,090 billion at the end of 2023 is 30.6 per cent higher than the HUF 11,557 billion recorded at the end of the previous year.

Investment firms also recorded an increase in all asset classes in 2023. Equities rose by 10.1 per cent from HUF 3,643 billion in 2022 to HUF 4,010 billion at the end of 2023 – the increase was present at sector level. Investment fund units jumped by 32.1 per cent from HUF 2,922 billion in 2022 to HUF 3,859 billion at the end of 2023 – the increase is mainly attributable to the first and second largest market participants. After a decline of 22.4 per cent in 2022, government securities registered with investment firms rose by 30.5 per cent in 2023 to reach HUF 873 billion, which is roughly consistent with the level of previous years. Bonds rose by 28.5 per cent from HUF 414 billion in 2022 to HUF 532 billion in 2023 – an increase that can be mainly attributed to the first and second largest market participants.

The number of client securities accounts held by investment service providers increased by 8 per cent in 2023 – growth was present at sector level. The number of client securities accounts held at credit institutions increased by 6.6 per cent to 1,620 thousand, while investment firms saw an increase of 54 thousand; accordingly, the closing stock of 466 thousand in 2023 translates to a 13 per cent year-on-year increase. (Chart 7.5)

Chart 7.5
Customer securities portfolio

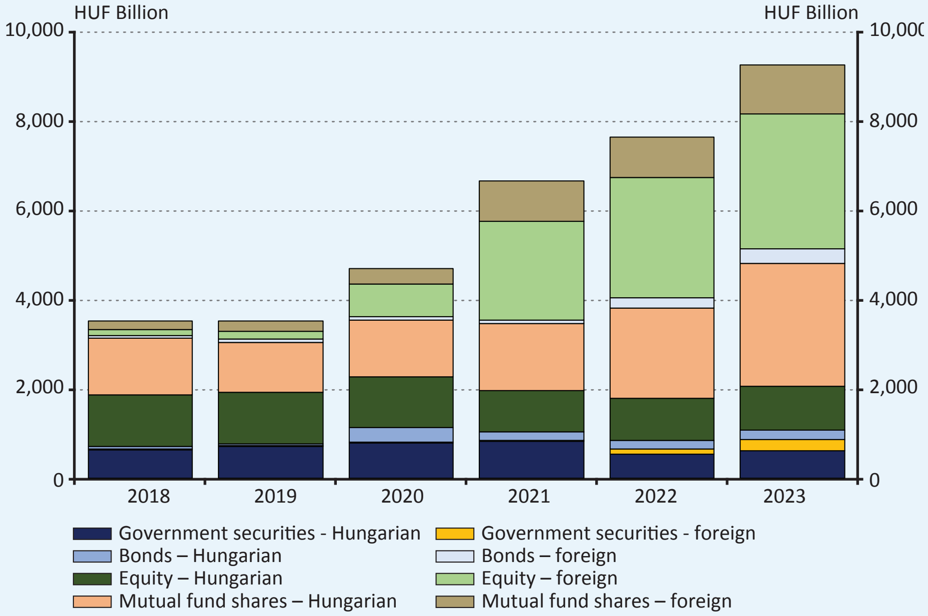


Source: MNB

7.1.5 In contrast with the trend of previous years, the share of foreign issuers in investment firms' holdings of client securities declined

In terms of the weight of asset classes in the client securities held by investment firms, the weight of the equity asset class fell by 4.8 percentage points to 42.2 per cent in 2023, but still remains in first place. The second largest asset class is investment fund shares with 40.6 per cent (2022: 37.7 per cent). The weight of the third-ranked government securities asset class increased from 8.6 per cent in 2022 to 9.2 per cent in 2023. The corporate bond asset class also showed growth, with its 5.6 per cent share in 2023 it is up 0.3 percentage points on the previous year. Looking at the resident/non-resident breakdown of asset classes, the weight of securities issued by non-residents fell by 0.5 percentage points to 51.9 per cent in 2023, breaking the previous upward trend. It should be noted that in 2021, the entry of a new large foreign-backed investment firm has significantly increased the weight of foreign-issued securities, mainly equities. The share of government securities issued by residents further decreased from 81.3 per cent in 2022 to 71 per cent in 2023 (fluctuating around 97–98 per cent in previous years) as the stock of government securities issued by non-EEA countries continued to increase. This increase is linked to the 2021 entry of a new large foreign-backed investment firm. (Chart 7.6)

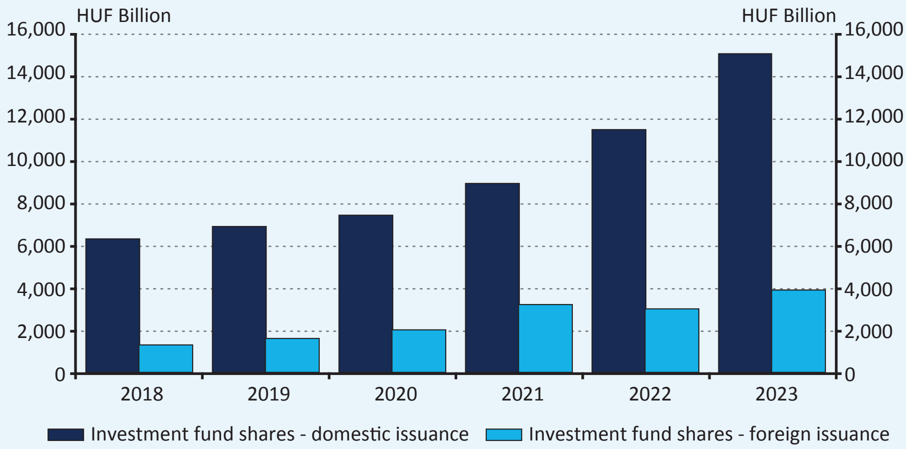
Chart 7.6
Customer securities portfolio by asset class



Source: MNB

Examining the client securities portfolios of domestic and foreign investment funds of investment service providers, it can be seen that in 2023 the portfolios of domestic investment funds grew slightly faster: the stock of investment fund units issued by residents increased by 31.5 per cent from HUF 11,480 billion in 2022 to HUF 15,094 billion by 2023, while the stock of investment fund units issued by non-residents increased by 29.7 per cent from HUF 3,005 billion in 2022 to HUF 3,897 billion by the end of 2023. In both cases, growth was present practically at sector level. For investment firms, the stock of investment fund units issued by residents increased by 36.9 per cent to HUF 2,768 billion, while the stock of investment fund units issued by non-residents grew by 25.7 per cent to HUF 1,132 billion in 2023. The share of foreign and domestically issued investment fund units was 25.8 per cent in 2023, practically the same as in 2022 when it was 26.2 per cent. (Chart 7.7)

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



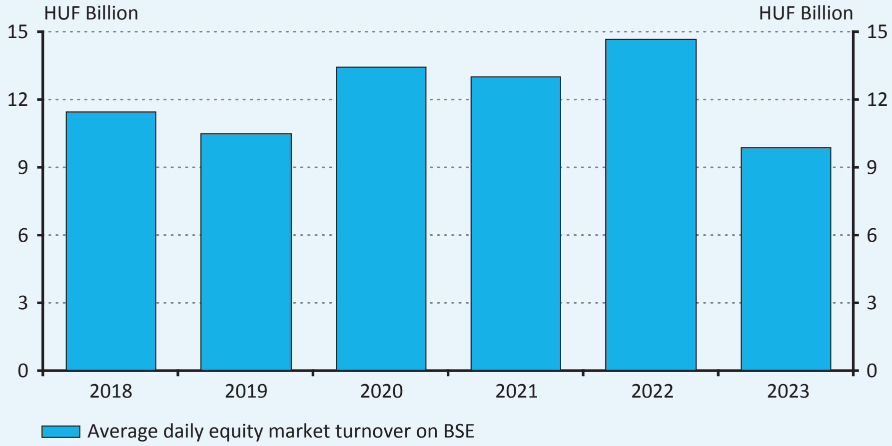
Source: MNB

7.2 REGULATED MARKET

7.2.1 Turnover on the Budapest Stock Exchange fell significantly in both markets

After several years, the turnover of the Budapest Stock Exchange was down significantly in 2023: the total turnover of HUF 4,466 billion in 2023 represented a decline of 42.5 per cent compared to 2022 and practically corresponded to the level seen 10 years ago. The decline is mainly driven by the negative performance of the derivatives market – derivatives turnover has practically halved compared to the previous year: the 2023 derivatives turnover of HUF 1,912 billion is 51.8 per cent lower than in the previous year. In addition, turnover in the spot market has also fallen: the 2023 turnover of HUF 2,554 billion is 32.8 per cent below the 2022 turnover of HUF 3,802 billion and corresponds to the turnover in the years before the spike in investor activity caused by COVID-19 and the Russia–Ukraine war. Derivatives turnover declined in all three relevant sub-sectors: the foreign exchange futures turnover of HUF 1,728 billion in 2023 fell 52.4 per cent behind the previous year's HUF 3,634 billion, index-based futures turnover fell by 59.5 per cent to HUF 63 billion, while equity futures turnover decreased by 43.6 per cent to HUF 90 billion. The concentration of the derivatives market continued to grow at a remarkable rate in 2023: the turnover generated by the top 5 exchange members covered 96.7 per cent of the total derivatives market turnover, up by around 9.7 percentage points from 87 per cent in 2022. In terms of derivatives turnover, the composition of the top five exchange members changed from 2022 to 2023, and this change concerned two investment service providers. In 2023, the HUF 1,248 billion decline in spot market turnover can be attributed to a HUF 1,193 billion (32.5 per cent) fall in domestic equity turnover (Chart 7.8) and a HUF 52 billion (44.2 per cent) decline in certificates turnover. The concentration of trading turnover in the spot market remained practically unchanged in 2023: the turnover generated by the first five members covered 84.2 per cent of the total spot market turnover, which translates into a drop of around 0.7 percentage points relative to 2022. In terms of spot turnover, the composition of the top five exchange members changed from 2022 to 2023, and this change concerned one investment service provider.

