

# Financial Risk&Regulation

## Supervisory expectations in the financial sector

Newsletter – December 2022

Towards the end of 2022 – for the fourth time – we analyzed how the fines imposed by the Supervisory Authority changed, which sectors were affected by the largest fines and what were the actions imposed by the Supervisory Authority for financial sector participants. Among the perceived deficiencies, there is a significant focus related to market manipulation and AML activity. Furthermore, the stakeholders need to put more emphasis on preventing insider trading, managing credit risk and correctly calculating capital adequacy, as well as providing the MNB with adequate information and corporate governance aspects. Our last year's newsletter on the subject is available [here](#).

### Supervisory expectations in the financial sector

Every year, the Supervisor conducts a number of inspections in the money and capital markets, insurance and fund sectors in order to monitor their internal processes and verify their compliance with EU, government and central bank regulations. Based on the [MNB's Annual Report 2021](#), the MNB issued a total of 2,302 prudential enforcement and authorizing substantive decisions, 262 consumer protection decisions, and 44 decisions and orders in the field of money laundering prevention. Furthermore, based on this annual report, a total of 74 prudential, 330 consumer protection, 23 market supervision, 1 issuer supervision target investigations, and 3 money laundering prevention topic investigations were completed in 2021. **Based on the figures, it can be seen that, for example, MNB's official activities in both the market and issuer supervision areas have increased significantly.**

In order to demonstrate again this year the main focuses of supervisory investigations and the risk areas for compliance, this year again we based our research on the decisions of the imposition of fines published on [MNB's website](#). Decisions published before 1 December 2022 have been included in this newsletter.

### Topic-specific comments

MNB discovered several issues and deficiencies during the comprehensive, thematic, targeted and follow-up inspections, as well as within the framework of continuous supervision. The most common observations are the followings:

- **Prevention of money laundering and terrorism financing:** Among other things, in order to fully comply with the legal requirements, MNB obliged the organizations to ensure the appropriate quality of the recording of electronic customer due diligence processes, the effective requirements control during customer due diligence, the establishment of appropriate procedures and practices, the review of reporting practices and appropriate for the establishment, the inclusion of control points in the supervision report, as well as the review of previous data services. The Supervisory Authority also revealed deficiencies in the proper assessment of unusual circumstances suspected of money laundering, the participation of employees in training programs, the sharpening of screening logic, the analysis of screened customers within the deadline, the running of additional screenings along the screening scenarios, and

the review of the practice of obtaining proof of source of funds. The new money laundering prevention recommendation, as well as the high number and amount of fines, lead to the conclusion that the institutions must place even greater emphasis on the topic in the future. We have written in detail about MNB's recent recommendations regarding money laundering prevention and internal defense lines in [this newsletter](#).

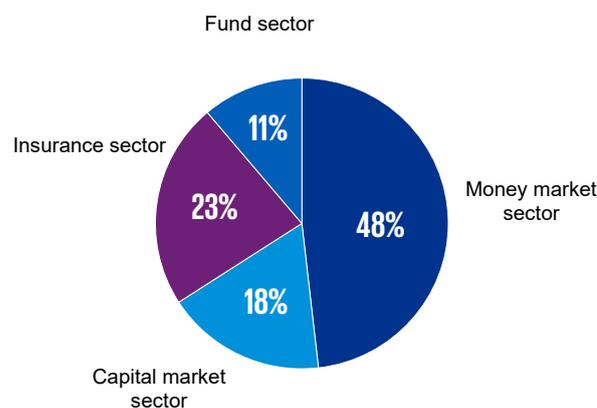
- **Market manipulation:** Supervisory inspections and findings have increased significantly in this area. A number of fines imposed in 2022 were imposed in connection with (repeated) violations of the legal provisions on the prohibition of market manipulation. The reasons for the decision included, among others, improper matched orders, misleading signals given to orders, self-binding, i.e. wash trades, as well as orders submitted and then withdrawn within a short period of time.
- **Credit risk management:** In the field of credit risk, MNB objected to the operation of the organizations and the incomplete compliance with the relevant legislation in the following areas: controls built into the process, updating of internal regulations, review and practice of customer group training, regulation of large risk taking, customer rating, evaluation of real estate collateral, regulation of JTM (debt-to-income ratio) calculation, lending process, customer monitoring, uniformity of risk assumption concept, data transfer to KHR (Credit Information System), changes related to problem customer management.
- **Capital calculation and adequacy, accounting loss:** The Authority identified deficiencies in the determination of capital requirements, the determination of the SME multiplier, the frequency of exposure calculation during leverage, the adequacy of liquidity stress tests, the application of lifetime PD as a Stage 2 trigger, the preparation of COREP tables, in relation to the controls built into the process, the application of risk weights, and the application of assessment correction. In relation to accounting loss, the customer rating and evaluation, as well as impairment and provisioning rules, the rating system, the PD and lifetime PD and LGD parameters, as well as the correct determination of the exposure value, should be highlighted.
- **Corporate governance, incomplete regulations and policies:** In several cases, MNB obliged the institutions to review and amend their internal regulations so that they

are comprehensive and comply with legal requirements. In addition, in many cases, the Supervisory Authority required companies to ensure regular and documented revisions of their regulations.

