



FINANCIAL CONSUMER PROTECTION REPORT



2017

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

Ferenc Rákóczi II



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Act CXXXIX of 2013 on the Magyar Nemzeti Bank designates the supervision of the financial intermediary system and within this mandates in particular the protection of the interests of consumers using the services rendered by financial organisations as the duty of the Magyar Nemzeti Bank, for the purpose of strengthening public trust in the financial intermediary system. Prudently operating, profitable institutions cannot exist over the long run without satisfied consumers, which would also render the existence of a stable financial sector which duly supports national economy goals impossible. Consumer confidence and stability are two inseparable concepts. Accordingly, since the supervisory duties have been integrated in the central bank, the Magyar Nemzeti Bank pursues its duty with reinforced consumer protection and a market surveillance approach.

The publication entitled ‘Financial Consumer Protection Report’ aims to inform the public and the institutions of the financial system in respect of current financial consumer protection issues, thereby enhancing the risk awareness of stakeholders and maintaining and strengthening confidence in the financial system. According to the intention of the Magyar Nemzeti Bank, its official activities to identify and reduce risks, its information and educational activities, and its efforts to enhance financial literacy all contribute to making the information necessary for decisions concerning financial institutions and products available to stakeholders, and thus strengthen the stability of the financial system as a whole.

The Report was prepared by staff members of the executive directorate in charge of consumer protection and market supervision. The Report was approved for publication by Deputy Governor Dr László Windisch.

The editorial deadline was 4 May 2018

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Greeting by the Deputy Governor

In accordance with the practice of previous years, the Magyar Nemzeti Bank (MNB) regards it as its important duty to inform the institutions of the financial system and the general public on the current consumer protection issues, thereby also enhancing the risk awareness of the stakeholders and strengthening trust in the financial system. The purpose of the Financial Consumer Protection Report, published annually, is to summarise the experiences, results and data of the previous year and provide consumers and institutions operating in the financial sector with a comprehensive picture on the current consumer protection topics. The MNB makes the publication available both online and in printed form to provide information to the widest range of stakeholders.

Our intention is to present in the publication the financial products and services offered to consumers and the common situations where consumers are directly exposed to financial risks. In order to protect consumers, the MNB examines domestic and international market developments, and as part of its supervisory functions it monitors and controls the lawfulness of the operation of institutions, their communication channels and the content of the latter. In addition, the MNB continuously monitors the topicalities of key importance in terms of consumer protection, it pays special attention to summarising the enquiries and indications received from customers, based on which it strives to pursue as efficient as possible consumer protection activity and active communication. The latter objective is served by the central bank's proactive consumer protection communication strategy as well. With its means, it facilitates conscious, well-founded decisions of consumers, gathering of in-depth information and the development of domestic financial literacy as a whole. After summarising the priorities, the report provides a detailed description of the MNB's financial consumer protection, administrative and customer service activity and the priority cases that affected a wide range of consumers in the period under review.

We believe that the Financial Consumer Protection Report is a clear and straightforward summary, which arranges the active consumer protection activity performed in 2017 and the related communication in a comprehensive document, and thus helps you obtain a more complete picture of current financial trends. I am convinced that you will be able to utilise in your financial decisions the knowledge obtained from learning about the developments and analysing the expected risks, thereby we take another step together towards developing the financial awareness of consumers.

Dr László Windisch
Deputy Governor
Financial Institutions Supervision
and Consumer Protection

Executive summary

Of the risks identified in 2017, those that deserve special attention on the financial market include the developments in interest rate risks and the provision of proper information to the consumers prior to concluding the contract, on the insurance market compliance with the requirements prescribing the transparency of premiums and costs, while on the capital market compliance with the directive (MiFID II) and regulation (MiFIR) related to investment activity, as well as the risks of instruments falling outside the competence of the supervisory authority and of the derivative products and investment forms based on those.

The credit products with a variable interest rate may substantially increase the borrowers' debt service in the short run in case of an increase in the reference rate; at the same time it may be much more difficult for the borrowers to assess the risks of variable-rate loans in full compared to fixed-rate loans. When the borrower tries to take out a relatively large loan compared to his income or debt service capacity, he may be encouraged to opt for a variable-rate loan product, as the initial debt service of these loans is usually lower than that of loans with fixed interest period. On the other hand, it is exactly these borrowers who may face the greatest difficulties when the reference rates increase, as they have already exhausted their debt service capacity to a great degree even under the level of interest rates that prevailed at the time of the drawdown.

After the turn in lending, the ratio of variable-rate loans is still significant within the new disbursements. These loans, particularly in the case of a stretched income situation, may increase the probability of late payment, and thus they represent a risk to be monitored closely, both in terms of consumer protection and financial stability.

With a view to facilitating the comparability of the banks' offers, stimulating competition in the banking sector and supporting the spread of housing loans with longer interest period, also bearing in mind consumer protection considerations, in the spring of 2017 the MNB created the Certified Consumer-Friendly Housing Loan certification. The MNB supports familiarisation with and comparability of the products by operating an online comparison site and by developing a certification mark linked to the products. Since the introduction of the certification, all significant large banks and all cooperative credit institutions have successfully applied for the certification. In view of the positive developments observed in 2017, the certification may have acted as a catalyst in the housing loan market.

In addition, providing the consumers with proper information is still a key risk in the financial market, evidenced both by the feedback from customers and the inspections performed by the MNB in 2017. The inspections revealed significant errors in the commercial communication of the institutions in several cases; of these the ones to be highlighted include the indication of the APR in advertisements of loan products in a hardly visible form or not indicating it at all, the absence of a representative example or when the data shown therein contradict the provisions of the APR regulation. Beyond that, in the case of financial service providers granting pawn loans, it was found during the inspection of a large number of institutions that the methodology used for the APR calculation was incorrect and the statutory provisions related to the maximum APR were breached, and compliance with these provisions still represents high risk.

The ethical life insurance concept introduced in 2017 resulted in major changes in the transparency of costs. With a view to restoring customer confidence and reducing misselling, i.e. sales as a result of providing misleading information, the Magyar Nemzeti Bank elaborated the elements of the ethical concept in close cooperation with the legislator and after long consultation with the market participants. The new regulation serves as a point of reference for the insurers, similarly to the Act on Fair Banking, but in certain topics even beyond that on how to adjust their products and behaviour to such common norms that serve the customers' interest and may result in a long-term, stable portfolio for the insurers. Based on the available data, the change in the regulatory framework had a substantial effect on the insurance product range, while more expensive products were phased out, as a result of which customers may choose from a more homogenous product range with higher safety. Going forward, the maintenance of this customer-friendly situation is the long-term objective, which will be supported by the MNB with all available means.

In the insurance market, the entry into force of the EU regulation containing uniform requirements with regard to information and distribution of retail investment package products and of the EU insurance distribution directive prescribing the creation of standard information brochures and the making of intermediary commissions public in 2018, may generate additional major changes, the preparations for which have been started by both the supervised institutions and the supervisory authorities.

As regards the operating rules of investment firms, the legislative changes linked to MiFIR and MiFID II represent major changes in a number of areas. The MiFID II regulation introduces a completely new, EU-level product governance system, covering the full life-cycle of financial instruments. The product governance requirements apply to investment service providers developing and distributing financial instruments, as well as to those that sell or offer to their customers financial instruments developed by others. Furthermore, the requirements apply to all customer types (retail, professional, eligible counterparty) and all financial instruments (including structured deposits). In addition, with MiFID II entering into force, the rules applicable to inducements place greater emphasis than before on investor protection and on ensuring and enhancing transparency.

The preparation for the new regulation represented a significant task in 2017 both for the supervisory authorities and market participants. The survey of financial innovations has commenced already in 2017, and the EU issued a warning on the risks of certain innovations; in addition, accompanied by measures at the level of Member States, the investigation of the possibilities of a potential Community level intervention has also commenced. The MNB actively participated in the tasks related to the implementation of the law, provided an opinion on and proposals for the draft legislative provision, and supports market participants in the practical implementation of the requirements.

In addition to the foregoing, in the capital market those forms of investment and activities that fall outside the supervisory competence of the MNB and other foreign authorities continue to represent key risk. The MNB issued warnings on several occasions on the risks of the virtual means of payment promoted on the internet and operating in a system not regulated by law (also known as cryptocurrencies) and the related derivative products. In view of the fact that cryptocurrencies do not come under the supervision of any central bank or public authority (the MNB does not license or register them), they may involve extremely high risks, as there are no proper liability, warranty and loss bearing rules that would protect the consumers' interest in the event of fraud. Such instruments are issued by a community of users, rather than by an institution with obligations and responsibilities. If a problem emerges either in the records or during the execution of a transaction, no institution will guarantee for users the execution of a transaction or compensation for damages.

In connection with this, in 2017 both the European Securities and Markets Authority (ESMA) and the MNB called consumers' attention to the spread – across Europe, including Hungary – of the initial coin offering (ICO) public form of fund raising, qualifying as an extremely high-risk investment. The feature of ICO is that an enterprise or a private individual issues – by applying distributed ledger technology, e.g. block chain – tokens and offers them for sale (most often for virtual currency) in order to raise capital for its project or finance its start-up company. ICOs are regarded as highly speculative forms of investment, since the price of tokens is usually extremely volatile and it may as well happen that investors are unable to redeem them for long periods. The ICO projects are usually associated with non-resident enterprises rendering cross-border services, the supervision of which falls outside the MNB's competence. In addition, even in the case of ICOs implemented by a Hungarian enterprise or private individual, it can be determined only on an ad hoc basis whether or not it comes under the MNB's oversight, and a number of ICOs – depending on their structure – may fall outside the scope of the EU or Hungarian legislation.

1 Background of the financial consumer protection activity

1.1 MACROECONOMIC OUTLOOK

Economic growth may continue both in the developed and developing countries, still accompanied by divergence in the monetary policy of developed countries. The previously global rising inflation halted, and thus monetary tightening by dominant central banks is likely to be postponed. The Federal Reserve in the US may continue gradual interest rate hikes, while monetary conditions in the euro area may remain loose for an extended period of time. In 2018, the economy of both the United States and China may pick up, while euro area economy may rise further at a slower rate.

Political uncertainty, problems of the banking sector and the growth in indebtedness may generate major systemic financial risks in several European countries. Although elections in the Netherlands, Germany and France have already taken place, doubts about the future of the European Union and the geopolitical risks still forewarn investors. In terms of lending, there are still significant differences between European countries and country groups. The banking sector of several European economies still struggle with problems inherited from the crisis, which continuously restrains their lending activity. However, due to the improving economic prospects, an easing in credit conditions could be observed. The sustainability of outstanding debt of the general government and the private sector continues to be questionable in several European countries.

As a result of the low interest environment, investors turn to riskier products, while bank profitability weakens. The globally low interest environment may result in a continued rise in the price of real assets, including real property, which carries the risk of the development of an asset price bubble. In the present low interest rate environment, imbalances may evolve in the capital markets, and this may also spread to new instruments, such as cryptocurrencies. In addition to the large investors, small investors also may opt for riskier investments offering higher yield instead of the lower yields realisable on bank products. The low interest environment may have a negative impact on banks' profitability, which is offset by institutions, in addition to cost cutting measures relying on digitalisation, by increasing fee and commission incomes.

In 2017, a major growth in GDP could be observed and this is expected to continue in 2018 as well; however, in the medium term the growth rate will presumably gradually decelerate. The substantial growth in real wages contributed to the upturn in consumption. Increasing domestic demand was the driver of economic growth, but this resulted in a decline in net exports. Expanding investments are expected to contribute to GDP growth until 2019; in addition to the public sector investments realised from EU funds, the investment activity of the private sector is also continuously strengthening. In the beginning of 2017, after the effects of the previous decline in oil prices had faded out, the consumer price index reached its tolerance band, and stayed between 2.0 per cent and 2.5 per cent. The dynamic two-digit wage growth had a moderate impact on inflation developments. The pace of domestic price growth is dampened by anchored household inflationary expectations and a moderate foreign inflationary environment.

The upturn in domestic demand resulted in a growth in outstanding borrowing in the household segment. The volume of loans disbursed to households until November 2017 outstripped the year-on-year value by 40 per cent. At the same time, owing to the debt cap rules introduced by the MNB, the growth in lending – contrary to pre-crisis years – may take place in a much sounder structure. In parallel with a pick-up in demand, slight easing in credit conditions was observed, primarily in respect of the price conditions. The pick-up in household demand could also be observed in the case of consumption and housing loans. As regards the growth of the housing loan market, monitoring of domestic housing market developments is also justified. The average house prices across the country are still below the level justified by the fundamentals, while even in the case of house prices in the capital we cannot yet talk about a level that is materially above the equilibrium.

The unfolding turn in lending was not accompanied by excessive indebtedness of households. The additional household loan/GDP gap, indicating the current level of cyclical systemic risks, is still well in the negative range and based on the expected dynamics of lending and economic growth, the development of positive gaps, i.e. overheating of the credit market, is quite unlikely in the near future as well. In the past two and a half years, a somewhat higher ratio of household loans was disbursed close to the limits applicable to the payment-to-income ratio (PTI): in the first half of 2017, one fifth of the loans were disbursed to more highly indebted clients, with PTI ratio of 40-60 per cent, which exceeds the ratio observed in 2015 by 5 percentage points. In parallel with this, the average PTI value rose from 24 per cent to 27 per cent between these two years. At the same time, with growth in real wages, the dynamics of indebtedness may also potentially decelerate. In recent years, a slowly rising trend may also be observed in the encumbrance of real properties serving as collateral. Since 2013, the loans disbursed under real estate collateral encumbered to a higher rate than 70 per cent of the market value, after a slow growth, reached a share of 29 per cent by mid-2017; however, on the whole the encumbrance of real estate collaterals was stable in the past two years: the average level between 2015 and 2017 was 55 per cent throughout the period. The increasing encumbrance of real estate collaterals may be decelerated by the slowdown in the housing market price increase resulting from the anticipated soar in home construction and – as a result of the favourable macroeconomic environment – by the dynamic growth in the households' net financial assets usable as self-contribution.

However, riskier loans with shorter interest periods still have a high share in the disbursement of housing loans. In 2017, similarly to the previous year, roughly 40 per cent of new housing loans were disbursed with interest fixed for a period not longer than one year, i.e. the exposure of new loans to interest rate risk may still be deemed high. In view of the fact that variable-rate products are typically chosen by borrowers of higher financial vulnerability, it has outstanding importance also in terms of financial stability and consumer protection that lending in sound structure is also supported by the proper ratio of loans with more favourable risk attributes, with the interest rate fixed for a longer term.

In 2017, the reduction of non-performing mortgage loans continued. The non-performing loan portfolio no longer represents extreme risk for the banking sector; however, in the entire financial system, the total ratio of non-performing household loans, despite the declining trend, was still 12.4 per cent at the end of the third quarter of 2017. The largest part and also the highest social risk are represented by the roughly 122,000 overdue mortgage loan contracts. At the end of the first half of 2017, the larger part of this portfolio was in the balance sheet of financial enterprises (mostly taken over for workout). Although these loans no longer represent key risks for the banking sector, the activity of the workout companies still requires strong consumer protection control.

1.2 DIRECTIONS OF SUPERVISION AND CONSUMER PROTECTION

The progress of information technology continuously generates new challenges for the oversight activity, since innovations may also carry new risks in respect of which no past experience is available for the assessment of the probability of negative events.

The generation, storage and processing of datasets of increasing size and complexity and the application of big data in the financial sector pose major challenges to the supervisory authorities. The processing of the vast datasets may carry, in addition to data protection problems, consumer protection risks such as the restriction of clients' access to certain products and the disadvantages arising from cross-selling. At present, no single European regulation exists for big data; however, there are industry legislative acts, and thus both the member states and the European supervisory authorities should make efforts to facilitate the provision of proper information to consumers and the enhancement of transparency.

With the spread of digitalisation and financial innovations, financial service providers operating outside the classic banking framework have become increasingly popular, as they often offer convenient and cost-efficient solutions to their customers. On the one hand, this process may be favourable for the customers, as the growing competition may stimulate financial institutions to enhance the quality of financial services. On the other hand, with the spread of these service types, consumer protection risks may also increase, in view of the fact that they typically fall outside the competence of the national supervisory authorities.

The EU's revised payment service directive (PSD2) addressed part of the aforementioned dilemmas related to financial innovation, the transposition of which in the national legislation was approved by the Hungarian Parliament in 2017 with effect of January 2018. The purpose of PSD2 is to foster competition and innovation, enhance legal and IT security, in addition to further strengthening consumer protection. To this end, it also permits new players to enter the payments markets within a regulated framework, and thus new innovative fintech companies complying with the directive, referred to as "third party service providers" may gain access to the account servicing banks' IT systems and a part of the information stored therein. Customers may initiate payments from their payment accounts through the new service providers, and also use account information services. It should be noted that in addition to the increased openness of banking, customer protection rules are also substantially strengthened. The payment service providers bear increased liability in the case of fraud related to payment instruments (such as bankcard, telebank or internet banking), which may be as high as full compensation, if the omission of the customer cannot be proven by the payment service provider or if the payment service provider did not apply strong client authentication. In addition, other provisions related to information and complaint management have been introduced and supplemented with a view to protecting consumer interests more efficiently. On account of the further strengthening of consumer protection, the legislator incorporated a number of new IT and data processing requirements in the directive, the purpose of which is to enhance the security of electronic payments, responding to the increasing challenge of recent years posed by cyber crimes.

PSD2 prescribes for the account servicing payment service providers that from January 2018 they must not hinder their customers in using the services of "third party service providers" or hinder "third party service providers" in rendering their services. Accordingly, in possession of a proper authorisation, the latter may operate freely, thereby strengthening market competition. In addition, it is a new IT requirement that payment service providers and the new type of "third party service providers" must communicate with each other through a safe, dedicated interface.

The European legislator regulates the technical requirements applicable to the safe communication interface in a regulation, which will enter into force in Hungary only in January 2019, thereby providing market participants with sufficient time to implement their IT investments. Thus, there is a transitional period between January 2018 and January 2019, during which it is not mandatory to use the safe communication interface. Without this, the services of "third party service providers" can only be used if the customers provide the "third party service providers" with their internet bank username and password, and this IT solution carries serious security risks.

It should be noted that, on account of the foregoing, during the transitional period the rules applicable to the liability for losses related to the use of "third party service providers" depart from the general rules. Based on the relevant statutory provisions, if in the transitional period a customer uses the services of a "third party service provider" by transferring his internet banking username and password to it, in the case of a potential loss event the full loss shall be borne by the customer. After the transitional period, due to the mandatory use of the safe communication interface, the general rules will apply to the liability for losses.

The new set of standard European Union rules transforming the structure of the capital market and enhancing the protection of investors (MiFID II and MiFIR) entered into force on 3 January 2018. The protection of investors is served, among others, by the enhancement of the transparency of capital market schemes and the regulation of new, innovative technologies. Based on the new, standard product intervention rules, certain speculative products may be restricted or prohibited by the national authorities within their own jurisdiction and by the European Securities Market Authority (ESMA) in the whole territory of the European Union. After the data collection and analysis related to defined, high-risk products, the ESMA elaborated the first EU-level product intervention measure, published the planned implementation thereof and also announced consultation with the market participants.

As a result of the EU legislative process aimed at the protection of household investors, from 2018, in relation to the household investment products appearing in various financial sectors, an obligation to provide written information of mandatory form and content has been introduced, the purpose of which is to simplify the comparison of products for consumers, thereby contributing to well-founded investor decisions. On the model of MiFIR, the regulation on key information documents for packaged retail and insurance-based investment products (PRIIPs) also provides the authorities with power of intervention at the product level. Pursuant to the new regulation, the European Insurance and Occupational

Pensions Authority (EIOPA) and the member states' supervisory authorities will have the opportunity to restrict or prohibit (even in advance) the distribution of investment products that raise investor protection or financial stability concerns.