Chart 7.8
Average daily turnover on the Budapest Stock Exchange



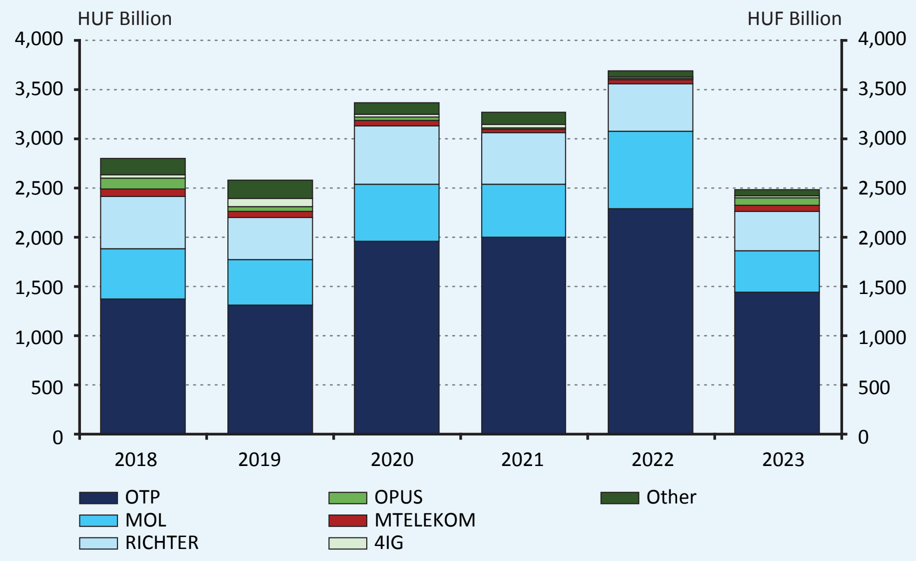
Source: MNB BSE

7.2.2 Concentration of turnover on the Budapest Stock Exchange decreased

In terms of issuers' stock market turnover, the composition of the top three most traded stocks – OTP, Richter, MOL – remained unchanged in 2023, but their order has changed: OTP remains in first place, while MOL, which was second in 2022, slipped to third place in 2023, replaced by Richter, which moved up from third place in 2022. The high concentration of the equity market decreased in 2023: the share of the top three largest issuers in total equity market turnover was 91 per cent in 2023, down by around 5.8 percentage points from 96.8 per cent in 2022 (2021: 93.5 per cent). The reduction in concentration is partly due to a decline in the turnover of blue-chips – the turnover of OTP shares fell by 37.2 per cent (2022: HUF 2,284 billion; 2023: HUF 1,434 billion), the turnover of MOL shares by 49 per cent (2022: HUF 784 billion; 2023: HUF 400 billion) and the turnover of Richter shares by 13 per cent (2022: HUF 486 billion; 2023: HUF 423 billion), and due to an increase in the turnover of small caps – the turnover of Opus shares increased by 427.7 per cent (2022:

HUF 14 billion; 2023: HUF 75 billion), the turnover of Mtelekom shares by 54.7 per cent (2022: HUF 40 billion; 2023: HUF 61 billion), and the turnover of 4IG shares by 116.7 per cent (2022: HUF 12 billion; 2023: HUF 25 billion). (Chart 7.9)

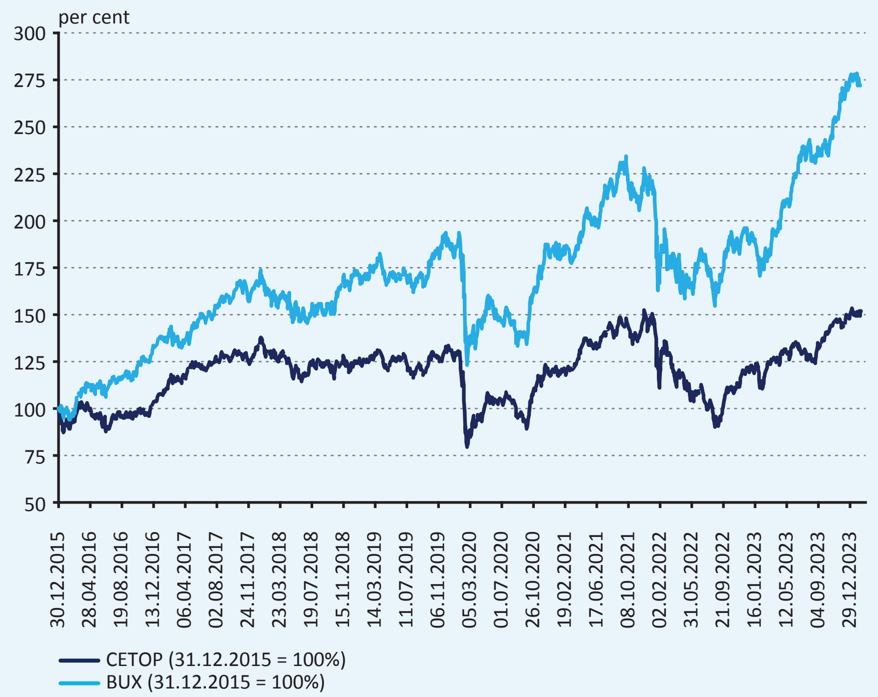
Chart 7.9
Annual stock exchange turnover of issuers



Source: MNB, BSE

After a decline of 13.7 per cent in 2022, the BUX index rose by 38.4 per cent in 2023 from 43,794 at the end of December 2022 to 60,620 at the end of December 2023, amid generally optimistic global capital market sentiment. The BUX index reached its annual high on 20 December 2023, with a closing value of 61,061. (Chart 7.10)

Chart 7.10
Changes in the BUX and CETOP indices



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

7.2.3 In 2023, shares of 7 new issuers were listed on BSE trading venues

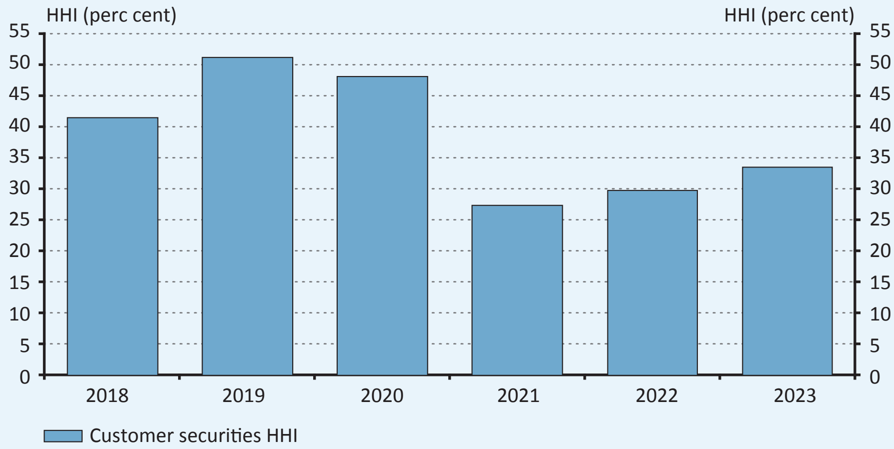
In 2023, the shares of Shopper Park Plus Nyrt., Biggeorge REIT Nyrt., Budapest Stock Exchange Nyrt. and Civita Group Nyrt. were admitted to trading on the main market of the Budapest Stock Exchange (i.e. Xbud), whereas the shares of OTT-ONE Nyrt. and SET Group Nyrt. were delisted, and the shares of Gloster Infocommunication Nyrt. were in the process of being transferred from the Xtend market to Xbud. In 2023, the shares of three issuers – Chameleon Smart Home Nyrt., STRT Holding Nyrt., Vertkai Group Nyrt. – were admitted to trading on the Xtend market of the Budapest Stock Exchange's lateral trading system for small and medium-sized companies, and the shares of one issuer (Cyberg Corp. Nyrt.) were cancelled.

7.3 RISKS OF INVESTMENT FIRMS

7.3.1 Market concentration in the investment firm sector remained low

The concentration of investment firms' holdings of customer securities, as calculated in accordance with the Herfindahl-Hirschman Index (HHI), was 33.4 per cent at the end of 2023, up 3.7 percentage points from the 29.7 per cent recorded in the previous year. The increase was mainly driven by the more dynamic growth in holdings of the first three investment firms in terms of client securities, but it should be noted that the concentration of the sector remains below that of 2020 and earlier years. The market share of small investment firms continued to decline in 2023: the market share of the 4 investment firms with the smallest holdings of client securities fell from 0.8 per cent in 2022 to 0.6 per cent in 2023. (Chart 7.11)

Chart 7.11
Market concentration of customer securities portfolio

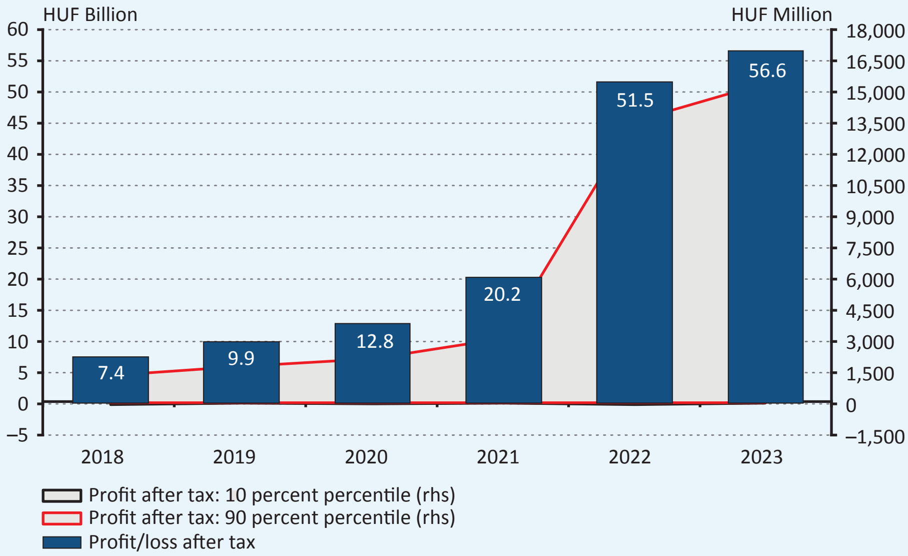


Source: MNB

7.3.2 Profitability of the sector is high

The profitability of the investment firm sector, including branch offices, continued to grow, albeit at a smaller pace, in 2023: the profit after tax of HUF 56.6 billion recorded in 2023 is 9.9 per cent higher than the HUF 51.5 billion profit after tax recorded in 2022 (year-on-year profit after tax grew by 155.4 per cent in 2022, 57.8 per cent in 2021 and 29.5 per cent in 2020), reaching a new all-time high for the sector. Growth varied at sector level: the growth dynamics can be attributed to the increase in the after-tax profits of the top three investment firms, including the foreign-backed investment firm that entered the market in 2021. At the same time, smaller investment firms experienced a decline in profit after tax compared to the previous year. Of the 14 investment firms operating at the end of 2023, 8 exhibited an increase in profit after tax, while 6 saw a decline. In 2023, the sector's earnings concentration increased further: the combined after-tax profit of HUF 47.6 billion earned by the top 3 market players with the highest after-tax profit increased to 84.1 per cent of the total sector's profit after tax, up from 80.3 per cent in 2022. (Chart 7.12)

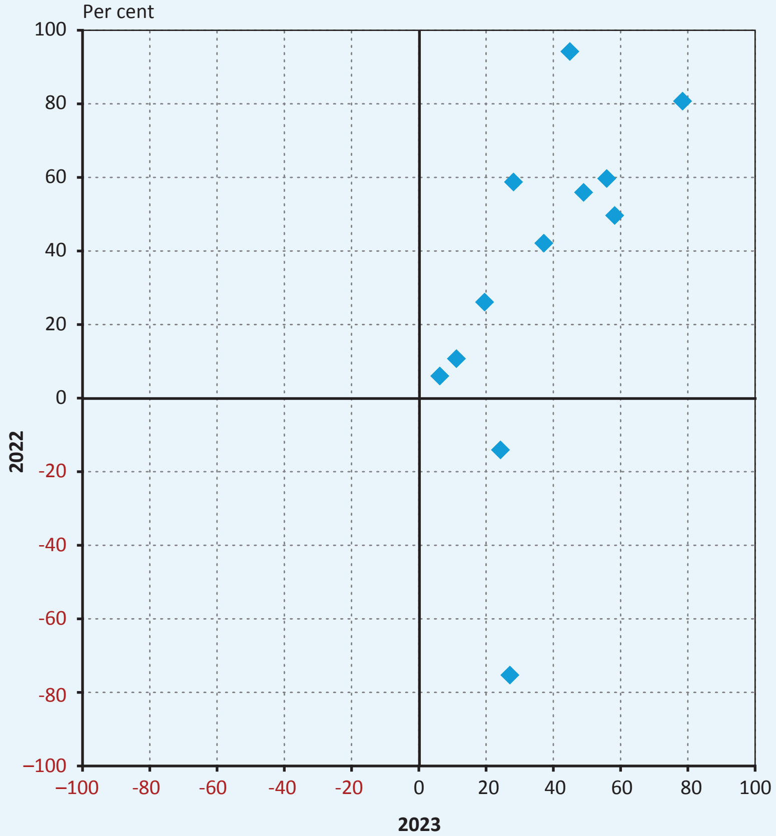
Chart 7.12
Profitability of investment firms



Source: MNB

In 2023, the number of loss-making investment firms decreased: while 3 investment firms were loss-making in 2022, this number dropped to 1 by 2023. Of the 3 investment firms that were loss-making in 2022, one has returned its operating licence and two have become profitable eventually. The investment firm that made losses in 2023 is a new entrant, where the initial start-up costs have obviously exceeded revenues. The improvement in sector-level income is shown also by the after tax return on equity (ROE): as shown in Chart 7.13, investment firms were clustered to the right of the vertical zero axis.