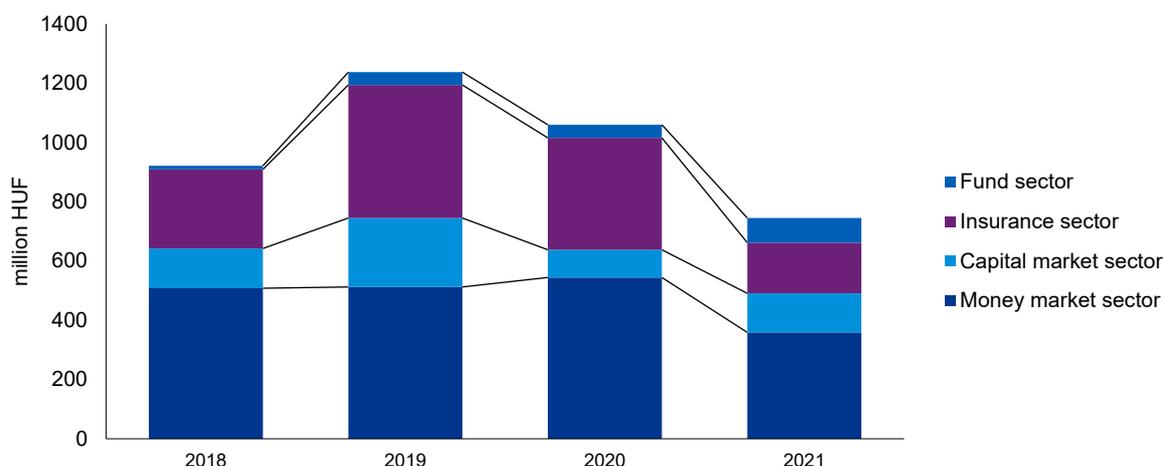
- **Data provision to the Authority:** The MNB called for the discipline of those concerned in connection with inadequate quality, incomplete and delayed supervisory data provision, with particular regard to the violation of the extraordinary obligation to provide information. The control of this area will receive even more attention in the future thanks to the new [recommendation 19/2022 \(XII 1.\) issued by the MNB regarding data reporting](#).
- **Unlicensed activities:** The Authority noticed financial service intermediary activities carried out without a license in the case of both natural persons and legal entities, in connection with which the MNB established a ban from the activity and a market supervision fine.

## Distribution of fines, trends

The Report summarizing the 2022 fines has not yet been published, but it appears beforehand - from the published MNB decisions - that the most significant part of the fines still affects the money market sector. Based on the 2018-2021 [annual reports](#) of MNB, it can be seen how the distribution of fines developed between the sectors and in time series. The following chart shows that in 2021, the money market institutions received approximately half of all prudential fines imposed, approximately HUF 359 million. Next came the insurance companies, which had to pay a total of HUF 171 million in fines. Among the actors of the capital market sector, the Supervisory Authority imposed a prudential fine of nearly HUF 132 million, while, as in previous years, the least affected sector was the fund sector.



The time series of prudential fines from 2018 to 2021 is presented in the following figure, which shows that the total amount of these fines has been between HUF 0.9 and 1.3 billion in recent years, the majority of which is borne by the financial market sector. The shares of the other sectors are less stable, and more significant changes can be observed between the years. The amount of fines in 2021 was lower than in previous years, which you can read more about in our [previous newsletter](#), as many investigations were rescheduled due to the COVID crisis. Based on our 2022 research presented in this newsletter, it can be seen **that the amount of fines in 2022 is expected to be higher compared to 2021.**



Another important trend is that the share of prudential fines within the total penalties imposed by MNB is decreasing, but at the same time market surveillance or money laundering fines have increased significantly. **Based on the data published by MNB, it can be seen, for example, that the level of money laundering fines increased by 72%, to HUF 321 million, between 2020 and 2021.**

In addition to the already mentioned sectors, the Supervisory Authority imposed numerous fines on natural persons, as well as established significant penalties against legal entities operating in other sectors. In this regard, the fines imposed for carrying out activities without a license are particularly large, for example in 2020 they exceeded HUF 1 billion. Furthermore, especially among natural persons, the MNB revealed serious deficiencies in connection with **insider trading and market manipulations**, during which customers misused insider information obtained in connection with the issuer's purchase.