The preparation for the new regulation represented a significant task in 2017 both for the supervisory authorities and the market participants. The survey of financial innovations has commenced already in 2017, and the EU issued a warning on the risks of certain innovations; in addition, accompanied by measures at the level of member states, the investigation of the possibilities of a potential Community level intervention has also commenced. The MNB actively participated in the tasks related to the implementation of the law, provided an opinion on and proposals for the draft legislative provision, and supports market participants in the practical implementation of the requirements.

The change in the international legislative environment further strengthens the direction that has been followed by the national supervisory authority for years. The oversight instruments that facilitate fast and efficient intervention in the financial markets have gained increasing weight. In addition to the ex officio inspections and those launched based on a petition, several market practices raising consumer protection concerns have been identified in the course of continuous surveillance. The identified problems typically related to customer information and the possibility of filing complaints and concerned, among others, shortcomings in the information displayed on the institutions' website and the accessibility of service providers by consumers. Undesirable market practices, indicated to the respective institutions, included the failure to update information on the risks of excessive indebtedness, the partial lack of compliance with the recommendation on the treatment of clients with disabilities and in several cases, the institutions complaint management regulations had to be amended. In 2017, the MNB used the tool of consumer protection warning in 255 cases in total, which permitted the proactive management of disquieting market behaviours.

In addition, the efficiency of surveillance is also supported by closer communication with the financial service providers, through which the indicated problems may often be rectified without launching an inspection or public interest litigation. However, this requires the MNB to have up-to-date information on the institutions' activity and products, which also necessitated, in addition to reforming data reporting, a conceptual change in the surveillance activity. A good example of this is the analysis performed by the MNB in 2017, where it scrutinised the effective regulations of 11 banks applicable to consumer mortgage loans, the prevailing list of conditions and sample contracts, with a view to identifying potentially unfair conditions and achieving repeal or amendment of those. The MNB identified in the case of all banks such general terms of contract that in a public interest litigation may prove to be unfair, and in respect of those sent notices to the respective financial institutions. As a result of its action, all banks adequately modified or cancelled the contractual terms that the MNB deemed disquieting.

2 Consumer protection risks

2.1 RISKS IDENTIFIED IN THE FINANCIAL MARKET SECTOR

Almost two-thirds of consumer protection petitions and half of the enquiries received by the MNB's Customer Service Desk were related to the products and services of the financial market sector. Similarly to 2016, the majority of the notifications received from customers concerned loan contracts and defaulting on the related payment obligations. It is a positive development compared to the previous years that the majority of the debtors struggling with payment difficulties already actively cooperate in the settlement of the debt as soon as possible, i.e. they enquire at the MNB's Customer Service about the options and continuously consult the respective financial service provider. The process between parties aimed at finding a solution was also fostered by the recommendation issued by the MNB in 2016 on the recovery of defaulted household mortgage loans to restore the solvency of debtors. The second largest number of consumer complaints, after loan contracts, concerned current account contracts, and in particular, customers complain about the fees and costs charged by the financial service providers. These settlement disputes usually resulted from the fact that the clients fail to obtain sufficient information prior to concluding the contract. In order to reduce the number of settlement disputes, it is important to emphasise the consumers' responsibility to obtain adequate information before concluding the contract on the opportunities offered by the various service providers and the related costs, and – in the knowledge of their financial practices – compare the services rendered by the financial service providers. The comparison of the offers is also supported by the MNB's Bank Account Selector and Loan and Leasing Product Selector applications.

In 2017, the strengthening of consumer awareness related to interest rate risk was a priority objective in the financial market sector. With a view to stimulating competition in the banking sector and further enhancing transparency, the "Certified Consumer-Friendly Housing Loan" product was introduced, which resulted in the spread of comparable housing loans with standard conditions and favourable pricing. The focus was still on the inspection of compliance with fair banking rules, which is inspected by the MNB at 16 additional financial institutions, primarily in respect of the information provided before concluding contracts and the application of the interest amendment indicators in accordance with the provisions of the law. In addition, the inspection of information applied in the commercial communication also received special attention, where the MNB identified shortcomings at the banks in relation to the indication of the APR and the illustration thereof by a representative example, while in the case of pawnbroking financial enterprises even the calculation of the APR often failed to comply with the law.

Customer information bears utmost importance in the protection of consumers' interest and in the facilitation of conscious financial decision, particularly in the case of intermediaries, where the relation between the customers and the lending credit institutions and financial enterprises is joined by a third actor as well. Accordingly, inadequate customer information was in the focus of consumer protection surveillance also in respect of independent financial market intermediaries.

2.1.1 Consumer awareness of interest rate risks

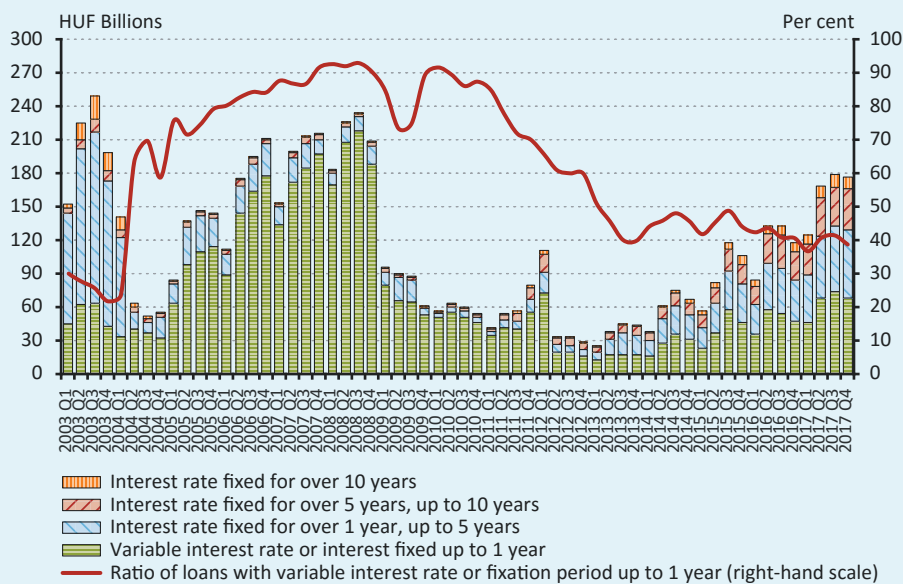
The variable-rate loan products may substantially increase the borrowers' debt service after a rise in the reference rate. The interest rate of variable-rate loan products may be repriced within maximum one year in line with the tenor of the reference rate. Although, at present, the level of the reference rates is historically low, close to zero per cent, and thus at present borrowers have access to loans with lower debt service, it cannot be precluded that the level of the reference rate may significantly rise in the future. This is a key risk particularly in the case of mortgage loans, as those typically represent long-term, over 10-15-year credit relationships. Consequently, the debt service of borrowers opting for variable-rate products may also increase substantially. Contrary to those opting for loan products with interest rates fixed for a longer period, borrowers of loans with interest rates tied to a reference rate may have much less time to prepare for the fulfilment of the higher debt service, and the increasing interest expenses generate substantial extra expenditure for them compared to a loan with interest rates fixed for a longer period.

Compared to fixed-rate loans, it may be much more difficult for borrowers to assess the risks of variable-rate loans in full. Even in possession of information related to the contractual rules applicable to interest calculation on loan products, it may be a challenge to develop reliable expectations; for example, consumers may – even despite receiving relevant information – erroneously apply the low level of interest rates experienced in the past period with high certainty to the future as well. Due to this, it may happen that the borrower opts for a variable-rate loan even in those cases when it is not necessarily favourable for him or her in the longer term. By choosing loans with short interest period many borrowers, for whom later on the loan instalment may generate problems, undertake substantial interest rate risk, and after an increase in the level of interest rates, their disposable income less the instalment may materially decrease.

The choice of housing loans with short interest rate fixation periods may represent an even greater risk for households with stretched financial conditions. When the borrower would like to take a relatively large loan compared to his or her income or debt service capacity, he or she may be encouraged to opt for a variable-rate loan product, as the initial debt service of these loans is usually lower than that of loans with fixed interest rate fixation periods. At present, in the Hungarian housing loan market, this is substantially contributed to by the fact that due to insufficient bank competition, in the case of loans with longer interest rate fixation periods, consumers face higher interest rate spreads compared to variable-rate loans. Since due to the initial interest spread the borrower may obtain the same loan amount with a lower instalment by opting for a variable interest rate, he/she has the opportunity to become indebted to a higher degree than by taking a loan with a longer interest rate fixation period. On the other hand, it is precisely these borrowers who may face the greatest difficulties when the reference rates increase, as they have already exhausted their debt service capacity to a great degree even under the level of interest rates that prevailed at the time of the loan disbursement.

After the upturn in lending, the ratio of variable-rate loans is still significant within new disbursements. In Hungary, in the past years, loan products with interest rate fixation for up to one year accounted for roughly 40 per cent of new housing loans characterised by longer maturities and thus representing higher interest rate risk for the borrower (Chart 1). Although in parallel with the pick-up in the disbursement of Certified Consumer-Friendly Housing Loans, this ratio dropped to 28 per cent by February 2018, variable-rate loans should still be monitored closely. These loans, particularly in the case of a stretched income situation, may increase the probability of late payment, and thus they represent a risk to be monitored closely, both in terms of consumer protection and financial stability.

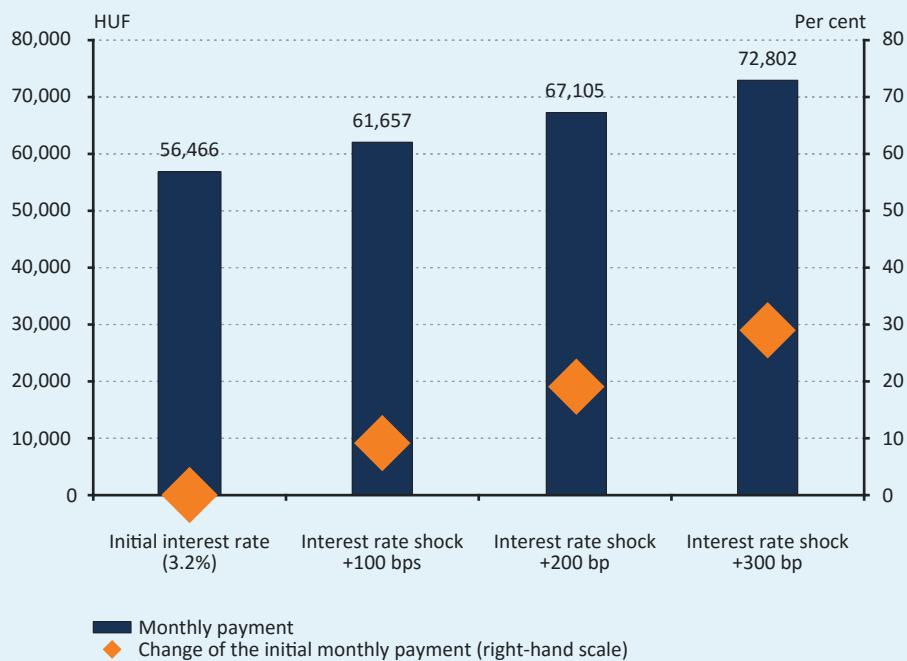
Chart 1
Distribution of new housing loans by interest fixation period



Source: MNB

Even a more moderate, 1-3 percentage point change in the level of interest rates may raise the debt service by roughly one third. After a potential increase of 1-3 percentage points (100-300 basis points) in the level of interest rates, the instalment of the contracts tied to a reference rate may rise by roughly 10-30 per cent in the case of a loan of HUF 10 million with a 20-year maturity (Chart 2). Due to this degree of potential variance of the debt service, taking out a loan product with a variable interest rate may only be an option to be considered by borrowers of an adequate income situation who are fully aware of the interest rate risk. However, in the case of the average borrower, the greatest safety may be offered by choosing products with a longer interest rate fixation period.

Chart 2
Changes in the debt service of housing loans with an interest fixation period of less than one year under various interest rate shocks



Note: Assuming a loan amount of HUF 10 million and a 15-year maturity. The calculation shown considers an immediate shock as a high estimate of the interest rate risk.

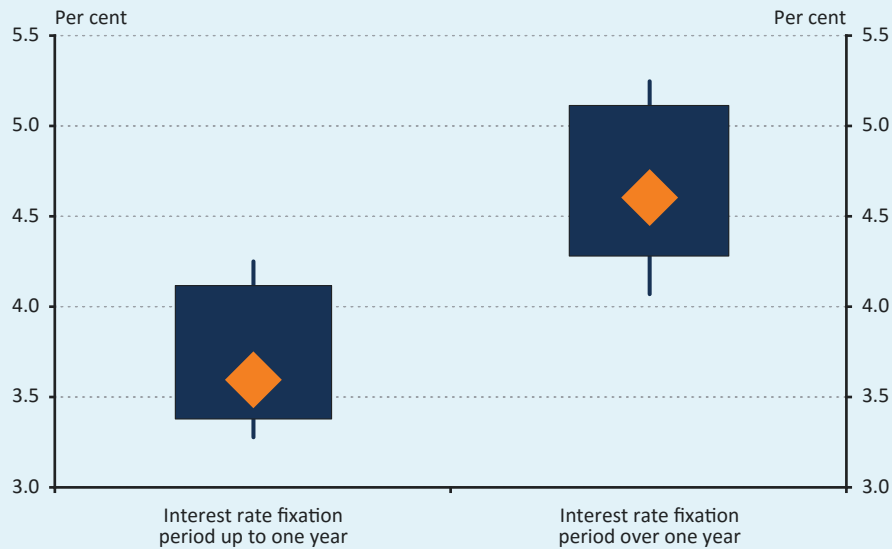
Source: MNB.

Box 1

Experiences of the introduction of the Certified Consumer-Friendly Housing Loan

In view of the dynamic growth in the volume of household lending, it is particularly important that it should take place in a healthy structure. In the present low interest rate environment, one key element of sustainable growth in lending is the spread of housing loans with longer interest rate fixation periods being less vulnerable to the rise in interest rates. However, due to the reasons described above, variable-rate products still have substantial weight in new housing loans, with substantial contribution to this by the banks’ pricing practices. At the end of 2016, the average difference in the interest rate spread of variable-rate loans and loans with longer interest rate fixation period was high even by international standards, and major differences could be observed between offers of the individual banks (Chart 3). The major differences between the banks’ offers may be attributable to the insufficient degree of bank competition, which may result, among others, from the difficult comparability of housing loans and the lack of transparent conditions.

Chart 3
Distribution of average interest rate spreads above the reference rate of loans contracted in 2016 among banks by interest rate fixation period



Note: First and fourth quintiles, and first and third quartiles. The rhombus represents the median values. The interest rate spread is calculated as the difference of APR and the BIRS applicable to the respective maturity.

Source: MNB.

With a view to facilitating the comparability of the banks’ offers, stimulating competition in the banking sector and supporting the spread of housing loans with longer interest period, also bearing in mind consumer protection considerations, the MNB created the Certified Consumer-Friendly Housing Loan certification in the spring of 2017. Upon fulfilling the strict certification conditions, banks became entitled to sell Certified Consumer-Friendly Housing Loan products and use the related logo. The Certified Consumer-Friendly Housing Loans are standard, easily comparable products (Chart 4).

Chart 4
Previous lending practices and characteristics of the Certified Consumer-Friendly Housing Loans

Previous housing loans	Certified Consumer-Friendly Housing Loans
Difficult cost and fee structure	<ul style="list-style-type: none"> Fees applied before disbursement and prepayment fees are capped No hidden costs
Difficult comparability of bank offers	<ul style="list-style-type: none"> Online price comparison website
Prolonging bank processes	<ul style="list-style-type: none"> Strict deadlines for evaluating the loan application and for disbursement
Frequently short interest rate periods	<ul style="list-style-type: none"> The length of the interest fixation period may only reach 3, 5 or 10 years, or the interest rate should be fixed for the whole loan term The interest rate spreads above the reference interest rate are limited
High prepayment and early repayment fees	<ul style="list-style-type: none"> Lower prepayment and early repayment fees than the regulatory limits

Source: MNB.

The MNB supports familiarisation with and comparability of the products by operating an online comparison site and by developing a certification mark linked to the products. In order to collect all information related to the certified products, the MNB created the minositetthitel.hu site, which also offers a dedicated online calculator ensuring comparability of the Certified Consumer-Friendly Housing Loan offers. With the use of the Comparison site, those wishing to take a loan may download personalised offers – in a transparent, tabular form in ascending order by the APR value of the loans – calculated on the basis of price formulas provided by the banks and data provided by the consumer. In addition to operating the comparison table, the MNB also applied for trademark protection in respect of the Certified Consumer-Friendly Housing Loan designation and the related logo with a view to making the certified products more well-known and clearly identifiable by consumers.

Since the introduction of the certification, all significant large banks and all cooperative-form credit institutions successfully applied for the certification. Until May 2018, the certified institutions started to sell several dozens of certified products, and thus they became available to a wide range of consumers (Table 1). Since the launch of the actual marketing in September, both the number of views of the online Comparison pages and the role of the products in lending showed dynamic growth. The MNB page, launched on 1 September 2017, was opened by more than 400,000 visitors on more than 1 million occasions by May 2018, and roughly 90,000 offers were downloaded from the calculator.

Table 1
Certified loan products by applicant institutions and marketed interest fixation periods

	3 years	5 years	10 years	Fixed interest rate
Takarék Kereskedelmi Bank Zrt.*		✓	✓	
Cooperative-form credit institutions of Takarék Group**		✓	✓	
Erste Bank Hungary Zrt.	✓	✓	✓	
K&H Bank Zrt.	✓	✓	✓	✓
MKB Bank Zrt.				✓
OTP Jelzálogbank Zrt.		✓	✓	✓
Raiffeisen Bank Zrt.		✓	✓	✓
CIB Bank Zrt.		✓	✓	
UniCredit Bank Hungary Zrt.	✓	✓	✓	✓
Budapest Hitel és Fejlesztési Bank Zrt.		✓	✓	

* Takarék Kereskedelmi Bank Zrt. was formerly known as FHB Kereskedelmi Bank Zrt.

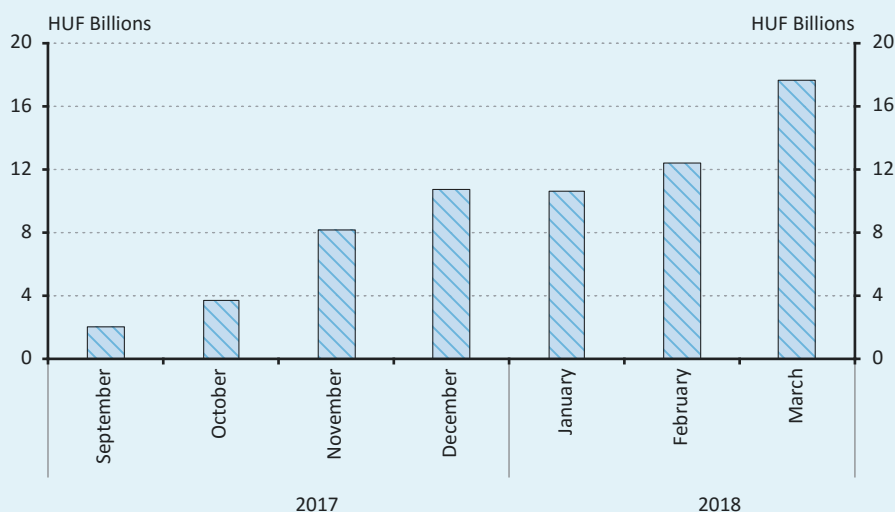
** Bóly és Vidéke Takarékszövetkezet has not commenced the distribution of its certified loan product.

Source: MNB.

The first acceptance offers were received by the banks as early as June, followed by a dynamic rise in disbursements from September. After the introduction of the certification in June, in July lenders issued offers for concluding certified loan transactions in a value exceeding half-billion forint. From September, the actual monthly disbursements also rose dynamically and by March 2018 they reached roughly HUF 18 billion.