Chart 7.13
ROE value of investment firms (%)



Source: MNB

Box 7.1
The European Commission's retail investment strategy

On 24 May 2023, the European Commission (EC) published its Retail Investment Package (RIS), a package of proposals intended to simplify and modernise investor protection rules, consisting of two legislative initiatives: firstly, a draft Omnibus Directive amending MiFID II for investment services, the IDD and Solvency II for insurance, the UCITS Directive and the AIFMD for investment funds, and secondly, a draft regulation amending the PRIIPs Regulation on packaged retail and insurance-based investment products.

The proposals were designed to increase retail investors' participation in EU capital markets, facilitate informed investment decisions and strengthen the protection of retail investors. The three main proposals of the package are the following: i) simplification of information provision to retail investors, ii) a partial ban on incentives for certain product sales in the capital and insurance markets, iii) development of a cost benchmark to curb unfair costs and ensure value for money.

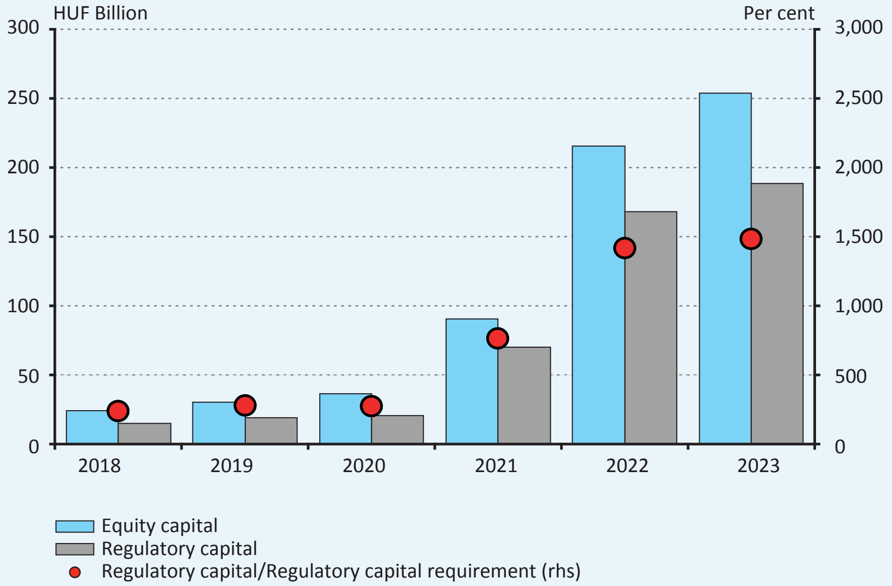
Among these, and in addition to the current positions, it should be stressed that the proposal would limit the payment of incentives for execution-only investment services without investment advice. The proposal would also require Member States to strengthen financial education at national level, as raising financial awareness is also a major contributor to making informed investment decisions.

Currently, the European Parliament (EP) and the European Council (EC) are consulting on the package of proposals, in accordance with the EU's ordinary legislative procedure. The EP has already published its first opinion on the package, which goes against the EC's proposals on several issues; accordingly, the EC's initial package of proposals is expected to be refined and modified on several points until the tripartite agreement is reached. The MNB, as the competent supervisory authority, is continuously monitoring the evolution of the proposals in its expert capacity. Under the current package of proposals, capital market participants are expected to mobilise significant resources to comply with the new rules, and the MNB intends to actively support their adaptation.

7.3.3 Good capital adequacy at sector level

The equity of investment firms reached HUF 253.4 billion at the end of 2023, up 17.7 per cent compared to the end of 2022: the increase can be essentially attributed to the growth in the shareholders' equity of the first two market players. The sector-wide regulatory capital requirement increased from HUF 11.9 billion in 2022 to HUF 12.7 billion in 2023 (+7 per cent), while the own funds available at the end of 2023 of HUF 188.4 billion were 12 per cent higher than in the previous year: as a result, the capital adequacy of the sector of investment firms continued to increase and the ratio of own funds to the regulatory capital requirement increased from 1,417 per cent in 2022 to 1,484 per cent in 2023. Even if the large foreign-backed investment firm was excluded, sectoral capital adequacy was still outstanding: the ratio of own funds to regulatory capital requirement reached 439 per cent in 2023. At the end of 2023, all of the 10 investment firms incorporated in Hungary had own funds in excess of capital requirements. (Chart 7.14)

Chart 7.14
Capital and capital adequacy ratio of investment firms



Source: MNB

Table 7.3
Sector-wide risks to investment firms

Risk category	Risk groups	Risk rating	Risk prospects	Evaluation in words
Market risk	Global geopolitical and financial market events	●	➡	Global geopolitical tensions increase capital market trading and investment volatility, which require strict and effective risk management practices from institutions, both from prudential and consumer protection point of view as well.
Profitability	Interest rate environment, inflation	●	➡	The business model and profitability of investment firms is stable at sector level, and ensures long-term capital adequacy.
"Capital adequacy"	Risks related to proprietary trading book positions Partner risk	●	➡	The capital adequacy ratio of the investment firm sector is favorable and stable. Trading book exposure, as well as counterparty risk is affected by changes in the yield environment, as well as the exchange rate volatility: for the management of these, risk management controls defined in the IFR/IFD are applied proportionately by investment firms. Unique liquidity and capital adequacy risks related to the business model may arise, which require the prescription of additional capital requirements.
Regulatory risk	Continuous review of EU capital market regulations, emergence of new regimes	●	➡	The additional requirements of investment consulting and portfolio management activities related to sustainability issues remain a challenge for investment service providers. Furthermore, the EU capital market regulations regimes are constantly reviewed and amended, which requires continuous adaptation for market players.

Legend:

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

Source: MNB

From a capital market perspective, 2023 proved to be an outstanding year as both bond and equity investments delivered high returns. The outcome of the war between Russia and Ukraine, which could upset the investment outlook, is a major factor influencing the positive market sentiment. The profitability of investment firms remained robust in 2023, but looking ahead, the interest rate environment and inflation may pose downside risks. Geopolitical tensions and international macroeconomic risks increase the volatility of capital market trading and investment, which requires institutions to adopt rigorous and effective risk management practices, from a prudential and consumer protection perspective alike. In line with high profitability, the sector's capital position has also remained stable. It can still be said that ongoing compliance with international regulatory requirements and preparation for their application require significant organisational resources for investment firms, and this trend will continue in the future.

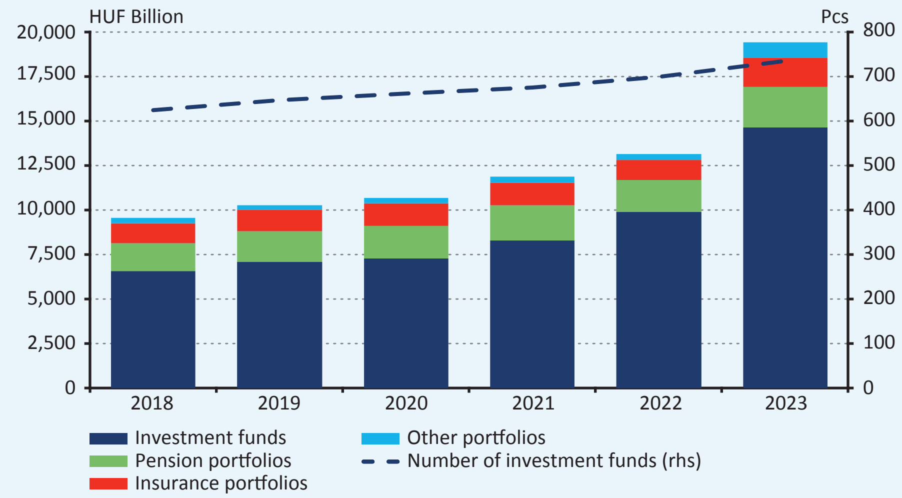
7.4 FUND MANAGEMENT MARKET AND RISKS TO INVESTMENT FUND MANAGERS

7.4.1 Further growth in assets managed by investment fund managers

The number of investment funds managed by 43 supervised investment fund managers increased by 36 to 734 in 2023. The trend of growth in the real estate fund sector continued in 2023, with the number of real estate funds increasing from 189 in 2022 to 201 at the end of 2023. The number of securities fund also increased further in 2023, reaching 533 at the end of the year (509 in 2022 and 504 in 2021). The number of public real estate funds available to small investors has not changed in 2023, and there are still 10 such funds.

Amid generally positive capital market sentiment, assets under management by domestic investment fund managers increased by HUF 6,247 billion from HUF 13,154 billion at the end of 2022 to HUF 19,401 billion at the end of 2023, a new historic high. The 47.5 per cent growth rate also represents a historic peak, following growth rates of 10.8 per cent in 2022, 11.3 per cent in 2021, 4 per cent in 2020 and 7.5 per cent in 2019. The increase in total assets managed by fund managers – including investment funds, pension funds, insurance and other portfolios – was essentially triggered by a rise in the net asset value of investment funds, but the assets of the rest of the managed portfolios also increased. At the end of December 2023, the net asset value of investment funds was HUF 14,632 billion, up by around HUF 4,760 billion (48.2 per cent) from HUF 9,872 billion a year earlier. The assets of pension funds managed by investment fund managers increased by 24.9 per cent in 2023 to HUF 2,274 billion at the end of the year, with all three types of pension funds – private pension funds, voluntary pension funds and health funds – seeing an increase in assets under management. There was a significant increase in the insurance portfolios managed by investment fund managers, which rose by 47.7 per cent from HUF 1,125 billion in 2022 to HUF 1,662 billion. In 2023, the assets managed by investment fund managers in other portfolios practically jumped 2.5 times, with the HUF 833 billion portfolio at the end of 2023 representing a 147.8 per cent increase year on year, attributable to a total of four investment fund managers. (Chart 7.15)