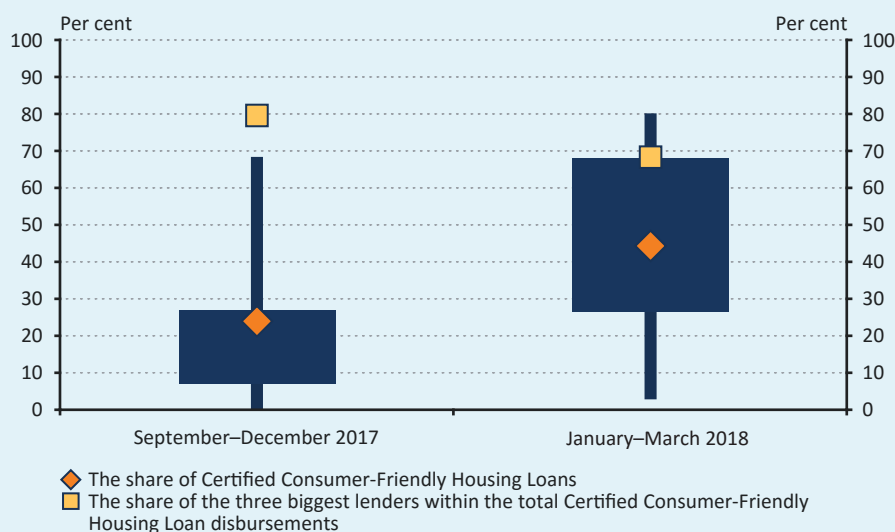
The vast majority of the Certified Consumer-Friendly Housing Loans were disbursed by three lenders, but in the past months market concentration started to decline. The three outstandingly active institutions pioneered the penetration of the certified loans, gradually followed by growth in the disbursement of Certified Consumer-Friendly Housing Loans by other institutions as well. As a result of the other disbursing institutions' catching up, the share of the largest lenders within the disbursement of these products declined close to 70 per cent by early 2018, which may lead to a gradual rise in market competition.

Chart 5
Changes in the disbursements of Certified Consumer-Friendly Housing Loans



Source: MNB.

Chart 6
Breakdown of the Certified Consumer-Friendly Housing Loans within new disbursements by lenders and share of the largest lenders in the disbursement of Certified Consumer-Friendly Housing Loans



Note: The ratio of certified products was calculated within the housing loan disbursement with an interest rate fixation period of at least 3 years, excluding the loans disbursed by building societies. The distributions show the minimum and maximum values, and the first and third quartiles.

Source: MNB.

In view of the positive developments observed in the second half of 2017, the certification may have acted as a catalyst in the housing loan market. In 2017, the disbursement of loans with longer interest rate fixation periods substantially increased, particularly from the last quarter of the year. In addition, in both periods, i.e. calculated from June 2017, denoting the start of the submission of applications and from September, the start of the actual distributions, to February 2018, a substantial, 60-70 basis point year-on-year decline can be identified in the interest rate spread of loans with an interest rate fixation period of at least 3 years. As a result of the decline in spreads, the relative cost disadvantage of these products compared to variable-rate loans dropped to almost one third from the start of the comparison website until February 2018, which supports the penetration of housing loans with longer interest rate fixation periods, entailing a lower interest rate risk.

The inadequate assessment of the interest rate risk by consumers is also attributable to the fact that according to the prevailing EU and Hungarian regulation, prior to concluding the loan contract such annual percentage rate (APR) is presented, which calculates the anticipated future instalments assuming constant interest rates even in the case of variable-rate loans. That is, according to the presently effective regulation of the APR calculation, if the financial organisation is unable to quantify the value of the parameters necessary for the calculation of the future amount of instalments, it has to estimate the debt service assuming the last known value. As a result of assuming a constant interest rate, the volume of cash flow does not reflect all information, available to the financial organisation, on the future change in the instalments.

Box 2

MNB recommendation on APR adjusted for interest rate expectations (IAPR)

With a view to improving the transparency of information related to the interest rate risk of mortgage loans, the MNB elaborated a new recommendation and sent it to the Banking Association early in 2018 for professional consultation. The expectation outlined in the new draft recommendation is that lenders should present the value of APR adjusted for the interest rate expectations, in addition to complying with their statutory information obligation. Furthermore, after the publication of the recommendation, lenders will be expected to call customers' attention more specifically to the interest rate risk, as well as to compare the interest rate risk of mortgage loans with different interest calculation more transparently, upon issuing the indicative offer and providing preliminary and customised information.

The information expected by the MNB presents the annual percentage rate adjusted for the interest rate expectations relevant for the mortgage loan chosen by the consumer, as well as the instalment and total amount to be repaid estimated on the basis of assumed future interest rates, comparing it with mortgage loan products with interest rate fixed in the interest period offered by the financial organisation and with interest fixed until maturity. At the same time, in addition to the information, it must also be borne in mind that due to future economic events the actual interest rate and instalment may depart from the value indicated in the information to an unpredictable direction and degree and that there is no theoretical limit for the future value of the interest, and thus the client's interest rate risk is also unlimited.

With the recommendation, the MNB also wishes to point out that the variable rate loans tied to the reference rate and the loans with interest fixed for a short interest period adjust to the changing interest environment faster, and hence the monthly instalments may change more frequently than in the case of loans with interest fixed for longer interest periods. It should be noted that although the interest rate of the loans fixed for longer period is often higher, they offer greater protection against and predictability of the variation in the instalments.

2.1.2 Fair lending

The fair banking inspections launched in 2016 ended in the first quarter of 2017. The MNB identified infringements at 21 of the 23 inspected financial institutions, and it imposed consumer protection penalties in the total amount of almost 19 million on 18 institutions. No systemic shortcomings could be identified in the practice of the institutions; nevertheless, the MNB identified deficiencies in certain pre-contract information elements, such as the preliminary information on tied agents, the personal information to be provided in the case of mortgage loans, information related to the period during which the instalment of the mortgage loan remains constant, information documents to be handed over to the customers before contract conclusion and publication of the sample text of typical loan contracts on a mandatory basis. In 2017, the inspection of compliance with the fair banking rules remained a key focus area; the MNB launched inspections at 16 additional financial institutions, primarily in respect of the information provided before concluding the contract and the application of the interest amendment indicators in accordance with the provisions of the law. The inspections are expected to be closed in the second half of 2018.

Inspection experience shows that during lending it is a high risk if financial institutions or their sales staff do not offer and sell financial products to consumers that meet the consumers' needs and are advantageous for them. Accordingly, it is extremely important that, in line with the legal requirements, the consumers receive the pre-contract oral and written information prior to each loan drawdown.

In addition to the foregoing, the MNB inspected – in relation to controlling the provision of advance information to consumers – the possibilities of optimising the documentation burden prior to concluding the mortgage loan contract. The volume of documents submitted by the determinant actors of the market was close to, and in some case even significantly exceeded, 200 pages. The major part of the documentation burden comprises of statutory obligation to provide information. The MNB, within its own competence, optimised the volume of the information, as a result of which the CCIS information condensed from seven to two pages and the information on the risks of excessive indebtedness from four to two pages, retaining the information included in the documents.

2.1.3 Disquieting provisions of mortgage loan contracts

Since the beginning of 2016, the MNB has been authorised by the MNB Act to initiate action in the public interest for the establishment of the unfairness of general contract terms and conditions that become part of financial organisations' consumer contracts. In view of the repeated soar in mortgage lending and the high number of consumers involved, the fostering of the fairness of mortgage loan contracts is a major interest of consumers and the MNB paid special attention to it in 2017. In order to identify potentially unfair conditions and achieve the repeal or amendment of those, the MNB scrutinised 11 banks' regulations governing consumer mortgage loan contracts and their current lists of conditions and sample contracts. The MNB conducted the analysis paying attention to whether general contract terms and conditions applied by the banks in consumer contracts to be concluded in the future complied with the requirements of good faith and fairness as specified in the Civil Code.

The MNB identified in the case of all banks such general terms of contract that in a public interest litigation may prove to be unfair. The central bank criticised – among others – the provisions that limited the rights of consumers to prepayment or made it more burdensome, the possibility of selecting or changing the insurer, and also those that made the cancellation of the preferential interest possible based on unjustified or disproportionate reasons, unilaterally interpretable by the lender. Conditions that permitted the unjustified charging of certain costs or the extraordinary termination of the contract due to disproportionate reasons were also identified in several cases. The most frequent problem was the lack of clarity, and thus in certain cases it was found that the wording of the provisions concerning the costs and fees, the default interest, the reasons for termination or prepayment were not understandable for the consumer in the contract terms.

The MNB notified the respective financial institutions, explaining its position with regard to the contract terms it deemed disquieting. As a result of its action, all banks adequately modified or cancelled the contract terms the amendment of which the MNB deemed necessary to eliminate the concerns.

2.1.4 Information shortcomings at a variety of loan products

As was evidenced by the previous sections, in order to ensure that lending meets the consumers' needs, it is necessary to pay special attention to the clear presentation of the products' attributes, which is warranted by the detailed provisions of the relevant laws. The provision of proper information to consumers still represents a risk in the financial market, which is evidenced by the fact that about one fifth of the complaints received by the MNB's Customer Service in 2017 in relation to loan products related to the provision of insufficient or inadequate information prior to concluding or during the existence of the contract. Accordingly, the MNB continuously inspected statutory compliance of the financial institutions' commercial communication and the methodology of the calculation of the published annual percentage rate (APR) in 2017.

The MNB passed a resolution in the case of three financial institutions (Budapest Hitel- és Fejlesztési Bank Zrt., Oney Magyarország Zrt., Kelet Takarékszövetkezet), where the identified key infringements included the indication of APR in a hardly visible manner or the absence of APR in the advertisements of consumer loan products, or the lack of a representative example or the data indicated therein contradicted the provisions of the APR regulation. As a result of the inspections consumer protection penalties were imposed in the total amount of HUF 24.5 million.

Of these, a consumer penalty of HUF 18 million was imposed on Budapest Hitel- és Fejlesztési Bank Zrt., due to the breach of the statutory provisions governing the commercial communication related to consumer loans. The inspection revealed that in certain cases the APR was not indicated or the indication of the APR value did not meet the visualisation requirement specified in the law, or the representative example in accordance with the legislative provisions had not been provided in the bank's commercial communication.

As a result of the inspection conducted at Oney Magyarország Zrt, the MNB imposed a penalty of HUF 5 million, as in its commercial communication the financial enterprise failed to indicate the APR value applicable to the consumer loans in a clearly visible manner or did not indicate it at all. The MNB imposed a penalty of HUF 1.5 million on Kelet Takarékszövetkezet due to the breach of the statutory provisions related to commercial communication, in view of the fact that applied APR had not been indicated properly and the slogan used in the advertisement of the cooperative credit institution was suitable for misleading the consumers in respect of an essential feature of the financial services, thereby encouraging them to make a transaction decision that otherwise they would not have made.

Beyond the foregoing, the inspection of pawn loans remains a key element, similarly to the practice of previous years, of consumer protection surveillance. In view of the fact that based on the experience of the supervisory authority a major part of the consumer category using such services are in a more vulnerable situation, in their case the provision of proper information and compliance with the statutory provisions related to the calculation of the maximum APR are of key importance.

During its surveillance activity, the MNB continuously inspects advertisements published on the website of pawnbroking financial institutions and on the internet, as well as documents submitted by the institutions. Based on these, it can get an overview at sector level on how the practice of the institutions complies with the statutory provisions related to the commercial communication, the publication and calculation of APR, and the maximum APR rate, and upon a suspected infringement it commences an inspection.

Of the inspections related to pawnbroking, it concluded 11 inspections in 2017, in relation to which it imposed penalties in the total amount of HUF 41 million. In the case of the inspected institutions, the infringements concerned the statutory provisions related to commercial communication, the APR calculation methodology and the maximum APR. The infringements identified in the practice of institutions and the penalties imposed in relation to those are summarised in Table 2. Despite the fact that inspections affected a large part of the sector, the MNB still perceives high risk in the case of pawnbroking institutions in relation to compliance with these laws. This is also evidenced by the fact that within the inspected institutions there was only one financial enterprise where no infringement was identified.

Table 2		
Data of the inspections of institutions granting pawn loans, completed in 2017		
Name of the institution	Topics involved in the infringements	Penalty amount (HUF million)
Boldva és Vidéke Takarékszövetkezet	APR calculation methodology	10
	Maximum APR	
Expressz Zálog Zrt.	APR calculation methodology	9
	Maximum APR	
	Commercial communications related to loans	
Corner Záloghitel Zrt.	APR calculation methodology	5
	Maximum APR	
Magnet Bank Zrt.	Commercial communications related to loans	5
Royal Záloghitel Zrt.	APR calculation methodology	4,5
	Maximum APR	
	Commercial communications related to loans	
Zálogfiók Zrt.	APR calculation methodology	2
	Maximum APR	
	Commercial communications related to loans	
Centrum Zálog Zrt.	APR calculation methodology	1,5
	Maximum APR	
Gold Orient Zrt.	APR calculation methodology	1,5
	Maximum APR	
Correct Zálog Zrt.	APR calculation methodology	1,5
	Maximum APR	
	Commercial communications related to loans	
Zálog és Hitel Zrt.	Commercial communications related to loans	1
Axe Capital Zrt.	No infringement was identified	0

Source: MNB.

2.1.5 Infringements identified in relation to product sales

In connection with lending activity, 17 per cent of consumer petitions received by the MNB's Customer Service and one tenth of enquiries concerned credit card contracts, which confirms the fact that the product carries higher consumer protection risk, and thus special attention must be paid to the inspection of consumer information.

In relation to credit cards sold as shopping cards, the MNB launched a targeted inspection at Budapest Hitel- és Fejlesztési Bank Zrt and Oney Magyarország Zrt in respect of the Tesco Shopping Card and the Auchan Shopping Card, respectively. It was found in both inspections that the products advertised as a shopping card are indeed credit card products and the relevant information had not been adequately shown in the commercial communication. In the case of credit products having a trading name, the MNB regards it as an expected practice that in the commercial communication related to the credit products the message that the advertisements present concerning a credit product is clearly enforced. Accordingly, in addition to indicating the APR, it is also necessary to designate the credit product clearly (in this case a credit card product).

In the commercial communication related to loans, the MNB expects in all cases – beyond the legislative provisions – that the communication indicated on such clearly and visibly shows the designation of the respective credit product, particularly in those cases when the lender uses a trading name for the credit product. Moreover, all such wording and manner of display should be avoided that may raise erroneous expectations of the consumer with regard to the availability or cost of the loan.

In view of their major role in the sales of financial products, the MNB also pays special attention to the inspection of the intermediaries' activity. Pursuant to the amendment of the Act on Credit Institutions and Financial Enterprises (Credit Institution Act), effective from 12 December 2015, it is forbidden to render financial services in the course of product sales at product road shows. This was inspected – based on notifications received from clients and peer authorities – with regard to the activity of intermediaries of three financial institutions and three independent financial market intermediaries.

During inspections, the MNB found that in April and May 2016 the tied agent of OTP Bank Plc – despite the statutory prohibition – referred the Bank's hire purchase product at 16 product sales made during product road shows. In view of the infringements, the MNB imposed a consumer protection penalty of HUF 12.8 million on the bank responsible for the tied agent's activity. It was also found in the case of Zepter International Ungarn Kft. (independent intermediary) that in the reporting period it organised product sales during product road shows where it rendered financial services in breach of the statutory provisions. In the course of the proceeding, the MNB imposed a consumer protection penalty of HUF 1 million on the intermediary.

Beyond the compliance with the prohibition specified in the Credit Institution Act, the MNB also inspected whether the information provided to consumers prior to contract conclusion complies with the statutory provisions. In the case of Hungaro Harmónia Kft. and Magyar Közérzetjavító Pont Kft, based on the declaration of the witnesses involved in the inspection and the documents submitted by the intermediaries, no breach of the prohibition related to the rendering of financial services, specified in the Credit Institution Act, was found; however, due to the shortcomings related to the information provided before concluding the contract, the MNB imposed a penalty on both intermediaries.

The MNB will pay special attention to the enforcement of the statutory prohibition in the future as well, and also counts on the reports of all consumers who experience the rendering of financial services at product road shows.

2.1.6 Management of payment difficulties

The notifications and requests for information received by the MNB's Customer Service from consumers also show that the fostering of the management of payment difficulties still bears utmost significance both for the financial institutions and the consumers in order to strengthen trust in the financial system. Similarly to 2016, the MNB received a large number of complaints and enquiries related to the rejection of petitions of equity; the notifications and requests received on this subject account for 5 per cent of enquiries and 8 per cent of complaints in the sector. Almost one third of the petitions related to the rejection of petitions of equity were submitted by consumers in respect of mortgage loan contracts. The 71 petitions related to workout account for hardly 3 per cent of the financial market complaints, while 6 per cent of the requests for information related to collection and workout activity.

Upon assessing the payment difficulties of loan debtor households, indebtedness, borrowing behaviour, financial awareness and vulnerability are important points to consider. In order to understand this better, MNB examined Hungarian loan debtors in Spring 2017 through a questionnaire-based survey of 1,500 households for the assessment of financial vulnerability of which it also took into consideration financial awareness aspects in addition to evaluated the income, wealth and indebtedness situation. Based on the results of the survey representative by region, settlement type and loan type, 3 to 8 per cent of loan debtor households may be regarded as excessively indebted (the ratio of indebted households varies depending on whether it is calculated on the basis of the payment-to-income ratio, the debt-to-assets or the debt-to-income ratio).

When considering the monthly financial balance (the balance of regular incomes and expenses) and the liquid savings of households together, 15 per cent of loan debtors may be regarded as financially vulnerable (Table 3). However, this proportion is sensitive to changes in household income: as a result of a decline in income, the rate of vulnerable households steeply rises. This reflects the fact that households need to respond swiftly to shocks that affect the financial situation of the household to ensure continued debt service. Situation awareness and problem-solving attitude may help to create the balance of the household budget in a stress situation, thus the survey also established the importance of forward-looking financial awareness essential for stability. Based on this, in addition to financially vulnerable households, there is a group of 12 per cent of households which is not vulnerable at present, but is close to the threshold and characterised by inadequate financial awareness.

Table 3
Dimensions of financial vulnerability and financial awareness among households with outstanding loans

		Vulnerability				
		Vulnerable	Temporary	Stable	Unknown	Total
Awareness	Low awareness	3,1%	3,8%	3,1%	2,3%	12,3%
	Medium awareness	6,0%	8,5%	13,8%	12,3%	40,6%
	Adequate awareness	5,2%	7,1%	16,9%	12,2%	41,4%
	Unknown	0,7%	1,5%	2,3%	1,1%	5,6%
	Total	15,1%	20,9%	36,1%	27,9%	100,0%

Note: Red denotes vulnerable groups, while orange denotes the vulnerable groups in a broader sense.
Source: MNB calculation based on the survey performed by Századvég.

Accordingly, the potential vulnerability of loan debtor households may substantially be reduced by enhancing financial awareness. During the analysis of groups of different awareness levels, it was found that lower financial awareness is accompanied by lower education level and – partially through this – with lower income level and standards of living. Another survey performed by the MNB, targeting the population below the age of 35, revealed that more than four-fifths of young people have not participated in any kind of financial education or training to date, and thus a general educational programme would be necessary to raise the level of financial awareness in Hungary to such a degree that would result in prudent borrowing attitude. The MNB took major measures in 2017, as well for the enhancement of financial awareness, more detailed information on which is provided in Section 3.

In addition to this, in the first quarter of 2016 the MNB issued a recommendation to financial institutions with regard to its expectations on the management of the overdue mortgage loan portfolio, and it also continuously monitors and analyses the situation of non-performing debtors. It can be established that the recommendation often served as a catalyst in the process of identifying a solution through the cooperation of debtors and lenders (as a result of this, banks contacted roughly 72,000 debtors with overdue loans by the end of 2016), and on the whole it encouraged the actors to assess the potential scenarios of emerging from the problem situation.

As a result of the portfolio cleaning process performed by the banks, a large part of non-performing loans were sold in recent years to financial enterprises purchasing receivables. This may be regarded as a positive development also in terms of consumer protection, as the workout companies are in many respects more suitable for managing the receivables from overdue debtors, as they are specialised in this both in terms of organisation and skills, and upon concluding the agreements they have more room for manoeuvre. In addition to this, they are interested in fast return and if they see the customer's willingness to cooperate, they can choose from a wider range of solutions instead of trying to enforce the claim at court. Considering the recovery of the housing market, now the sales of real estate may also be a way out of the difficult situation. In addition to the foregoing, until the end of 2017 participation in the National Asset Management Agency's (NAMA) programme helped almost 35 thousand socially vulnerable households. These debtors are exempted from their previous debt liabilities, their housing continues to be ensured and the rent payable by them is substantially lower than the instalment they used to pay. Moreover, in the first six years after joining the programme, debtors also have buyback right, and thus they may even regain possession of their home at preferential price.

The MNB placed special emphasis on the consumer protection control of the workout activity in 2017 as well. It still conducted a large number of petition-based consumer protection proceedings in respect of workout companies, and imposed penalties in a number of cases, particularly due to the breach of complaint management provisions and the Act on the Central Credit Information System. According to the experiences of the inspections, consumers often dispute at financial institutions the legal basis and the amount of the claim, which the MNB has no competence to inspect within the framework of consumer protection proceedings as it falls within the court's decision competence. However, within the framework of continuous surveillance, the MNB notified the workout companies on several occasions on the identified practices giving rise to anxiety in terms of consumer protection, and they cooperated in the correction of such practices.

From the point of view of consumers struggling with payment difficulties, it is also a significant risk whether the workout companies are accessible for their customers. The MNB has inspected and continues to inspect this with special care as part of the continuous surveillance and prudential inspections.

The MNB inspects the purchase and management of overdue receivables, and the sales thereof (potentially to an unauthorised buyer) in the framework of a thematic inspection, which commenced in 2017. In the seven inspections closed until the end of February 2018, it notified all affected institutions (Arthur Bergmann Hungary Zrt., Capital Hitelház Zrt., D.A. Faktor Zrt., DELTA FAKTOR Zrt., PK Zrt., Primátus Zrt., VIN-FAKTOR Zrt.) of practices giving rise to anxiety in terms of consumer protection, which contradict the expectations of the Recommendation No. 14/2012 (XII. 13.) of the Chairman of the Hungarian Financial Supervisory Authority on consumer protection principles for collection practices of workout companies (among others in respect of the notification after the assignment, the control of the liaison with debtors, the training of staff having contact with debtors and the record-keeping of receivables). At the same time, the majority of the financial enterprises modified their inappropriate processes already during the inspection, in accordance with the MNB's expectations.

2.2 RISKS IDENTIFIED IN THE INSURANCE SECTOR

More than one quarter (27 per cent) of the consumer protection petitions and 24 per cent of the enquiries received in 2017 by the MNB's Customer Service Desk related to insurance. Although within the total number of enquiries received the share of the insurance market rose compared to 2016, both the number of petitions and enquiries decreased year on year. According to the experience of the customer service, a rise was registered particularly in the ratio of disputes related to unit-linked life insurance concluded before 2017, which typically included disputes on information shortcomings, the amount and settlement of the insurance benefit. Special features of this type of insurance include the complex cost structure, long-term commitment and exchange rate risk. The received petitions also evidence that with a view to preventing potential future disputes, in the case of this product type special attention should be paid to scrutinising the terms and conditions of the contract and to conscious contracting, also supported by the ethical concept introduced in 2017.

In the insurance sector, the focus of surveillance continued to be on the consumer protection risks related to motor third-party liability (MTPL) insurance and unit-linked insurance. In the case of these products, the consumer protection inspection procedures identified infringements related to information and complaint management in several cases, and it was also revealed in a number of cases that the insurance companies pursued unfair commercial conduct in respect of consumers. In view of the disquieting practices revealed in the course of the individual procedures and consumer notifications, in 2017 the MNB sent enquiries to the insurance companies on several occasions as part of continuous surveillance and also launched several targeted and thematic inspections at these institutions during the year.

As regards insurance intermediaries, having the largest role in sales, in 2017 higher emphasis was placed on the inspection of compliance with the professional rules and the need analysis closely related to the first. The MNB launched a large number of proceedings at the consumers' petitions, where it identified the breach of insurance professional rules in the case of two institutions. It should also be noted that it was the first time the MNB conducted a procedure and imposed a penalty due to the breach of the obligation to cooperate with the Financial Arbitration Board, based on the provisions of Article 108(5) of the MNB Act effective from 1 July 2016. In the targeted inspection, the MNB found that CLB Független Biztosítási Alkusz Kft, in breach of its statutory obligation, failed to ensure the presence of a person authorised to conclude a compromise in the procedure conducted at the Financial Arbitration Board, and during the procedure it sent its response to the Financial Arbitration Board after the statutory deadline.

2.2.1 Transparency of premiums and costs

The ethical life insurance concept introduced in 2017 resulted in major changes in the transparency of costs. With a view to restoring customer confidence and reducing misselling, i.e. sales as a result of providing misleading information, the Magyar Nemzeti Bank elaborated the elements of the ethical concept in close cooperation with the legislator and after long consultation with the market participants. The new regulation serves as a point of reference for the insurers, similarly to the Act on Fair Banking, but in certain topics even beyond that, on how to adjust their products and behaviour to such common norms that serve the customers' interest and may result in a long-term, stable portfolio for the insurers.

Box 3

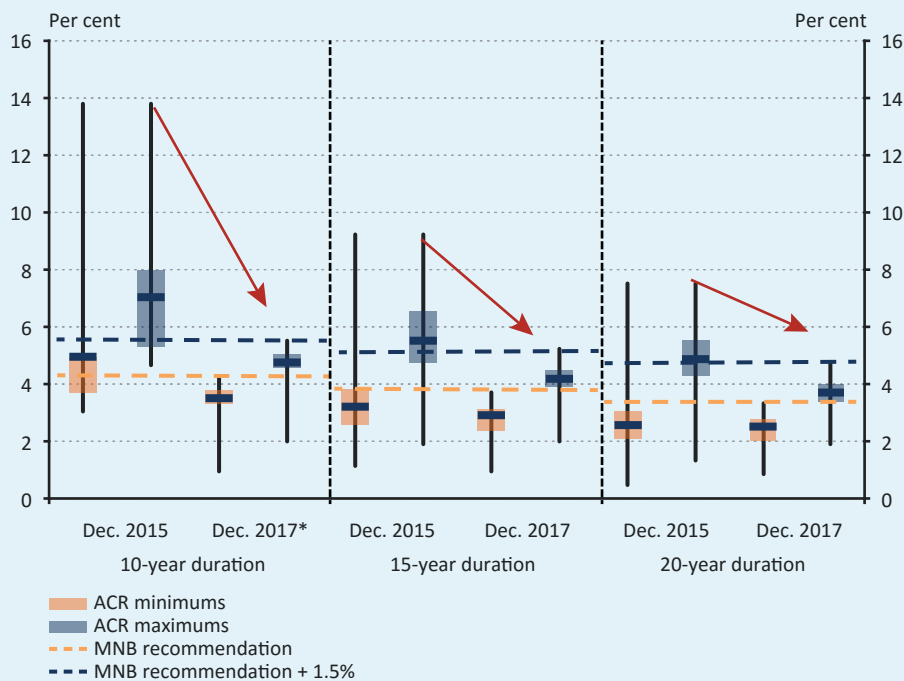
The ethical regulatory framework had a major market cleaning and cost cutting effect

Institutions are required to fulfil the most important measures of the ethical regulatory environment from 1 January 2017, as a result of which the transparency and comparability of products increased. The requirement that the designation of costs and their underlying content should be consistent with each other, and the minimum ratio of the saving to be repaid to the client and to be used for investment are specified by the law. The new regulatory environment specifies the MNB’s requirements for unit-linked insurance with regard to the practice to be followed in respect of the products, costs, records and during the sales, in a separate MNB recommendation (UL recommendation ¹). One of the most important elements of the recommendation is that with a view to achieving fair value for money, the annual cost ratio (ACR), applied earlier for pension insurance, was extended to all unit-linked insurance in addition to further tightening.

Based on the data reporting by insurers, the product range shrank to almost half, and according to the MNB’s questionnaire-based survey, the insurers modified or phased out almost all of their savings products and replaced them with new products. Owing to the introduction of the ACR limit scheme, the average ACR of the recurring premium of non-pension insurance fell from 4.95 to 3.84 per cent, while the average of single premium insurance, calculated for a term of 5 years, decreased from 4.02 to 2.65 per cent by the end of the year.

Based on the available data, the change in the regulatory framework had a substantial effect on the insurance product range, while the more expensive products were phased out, as a result of which the customers may choose from a more homogenous product range with higher safety (Chart 7).

Chart 7
Changes in the ACR value of recurring premium unit-linked insurance products



Source: MNB.
* In the case of 10-year duration only the fixed term contracts were taken into consideration

¹ Recommendation No. 8/2016 (VI.30) on the application of the prudential and consumer protection principles related to unit-linked life insurance.

The reduction of the costs paid by the customers temporarily decreases the insurers' income, and thereby their profit as well; however, due to the fact that as a result of the measures, the insurers and the customers are equally interested in the long-term maintenance of the contracts, a growth in the periods of contracts with settled premium may be expected. The increased trust, the further strengthening of self-provisioning willingness and the improvement in the retention ratio may be accompanied by further growth in the portfolio managed by insurers, the joint effect of which may offset the loss of income. Going forward, the maintenance of this customer-friendly situation is the long-term objective, which will be supported by the MNB with all available means.

In the insurance market, the entry into force of the EU regulation containing uniform requirements with regard to information and distribution of retail investment package products and the EU insurance distribution directive prescribing the creation of standard information brochures and the making of intermediary commissions public in 2018, may generate major changes, for which both the supervised institutions and the supervisory authorities started the preparations.

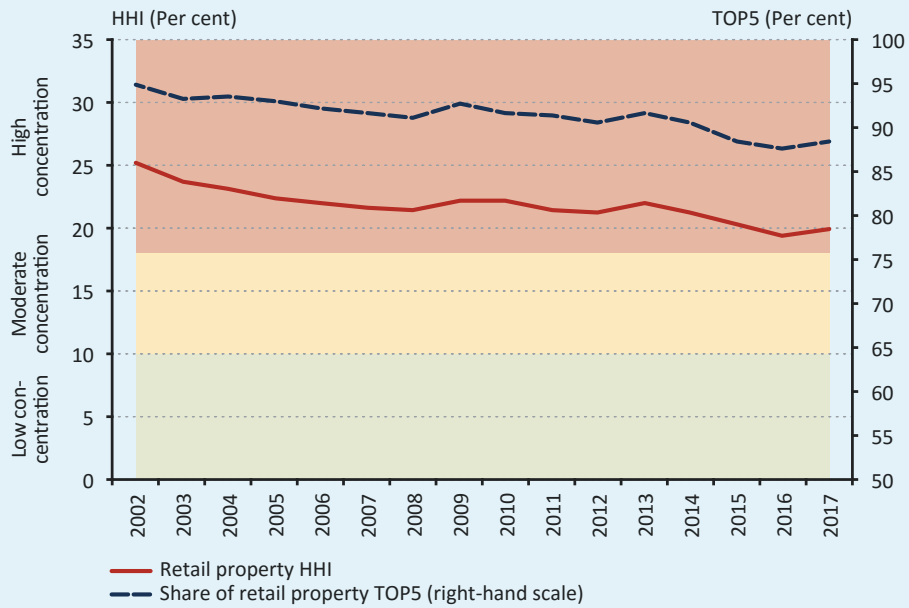
It is a key duty of financial consumer protection – by enhancing financial awareness – to enable consumers to take more substantiated decisions, to ensure that the markets become more transparent and the quality of the work of agents distributing financial service improves. The attainment of these objectives and market developments in the past decade, the products of more complex conditions dominating the market, the different product information and written brochures, as well as the non-transparent costs of insurance products necessitate a higher-level harmonisation at EU level, which is meant to be addressed by Directive 2016/97/EU on insurance distribution. The European legislative process projected tighter oversight of the insurance products and the spread of transparent, comparable product brochures. As part of this, uniform, standardised customer information brochures were introduced for life insurance and non-life insurance products across Europe. In order to provide more efficient protection for customers, insurers must have product oversight and governance policy and internal rules of procedures for the insurance schemes developed by them and that they wish to distribute. Those creating insurance products may only design and distribute insurance schemes that are compatible with the needs, features and objectives of the customers belonging to the target market. Product owners must also bear in mind the financial awareness of the customers belonging to the respective target market. It should be noted that the procedures and remuneration of the brokers and agents selling investment life insurance products must be developed and laid down in a regulation without generating a conflict of interest, i.e. the sales should be determined solely by the customer's need and it should not depend on the product that offers higher commission.

2.2.2 Need to strengthen market competition in the area of home insurance

For customers with real estate insurance covers that provide insurance benefit upon the occurrence of claim events affecting the movable and immovable property (e.g. natural disasters) are of key importance. As regards competition for the customers, the number of market participants and the range of services offered by insurers are essential elements.

In the Hungarian home market insurance, twelve domestic insurers render home insurance services; however, the segment is characterised by high premium income concentration. Although the concentration ratio trend from 2002 demonstrates declining concentration, it shows that from the fourth quarter of 2017 concentration has once again rose and according to the data, almost 90 per cent of the premium income of the Hungarian home insurance portfolio is still concentrated at five insurers (Chart 8), and of that four insurers dispose above 85 per cent of the premium income of the contract portfolio.

Chart 8
Concentration ratio of the household property insurance business



Source: MNB.

The remaining eight insurers share in the residual 15 per cent of the market’s premium income, based on which share it can be stated that the Hungarian home insurance market segment shows oligopolistic features.

The reasons for the high market concentration include – as a factor that hinders customers in switching insurers – that according to the relevant law the transferring of home insurance contracts from one insurer to the other, similarly to other indemnity insurance concluded for an indefinite duration, may be performed once a year, and a large part of the portfolio comprises contracts concluded together with housing loans, the amendment of which (transfer to another insurer) is subject to the approval of the credit institution.

Chart 9
Home insurance loss ratio



Source: MNB.

As regards the loss ratio of home insurance, the loss ratio² trend of around 33 to 35 per cent in the period of 2005 to 2017 is broken only by the outstanding loss ratio of almost 60 per cent observed in 2010 due to natural disasters, and by the loss ratio of almost 40 per cent, registered in 2011 (Chart 9). Although the insurers' related costs (e.g. claim settlement) somewhat qualify the performance of the segment, on the whole the stimulation of competition would be advantageous for the whole society, and could result in increasing service quality and decreasing price level for consumers.

2.2.3 Information provided prior to the expiry of life insurance

In 17 per cent of cases the consumers who submitted petitions to the MNB's Customer Services criticised the incomplete and insufficient information provided in respect of the insurance benefit. The largest number (52 pcs) of complaints related to insufficient information occurred in the case of index- or unit-linked life insurance.

In view of the high consumer protection risk arising from the shortcomings of information, the MNB developed the expectations applicable to customer information on unit-linked life insurance ceasing by expiry, which in addition to the elaboration of missing forms, also contains requirements related to time, form and content. Insurers are expected to remind their clients in the annual regular customer information to be sent in the year preceding the expiry that their insurance contract will expire next year.

In addition to the foregoing, the MNB recommends that the insurers should send the information on expiry at least 60 days before the expiry of the policy, through the means of communication specified in the contract, attaching all forms necessary for the payment of the insurance benefit. If the delivery of such notification to the customer fails, insurers should try to deliver the necessary information to the customers through other contact details specified by the customer or through the insurance intermediaries involved in the conservation of the portfolio. If the attempt to liaise with the customer fails, within 15 days prior to the expiry, it is recommended to send a letter to the mailing address of the customer, together with the necessary form and an addressed prepaid envelope for the customer.

The MNB also expects the insurers to keep the expiring amount, free of interest, separately between the ceasing of the contract by expiry and the fulfilment of the payment, and not to charge any handling cost or fee for the keeping of the expiry amount.

2.2.4 Risks related to the compulsory motor third-party liability insurance contracts concluded electronically

In the case of compulsory motor third-party liability insurance concluded with electronic liaison, which are extremely widespread and gaining further ground due to their favourable premium, the insurance companies fulfil their statutory obligation to provide information by sending it to the electronic mail address specified by the customers. However, it is a frequent problem that the customers do not receive the notices sent to the incorrectly specified or meanwhile terminated e-mail addresses, and this may generate substantial financial disadvantages for them, or – in extreme situations – their contract may be terminated without their knowledge.

In order to protect the customers' interests, the MNB surveyed the practice of insurers selling compulsory motor third-party liability insurance contracts electronically and found that it was not uniform either in terms of whether the customers have the opportunity to check the e-mail address specified by them during the contract conclusion or the procedure conducted by the insurer if an erroneous e-mail address was given. However, in view of the fact that when the compulsory motor third-party liability insurance contract is concluded electronically, the customers become entitled to preferential premium and the registered keeper of the vehicle is obliged by the law to maintain the insurance contract, the customers – in addition to the insurers – should act with due diligence and care when they specify their data.

After completing the inspection, the MNB formulated its expectations and made proposals for the necessary changes in management letters for the insurers pursuing incorrect practice. At the same time, the MNB also deems it necessary

² Loss ratio: ratio of claim payments relative to premium income.

to remind customers that only those should use the e-communication discount who are regular users of the electronic mailing system and they should pay special attention to providing their e-mail address accurately and regularly checking the spam folder in their mailbox. They should also pay attention to informing the insurer that manages their contract about the change in their e-mail address immediately.

2.2.5 Unfairness of travel insurance

In 2017, the number of complaints and enquiries related to travel insurance contracts received by the MNB's Customer Service Desk was negligible; nevertheless, it should be mentioned that the number of petitions almost doubled compared to 2016. In view of the fact that these products affect a wide range of consumers, the MNB pays special attention to identifying provisions in the contracts that potentially may raise concerns.

A court ruling – declaring the MNB as winner – classified several such general terms of contract unfair, which are also used by a number of other insurers, not involved in the litigation, in their travel insurance contracts. The terms are related to the reporting of the insurance event, and to the limitation of the insurer's services upon failed or late reporting.

Based on the ruling, the MNB called upon all insurers rendering travel insurance services and initiated the replacement of the terms declared unfair by the court ruling by terms of identical content. As a result of the MNB's initiative, the majority of the insurers modified their contract terms without further consultation.

2.3 RISKS IDENTIFIED IN THE FUNDS SECTOR

Similarly to previous years, the ratio of consumer petitions received by the MNB's Customer Service in respect of the funds market was negligible compared to the other sectors. More than two-thirds of these petitions related to the activity of voluntary pension funds. The most frequent consumer complaints concerned the settlement and payment of funds' benefits, and criticised shortcomings in the related information.

The MNB wishes to foster the informing of the fund members and the transparency of the sector by publishing the indicator presenting the annual cost rate of the voluntary pension funds across the sector and by institutions annually.