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

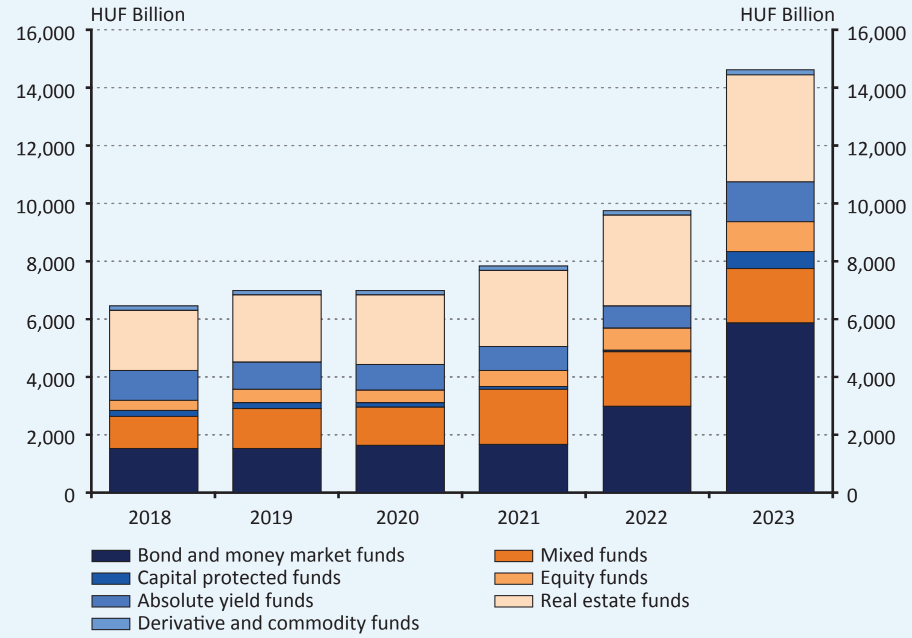


Source: MNB

7.4.2 Assets under management in investment funds reach new historic high thanks to capital inflows

Strong household demand led to a 48.2 per cent increase in the net asset value of investment funds to HUF 14,632 billion in 2023. In 2023, again, the increase in the net asset value of investment funds was mainly driven by net capital inflows: accordingly, of the HUF 4,760 billion increase in net asset value, HUF 3,266 billion can be attributed to net capital inflows, while the remaining HUF 1,494 billion is related to returns on investment. Bond and money market funds nearly doubled from HUF 2,996 billion in 2022 to HUF 5,863 billion at the end of 2023. The managed assets of mixed funds remained virtually unchanged in 2023 (2022: HUF 1,890 billion, 2023: HUF 1,900 billion). In more detail, the assets of bond-heavy mixed funds increased by HUF 10 billion (3.2 per cent) to HUF 318 billion, the assets of balanced mixed funds decreased by HUF 13 billion (1.2 per cent) to HUF 1,090 billion, while the assets of dynamic mixed funds increased by HUF 13 billion (2.9 per cent) to HUF 492 billion. The net asset value of equity funds increased significantly in 2023, by HUF 169 billion, or around 19.6 per cent, to HUF 1,031 billion: HUF 150 billion of the increase was mainly due to return on investments. The decline in the assets of capital protected funds, which was typical of previous years, came to a halt in 2023: at HUF 588 billion, the net asset value of capital protected funds in 2023 is more than nine times the HUF 58 billion recorded in 2022 – the jump can be attributed to one fund manager, given that two funds were reclassified from the short bond funds category to the capital protected category. In line with the market trends of previous years, the growth in assets managed by real estate funds – funds investing directly and indirectly in real estate – continued in 2023: the net asset value of real estate funds increased by 18 per cent to HUF 3,693 billion. (Chart 7.16)

Chart 7.16
Breakdown of investment funds by investment policy



Source: MNB

Box 7.2
Classification of investment funds – changing Government Regulation

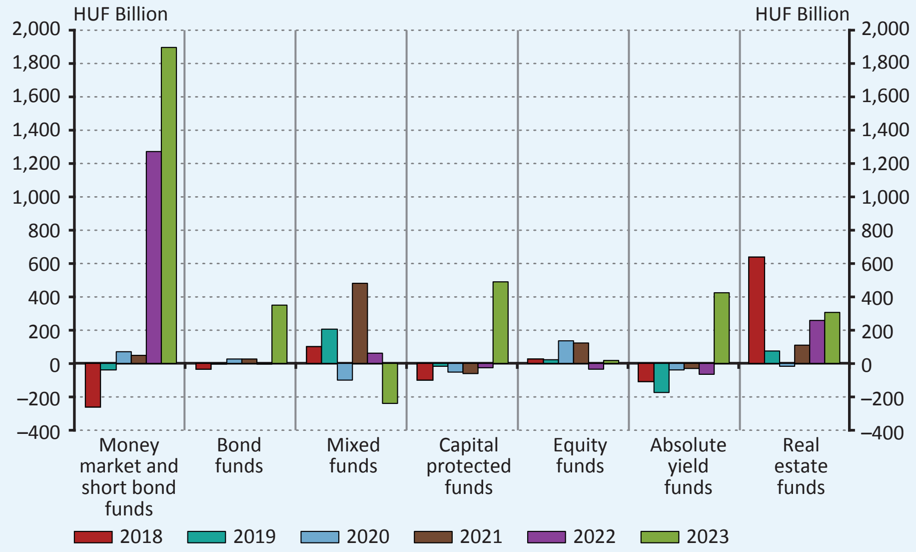
On 7 March 2024, Government Decree No. 55/2024 (III. 7.) amending Government Decree No. 78/2014 (III. 14.) on the investment and borrowing policies of collective investment trusts was published and brought the classification of investment funds into force. Compliance with the newly defined limits will ensure that the funds are assigned to a specific category: this will allow the funds' names to better reflect their portfolio composition, thus increasing transparency for investors. The amendment creates 14 investment fund categories. The legislation does not apply to closed-end investment funds, real estate funds with public entry barriers, or securities funds that invest at least 80 per cent of its assets in assets issued and traded outside of Hungary. Under the legislation, by 1 July 2024 the investment fund manager or the depositary must take all measures to comply with the provisions of the Government Decree in order to comply with the provisions of the Government Decree by 1 September 2024 at the latest.

The legislation introduces a mandatory government securities holding limit in 9 out of 14 categories of the investment funds; namely, in the case of 8 categories (bond fund, equity fund, mixed securities fund, capital protected fund, commodity fund, fund of funds, mixed fund, real estate fund) at least 5 per cent of the assets must be government securities; in addition, at least 3 per cent must be government securities with a maturity of one year or less or a remaining maturity of one year or less, and in one case (unique fund) at least 5 per cent of the assets must be government securities. For example, under the legislation at least 55 per cent of the assets of bond funds must be held in fixed income securities, while 80 per cent of the assets of equity funds must be equities. Under the rules, capital protected funds must hold at least 60 per cent of their assets in bonds or deposits, but bonds cannot exceed 40 per cent.

7.4.3 The net inflows of investment funds reached a new historic high

In 2023, the extremely high positive capital inflows into investment funds continued, far exceeding the record inflows of the previous year: the net capital inflow of HUF 3,266 billion in 2023 is more than double than the HUF 1,470 billion in 2022 and several times higher than in previous years. Behind this strong net inflow of capital is the increased household demand for money market and bond funds, owing to the attractive returns on money market and short bond funds. The largest net capital inflow in 2023 was observed in short bond funds, which reached HUF 1,731 billion (HUF 993 billion in 2022). Other funds investing in interest-bearing assets also saw strong net inflows in 2023: net inflows of HUF 179 billion and HUF 174 billion for long and open-end bond funds, respectively, followed by money market funds with HUF 159 billion. After the declining demand in previous years, mixed funds saw a net capital outflow of HUF 242 billion in 2023 (there were net capital inflows in 2022 and 2021 amounting to + HUF 63 billion and + HUF 484 billion, respectively). After the capital outflows of previous years, in 2023 absolute return funds experienced a significant net inflow of around HUF 437 billion, which can be attributed to the appearance of household demand, complemented by the reclassification of other fund types – typically mixed funds – to absolute return funds. (Chart 7.17)

Chart 7.17
Net capital flows of investment funds

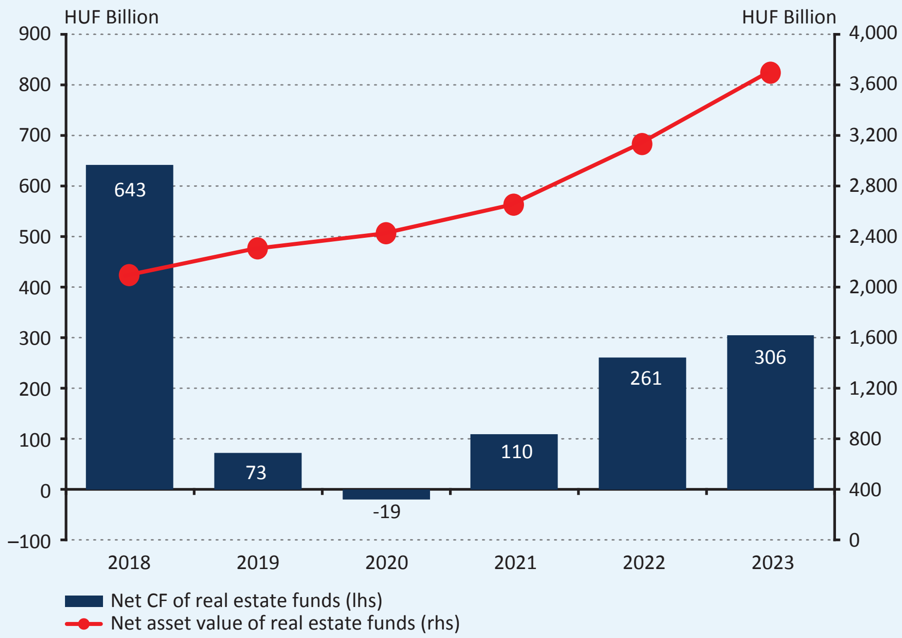


Source: MNB

7.4.4 The net asset value of real estate funds increased further

In 2023, net capital inflows into real estate funds – funds investing directly or indirectly in real estate – continued to increase at a slower pace than in previous years: net capital inflows of HUF 306 billion in 2023 represent an increase of nearly 17 per cent compared to HUF 261 billion net capital inflows in 2022. For funds investing directly in real estate, the net asset value increased by 19.1 per cent from HUF 2,640 billion in 2022 to HUF 3,144 billion in 2023: of the HUF 504 billion increase, the investment return on assets managed was HUF 241 billion, while net capital inflows amounted to HUF 263 billion. The HUF 549 billion net asset value of funds investing in indirect real estate in 2023 is 11.8 per cent higher than the HUF 491 billion portfolio in 2022. Of the HUF 58 billion increase in net asset value, HUF 43 billion can be attributed to net capital inflows and HUF 15 billion resulted from returns on investments. (Chart 7.18)

Chart 7.18
Portfolio and net capital inflows of real estate funds



Source: MNB

Box 7.3
Presentation of the real estate investment fund recommendation

On 18 December 2023 the MNB published on its website Recommendation No. 13/2023 (XII. 15) of the MNB on issuing the units of public open-end real estate investment funds, designing their liquidity profile and managing their concentration risks. The MNB requires the application of the new Recommendation from the day after its publication, i.e. from 19 December 2023. At the same time, the previous MNB Recommendation No. 5/2019 (IV. 1.) on issuing the units of public open-end real estate funds was repealed.

The publication of the Recommendation was preceded by the entry into force of Government Decree No. 449/2023 (X. 3.) on the redemption of the units of real estate funds on 9 October 2023. With the entry into force of Government Decree No. 449/2023, it also became necessary to update the MNB's 2019 Recommendation. The new rules laid down in Government Decree No. 449/2023 apply to public open-end real estate funds already registered on 15 May 2019. Therefore, the 2023 Recommendation was intended to address the issue of subsequently established funds by taking the principles set out in the 2019 Recommendation as a guiding principle.