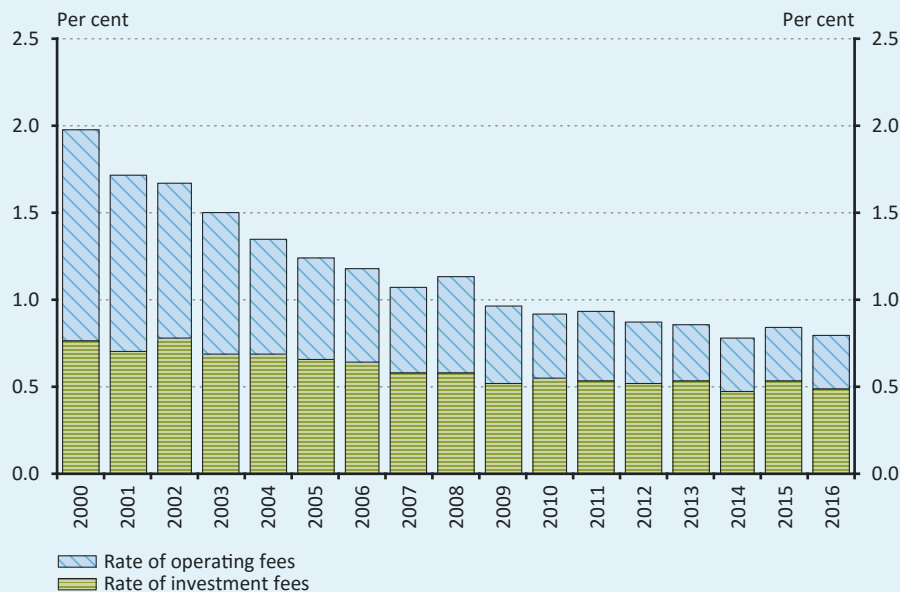
The annual cost rate informs the fund members about the percentage of their savings paid as operating and liquidity (operating fee charge) and as asset management and custodian fee (investment fee charge) in the individual years in their selected institution.

In the past 16 years, the annual cost rate has gradually decreased from 1.97 per cent to 0.80 per cent. (Chart 10) At sector level the rate of operating fees stabilised at 0.31 per cent, while the rate of investment fees dropped to 0.49 per cent at the end of 2016; the rate of decrease was faster in the case of operating fees.

Upon comparing the annual cost rate data, the time elapsed since the commencement of individual institutions' activity must be borne in mind. In the initial period of the fund's activity the items related to operating activities represent higher ratio, since the volume of assets, as projection basis, is also smaller. The rate of investment fees is determined primarily by the remuneration conditions specified in the contracts concluded with the asset management and custodian partners and the yield realised on the investments. In the case of success fee schemes, the rate of the paid asset management fee changes depending on the deviation from the benchmark index.

The annual cost rate may provide assistance in selecting the fund by presenting the charged costs; however, the growth of the members' individual account primarily depends on, in addition to the contributions, the yield result of the funds' portfolios, and hence prior to joining a fund it is recommended to review the short- and long-term investment performance indicators of the individual portfolios.

Chart 10
Developments in voluntary pension fund fee charges



Source: MNB.

2.4 RISKS IDENTIFIED IN THE CAPITAL MARKET SECTOR

The number of petitions and enquiries received by the MNB's Customer Service in 2017 in respect of capital markets declined further compared to 2016. In addition to the favourable change in the number of disputed cases, it should be borne in mind that compared to other financial sectors, consumers undertake the highest risk in the capital market sector if they do not pay sufficient attention to selection of the appropriate service provider and service. Experiences of the customer service show that the consumer acts with due diligence if prior to using the service he/she checks in the register on the MNB's website whether the service provider holds a licence for the rendering of the specific financial services and he/she chooses a product that is in line with his/her financial experience and risk appetite. Compared to the previous year, there was a rise in the number of customers who sought the advice of the MNB in respect of cryptocurrencies or the related derivative products. In these cases, the MNB reminds enquirers of its previously published clear position: due to the absence of rules related to liability, warranty and loss bearing, investments in virtual instruments are characterised by even higher risk than usual.

In the course of consumer protection inspections performed in respect of the capital market sector, the MNB paid special attention to the control of complaint management activity and inspection whether the capital market participants rendering the investment services activity proceed in accordance with the relevant legislative provisions upon fulfilling their obligation related to the provision of information to customers. Within the aforementioned topic, during the inspections conducted based on petitions, the checking of information provided in relation to the risks of transactions and the expenses and fees linked to the use of services formed key inspection areas, while in the course of inspections performed with the framework of comprehensive audits the inspection focused on whether the customers qualifying as consumers have received full information prior to concluding the contract or deal. During the comprehensive audits, the focus in terms of consumer protection was, in addition to the provision of advance information, on the gathering of preliminary information and the fulfilment of the obligation to provide subsequent information.

2.4.1 Preparation for the implementation of MiFID II

Directive 2014/65/EU (**MiFID II**) created by the recast of Directive 2004/39/EC on the operation of markets in financial instruments, effective since 2007 (**MiFID I**), has set the objective to elaborate a scheme of EU legislation that is able to ensure more efficient protection for investors and greater transparency of financial markets. The transposition of the directive into national law took place by adopting Act LXIX of 2017 on the modification of acts regulating the operation of

financial markets and the trading of financial instruments for legal harmonisation in the session of the National Assembly on 30 May 2017. The start date of the application of the acts amended in accordance with the directive and the related, directly applicable, Regulation 600/2014/EU (**MiFIR**) was 3 January 2018.

The legislative changes related to MiFIR and MiFID II represent major changes in several areas in terms of the investment firms' operating rules. The changes with consumer protection relevance impact the product governance system and the inducements.

Product governance system

The MiFID II regulation introduces a completely new, EU-level product governance system, covering the full life-cycle of financial instruments. The product governance requirements apply to investment service providers developing and distributing financial instruments, as well as to those that sell or offer to their customers financial instruments developed by others. Furthermore, the requirements apply to all customer types (retail, professional, eligible counterparty) and all financial instruments (including structured deposits) defined in the MiFID II framework.

The investment service providers developing or distributing financial instruments must elaborate a product approval process, which identifies the target market of the ultimate customers within the customer categories of individual investment vehicles. It is an additional requirement that all relevant risks of the given identified target market must be assessed and the planned distribution strategy must be consistent with the identified target market. Investment service providers distributing financial instruments not developed by them must obtain all information necessary for understanding the attributes of the respective financial instrument and identifying the target market. It is of utmost importance that in the course of developing financial product investment service providers must consider the threat the respective product may represent on the operation of the market and financial stability.

In addition, investment service providers must regularly review the financial instruments developed, distributed or offered by them, and whether the respective financial instrument still satisfies the needs of the identified target market and the distribution strategy is still valid. The management board and compliance function of the investment service providers must ensure efficient control for the approval of products.

Inducements

With MiFID II's entry into force, the rules pertaining to inducements place greater emphasis, compared to MiFID I, on the protection of investors, and on ensuring and enhancing transparency.

Based on the provisions of MiFID II, inducements include the remuneration paid or received by a third party, other than the investment firm and the customer, to or from the investment firm in relation to the provision of the investment services or ancillary investment services.

In the case of non-independent advisory services, the payment or fee that renders the provision of the investment services possible or is necessary (custody fees, settlement and conversion fees, administrative duties, legal costs) and that by nature do not generate conflicts of interest between the investment firm and its customer, do not qualify as inducements.

Fees other than those described above qualify as inducements, and the investment firm is obliged to transfer it to the customer, unless they are capable of enhancing the quality of the service provided and do not hinder the firm in acting professionally, fairly and in the best interests of the customer. In this case, the investment firm must use the fee for the enhancement of the quality of the service provided to the customer.

In the case of independent advisory services or portfolio management, the investment firm must not accept or withhold any fee paid or provided by any third party or person acting on behalf of a third party in relation to the services rendered to customers. The exception to these include such minor non-monetary benefits that are capable of enhancing the quality of the service provided to the customer and due to their magnitude or nature do not prejudice compliance with the firm's duty to act in the best interests of the customer.

In the Hungarian capital market, the requirements related to inducements represent major changes in respect of the distribution fee paid by the asset managers in relation to the distribution of their mutual fund shares to investment firms (distributors). Pursuant to Section 24(9) of MiFID II and Section 41(5) of Act CXXXVIII of 2007 on Investment Firms and Commodity Dealers, and on the Regulations Governing their Activities, effective from 3 January 2018, in terms of the legal relationship between the client (investor) and the distributor, the issuer (mutual fund or investment fund manager acting on behalf of the mutual fund) qualifies as a third party, which provides the distribution commission paid to the distributor in relation to the provision of the investment services or ancillary services between the customer and the distributor.

The distribution fee paid by the issuer to the distributor in the distribution legal relationship established between them represents the consideration (remuneration) for the service (distribution), which cannot qualify as inducement as long as the distributor can confirm that there is real service behind the distribution fee (and certain sub-components thereof). Accordingly, that part of the distribution fee behind which there is real activity, actually related to and proportionate with the distribution, does not qualify as an inducement. However, the restrictive provisions applicable to inducements are valid for the fee components beyond the aforementioned rate, i.e. these tariffs may only be used for the enhancement of the quality of the service provided to the customer and must not generate a conflict of interest.

Box 4

Response of the supervisory authority to capital market products representing outstanding risk

MiFIR entered into force on 3 January 2018, which permits the restriction or prohibition of certain financial instruments, structured deposits, activities and practices. Based on new, standard product intervention rules, certain speculative products may be restricted or prohibited by the national authorities within their own jurisdiction and by the European Securities Market Authority (ESMA) in the whole territory of the European Union. The product intervention ordered by ESMA may be for maximum 3 months, but if the conditions exist, it may be prolonged several times.

After collecting and analysing data related to defined products, ESMA approved the first EU-level product intervention measures, which apply to all investment firms marketing, distributing or selling CFDs or binary options to retail customers in the European Union.

The ESMA measure adopted in the case of binary options prohibits the advertising, distribution and sales of these products to household customers, while in the case of CFD transactions it ties it to restricting conditions. In respect of CFDs (including the rolling spot forex transactions), it specified leverage limits, and with a view to reducing the loss suffered by customers, it introduced the rule of automatic closing and negative balance protection. Furthermore, it prescribes uniform warnings related to risks and also restricts the benefits – inducing trading – that may be granted to customers.

The measures of ESMA, together with the measures of the MNB and other national supervisory authorities, strengthen investor protection across Europe, particularly because the respective products (similarly to the other member states of the European Union) are typically available in Hungary at cross-border investment service providers, and thus the uniform European measure is particularly important to suppress the capital market products that represent particularly high risk for consumers.

The MNB started the preparations for the implementation of the member states' intervention measures, and in the future continuous market monitoring will be stressed even more with a view to enabling the MNB to identify and take action against financial instruments and activities that represent overly high risk for retail investors.

During its supervisory activity, the MNB placed great emphasis on informing investors on the capital market products of particularly high risk, therefore several press releases were issued in relation to the products or services appearing in the market, which raise consumer protection concerns.

2.4.2 Incomplete, misleading information in relation to products of particularly high risk provided to customers

The MNB paid special attention in 2017 as well to the provision of proper information to customers in relation to investment services activity, and imposed the highest penalty in this issue on eBrókerház.

During the inspection, the MNB found that the interests of the execution partner employed by eBrókerház for the execution of the customers' orders were not fully in tune with the investors' interests. The conflict of interest policies of the investment service provider contained no such rules or measures that would have addressed this conflict of interest detrimental to investors.

The MNB found that eBrókerház had failed to provide proper information to its existing and prospective clients on the manner and basis of the cost calculation of certain capital market transactions. The questionnaire used by the investment service provider for collecting preliminary information from the investors did not touch upon the essential features of the offered transactions and also failed to assess the customer's knowledge related to the risks of such.

Upon providing information to several existing or prospective retail clients, eBrókerház failed to reveal the conflict of interest related to the execution partner and also provided misleading information – in advertisements – on the type of offered financial instruments. During the conversations between the parties, the investment service provider failed to provide the customer with balanced information, since it did not describe or described only partially the disadvantageous features, risks and costs of the offered services in addition to the positive features thereof.

As a result of the foregoing, in its resolution the MNB imposed a consumer protection penalty of HUF 15 million on eBrókerház and called upon it to rectify the revealed infringements within a short deadline. In determining the penalty amount mitigating circumstances included, among others, the low market share of the investment service provider and the fact that the company started to rectify part of the shortcomings already during the inspection. Aggravating circumstances included, among others, the high risk generated by the multiple infringements and the fact that part of those were systemic shortcomings.

2.4.3 Cross-border services

The MNB paid special attention, in the reporting year as well, to the activities of non-resident financial service providers, pursuing their activity in Hungary under the licence of another EU member state, which offer high-risk investment products to customers as institutions rendering cross-border services.

The MNB conducted consumer protection targeted inspection in relation to the activity of Invest and Trade Kft., where it wished to review whether during its operation the company breaches the Act on the Prohibition of Unfair Commercial Practices against Consumers (Unfair Commercial Practices Act).

As part of the targeted inspection, the MNB performed on-site inspection in the registered office of Invest and Trade Kft, and heard some of the company's employees, existing and prospective clients as witnesses. The inspection revealed circumstances that suggested that the conduct of Invest and Trade Kft. may violate the provisions of the Unfair Commercial Practices Act. These included, among others, the urging of the consumer repeatedly and in an undesired manner over the phone, and the provision of false information, suitable for misleading, on essential features of the products, particularly in respect of their suitability for the given objective, the results and benefits that may be expected of their use.

Based on the obtained information and data, and notifications by the customers, the MNB found that the commercial practice applied by Invest and Trade Kft, in view of its extensiveness – with special regard to the nature of the communication means and the size of the affected geographic area – it exerts material influence on financial competition, in which case, pursuant to the law, it falls within the competence of the Hungarian Competition Authority (HCA). After prior consultations with HCA, in May 2017 the MNB took the necessary measures to launch the proceedings of the competition authority.

In addition, in June 2017, the MNB also notified the Cyprian financial supervisory authority (CYSEC) performing the oversight of Goldenburg Group Limited, the principal of Invest and Trade Kft, since based on the information obtained during the inspection it cannot be precluded that the potentially incorrect commercial practice of Invest and Trade Kft. derives from the business model followed and expected by its principal, and it is also necessary to inspect how Goldenburg Group Limited, holding a Cyprian licence, complies with client due diligence obligations under the money laundering act.

Box 5**The boiler room phenomenon**

Boiler room means a large group of brokers who make several hundreds of unsolicited phone calls targeting potential investors. One of the features of boiler room activity is the extremely aggressive sales technique and the provision of misleading information in respect of the securities investment vehicles recommended by them. The target group of their sales activity usually included inexperienced investors.

The essence of the method is that companies operating the boiler room usually recruit less experienced sales staff, who contact the prospective or existing clients over the phone based on an address list. The objective is for the sales staff to call as many as possible prospective clients daily and convince them to conclude a contract or buy securities or other capital market products presented by them as an extremely favourable investment opportunity, or to encourage existing clients to make further purchases. With this goal in mind, their communication and behaviour are usually more aggressive than is common in trade. They pursue their activity ignoring the investors' interest, in order to earn the highest possible profit from commissions.

The boiler room phenomenon can be recognised primarily by its special communication style and content. Special features of the style include vivacity, the use of simple, less sophisticated expressions of everyday conversation, interspersed with frequent, but often incorrectly used foreign, financial technical terms. The potential content of the communication includes the recommendation of extraordinary investment opportunity; reference to insider, confidential information; promise of outstanding yield without satisfactory explanation and concealment of the importance of risk; and emphasising that the recommended investment opportunity is available only for a short time, and thus requires a fast, immediate decision. It may also raise suspicion, if a person who had already been called and refused to cooperate, is repeatedly called by the broker on the same day or later.

In order to avoid the severe financial risks represented by the boiler room, prospective investors are warned to ask for preliminary, precise information – before using a product, particularly in the case of leveraged investment vehicles (e.g. FX, CFD) – on the partner that they would conclude the contract with should they use the recommended service, rather than checking only after the occurrence of the loss whether the respective service provider has the licence or registration necessary for the pursuance of the financial or investment activity, and is included in the central bank's registers of market participants. This information is available on the MNB's website, at its Customers Service Desk and the financial advisory office nationwide. Customers are reminded to report to the MNB, anonymously if they wish to do so, if they encounter a company that raises the suspicion of irregular operation. As the MNB had made clear before, it would take action in all cases if the detected circumstances imply infringement and use all instruments available to it to eliminate the infringement.

2.4.4 Initial Coin Offering

In 2017, both ESMA and the MNB called consumers' attention to the spread – across Europe, including Hungary – of the initial coin offering (ICO) public form of fund raising, qualifying as extremely high-risk investments.

The feature of ICO is that an enterprise or a private individual issues – by applying distributed ledger technology, e.g. block chain – tokens and offers them for sale for legal tender (e.g. euro) or more often for virtual currency (e.g. bitcoin, ethereum) in order to raise capital for its project or finance its start-up company. Tokens represent “value” outstanding against the issuer or the issuing community, of the traditional investment vehicles resembling equity investment the most, but it is an important difference that tokens usually do not offer ownership rights and typically do not represent corporate share.

ICOs are regarded as highly speculative forms of investment, since the price of tokens is usually extremely volatile and it may as well happen that investors are unable to redeem them for long periods. In these transactions chances that investors may lose part or the whole of their invested capital are high, as ICO projects are typically in the early phase of development and their business models are of experimental nature.

Nevertheless, the scheme itself could be a progressive initiative subject to proper regulatory guarantees. The outstanding consumer protection risks arise primarily from the fact that at present ICOs do not qualify as clearly regulated forms of public fund raising in the European Union. In relation to this, the investment information related to ICO is not yet sufficiently mature. In relation to the white paper introducing the ICO, it represents special risk that the document – in the absence of regulation – does not contain, or does not contain in full, the information necessary for the investment decision, and typically contains overly optimistic market forecasts. Furthermore, clients investing in ICO are not protected by the liability and loss bearing rules of the EU or Hungarian guarantee institutions either.

The ICO projects are usually associated with non-resident enterprises rendering cross-border services, the supervision of which falls outside the MNB's competence. In addition, even in the case of ICOs implemented by a Hungarian enterprise or private individual, it can be determined only on an ad hoc basis whether or not it comes under the MNB's oversight, and a number of ICOs – depending on their structure – may fall outside the scope of the EU or Hungarian legislation.

Box 6

Risks of cryptocurrencies and the related derivative products

The MNB issued warnings on several occasions on the risks of the virtual means of payment promoted on the internet and operating in a system not regulated by law (also known as cryptocurrencies) and the related derivative products.

In view of the fact that cryptocurrencies do not come under the supervision of any central bank or public authority (the MNB does not license or register them), they may involve extremely high risks, as there are no proper liability, warranty and loss bearing rules that would protect the consumers' interest in the event of fraud. Such instruments are issued by a community of users, rather than by an institution with obligations and responsibilities. If a problem emerges either in the records or during the execution of a transaction, no institution will guarantee for users the execution of a transaction or compensation for damages. Customers may settle their legal disputes arising due to potential losses incurred in a common lawsuit or they may turn to the investigative authorities in cases of suspected crime (e.g. a pyramid scheme). Another risk is that the price or value of cryptocurrencies may change extremely rapidly and in unpredictable ways for consumers. This is due to the fact that the means of payment has no such underlying product that would determine its value, and thus the exchange rate is exposed to strong speculative impact. Moreover, cryptocurrencies can usually be purchased in US dollar, euro or Japanese yen denominations, and thus, in addition to high volatility, they also carry currency risk. Hence it can be stated that derivative products based on cryptocurrencies, also available to Hungarian

investors – due to the features of cryptocurrency described above – are regarded as extremely high-risk, speculative investment products.

On the whole, the market of cryptocurrencies and the related derivative products is a relatively new market, which requires special, often difficult-to-obtain competence, and thus small investors may not be able to assess the fundamentals and due to this these instruments carry particularly high consumer protection risk.

The MNB continuously monitors the operation of virtual instruments that may be used for payment, in order to protect the interest of investors and endeavours to assist inexperienced users by better informing them.

3 Financial consumer protection communication

In the course of its consumer protection activity, the central bank continues to place great emphasis on financial consumer protection communication, the purpose of which is to call the attention of the public, through as many channels as possible reaching the widest range of the population, to the current risks, changes taking place in the financial markets and the effects thereof impacting consumers. One of the most important cornerstones of prevention is the development of informative and educational activities necessary for making informed financial decisions and the enhancement of financial literacy.

In cooperation with the supervisory authority's press communication area, the 13 press releases published during the year continuously strengthened the messages of consumer protection campaigns, provided up-to-date information on tender results and cooperation with market participants outside of the financial sector, as well as on the operation of the Financial Advisory Offices.

3.1 DEVELOPMENT OF NEW TOOLS AND COMMUNICATION CHANNELS

3.1.1 The MNB's first creative contest organised for universities

In spring 2017, the MNB announced, together with four universities with a faculty of economics³, its first creative contest on the topic of financial consumer protection, entitled "Financial affairs at advanced level – be creative", which raised the interest of hundreds of university students. Within the framework of the contest, individuals or teams had to develop novel, creative and feasible proposals suitable for enhancing the skills of a wide range of financial consumers in a cost-efficient manner. The contestants could choose from four topics; 57 competition essays were submitted in the contest, of which the professional jury selected the winners from the five best essays of each university and rewarded the three best works with cash award. The winners also had the opportunity to present their proposal at a public event open for the press, organised by the MNB. The winning concepts included a web-based game simulating the use of banking products, a mobile application for searching investment funds and recommending forms of investments, online communication campaign supporting young people's conscious choice of bank account and an application for the analysis of household credit risk. Based on the evaluation, the concept of further two competition essays can be implemented in practice within the framework of the tender entitled "Civil Network Support Programme".

3.1.2 Financial consumer protection and education campaigns

In 2017, based on a novel concept, the MNB tried to deliver the financial consumer protection messages relevant in the respective period, to the consumers through thematic communication campaigns. Upon development of the campaign strategy, the primary goal was to strengthen in common knowledge the role of the MNB as the institution responsible for financial consumer protection in Hungary. It was an essential point to also make consumers aware of the fact that the set of Financial Navigator ("Pénzügyi Navigátor") tools, operated by the MNB, is the primary and authentic source of financial information. The timing of the campaigns was determined based on general consumer and commercial trends. During the four large – start of year-Easter, summer, autumn and Christmas – campaigns of 2017, the key messages originated from the financial consumer protection topics relevant in the respective period, while the fifth thematic campaign of the year took place on account of World Investor Week 2017 (WIW) organised by IOSCO at the beginning of October.

³ Corvinus University of Budapest, Budapest Business School, University of Miskolc, Pallas Athene University.

Box 7**Cooperation agreements as part of social responsibility**

One of the key duties of the MNB is to strengthen financial consumer protection and enhance financial literacy in Hungary. With a view to reaching the widest possible range of consumers and delivering financial information useful in everyday life and responding to current trends, the MNB is continuously looking for partners open for cooperation. As a result of these efforts, in 2017 major actors of the commercial and service sector joined the communication activities aimed at the enhancement of financial literacy. Of the leading store chains of the Hungarian retail sector, ALDI, CBA, Decathlon, Media Markt, SPAR and TESCO, Volánbusz – one of the largest Hungarian transport companies, the Hungarian Post – a service provider with one of the widest access to customers, and the organisation exhibiting the “All You Can Move SportPASS”, all regard the enhancement of domestic financial literacy and the strengthening of financial consumer protection as priority tasks. In 2017, several of the aforementioned enterprises also laid down in a cooperation agreement that they wished to contribute, together with the MNB, to the enhancement of financial literacy and the development of a financially aware consumer society, thereby reducing the financial disadvantages and losses resulting from careless consumer decisions. It should be noted in respect of the agreements that the partners provide free-of-charge space for publication and other communication facilities (e.g. venue for off-site campaigns) to reach consumers, and thus the MNB’s messages enhancing financial literacy reach an increasingly wide range of consumers.

The first campaign of the year focused on the pre-Easter period, and the messages called attention to the planning of expenses. The placements were made exclusively on interfaces provided through the cooperation with partners. Financial Navigator posters and leaflets were placed in stores, while online advertisements were also published on the stores’ websites and social media sites. In the campaigns organised later in the year, media support also facilitated reaching consumers more efficiently. The early summer campaign emphasised the risks of summer holiday and travel insurance, at the end of the summer the planning of costs related to the start of the school-year, while at the end of the year the risk of excessive indebtedness. The campaign launched in relation to the international programme announced in autumn, i.e. the WIW, covered the importance of investment protection and the gathering of in-depth information. At the thematic lectures, organised as part of the programme at four universities, students could learn about the operation of the capital market, the importance of diversification and investor protection rules.

Chart 1
Christmas and WIW campaign posters



Source: MNB.

Roughly 1.5 million leaflets and 8,000 posters were printed for the campaigns, distributed to consumers – as a result of the cooperation agreements concluded during the year – in almost 800 stores and 500 post offices. The campaign messages of the Financial Navigator were published in more than 28 million instances in the form of banners, animations, advertisements and PR articles in various online interfaces. Experiences show that the number of views of the relevant content on the consumer protection micro-site of the MNB's website rose in all campaigns.

3.2 MAINTENANCE AND EXPANSION OF THE FINANCIAL NAVIGATOR SET OF COMMUNICATION TOOLS

3.2.1 “Civil Net” NGO Support Programme 2017 and individual NGO cooperation

Based on its Statute and social responsibility strategy, the MNB regards as its key duty to enhance financial literacy, financial awareness, underlying economic and social thinking, as well as the related institutional system and infrastructure. To this end, it participates in the support of financial consumer protection activity of civil consumer protection organisations, and thus, among others, it organises regular tenders within the framework of the Civil Net NGO Support Programme.

In 2017, the competition essays, submitted during the creative contest organised for universities, included two concepts that – based on their topic and selected target group – the MNB deemed worth implementing. A total of eight applications were submitted to the tender invited in August as part of the Civil Net NGO Support Programme.

In relation to the topic entitled “Educational programme for the enhancement of financial literacy of public workers”, the applicants had to develop education projects where the participants can gain insight into the correlations in simulation drills, in addition to mastering the rudiments of responsible borrowing, thereby enabling them to assess the risks of their decisions as well. In this topic three NGOs may launch their programmes in four counties in 2018, for which they received financial support from the central bank in the amount of almost HUF 18 million.

In addition to the tenders invited by the central bank, the MNB is also open to supporting the financial consumer protection programmes initiated by civil organisations on their own, in respect of which it accepts relevant project initiatives throughout the year. In 2017, five projects of four NGOs received support in the amount of almost HUF 32.2 million.

Within the framework of its project entitled “Debt settlement – Application of the MNB's recommendation in everyday life”, the Hungarian Charity Service of the Order of Malta organised mentor education in the social sector and for local family aid organisations. The participants could learn about the debt settlement processes, the related terminology, actors and those legal and advisory services that are available to financially distressed borrowers. Within the educational programme entitled “Being well-versed in financial matters”, regular workshops are organised based on the experiences of social workers, district nurses and field workers of ethnic minority local governments active in South Transdanubian regions, as well as a series of lectures enhancing financial skills and personal consultancy to support financially vulnerable consumers.

During the implementation of the project entitled “Organisation of community campaign and off-site events to enhance financial awareness”, the Association of Consumer Protection and Patients' Rights operated a mobile advisory at several large-scale events (e.g. 2017 Home Exhibition and Fair), where consumers could use personal financial legal advisory services and master financial skills in hypothetical form.

The Association of Independent Insurance Brokers in Hungary prepares animations on the particulars of insurance within the framework of the “FÜGE – Consumer Education Programme”. Each of the dialogues arranged in shots presents the respective topic and the related insurance product through situation drills of 1-2 minutes. The animations will also be available through the brokers' online interfaces. The target group primarily includes adults contemplating the purchase of insurance products also available online.

Within the framework of the project entitled “Our daily finances – Family and wallet”, the Szó-Tér Association creates a TV broadcast on current financial skills. The programmes are published once a month (with two reruns) as a permanent column of the Szó-Tér Magazine. Each topic is elaborated in a duration of 8-10 minutes, and at the end of the programmes

consumer questions received during the previous broadcast online are answered at the end of the programme in 2-3 minutes. The programmes are broadcast in the Szegedi Városi TV, TiszapART TV and Magyarkanizsai Info TV, and also uploaded to YouTube. The studio discussions will also be available through webinars.

3.2.2 Financial Navigator tools

In order to ensure that the financial information useful in everyday life and the particulars of various current events reach consumers in an easy-to-understand form, the MNB developed the Financial Navigator information scheme, comprising of a website, a series of booklets, short films and applications facilitating the search and comparison of financial products.

The one-minute animation series of 20 parts, available on YouTube, have been completed, while seven parts of the video series, elaborating the individual financial topics in 4 to 5 minutes, also usable as teaching aids, planned to have 15 parts, were uploaded in 2017 to the YouTube channel of the Financial Navigator.

The consumer protection micro-site is one of the most important channels of the Financial Navigator information materials. The MNB's goal is to best meet the consumer and user requirements, to make the content and appearance compliant with the current trends and always provide up-to-date information. To this end, several surveys have been conducted to examine to what extent the website meets these requirements. A SEO⁴ survey assessed the micro-site's capabilities related to search engine optimisation, there is an expert audit in progress to review the web content accessibility, while it is also reviewed in terms of ergonomics through eye camera research. Based on the results of the individual analyses, the transformation of the consumer protection micro-site has commenced, and it is expected to be fully refreshed in 2018.

Financial terms often used in everyday life are available in alphabetic order on the Financial dictionary site, while the references often used or recommended in terms of financial consumer protection are shown on the Useful Links page. During the year, the MNB initiated cooperation with several of the key players of the Hungarian commercial and service sectors; the logos of the cooperating partners are now shown on a dedicated micro-site.

Of the online interfaces and applications operated by the MNB, it is worth noting the new www.minositethitel.hu website and calculator, linked to the Certified Consumer-Friendly Housing Loan concept and tender. The design, which satisfies modern trends in all respects, the easy to understand language and calculator supporting enquiries on customised housing loan offers, have become increasingly popular with the general public.

During the communication campaign related to the introduction of certified products, the MNB made consumers acquainted with the key features of the product through a media mix comprising of both traditional and alternative marketing communication tools. In the last four months of the year a number of TV spots, printed and online articles, social media posts and professional background materials were published.

3.2.3 Financial Advisory Office Network

The purpose of the Financial Advisory Office Network ("Pénzügyi Tanácsadó Irodahálózat"), established in 2011, is to ensure that consumers living away from the capital can obtain professional help for answering their questions and problems related to financial services, and thereby to strengthen the financial consumer protection system and make it available nationwide.

Research and empiric knowledge also confirm that in several regions of Hungary financially vulnerable households are overrepresented. Based on the experiences of the past years, it can be stated that there is great demand for the activity of the offices in Hungary, as due to the special nature of financial services, information asymmetry between consumers and service providers is larger than average, which may only be reduced by professional, but easy-to-understand information and knowledge transfer.

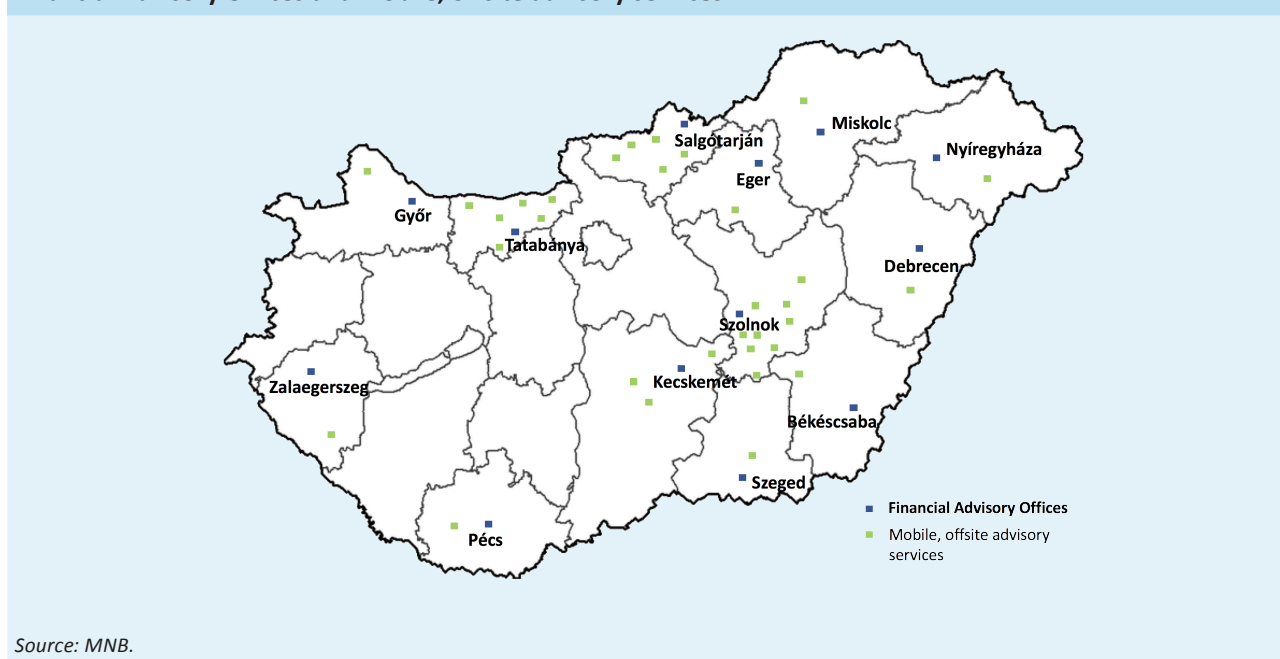
⁴ Search Engine Optimisation.

The office network, which is also unique by international standards and renders long-needed services, in addition to customer service work also takes substantial measures for the enhancement of financial awareness, by continuously making efforts to transfer information related to household finances and the associated risks in a proactive manner, at festivals, lectures, in printed and electronic media, in television and radio programmes and in social media. The experts working in the network facilitate the efficient pre-screening of complaints, the professional preparation of petitions and complaints, and upon detecting blatant infringements, consumer protection risks or unauthorised activities, they notify the MNB.

In 2017, the Financial Advisory Office Network, rendering financial consumer protection services, which used to operate at nine sites, was expanded with a further four offices, and thus it became available – in addition to Békéscsaba, Debrecen, Eger, Győr, Miskolc, Nyíregyháza, Pécs, Szeged, Zalaegerszeg – also in Szolnok, Kecskemét, Salgótarján and Tatabánya, as a result of which the population can obtain expert answers to their financial questions at 13 county seats in total.

In addition to the largest towns, the financial consumer protection experts also organise regular offsite consultancy and financial presentations in the respective counties, at variable sites and in smaller settlements. Accordingly, in addition to county seats, the population had the opportunity to use free-of-charge expert help in financial matters in a total of 32 Hungarian settlements.

Chart 12
Financial Advisory Offices and mobile, offsite advisory services⁵



Since its foundation, the Financial Advisory Office Network provided more than 50,000 consumers with advice, of which in 2017, it handled 13,527 customer enquiries. In addition, it organised 275 offsite events and made more than 20 appearances in the television and radio.

As the next step of achieving nationwide coverage by the office network, in mid-October 2017 the MNB launched a public procurement procedure to open offices in a further five county seats. Sites included in the tender invitation: Kaposvár, Szekszárd, Székesfehérvár, Szombathely and Veszprém. National coverage is expected to be achieved in the first quarter of 2018.

⁵ Offsite advisory locations: Balassagyarmat, Ballószög, Bátor-terenyé, Berettyóújfalú, Dorog, Esztergom, Érsekvadkert, Helvécia, Heves, Hódmezővásárhely, Kazincbarcika, Kisújszállás, Komárom, Kunmadaras, Kunszentmárton, Martfű, Mezőtúr, Mosonmagyaróvár, Nagykanizsa, Nyergesújfalu, Nyírbátor, Oroszlány, Pásztó, Rákóczi falva, Szajol, Szarvas, Szentlőrinc, Szécsény, Tata, Tiszakécske, Tószeg, Törökszentmiklós.

Box 8**National strategy for the development of financial awareness**

The enhancement of financial literacy and financial awareness is also in the focus internationally, as individual financial decisions exert aggregated impact on the national economy processes and the quality of social welfare, and through that on the rate of global economic development and social convergence. By now, the change in the quality of financial literacy has become one of the cornerstones of sustainable development. In the past 10 to 15 years, and particularly after the outbreak of the 2008 financial crisis, several nations and international organisations (OECD⁶, World Bank⁷, Financial Literacy and Education Commission⁸) have also made substantial efforts for the enhancement of financial literacy. Individuals are essentially responsible for their own financial decisions, and thus the assessment of the current status of financial literacy, the definition of future development targets based on results, the planning of actions and activities, measurement and evaluation of the results, the updating and fine-tuning of strategies and the making of best practices public property bear utmost importance. Based on domestic and national research it can be stated that the financial knowledge of the Hungarian population is insufficient, and the practical application of the existing knowledge also poses problems. In view of the foregoing, the Government of Hungary determined for the next seven years the enhancement of the population's financial literacy as an important objective, which may be realised – as a result of an unprecedented cooperation – along the Strategy for the development of the population's financial awareness elaborated by the Ministry for National Economy, the Ministry of Human Capacities, the Hungarian Central Statistical Office, the State Audit Office, the Hungarian State Treasury, the Money Compass Foundation and the MNB. The elaboration of the strategy was also supported by the business federations⁹ of the market participants and civil organisations (NGOs)¹⁰ having vast practical experience. The strategy was elaborated along the OECD's handbook on the enhancement of financial literacy and supporting the development of national strategies, considering Hungarian special features and the international best practices.

Chart 13**National strategy for the development of financial awareness**

7 main strategic objectives

1. Create, strengthen and promote the foundation of real financial education within the system of public education
2. Strengthen the foundation of financial awareness and the households' financial stress resistance
3. Create an attitude promoting prudent financial decisions; create and provide comprehensive information on institutions and infrastructures supporting consumers' financial awareness
4. Strengthen households' self-provisioning attitude
5. Improve the accessibility of financial products, basic financial services and increase financial inclusion
6. Encourage the use of modern, no-cash payment instruments
7. Encourage prudent borrowing



Source: Strategy for the development of financial awareness¹¹.

⁶ Organisation for Economic Cooperation and Development.

⁷ World Bank.

⁸ Financial Literacy and Education Commission (USA).

⁹ Hungarian Banking Association, Association of Hungarian Insurance Companies, Association of Hungarian Investment Fund and Asset Management Companies, National Association of Voluntary Funds, Hungarian Leasing Association.

¹⁰ Hungarian Charity Service of the Order of Malta, National Association for Consumer Protection in Hungary, Consumer Protection Association for Financial Services, Household Monitor of Financial Organisations, Association of Consumer Protection and Patients' Rights.

¹¹ <http://www.kormany.hu/download/c/85/51000/P%C3%A9nz%C3%BCgyi%20tudatos%C3%A1g%20strat%C3%A9gia.pdf>

The national strategy builds on the currently operating programmes and exploitable synergies in the long run. Within those, the MNB's financial consumer protection communication and education activity, particularly financial education projects implemented within the framework of Civil Net tenders, the expansion of the Financial Advisory Office Network and the entire Financial Navigator information system, play a central role. The operation of the Financial Advisory Office Network is a unique, good practice also by international standards. One of the purposes of the free-of-charge service is to ensure that households ask for assistance in preparation for the decision prior to making a financial commitment, and select the suitable financial product aligned with various situations of life, also assessing personalised offers. The prudent gathering of information is also supported by online Financial Navigator product comparison applications. The computer programmes, based on the data supplied by the institutions and independent of commercial interests, facilitate the fast and simple comparison of the products of all financial institutions.