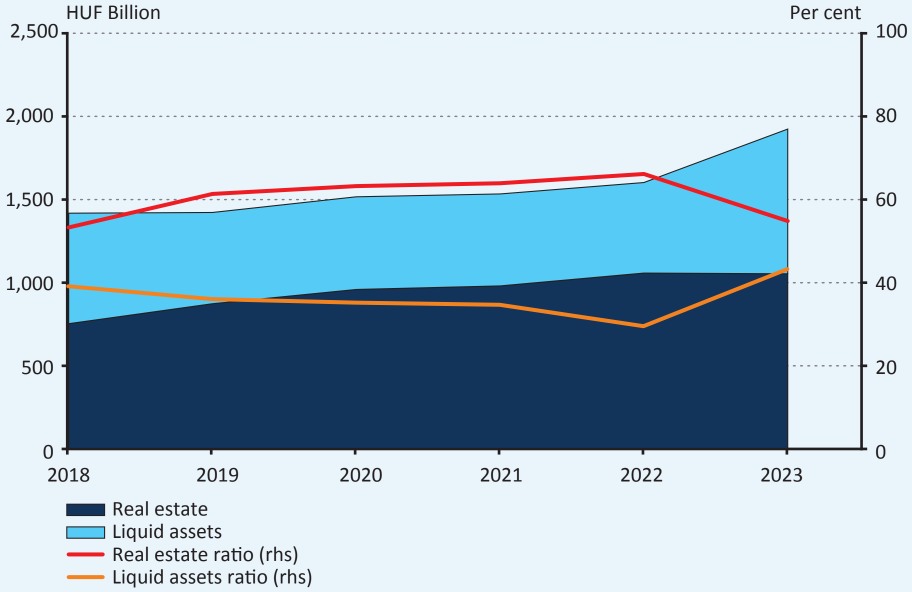
According to the new rules, in public open-end real estate funds already registered on 15 May 2019, units with a long redemption period must represent at least 15 per cent of the value of the real estates owned by the fund. The sale of units with a long redemption period has been already supported by the MNB in the past, and this was confirmed by the 2023 Recommendation. The main messages of the Recommendation are that (i) the MNB expects the seller institutions to give preference to selling long redemption series, (ii) the MNB considers it of paramount importance that investors make informed investment decisions and therefore information on risks should be readily available and accordingly, the MNB expects information to be provided by both fund managers and distributors, (iii) the creation of short redemption series or the increase of the distribution limit for such series is still not accepted for the above funds.

Fund managers of public open-end real estate investment funds already registered on 15 May 2019 must submit to the MNB a detailed plan on the date and manner in which they intend to comply with the provisions of Government Decree No. 449/2023. In addition, the MNB has included in the text of the public recommendation the additional prudential requirements that were previously sent only to the relevant fund managers. Accordingly, the previous 25 per cent liquidity requirement remains, but for funds that reopen the sales of units with a short redemption period, the MNB requires the submission of an action plan under 30 per cent. This requirement is also based on supervisory experience, as many large, market-leading public open-end real estate investment funds have maintained liquidity levels higher than 30 per cent for safety reasons. In the case of real estate investment funds that have fallen below the required level of liquidity, the fund manager must take the necessary measures to restore liquidity. If the real estate investment fund has made use of the possibility provided by Government Decree No. 449/2023 and increased the maximum distribution limit for short redemption units, it must carry out these stress tests not only during the 30 per cent liquidity limit, but also on a monthly basis and send them to the MNB.

7.4.5 Assets managed in public real estate investment funds continued to grow, essentially driven by returns

The net asset value of public real estate investment funds grew dynamically in 2023, with the net asset value increasing by 20.1 per cent from HUF 1,599 billion at the end of 2022 to HUF 1,921 billion at the end of 2023 (growth was 4.3 per cent in 2022, 0.6 per cent in 2021, 6.9 per cent in 2020 and 0.4 per cent in 2019). The HUF 322 billion increase in the net asset value in 2023 is partly due to HUF 197 billion return on investments and HUF 125 billion net inflow of capital. It should be noted, however, that out of the HUF 125 billion net capital inflow, HUF 90 billion was allocated to three public real estate funds under the Baross Gábor Capital Programme; thus the net capital inflow generated by investors outside of the public sector is HUF 35 billion, which is higher than the HUF 41 billion and HUF 69 billion net capital outflow in 2021 and 2022, respectively. However, it can be argued that the previous interest and demand of households for public real estate investment funds has not returned, as much more attractive alternative investment opportunities are available to retail investors, such as retail government bonds and their yields. The share of real estate assets in public real estate investment funds fell by 11 percentage points from 66 per cent in 2022 to 55 per cent at the end of 2023: the decline was sector-wide, but the magnitude of the fall is attributed to a single fund manager. It should be noted that this ratio is roughly the same as the ratio for the years before 2020 (Chart 7.19). The high market concentration of public real estate funds continued to increase in 2023: the 3 public real estate funds with the highest net asset values accounted for 80.9 per cent of the total net asset value of public real estate funds, up 3.7 percentage points relative to 77.2 per cent in 2022.

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



Source: MNB

Box 7.4
The first green real estate fund – expectations for green real estate funds

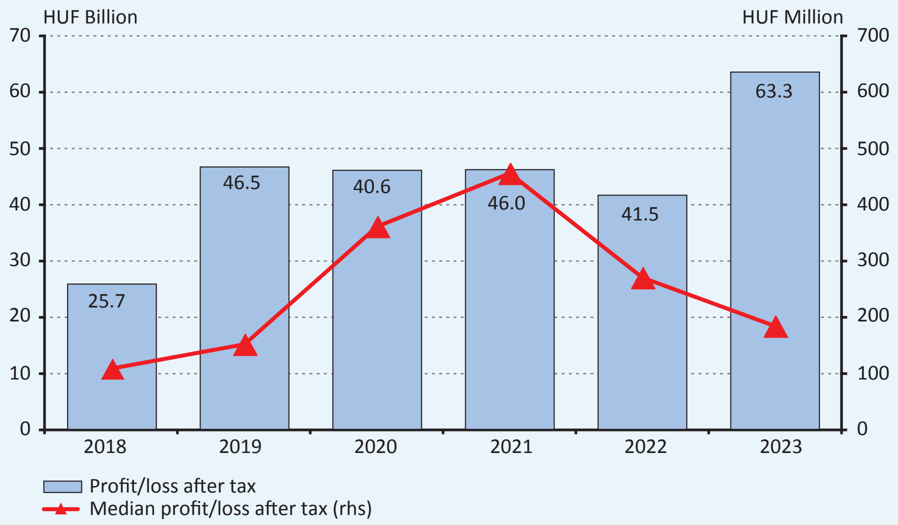
At the end of 2023, 59 per cent of the assets managed by investment funds in the EU were "green", of which 3.5 per cent were sustainable (SFDR 9) and 55.5 per cent were ESG (SFDR 8) products. The net asset value of more than 11,600 investment funds reached EUR 5,200 billion. In Hungary, although growth is undeniable, the share of ESG investment funds is low by international standards. The aggregate net asset value of these funds represents less than 2 per cent of the total market. At the end of 2023, a total of 38 ESG investment funds were available on the capital market in Hungary, while the number of sustainable investment funds was 1. The requirements of the SFDR and its supplementary regulation (SFDR RTS) are complex and market participants continue to find them novel and difficult to apply. The complexity of the legislation is also demonstrated by the fact that the European Supervisory Authorities (ESAs) have published a number of clarification documents, questions and answers, which were also published as a single document in spring 2023.

The first green real estate fund in Hungary was approved by the MNB in January 2024. The fund does not have a sustainable investment objective, but its investments promote environmental/social characteristics and therefore comply with Article 8 of the SFDR. The fund aims to invest at least 10 per cent of its assets in sustainable investments linked to economic activities with environmental objectives. The fund also aims to invest in properties with a long useful life and green certificates.

7.4.6 Dynamic growth in the profitability of the fund management sector

The profit after tax of investment fund managers grew dynamically in line with the growth in assets under management: the 2023 after-tax profit of HUF 63.3 billion is almost one and a half times the 2022 after-tax profit of HUF 41.5 billion. While growth was present at sector level, the increase in the after-tax profit of the market-leading fund manager was outstanding. In 2023, the number of loss-making fund managers increased from 3 in the previous year to 7. Loss-making fund managers reported a net loss of HUF -293 million in 2023. Of the seven loss-making fund managers, one is a new entrant and two have been loss-making since their establishment. (Chart 7.20)

Chart 7.20
Profitability of investment fund managers



Source: MNB

In 2023, after-tax profit concentration in the investment fund management sector increased significantly: the top 5 market players with the highest after-tax profits generated 63.9 per cent of the total sector's after-tax profits in 2023, up 16 percentage points from 2022 – the significant increase reflects the dynamic growth in the earnings of the market-leading fund manager. Overall, investment fund managers continued to be characterised by high profitability in 2023, evidenced also by the high level of ROE (profit after tax to equity): Chart 7.21 includes only those investment fund managers that were active both in 2022 and 2023 and did not surrender their licence in 2023.

Chart 7.21
ROE value of investment fund managers (%)

Source: MNB

Table 7.4
Sector-wide risks of investment fund managers

Risk category	Risk groups	Risk rating	Risk prospects	Evaluation in words
Market risk	Liquidity, foreign exchange market turbulence, operation of real estate funds in a stress environment	moderate (yellow)	stagnant (➡)	2023 proved to be an outstanding year from an investment point of view, and the fund managers experienced a significant inflow of capital into various funds. With the end of the effects of the pandemic, the underperformance of previous years has been resolved by the fund management sector, and it also looks positively in 2024.
Corporate governance	View related to sustainability, digitization	moderate (yellow)	stagnant (➡)	Compliance with ESG aspects is increasingly integrated into the corporate governance system of fund managers, and we can expect this process to continue in 2024. Managing the information security and prudential risks of digitization is a significant challenge for the next period.
Profitability	Market yield environment	significant (orange)	increasing (⬆)	The profitability of the fund management sector was high in 2023. In the next period, however, with the decrease in inflation, we can expect lower yields, which may also be reflected in the profitability indicators.
Operational risk	Risk management systems	significant (orange)	increasing (⬆)	The serious data requirements for complying with ESG aspects and the increased analysis tasks related to sustainability continue to challenge domestic fund managers.
Capital adequacy	Profitability	low (green)	decreasing (⬇)	The profitability of the fund management sector was high in 2023, which improved the already stable capital position of fund managers.

Legend:
Degree of risks — *high* (red), *significant* (orange), *moderate* (yellow), *low* (green)
Direction of risks — *increasing* ⬆, *stagnant* ➡, *decreasing* ⬇

Source: MNB

From an investment perspective, 2023 proved to be an outstanding year as both bond and equity investments delivered high returns. The positive sentiment also resulted in significant capital inflows for fund managers across funds. With the effects of the pandemic behind us, the fund management sector has made up for the underperformance of previous years and is positive about 2024. The outcome of the Russia–Ukraine war is a major factor affecting market sentiment and may even upset the fundamentally positive investment outlook. The Russia–Ukraine conflict has previously led to the suspension of two leading fund managers' Russian-oriented equity funds, and the prolonged crisis has led to the segregation of assets in these funds that have become permanently illiquid due to the war in Ukraine. The illiquid series of fund unit series therefore continue to be investors' assets alongside the liquid series, but fund managers do not charge their clients specific fees for this asset element. Generally speaking, the stock of domestic investment funds with Russian exposure continued to be minimal within the investment fund market.

ESG compliance is increasingly embedded in the corporate governance of fund managers and this process is expected to continue in 2024. In addition to this process, we can expect to see a strong digitalisation of corporate operations and the spread of the latest technologies (artificial intelligence, machine learning) in many areas of fund management. Addressing the information security and prudential risks of this is a major challenge for the period ahead. The heavy data requirements for ESG compliance and the increased analytical tasks related to sustainability continue to challenge domestic fund managers who, as part of their operations, need to invest simultaneously in new digital solutions and infrastructure to support sustainable operations. These challenges require the enhancement of product development and distribution solutions and the strengthening of risk management.

The profitability of the fund management sector in 2023 was high thanks to a favourable investment environment, retail inflows in investment funds and success fee income, which improved the already stable capital position of fund managers. As a result of the consolidation that has taken place, fund managers still have significant reserves.

7.5 CONSUMER PROTECTION IN THE CAPITAL MARKET

In line with the objectives set out in the MNB's 2020–2025 supervisory strategy (consumer focus, strong consumer protection), consumer protection supervision in the capital market first and foremost seeks to ensure the transparent, understandable and fair provision of information and marketing in relation to the investment services offered and the financial instruments sold, as well as the implementation of product sales practices resulting in the recommendation of capital market investment opportunities that suit the needs and objectives of customers. Guided by this approach to consumer protection, in recent years the MNB has carried out inspections focused on consumer protection, examining various aspects.

7.5.1 Marketing activity thematic inspection

In 2023, the MNB continued the process of thematic inspections on capital market consumer protection started in 2019, covering the activities of investment service providers. Following the inspections on compliance (2019), suitability assessment (2020), product governance (2021) and preliminary cost information (2022), the MNB examined the marketing activities of market participants in 2023, mainly in terms of the level of regulation of activities and the balance of marketing content to investors. The MNB included 14 investment service providers in the thematic inspection carried out in the framework of its ongoing supervision, which, as in previous years, was conducted as part of the contribution to the Common Supervisory Action (CSA) coordinated by the European Securities and Markets Authority (ESMA) and concluded with a report to ESMA, and covered all channels of marketing activities: social media, online banners and related landing pages, newsletters, EDMs, own websites, CRM campaign, printed content and TV spots. The thematic inspection found that market players had detailed and regulated processes for the production and approval of marketing content that commensurate with the actual activity, that regulatory compliance functions are adequately involved in the approval of content, that product distributors with own-produced content take into account the formal documentation prepared by the product producer, and that the processes for the production of marketing content are regularly reviewed. The MNB has examined the marketing content produced by investment service providers to target a specific product (typically an intra-group investment fund) or to promote an element of the service in terms of the messages, information and visuals delivered to clients. Based on the experience of the thematic inspection, the messages in the marketing content were sufficiently balanced and no misleading nature was identified. Taking into account the conservative marketing activities of market players both in terms of the products promoted and the channel used (e.g. marketing via social media platforms with the involvement of influencers is not common among domestic market players), as a result of the thematic inspection the MNB did not identify any consumer protection risks that would have required action towards service providers. As part of its ongoing supervision, the MNB will continue to monitor and control the marketing content of service providers in 2024, in conjunction with the monitoring of investment advice activities.

7.5.2 Follow-up to the suitability assessment thematic inspection

The MNB's 2020–2021 thematic inspection, the second consumer-focused inspection of the capital market under the CSA, examined in detail the suitability assessment practices of 13 investment service providers for the investment products they sell. As part of its ongoing supervision, the MNB has closely monitored the implementation of the measures imposed on investment service providers and the related IT developments. In the context of its capital market consumer protection activities, the MNB attaches particular importance to the monitoring of investment advice, in particular with regard to the appropriateness of the product offered and the communication and information provided in connection with the advice.

7.5.3 Product governance thematic inspection

In 2022, the MNB concluded its thematic inspection on the monitoring of the product governance practices of investment service providers, which was the third in a series of thematic inspections related to participation in the ESMA-coordinated Common Supervisory Action (CSA) on capital market consumer protection. The thematic inspection covered 16 institutions. The MNB did not detect any serious irregularities but identified practices of concern in terms of consumer protection at several institutions. A recurring problem was that the target market criteria for certain products and product groups were not always well defined. For some service providers, some elements of the criteria required by the MNB were not assessed, while for others, although all aspects were included in the assessment, there was insufficient differentiation between products or, in particular for higher risk products, the target market was not adequately characterised. According to the legal requirement, essentially products can be sold within the defined (positive) target market; however, service providers must also define a negative target market. Customers within this market are not normally matched by product characteristics, but products can also be sold with due justification in this case. For several institutions, it was noted that a negative target market was not defined for complex, high-risk products. During the inspection, the MNB also paid particular attention to the exchange of information between distributors and product designers, which was not fully implemented in the case of several institutions due to the lack of adequate records of sales outside the target market and negative sales on the target market. In 2023, the MNB closely monitored the actions taken by service providers as part of its ongoing supervision, which showed that service providers complied with the requirements specified in the MNB's decision and management letter.

Box 7.5
Thematic inspection – Sale of derivative products to retail investors

ESMA's Heatmap 2023, which forms the basis for ESMA's coordinated supervisory work and the Union-wide Strategic Supervisory Priorities (USSP), has identified the investment of retail clients without sufficient capital markets trading experience in derivatives and other complex financial products as a high-risk topic and supervisory priority. ESMA's risk categorisation also proved to be valid for the domestic capital market investment environment, as the summary of data sent daily by domestic market participants to the MNB showed that in 2022 retail customers suffered losses of significant amounts on leveraged derivative positions (forwards and futures, stock exchange and OTC options, CFDs) with a notional principal amount of ten thousands of billions of forints, in some cases at the individual level. While the restrictions introduced by the MNB on the sale of CFDs to retail clients are an effective means of preventing extreme losses for investors, based on an analysis of loss rates on forward and options positions, and also in light of the ESMA Heatmap, the MNB launched a thematic inspection in mid-2023 at 8 investment service providers to monitor their practices in selling leveraged derivative products to retail clients.

In the framework of the thematic inspection, the MNB examines the sales practices of investment service providers from the perspective of consumer protection, risk management and the protection of client assets: the focus of the inspection is on communication related to product recommendations, the presentation of risks to clients, the statements sent to clients on the portfolio of derivative positions, the daily risk management procedures and methodologies related to leveraged products, and the handling of client complaints. In addition to consumer protection, risk management and client claim protection aspects, the MNB continuously monitors and analyses the characteristics of the leveraged derivative exposures of the clients of investment service providers (distribution by product, volume, leverage, P/L, etc.). Based on the data analysis and the experience gained from the thematic inspection, the MNB considers whether there are any general shortcomings or risks that need to be addressed, or market best practices that need to be communicated to service providers in a management circular.

7.5.4 Expanding suitability and product governance requirements

In 2022, a new element was added to the suitability assessment and product governance obligations of investment service providers: following the revision of the MiFID II Directive, the suitability assessment will require information to be collected and assessed on clients' sustainability preferences and its results to be incorporated into the providers' target market analysis and distribution practices in relation to the provision of advice and portfolio management services. The supervisory expectation in this regard had already been formulated by the MNB in the management circulars to market participants that concluded the suitability assessment. In addition, the MNB had consulted market participants on the interpretation and implementation of the new rules and practices on several occasions and supplemented its recommendations on suitability assessments and product governance requirements, taking into account ESMA guidelines on the same subject. The MNB also launched a data collection exercise among domestic investment service providers as part of its ongoing supervision, for the preliminary assessment of how market participants had introduced the assessment of investors' sustainability preferences into their suitability assessment practices. The data collection serves as an informative tool for the MNB, as the MNB plans to participate in the common supervisory action coordinated by ESMA on the assessment of sustainability preferences, as it has done in previous years in the capital markets.

Box 7.6
Monitoring the activities of cross-border CFD providers

A significant number of capital market service providers operating in Hungary and registered in other EU Member States also offer – based on their freedom to provide services – high-risk CFDs to Hungarian customers as part of their cross-border services. The MiFID II/MiFIR framework, which came into force in 2018, also enabled ESMA and national supervisory authorities to impose restrictions or even bans on the design and marketing practices of certain products in order to mitigate consumer protection risks. Because of the speculative nature and high risk of CFDs, initially ESMA and subsequently the supervisory authorities of the Member States of the Union – including the MNB – have taken advantage of this possibility, imposing strict restrictions on the sale of CFDs.

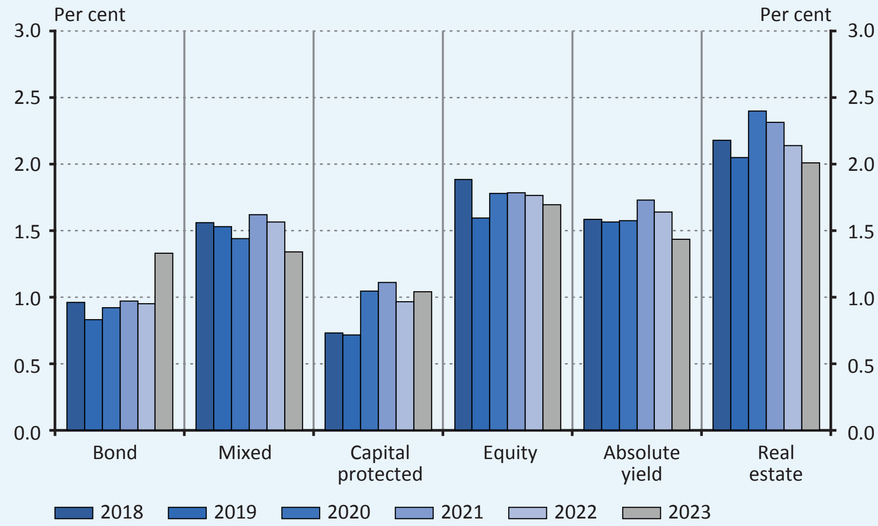
The MNB continuously monitors the advertisements and websites of the more popular cross-border service providers that advertise in Hungarian on social media or other internet platforms as part of its consumer protection monitoring activities in the capital market. As part of its monitoring activity, the MNB primarily checks the existence of the information elements it requires, such as mandatory risk warnings, but also monitors the balance and accuracy of the messages conveyed in connection with CFD trading. During its ongoing monitoring, the MNB has not identified any serious breaches of the law in the recent period, but it has identified a number of cases of consumer protection risks, which have led the MNB to refer several cases to the foreign supervisory authority supervising the institutions. Thanks also to active monitoring, the MNB is encountering fewer and fewer errors in its monitoring.

In addition to the consumer protection monitoring described above, by analysing available transaction data, the MNB also monitors, as part of its ongoing supervision, the compliance of domestic service providers with product intervention requirements with special regard to the leverage applied. In addition, it also monitors the profit/loss ratios of clients' CFD transactions.