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Annexes

Annex 1: The MNB's consumer protection activity

Annex 2: Complaint statistics

ANNEX 1: THE MNB'S CONSUMER PROTECTION ACTIVITY

Table 4
Number of proceedings started in 2017

Institution type	Ex officio targeted inspections (pcs)	Ex officio consumer protection thematic inspections (pcs)	Number of institutions audited within the framework of exofficio consumer protection thematic inspections (pcs)	Consumer protection inspections conducted jointly with theprudential area (pcs)	Consumer protection inspections launched based on consumer petition (pcs)
Credit institutions sector, Bank	21	1	9	0	165
Credit institutions sector, Cooperative credit institution	7	1	6	0	2
Financial enterprise	8	1	1	14	36
Independent financial market intermediaries	0	0	0	0	6
Insurance market	2	3	16	6	82
Capital market	3	0	0	2	11
Funds market	0	0	0	1	2
Total:	41	6	32	23	304

Source: MNB.

Table 5
Number of proceedings carried over from 2016 and initiated in 2017

Institution type	Ex officio targeted inspections (pcs)	Ex officio consumer protection thematic inspections (pcs)	Number of institutions audited within the framework of exofficio consumer protection thematic inspections (pcs)	Consumer protection inspections conducted jointly with the prudential area (pcs)	Consumer protection inspections launched based on consumer petition (pcs)
Credit institutions sector, Bank	30	2	23	0	222
Credit institutions sector, Cooperative credit institution	12	2	16	0	3
Financial enterprise	13	2	5	15	49
Independent financial market intermediaries	4	0	0	0	6
Insurance market	4	4	17	16	118
Capital market	3	0	0	3	19
Funds market	2	0	0	4	4
Total:	68	10	61	38	421

Source: MNB.

Table 6

Result of proceedings by sector

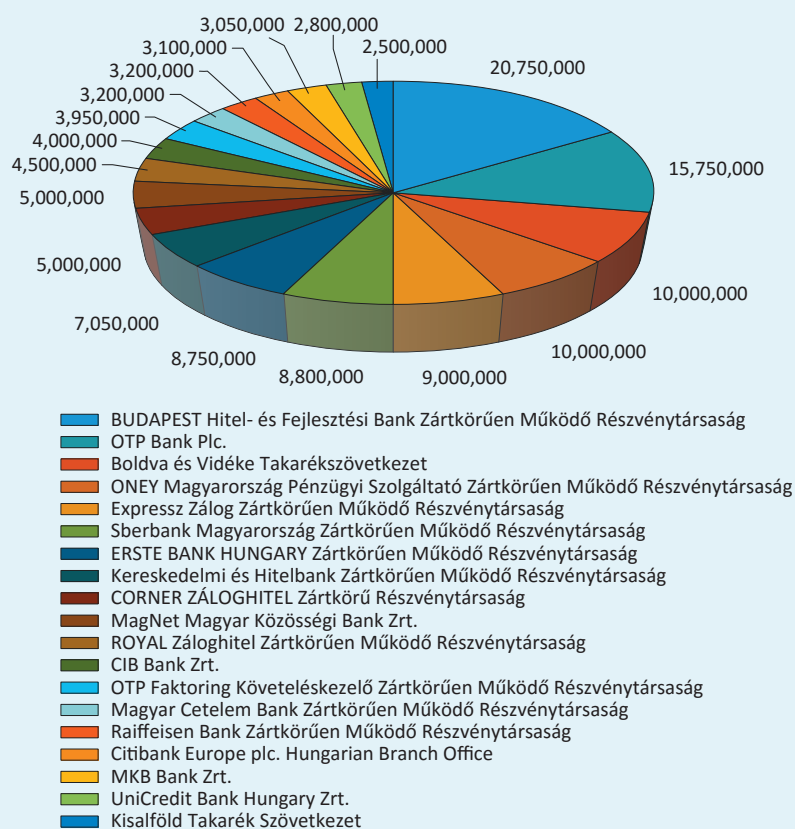
Institution type	Money market	Insurance market	Capital market	Funds market	Total
Total number of orders (pcs)	359	181	57	6	603
of these: substantive (pcs)	178	116	13	2	309
non-substantive (pcs)	181	65	44	4	294
Total number of resolutions (pcs)	279	128	14	6	427
of these: no infringement (pcs)	73	38	4	1	116
involve infringement (pcs)	206	90	10	5	311
Consumer protection penalty imposed	145 700 000 HUF	64 200 000 HUF	18 200 000 HUF	500 000 HUF	228 600 000 HUF

Source: MNB.

Chart 14

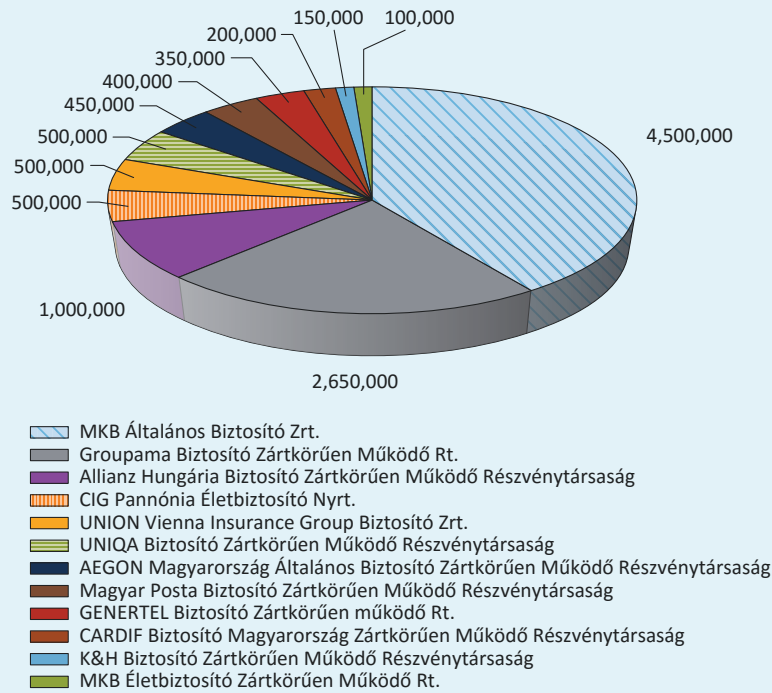
Amount of major consumer protection penalties imposed on the participants of the financial market

(HUF)



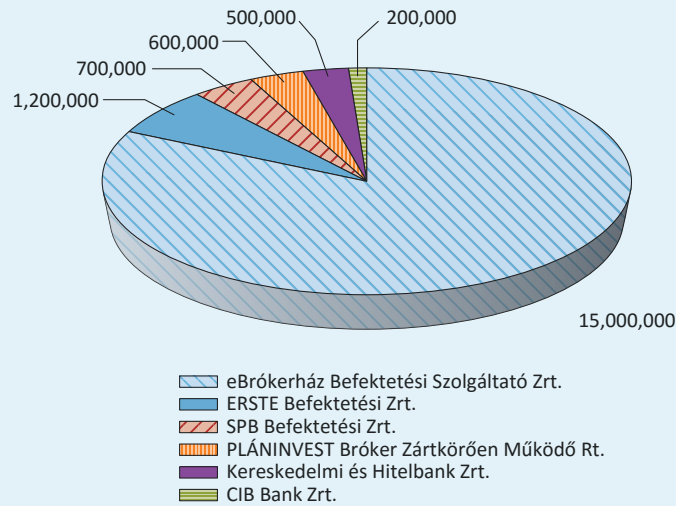
Source: MNB.

Chart 15
Amount of major consumer protection penalties imposed on the participants of the insurance market
 (HUF)



Source: MNB

Chart 16
Amount of major consumer protection penalties imposed on the participants of the capital market
 (HUF)



Source: MNB.

ANNEX 2: COMPLAINT STATISTICS

Features of the consumer complaints identified based on the institutions' reports on complaints¹²

In 2017, the institutions registered more than 365,700 complaints in total in the financial market, insurance and capital market sectors. It should be noted that this number includes all objections related to the activity of the institutions, reported to them by consumers; the service providers did not find all of these complaints substantiated. At the end of 2017, the institutions had approximately 44 million household contracts, comparing which with all complaints received during the year, on average eight complaints were received per one-thousand household contracts.

Credit institutions

Based on the credit institutions' complaint statistics, it can be established that a good two-thirds of the complaints are related to bankcard operations and lending. The most typical problems arose from the settlement, rate of the commissions, costs and fees, service quality, fulfilment of orders, administrative errors and electronic services (72 per cent). The number of complaints per one-thousand contracts was 11.22 in 2017, which exceeds the aggregate average.

Financial enterprises

Based on the complaint statistics of financial enterprises it can be established that more than three-quarters of the complaints were received in respect of the institutions' workout activity. In addition, it should be noted that the factoring portfolio purchased for workout account for more than 80 per cent of the household contracts in the sector. In the complaints, the clients most frequently (86 per cent) reported objections to the financial enterprises related to administrative issues, rate of the commissions, costs and fees, settlement, unauthorised activity, service quality and transfer of data to CCIS. The number of complaints per one-thousand contracts is 7.57, which is below the aggregate average.

Insurers

The insurers' complaint statistics show that 86 per cent of complaints related to non-life business. Within this, more than four-fifths of the complaints concerned household property insurance and compulsory motor third-party liability insurance. The remaining 14 per cent of complaints related to the life insurance business, and within that half of the reported problems concerned index-linked or unit-linked life insurance. The notifications related to traditional life insurance accounted for more than one third (35.55 per cent) of the life business complaints. Almost 30 per cent of all complaints related to insurance products concerned administrative issues and errors, but quite a few complaints were registered also in relation to the rejection of claims (15 per cent), the degree of the compensation (10 per cent), the lengthy claim settlement (12 per cent) and information shortcomings (7 per cent). The number of complaints per one-thousand contracts is 3.17, which is below the aggregate average.

Investment firms

The complaint statistics of investment firms show that 40 per cent of the registered complaints related to the management of client accounts and securities accounts, while more than one third of those concerned investment services and in particular the acceptance, finalisation and execution of orders. The most typical problems arose from the rate of the commissions, costs and fees, order execution, settlement, electronic services and information shortcomings (60 per cent). The number of complaints per one-thousand contracts is 5.12, which is below the aggregate average.

Mutual funds

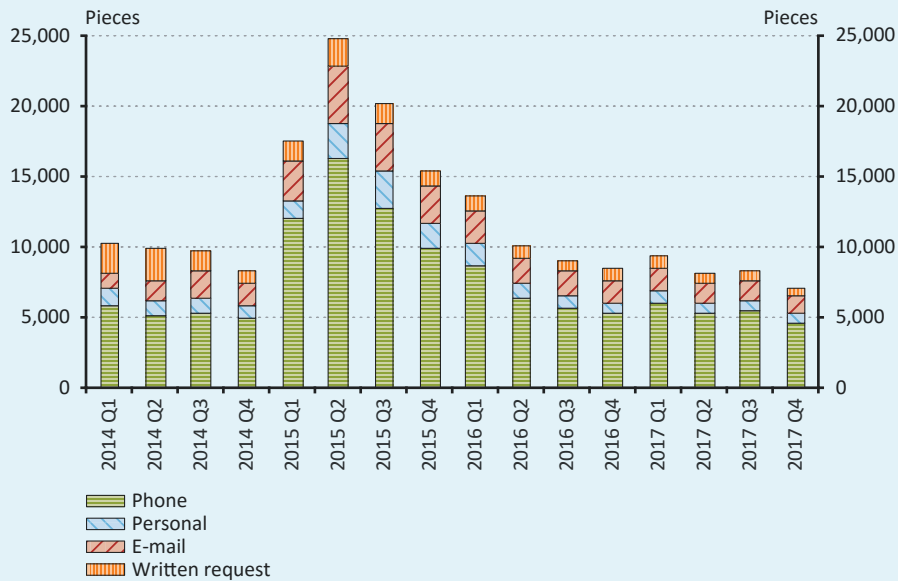
The complaint statistics of mutual funds show that half of the registered complaints related to the management of investments, while 47 per cent of complaints concerned the administrative part of collective portfolio management and

¹² The review was prepared based on the data reported by the institutions up to 22 February 2018.

the distribution of collective investment securities. The most typical problems (65 per cent) related to the rate of interest and yields, the use of electronic services and agents. The number of complaints per one-thousand contracts is 10.6, which exceeds the aggregate average. However, it should be noted that the number of active household investors is extremely low compared to the consumers of other sectors.

Developments in the consumer petitions and customer service enquiries received by the MNB

Chart 17
Distribution of petitions and customer service enquiries by the channel of submission
(pcs)



Source: MNB.

The distribution of written and oral customer notifications has not shown a major change in the past years. Similarly to previous years, the enquiries are dominated by oral enquiries, accounting for 74 per cent (24,328 pcs) of all notifications. The vast majority of oral enquiries, 87 per cent, were received over the phone, while the ratio of those visiting the MNB's Customer Service in person fell to 13 per cent. The ratio of e-mail enquiries declined from 18 to 17 per cent compared to 2016 (5,546 pcs). The ratio of petitions submitted by post or via the e-government customer portal continued to account for 9 per cent (3,053 pcs) of all consumer protection petitions.

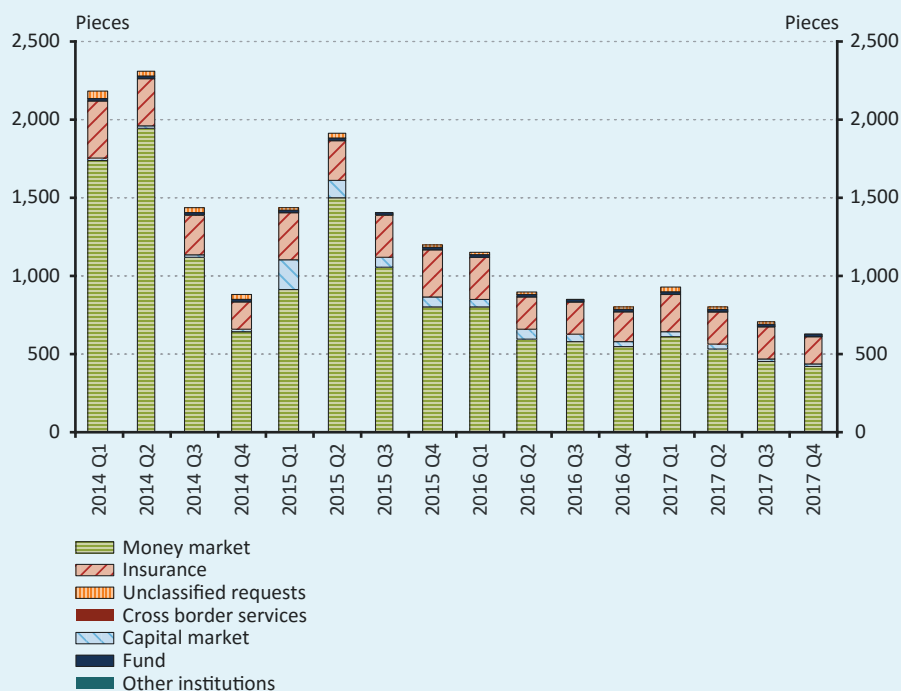
Most typical petition types

In 2017, the MNB received 3,053 consumer protection petitions, representing a 17 per cent decrease compared to the previous year. The distribution of the petitions by sectors has slightly changed. The ratio of financial market petitions fell from 68 per cent to 66 per cent (2,018 pcs), in the insurance sector it increased from 24 per cent to 27 per cent; however, compared to the 888 petitions received in 2016, in 2017 only 836 petitions were submitted. The ratio of the capital market petitions was 3 per cent (81 pcs), while in the funds sector it was less than 1 per cent (16 pcs).

The consumer petition types reflect the nature of the problems formulated by the consumers independently of the sector. Similarly to previous periods, the majority of complaints, 19 per cent (573 pcs) related to financial settlement linked to various contracts and in 19 per cent (589 pcs) to information shortcomings. The category of other administrative errors includes errors during transaction management and administration – with the exception of complaints to be classified as IT system error – the conduct shown to customers, impolite service, difficulty of reaching the tellers, slow administration

Chart 18
Developments in the number of petitions received by the MNB, by sectors

(pcs)

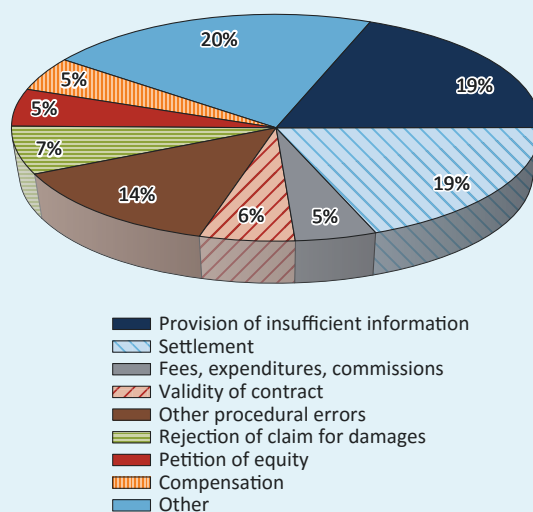


Source: MNB.

and underlying accounting errors. The ratio of the petitions in this category was 14 per cent (413 pcs). The other category includes a number of real or presumed shortcomings, among others, IT system errors, the prepayment and final repayment, lengthy claim settlement, the activity of intermediaries, but the customers' notifications in all sectors related to suspected unauthorised activity also belong to this category.

Chart 19
Main petition types in 2017

(per cent)



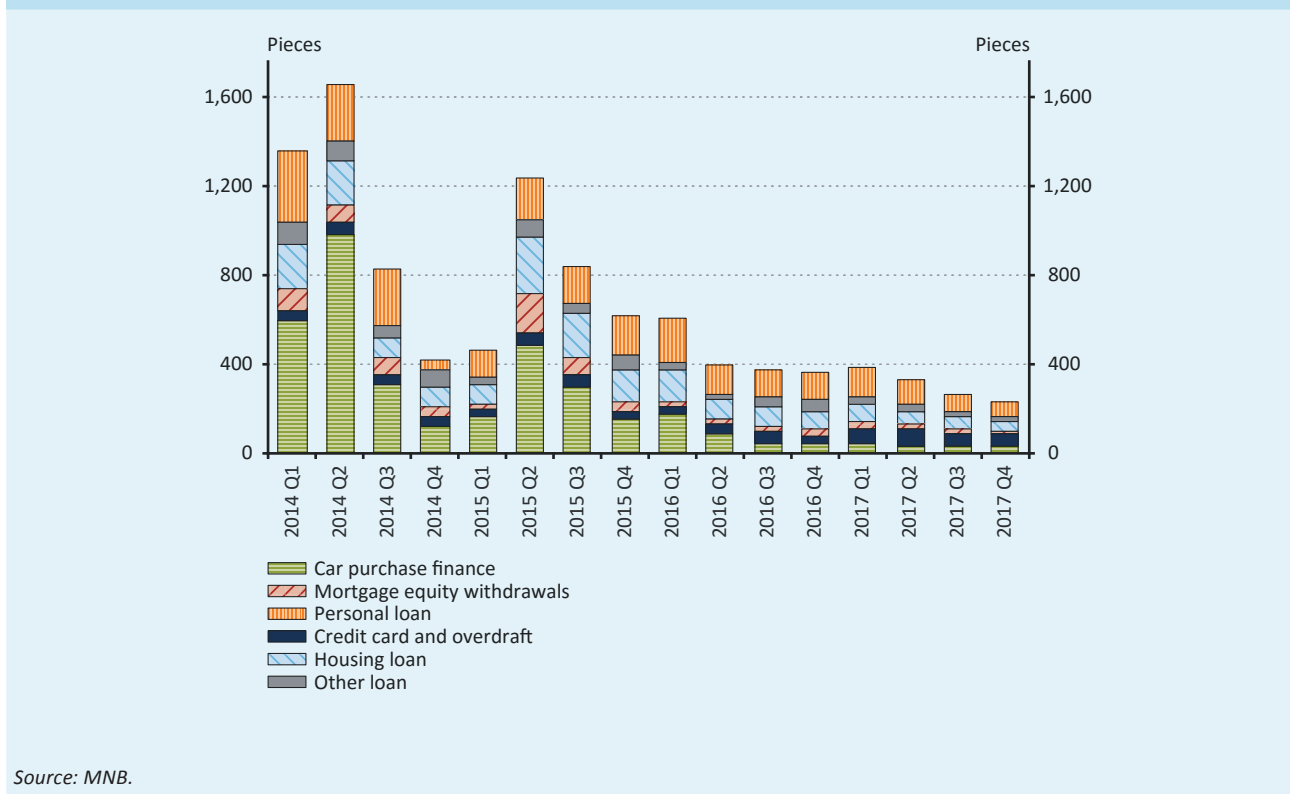
Source: MNB.