7.5.5 Costs of public investment funds in 2023

Looking at the total expense ratio (TER) – which was calculated on the basis of preliminary unaudited individual disclosure – it can be seen that the funds with low average cost ratios are bond funds that preferred interest-bearing instruments (such as liquidity, money market, short, long and free bond funds). The expense ratios of these funds increased in 2023 compared to the changes in previous years, but even with this increase, they still have the second lowest expense ratios among the funds categorised according to investment policy. For capital protected funds, the low TER was justified by the funds' investment strategy and business model, as they incur higher costs in the year of inception. The TER ratio for capital protected funds increased marginally in 2023. In the case of funds with a higher risk profile (such as equity funds, absolute return funds), the higher average TER is due to the extra expertise required for investment, but both categories have seen a drop in costs in 2023, despite the fact that the two fund types have the highest TER after real estate funds. Real estate funds have exhibited a slight downward trend since 2020, which also continued in 2023. Overall, investors faced a 1.47 per cent TER ratio on average when purchasing investment fund units in 2023, down slightly from 2022 (1.50 per cent) at sector level. Following the receipt of the audited data, the MNB will publish the TER indicators broken down by fund, in line with previous practice. (Chart 7.22)

Chart 7.22
Changes in the TER ratio of public investment funds in Hungary



Source: MNB

7.6 ISSUER SUPERVISION AND MARKET SURVEILLANCE

7.6.1 Market abuse investigation

In 2023, the MNB initiated 20 market surveillance procedures on market abuse and closed 13 of them; in addition, it closed 3 procedures on suspected breaches of reporting requirements. It also initiated criminal proceedings in 5 cases of the market abuse cases closed in 2023. The MNB imposed measures and sanctions on 5 individuals and 2 legal entities, as well as a total of HUF 32.2 million in market surveillance fines.

In a market surveillance case investigating market abuse in 2023, which was closed at the beginning of 2024, the MNB found that an individual had engaged in illegal market manipulation by entering into transactions over several months in shares issued by Kulcs-Soft Nyrt. Through a large number of buy and sell orders placed over several months, the individual increased the average daily trading volume of Kulcs-Soft stock by a factor of almost six, and the cumulative increase in the price of Kulcs-Soft stock during the period was 97 per cent on the trading days affected by his transactions. In addition to these transactions resulting in turnover generation and price manipulation, the individual's conduct in the capital markets also constituted a practice of market manipulation known as "momentum ignition" by placing orders of exceptionally large volume, typically at the beginning of several trading days during the period under review by the MNB, which the average trading volume precluded from actually being executed. In addition, on one occasion, near the end of trading hours, the individual made a put offer at a higher price than the bids in the bid book, which set the closing price of the Kulcs-Soft stock for the day. This capital market activity by the individual was capable of constituting a market manipulation practice known as "marking the close". As a result, the MNB prohibited the individual from repeatedly violating the legal provisions on market manipulation and imposed a market surveillance fine of HUF 100 million. In determining the amount of the fine, the MNB considered as a key aggravating circumstance that the individual carried out the above actions as a senior executive of Kulcs-Soft Nyrt. – an issuer listed in the regulated market –; consequently, he is likely to have had a broader knowledge of the provisions of the EU Market Abuse Regulation (MAR) than the average investor. In addition, six months before the period under review in the market surveillance procedure, the MNB had already prohibited the individual from repeatedly violating the provisions of the MAR on market manipulation and also ordered him to pay a market surveillance fine of HUF 30 million. In addition to this, the MNB considered as an aggravating circumstance when determining the market surveillance fine that the customer had carried out the prohibited market manipulation by engaging in several forms of conduct prohibited by MAR.

At the initiative of the MNB – precisely with regard to such cases – the provisions of the Criminal Code on capital market abuse were tightened in 2023: from 1 January 2023, insider trading and illegal market manipulation are now considered more serious offences if committed by a person connected to a listed company.

Box 7.7
Framework for the regulation of crypto-assets (MiCA)

The new digital finance package, which also included draft regulations for crypto-assets was part of the FinTech Action Plan. As a prelude to the launch of the regulations, the Action Plan mandated the European Banking Authority (EBA) and ESMA to assess the applicability of the current financial services framework to crypto-assets.

Due to their specific nature, crypto-assets are outside of the scope of the regulations applicable to the financial sector of the EU, which is why the European supervisory authorities have developed the MiCA regulation. The regulation is intended to address the markets for crypto-assets, which are not considered other regulated products. The MiCA was designed to harmonise at European level the rules applicable to crypto-assets, their issuers, offerors and service providers, to mitigate risks to financial stability and to protect investors.

Under EU financial services legislation, the MiCA is only applicable to crypto-assets that are not classified, for example, as financial instruments, deposits or structured deposits. In addition to this condition, the Regulation defines as a crypto-asset any asset or right in digital form based on a distributed ledger (DLT) or similar technology that is transferable and can be stored electronically.

It is worth clarifying the difference between DLT and blockchain. DLT is a technology that allows transactions that have been accepted and validated according to defined rules and procedures to be stored by all actors in the network. A blockchain is a type of DLT where transactions are linked block by block using cryptographic solutions to create a chain. Essentially, a blockchain functions as a big ledger. There are also DLT solutions where data are not sorted into blocks, but the balances of network participants are properly updated after the validation of transactions.

Harmonised with EU legislation, the MiCA Regulation sets out definitions of market activities in relation to crypto-assets, with crypto-assets falling into four categories:

- Asset-referenced token: a (type of) crypto-asset – other than an e-money token – the main purpose of which is to maintain a stable value by referring to the value of several fiat currencies (legal tender issued by a country's central bank), commodities, or crypto-assets, or a combination of such assets;

- E-money token (asset-referenced token and e-money token together: stablecoin): a (type of) crypto-asset the main purpose of which is to be used as a means of exchange and that purports to maintain a stable value by referring to the value of a fiat currency that is legal tender;

- Utility token: a (type of) crypto-asset which is intended to provide digital access to a good or service, and is only accepted by the issuer of that token; This could be a tokenised voucher or a fitness pass. In principle, these are exempted from the obligation set out in the MiCA to publish a white paper;

- General crypto-asset: includes all crypto-assets that are neither asset-referenced nor e-money tokens, e.g. Bitcoin.

Under the MiCA, service providers that place general crypto-assets on the public market or wish to introduce them on trading platforms in the EU – and are not subject to an exemption – must comply with detailed rules. Those who offer crypto-assets to the public or wish to list them on a trading platform must be legal entities established in the EU. The persons concerned must prepare a white-paper before the offer/listing starts.

This should, *inter alia*, describe the crypto-asset and the main risks associated with it in plain language. In fact, consumers should be specifically warned that crypto-assets may completely lose their value. The white paper must be sent to the financial supervisory authority of the home Member State 20 days before publication. In the lack of the authority's objection, the crypto-asset can be offered/listed on trading platforms in the EU.

Stablecoins and their issuers are subject to stricter rules, in particular regarding capital, investor rights and supervision. The draft sets out the authorisation procedure applicable to the issuers of asset-referenced tokens. To be authorised to operate in the Union, issuers of asset-referenced tokens must be legal entities established in the Union. An asset-referenced token may not be offered to the public or traded on a crypto trading platform in the Union if the issuer is not authorised in the Union and does not publish a crypto-asset white paper approved by its competent authority.

Issuers of asset-referenced tokens are also subject to significant additional obligations, including in relation to an additional own funds requirement, liquidity management and interoperability. The draft also includes exemptions for low-volume asset-referenced tokens and asset-referenced tokens marketed, distributed and held exclusively by qualified investors.

7.6.2 Investigation of unauthorised activities

In 2023, the MNB initiated 17 market surveillance procedures due to suspected unauthorised activities, i.e. unlicensed or unreported activities, and closed 20 market surveillance procedures, in connection with which it imposed market surveillance fines totalling HUF 2.345 billion. As in previous years, the MNB continued to conduct a wide range of inspections in 2023, with market surveillance procedures covering a variety of suspicious financial, investment and insurance activities. At the same time, a significant number of inspections have focused on unauthorised lending and financial intermediation.

Within the framework of this activity, the MNB conducted a market surveillance procedure to inspect the activities of Primus Trust Bizalmi Vagyonkezelő Zrt., during which it found that beyond the scope of its fiduciary asset management licence, the company – as the trustee of 5 trusts managed by it – provided monetary loans to 8 persons in the period between 27 June 2018 and 19 January 2022 totalling approximately HUF 29 billion under a total of 27 loan agreements, and these loans did not constitute group financing, which could be carried out without the MNB’s authorisation. In its decision concluding the market surveillance procedure, the MNB imposed a HUF 300 million market surveillance fine on the company for the unauthorised provision of financial services, among other measures.

The MNB also conducted a market surveillance procedure to investigate the activities of SAFIS EVO Inc., during which it found that the seven “investment companies” owned by SAFIS EVO Inc. have concluded so-called “Profit Sharing Right Acquisition and Participation Agreements” with investors in the amount of at least HUF 1.6 billion in more than 2,000 transactions since January 2019, which can be assessed as collective investment securities. According to the agreements mentioned, the “investment companies” managed by SAFIS EVO Inc. raised investor capital in the form of asset contributions in order to provide capital increase to the “project companies” under the agreements, and accordingly, the investment companies would qualify as collective investment trusts that can be considered “quasi venture capital funds”. In view of the above, the MNB found that SAFIS EVO Inc. was engaged in the investment fund management activity of “collective investment securities distribution” in Hungary in violation of the law, without the relevant licence, and therefore the MNB imposed a market surveillance fine of HUF 320 million on the company and HUF 32 million on the natural person who substantially contributed to the activities, in addition to a ban on the company’s activities and the blocking of its website.

The most significant case in the inspection of unauthorised activities in 2023 was the market surveillance procedure in relation to Falcon Kereskedőház Kft., Falcon Benefit Kft. and the activities of a natural person involved in their operation. The inspection found that Falcon Kereskedőház Kft. and Falcon Benefit Kft. had entered into so-called “voucher purchase agreements” and variously named “programme agreements” with at least 4,400 investors, collectively worth HUF 1 billion. In these, they undertook that if investors did not use the vouchers they had bought at half price, they would pay back – typically after 3 months – their face value, i.e. twice the amount transferred by the investors. This guaranteed amount was an unrealistic promised return. In the course of the market surveillance procedure, the MNB found that the vouchers could not be used at any service provider, and the majority of investors did not even claim the vouchers in the first place. The reference to vouchers was only a cover for unauthorised fundraising. During the market surveillance procedure, the MNB also found that the natural person acting on behalf of the companies was materially involved in the unauthorised activities of the Falcon companies. The MNB imposed a market surveillance fine of HUF 940 million on Falcon Kereskedőház Kft. and HUF 500 million on Falcon Benefit Kft. for unauthorised financial services – accepting funds from the public –, and permanently prohibited them from pursuing the unauthorised activity. The natural person involved in the activities of the companies was fined a total of HUF 100 million by the Supervisory Authority. The combined fine is the largest ever imposed by the MNB for market surveillance. During the market surveillance inspection, the MNB blocked the companies’ websites, blocked several bank accounts linked to Falcon Benefit Kft. and blocked cash received by the companies. The MNB recovered around HUF 2.3 billion of investors’ money from entities breaching the law, and handed it over, in line with the relevant legislative requirements, to the investigating authority in the course of the market surveillance procedure.

In addition to conducting the procedures, the MNB continues to place great emphasis on improving financial awareness: in the investor alerts section of its website, financial consumers can review and check the warnings of foreign supervisory partner authorities, and in the search engine of the website, which lists legal market operators, they can check whether the person or company offering a financial service or investment product is licensed or registered by the MNB before they use it. The MNB also publishes on its website the main characteristics of unauthorised financial activities and extracts of decisions on market surveillance procedures that have been closed with a finding of non-compliance. The MNB's website, its customer service and its financial advisory offices in rural areas provide all the necessary information on financial operators operating within the legal framework.

Box 7.8
The concept of "business activity" in relation to unauthorised activities

The concept of business activity is defined in the Act on Credit Institutions and Financial Enterprises [Section 6 (1) (116) of the Credit Institutions Act] as follows: "Business activity: gainful (for-profit) economic activities performed on a regular basis for compensation, involving the conclusion of deals which have not been individually negotiated". The Insurance Act, in turn, regulates the concept of business activity in an identical manner as the Credit Institutions Act (Section 4 (1)(104) of the Insurance Act), and in a nearly identical manner as the Act on Payment Service Providers (Section 3 (39) of the Payment Service Providers Act). Contrary to the above, the Investment Firms Act [Section 5 (1)] only includes one element of the business activity above, specifically, the phrase "provided within the framework of regular business activities" in the list of investment service activities. In addition, a "regular economic activity" is mentioned under the definition of an undertaking, similar to the Capital Market Act. As regards other legislation, the Criminal Code, the Accounting Act, the Act on the Rules of Taxation, the Act on Sole Proprietors and the Act on Associations contain definitions similar to those of the Act on Credit Institutions and the Insurance Act. They have in common a regularity and the goal to achieve value for money, as well as the objectives of profit, gain and wealth.

Based on the above, in accordance with the Act on Credit Institutions, the Insurance Act and the Payment Service Providers Act, three elements must be in place simultaneously in order to establish the business nature of an activity. In the MNB's view, these three conjunctive criteria can only be interpreted together and in relation to each other, and whether they are met is assessed on a case-by-case basis. In its relevant resolutions, the MNB also refers to the need to examine, in accordance with these principles, the various elements of "business activity" in relation to a given activity. The three components above can be interpreted as follows.

The "for profit or gain" part of the definition of "business activity" is the criterion for which, if the service is provided at any additional cost or charge over and above the normal cost of providing the service, or for other indirect economic advantage, then the objective to achieve a profit or gain can be established. One of the determinants is whether the activity generates income for the person carrying it out or whether it is carried out for profit. This circumstance must be interpreted in the light of both the direct consideration and the realisation of revenue from a seemingly free service which is indirectly derived from another service closely linked to the service in question.

The element of "involving the conclusion of deals which have not been individually negotiated" may exist where essential elements of the legal transactions to be concluded by the parties are not determined in advance, including, in particular but not exclusively, the identity of the parties, the purpose of the transaction, the amount of the consideration or the value of the transaction, or other material circumstances of the conclusion of the contract, such as the terms of performance or the duration of the contract. A given transaction can be considered to be individually negotiated if all the elements of the contract are defined specifically and in advance.

The question of "regularity" can only be assessed on a case-by-case basis, taking into account all circumstances of the case. According to the text of the MNB's positions: based on its grammatical interpretation "regularity" refers primarily to events that occur repeatedly in the future. Its assessment depends primarily on the number and frequency of transactions; however, according to the MNB's experience, even ad hoc transactions – up to one or two per year – can be businesslike. Within this definition, the activity will be deemed regularly performed if the content of the contract otherwise refers to the regular, continuous provision of the service.

7.6.3 Issuer supervision

At the end of 2023, 44 companies were listed on the regulated market operated by BSE (Xbud), 20 companies were listed on the Xtend multilateral trading facility and a further 92 companies were listed on the Xbond multilateral trading facility. In the framework of continuous supervision, the MNB issued 33 decisions in 2023, including 11 decisions imposing fines and a total of HUF 149.3 million in supervisory fines. In addition, in 120 cases, it sent requests for information or statements to issuers, shareholders or auditors. In addition, in 2023 the MNB initiated 3 targeted inspections on public issuers and closed 4 targeted inspections on IFRS; in addition, it closed 1 targeted inspection on regular and extraordinary disclosures.

The MNB imposed fines totalling HUF 105 million on SET GROUP Nyrt.: HUF 20 million supervisory fine for breaching the provisions on the extraordinary disclosure obligation and a HUF 85 million market surveillance fine for breaching the legal provisions on the prohibition of market manipulation. The investigation by the central bank revealed a significant number of disclosure failures by the issuer. On the one hand, SET GROUP Nyrt. has regularly published disclosures that may have raised positive expectations among investors regarding the issuer's future, business opportunities, performance and financial position. However, in a number of cases, the issuer was unable to substantiate these disclosures during the investigation and as a result, the overall effect of the disclosures may have been to create an unfounded positive image of the issuer in the minds of investors. SET GROUP, on the other hand, failed in several cases to disclose information directly or indirectly affecting the value of its securities or the perception of the issuer. For example, it did not provide information on the failure of a group member to acquire assets, the fact that its granddaughter was excluded from the scope of consolidation, the sale of shares in its subsidiary, the existence or termination of significant contracts of its consolidated companies, or the existence of a third-party claim against its subsidiary that is large in relation to its consolidated turnover.

Box 7.9
Crowdfunding through the eyes of a supervisory authority

Crowdfunding is intended to facilitate the financing of a project by providing capital to the project, while taking advantage of the benefits created by the community. Under the scheme, each investor sympathising with the project contributes to the project by making a payment or investment of varying amounts through a publicly accessible, internet-based information system (platform) operated by the service provider. This type of financing is not usually characterised by a large contribution from one or two investors but, as the name implies, relies primarily on the strength of the community. Typically, there are three players: the investor, the service provider and the project owner. The project owner wants to raise funds for the implementation of its business plan, which is provided by the investor's available cash. The link between these two persons and needs is provided by the service provider and the platform it operates. This activity can only be carried out if the service provider holds an activity licence authorising it to carry out crowdfunding activities. The licence is issued by the MNB, which also supervises the service providers.

Crowdfunding has not been properly regulated for a long time, and this was changed by the EU Regulation on European Crowdfunding Service Providers (ECSP) for business. Published in October 2020, the Regulation is in force and directly applicable in Hungary, as well, along with a number of additional EU regulations (RTSs) designed to facilitate its implementation. The EU legislation has closed a very significant regulatory gap, providing the opportunity for crowdfunding to be carried out legally. However, the Regulation only covers investment and lending-based crowdfunding and does not address reward and donation-based funding, which are left unregulated, raising numerous questions. Services provided to a project owner who is a consumer are also excluded from the scope of the Regulation; thus these activities cannot be considered crowdfunding.

One of the essential advantages of crowdfunding is that it can be used to help the implementation of projects that would otherwise not be possible without some other means of raising capital. This means that this form of fundraising can be a good addition to the range of financing available to date, such as institutional (venture capital funds) and non-institutional (angel investors) forms of investment, as well as traditional bank loans provided by credit institutions. Crowdfunding allows direct communication between the participants, which can provide immediate feedback on the success of a project. In addition, investors who may be able to support the effective implementation of the business plan with their higher level of expertise in the area affected by the project may also come forward. Moreover, the internet platform operated by the service provider means that individual intermediary institutions do not have a role to play, which results in significant cost savings. Finally, the project posted on the interface also has an advertising function from the project owner’s point of view. SMEs and start-ups are the main target audience for crowdfunding; it is therefore a new fundraising opportunity for them in particular, but obviously, crowdfunding is not excluded for other types and sizes of project owners either.

In relation to the gaining ground of crowdfunding activities in Hungary, it should be noted that in 2024 Q1 no domestic legal entity held an MNB licence for crowdfunding in Hungary, and prior to 10 November 2023, only one domestic entity was engaged in crowdfunding activities covered by the Regulation, taking advantage of the moratorium on licences granted under the Regulation. Foreign service providers are more plentiful; therefore, there are more participants among cross-border service providers.

The reasons for this lie in the licensing and operational requirements for the service provider and the regulations governing the conduct of the activity. The prudential requirements for a service provider to obtain a licence and to continue to operate are quite extensive and may discourage some participants from doing so. However, the existence of strict licensing and operational requirements is justified, as in crowdfunding, the financial contribution provided by investors is at stake. A further potential concern is the risk of breaching the constraints of an activity that is subject to licensing. The latter is, however, unfounded since, as long as crowdfunding is carried out on the basis and within the framework of the licence which authorises it, it does not constitute an activity subject to authorisation under the legislation of the financial and capital markets sector, on the part of any of the participants.

To sum up, contrary to preliminary expectations, the previously anticipated increase in crowdfunding has not taken place in Hungary as yet. This may also be due to the rather strict requirements imposed on service providers and the fear of operating without a licence. Despite the concerns outlined above, there is considerable potential for crowdfunding, and it is possible that, after the initial period, there will be an upswing in this area. For the start-ups and SMEs that are its primary target audience, this form of financing can be an appropriate alternative to traditional fundraising options, and the inflow of funds into the capital market in this way can act as a significant catalyst for the creation, survival or growth of these firms.

As per the decision of the MNB, the products of two issuers were removed from the BSE product list in 2023. The MNB has taken measures against the issuers concerned – OTT-ONE Nyrt. and SET GROUP Nyrt. – on several occasions in previous years, including fines, for breaching the obligation to provide regular information under the Capital Market Act, including the publication of annual reports. Trading the stock of both issuers has been suspended in previous years due to these deficiencies. However, the MNB's calls for statements and the provision of the obligatory disclosures in relation to the restoration of lawful operations have not led to any results for either issuer.

Despite numerous MNB decisions and notices, and the prospect of the sanction of cancelling its listing, OTT-ONE Nyrt. has not been able to comply with the transparent operation requirements for listed public limited companies and the minimum professional requirements pertaining to being traded on the stock exchange for years. These facts jeopardised the equal opportunities and legitimate interests of investors and public confidence in the financial intermediary system – including the functioning of the capital markets – with regard to the potential continuation of trading OTT-ONE Nyrt.'s shares on the stock exchange to such an extent that necessitated the delisting of the issuer's shares from the stock exchange product list. The MNB therefore ordered the delisting of OTT-ONE Nyrt.'s shares from the stock exchange as of 2 October 2023.

In addition, the MNB ordered the delisting of SET GROUP Nyrt.'s shares from the stock exchange product list as of 31 July 2023 for violations incompatible with the status of a public issuer of securities. Despite several previous measures taken by the MNB, the company has not fulfilled its basic disclosure obligations expected of stock exchange participants for years.

7.6.4 Ongoing supervision of issuers

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

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

The MNB's objectives are to encourage voluntary compliance by public issuers of securities, rather than imposing sanctions ex post, and to inform as widely as possible about the MNB's expectations and the practices required by law. To this end, the MNB held a Capital Markets Workshop on 12 October 2023, which was attended by 209 participants representing 55 issuers. During the workshop, the MNB staff gave presentations to the participants on insider information and insider lists, transactions by senior management and by persons closely associated with them, share buyback programmes and stabilisation, and the ESEF.

During the auditor training organised by the Education Centre of the Hungarian Chamber of Auditors (MKVK) in May 2023, a member of the issuer supervision team of the MNB presented the specific audit tasks, related regulations and MNB requirements for the institutions it supervises. Following the inspection of the 2022 annual reports, the MNB shared with stakeholders its findings and the detected deficiencies in several ways. In addition, the MNB shared its findings regarding the 2022 annual reports produced in the ESEF format with a wider audience of auditors as an invited speaker at the workshop of the Finance and Capital Markets Section of the MKVK on 7 December 2023.

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