Financial market petitions

Financial market petitions include credits, loans and leases, deposit savings, payment accounts, payment services, e-banking, as well as bankcards, credit cards and workout.

Similarly to previous years, a major part – 60 per cent (1,217 pcs) – of the financial market petitions related to some kind of loan product; however, the number of complaints related to various lending activities declined substantially, by roughly 30 per cent. One fifth (245 pcs) of the complaints related to loan products concerned credit card contracts and overdraft facilities, representing a 55 per cent year-on-year growth. Consumer complaints related to housing loans were received in almost the same number (238), representing a fall of 56 per cent year on year. The number of complaints (133) related to car purchase finance substantially declined compared to previous years, with its ratio falling from 20 to 11 per cent. The declining trend in the number of petitions can be also observed at the personal loans (112 pcs). The ratio of complaints related to mortgage equity withdrawals rose slightly, from 5 to 8 per cent. As regards the types of petitions related to lending, the most typical complaints, similarly to the previous year, concern settlements (27 per cent), information shortcomings (21 per cent) and administrative errors (20 per cent).

Chart 20
Number of petitions by main type of credit
(pcs)



The experiences of the MNB’s Customer Service Desk show that – similarly to previous years – the majority of petitions concerning the financial market sector were received from clients who defaulted on their payment obligations arising from the loan contracts. The problems of the contracting customers often derive from the fact that they do not fully understand their obligations specified in the contract (payment of the interest, fees and costs to the financial service provider) and the consequences of their default, or they fail to assess properly the limits of their financial capacity, and thus they are unable to pay the loan instalments, maybe through no fault of their own, for a longer period. Another typical problem relates to credit cards. Customer complaints often concern cross-selling (selling of supplementary product in addition to the main product), e.g. credit card together with a hire purchase loan or payment protection insurance with credit card. Although the number of customer complaints related to the selling of the receivables portfolio between the individual financial service providers of the financial market, or the partial or full transfer of the contract portfolio, is negligible

relative to the total number of complaints received in the sector, it is obvious that the complaints criticise primarily the information provided by the service provider. With a view to supporting general customer information, the MNB placed an easy-to-understand information material related to portfolio transfer on its consumer protection micro-site.

The vast majority, 71 per cent, of the financial market petitions, concerned the activity of banks, almost one fifth (19 per cent) of financial enterprises, more than 4 per cent of specialised and cooperative credit institutions, 2 per cent of non-financial institution – intermediaries, agents, payment institutions, currency exchange office and electronic currency issuer institutions – and more than 3 per cent the activity of other financial institutions.

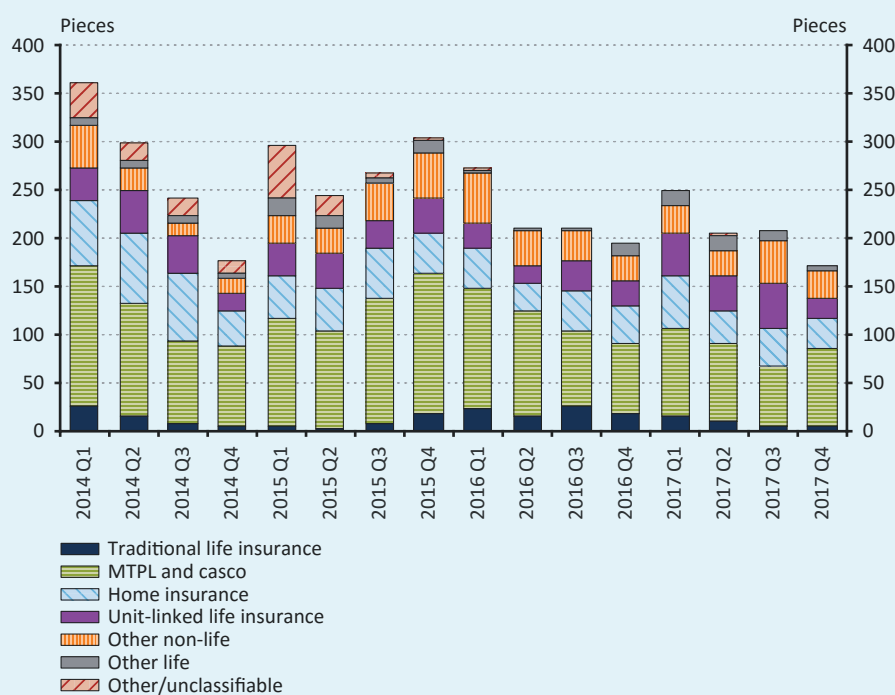
Insurance market petitions

Insurance market products include a variety of life insurance – traditional, index- or unit-linked life insurance, health and pension insurance –, and non-life insurance –, household property insurance, liability insurance, travel, accident and health, casco insurance, insurance related to legal protection etc.

Similarly to previous years, the MNB received the largest number of petitions related to motor insurance: compulsory motor third-party liability insurance (281 pcs) and casco insurance (34 pcs) accounted for 38 per cent of the complaints related to the sector. The number of complaints related to home insurance (160) slightly increased compared to the previous year. In the life insurance sector, the largest number of complaints related to unit-linked insurance concluded before 2017: the number of complaints rose substantially, from 105 to 148, compared to the previous period; this product type accounted for roughly 18 per cent of the petitions. Traditional life insurance complaints accounted for 7 per cent, while complaints related to travel insurance and general liability insurance each accounted for 2 per cent of the complaints on the insurance market. When examining the types of petitions, the largest part of the complaints (25 per cent) related to the rejection of the claim, followed by complaints concerning the amount of the compensation (17 per cent) and information shortcomings (17 per cent). In addition, more than one tenth of the complainant consumers disputed the validity of the insurance contact, the amount of the insurance premium or the method of premium calculation.

Chart 21
Breakdown of petitions related to the insurance sector, by service type

(pcs)



Source: MNB.

The experiences of the MNB's Customer Service Desk showed that a large part of the petitions affecting compulsory motor third-party liability insurance included disputes on claim settlement, where the injured clients criticised particularly the amount of compensation, but some of the complaints were submitted due to the rejection of the claim or the lengthy claim settlement process.

Among non-life insurance, it is worth highlighting increasingly popular extended warranty insurance, typically taken out in stores, where the standard problem is that customers fail to obtain the information whether they join a group insurance or conclude the contract as a contracting party, and which insurance company underwrites the risk based on the contract. Customers often do not read the terms of contract, fail to obtain information on exclusions and exemptions, and thus the reporting of a claim event may easily entail a dispute between the parties. Accordingly, in the case of this type of insurance all complaints concerned claims for damages and information shortcomings. Within the petitions received in relation to life insurance, various unit-linked life insurance have outstanding weight. In the area of these, complaints related to the misleading or incomplete information provided before concluding the contract are still typical, as well as settlement disputes related to the amount of the insurance benefit, which – as experiences show – is partially caused by the unfavourable development in prices and partially by the costs.

Similarly to the previous period, a high ratio of the petitions related to the activity of insurance corporations (92 per cent), insurance associations and brokers (3 per cent each), branch offices and multiple agents (1 per cent each).

Capital market petitions

Capital market activities include, among others, investment services – the acceptance, forwarding and execution of orders, portfolio management, investment advisory services –, ancillary investment services – custody, securities account management, granting of investment loans –, and commodity exchange services.

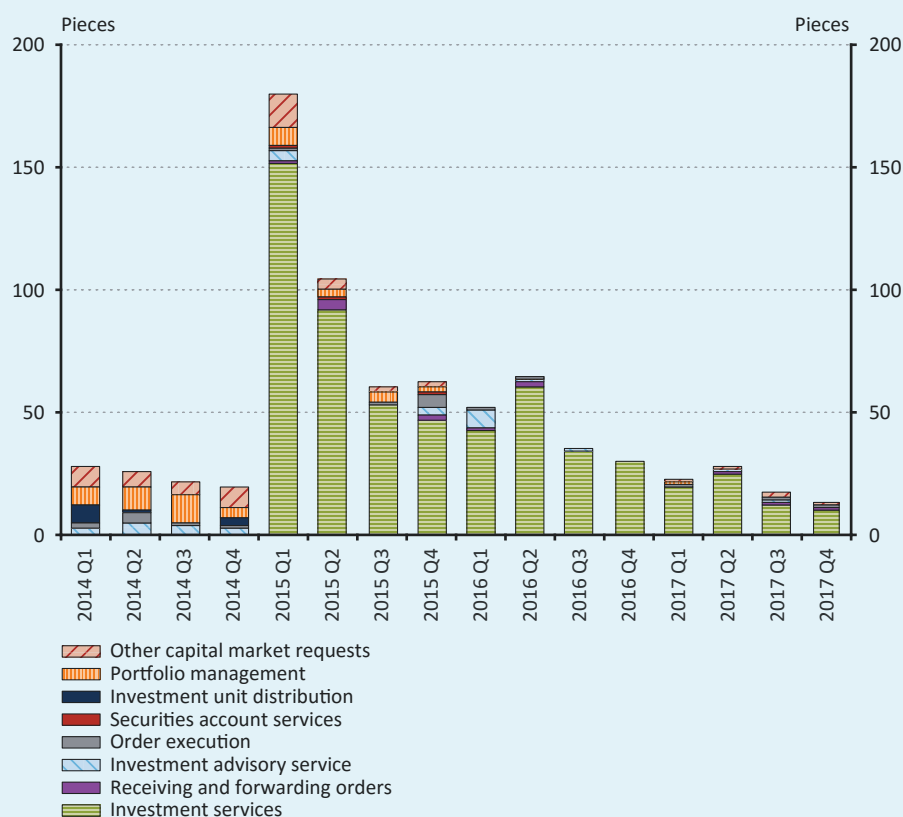
Similarly to previous years, most of the petitions related to investment services, accounting for 83 per cent of the petitions. When examining the petition types, similarly to the experiences in the financial market, complaints typically concern settlements (27 per cent) and information shortcoming (23 per cent), while almost 9 per cent of the petitions disputed the amount of commissions, costs and fees charged. It is a positive change compared to the previous year that the number of complaints received due to suspected unauthorised financial activity and financial fraud declined from 12 to 5.

Customer Service experiences show that it is the capital markets where the largest part of the clients choose a foreign service provider; however, this is not always a conscious decision and sometimes it implies lack of information. It should be borne in mind that in the case of such service providers different legal remedy and investor protection rules apply, and thus the client undertakes higher risk than in the case of choosing a Hungarian service provider. This risk is particularly high when the prospective investor fails to gather prior information on the identity of the provider and its licence to render the respective services. Many of the complaints received from clients choosing domestic service providers concern fees incurred in relation to the securities account and the amendment of such. Compared to financial market services, the rules applicable to the assessment and amendment of the fees for securities accounts are typically more liberal, and thus it is recommended to monitor the changes applicable to the account continuously on the service providers' website. Based on the petitions received by the Customer Service Desk, still many clients are uncertain with regard to their rights based on the share and the legal remedies available to them upon the breach of these.

The majority of the petitions affected investment firms (55 per cent), more than one third of them related to investment services activities of financial institutions (38 per cent), 3 per cent that of agents and intermediaries, 2 per cent that of fund managers and 2 per cent that of the central securities depository.

Chart 22
Breakdown of the most typical petitions related to the capital market sector, by service type

(pcs)



Source: MNB.

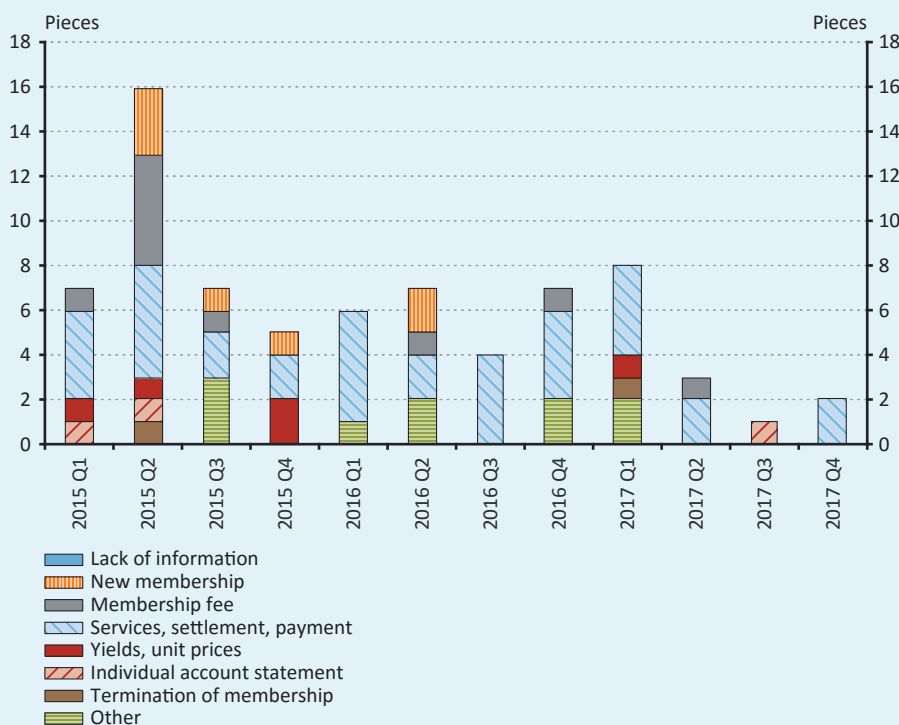
Petitions related to the funds market

Similarly to previous years, the ratio of petitions related to the funds market remained marginal, accounting for less than 1 per cent of all petitions. There was no material change in the sector compared to previous periods. As regards the funds, the low number of petitions and the payment of fund benefits, as a single product, limit the possibilities of evaluation. Similarly to the previous year, the most frequent consumer complaints (57 per cent) concerned the settlement and payment of the benefits of the various funds. As regards the petition types, most of the petitions concerned settlements between the fund and the member (31 per cent), while 19 per cent of the complaints related to information shortcomings and 19 per cent of them related to member's claims.

More than two-thirds of the petitions related to voluntary pension funds (69 per cent), almost one fifth of them to the activity of voluntary health funds (19 per cent) and 12 per cent to that of the private pension funds.

Chart 23
Breakdown of the most typical petitions related to the funds sector, by service type

(pcs)



Source: MNB.

Customer service enquiries

In 2017, the MNB’s Customer Service Desk received 29,874 enquiries requesting information. The largest part of the enquiries, 71 per cent, were received over the phone, almost one fifth of them by e-mail, while the MNB’s Customer Service Desks was visited by one tenth of the consumers in person.

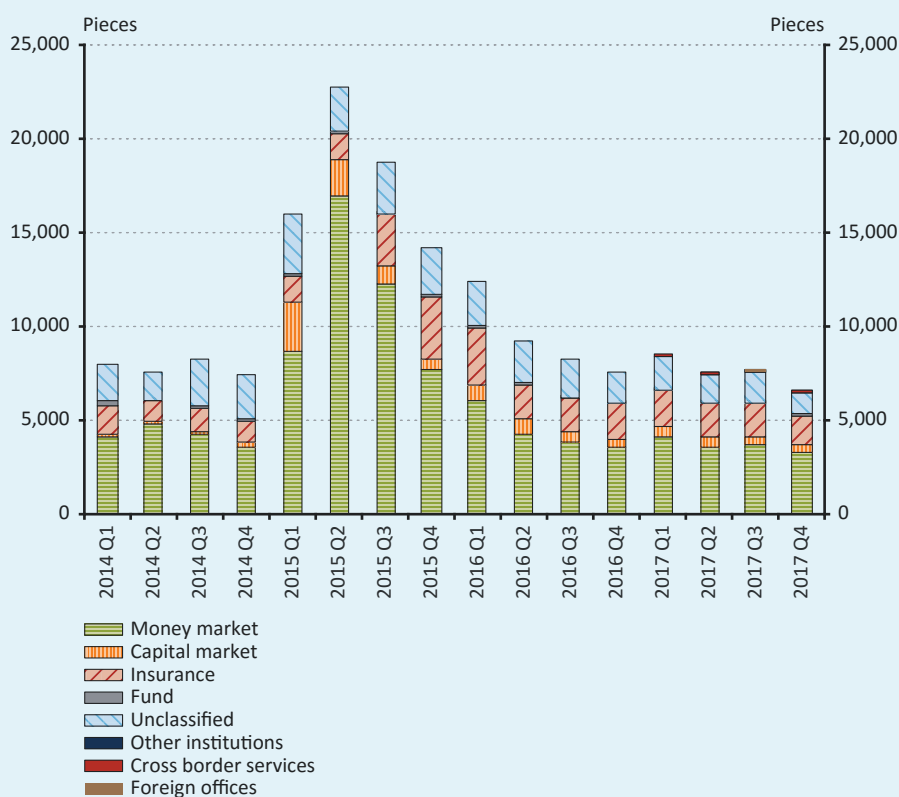
Almost half of enquiries requesting information (14,955 pcs) related to the financial market sector and about one quarter of them (7,022) involved the insurance market. Compared to previous periods, the ratio of capital market enquiries dropped from 7 per cent to 5.5 per cent (1,651 pcs), while enquiries related to the funds market remained low, below 1 per cent of all enquiries (238 pcs). Similarly to the previous period, the ratio of other enquiries, not affecting the sector supervised by the MNB, and those related to the central bank’s activity accounted for one fifth of all enquiries (5,991 pcs).

In 2017 – similarly to the petitions – the highest ratio (50 per cent) of enquiries related to the financial market sector. The number of enquiries related to credit, loans and leasing, similarly to previous years, is still significant (4,560 pcs), followed by – in descending order – enquiries related to collection and workout, current account management, payment services and building society contracts. Several consumers requested information in connection with the Certified Consumer-Friendly Housing Loan concept, introduced by the MNB in summer 2017, and this is expected to continue in 2018. It is a positive development that the number of enquiries related to deposit insurance is negligible, and it was also experienced in the individual client notifications that clients are typically familiar with the rules of deposit protection.

The number of enquiries related to the insurance sector declined compared to previous years, while they still account for roughly one quarter of all enquiries. The non-life insurance enquiries were still dominated by questions related to compulsory motor third-party liability insurance (1,596 pcs), followed by home insurance (906 pcs). The number of enquiries related to life insurance (774 pcs) still substantially falls short of those related to non-life insurance. When

Chart 24
Customer service enquiries, by sector

(pcs)



Source: MNB.

examining the enquiries, the request for information concerned the rejection of the claim for damages or benefits, the rate of the insurance premium or the premium calculation method.

The ratio of enquiries related to capital market decreased by 1.5 per cent, while in terms of quantity, the decline is quite substantial (from 2,702 to 1,651 pcs). More than one quarter of consumers contacted the MNB's Customer Service Desks with questions related to investment services, and several enquiries concerned brokerage firms in liquidation, supervisory proceedings, intermediaries and ancillary services. When examining the types of enquiries, the largest part related to settlements and order execution, but a large number of notifications were received in the sector in respect of suspect unauthorised activity.

The number of enquiries related to the funds sector declined further compared to previous years. Thirty-five per cent of the enquiries related to voluntary pension funds, one quarter of them to voluntary health and mutual aid fund benefits, one fifth of them to private pension fund benefits and almost one fifth to supervisory proceedings and other general requests for information. Enquiries were still dominated by questions related to membership fee accounting, and a large number of enquiries were received in relation to information shortcomings and complaints about changing of funds.

Ferenc Rákóczi II

(27 March 1676 – 8 April 1735)

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

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

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

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

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

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