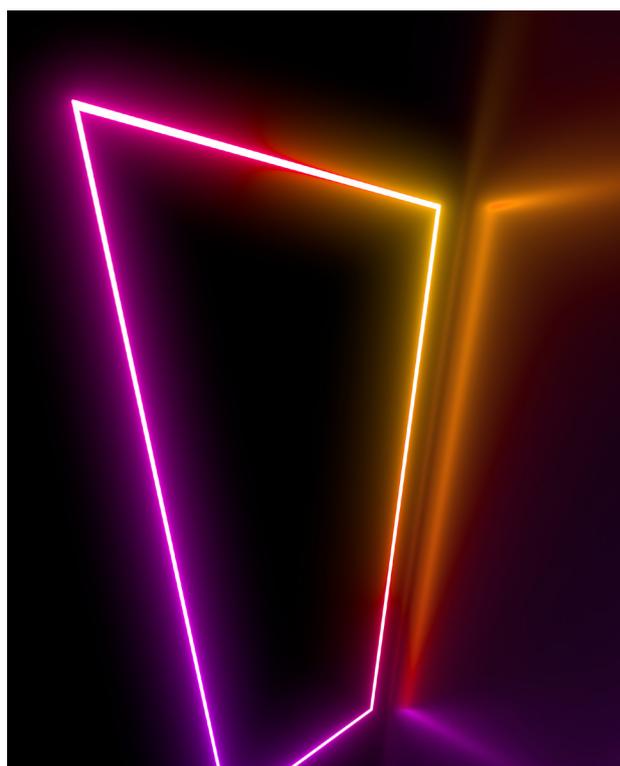
## Sector-specific remarks

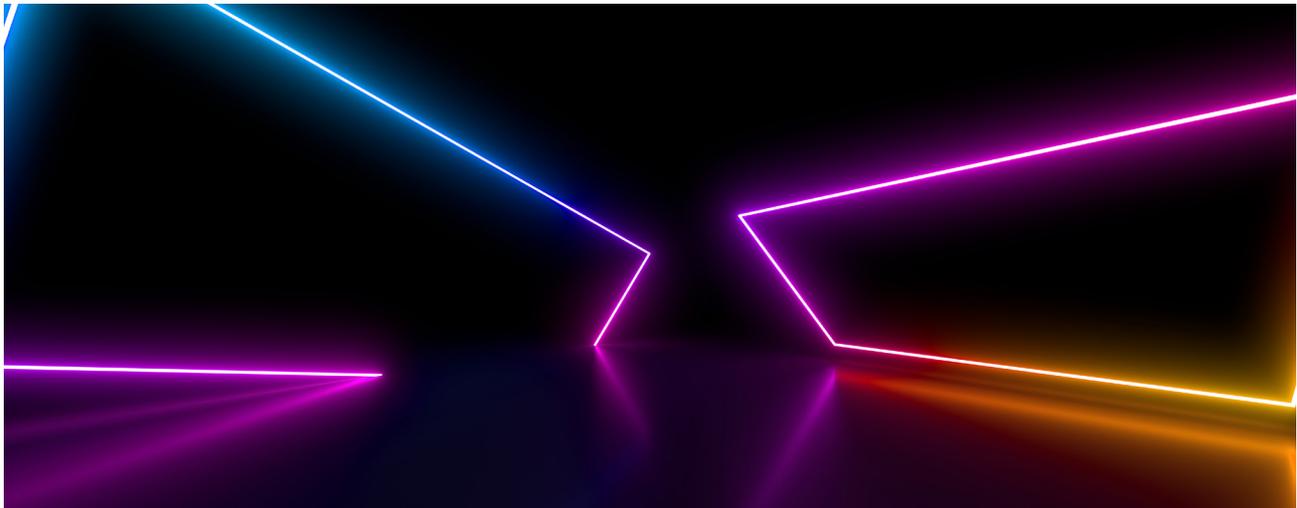
### Credit institutions, financial enterprises

In the course of the supervisory investigations, MNB called on several credit institutions and financial enterprises to fill in gaps and amend processes.

The number and extent of Supervisory fines imposed in connection with the **prevention of money laundering and terrorism financing** can be considered very significant in relation to the past year.

The MNB identified violations in the **area of credit risks** at several credit institutions, and called on the institutions to amend their internal regulations, implement the CRR amendments in connection with the calculation of high-risk commitments, and to establish controls and checkpoints built into the process. According to the findings, credit institutions need to modify their internal procedures and rating methodologies, and MNB drew their attention to the elimination of deficiencies related to customer group formation.





With regard to the **provision of supervisory data**, provision MNB called on the credit institutions to always comply with the data provision correctly, in accordance with the elements of the filling instructions indicated in the decision. The data provision policy should refer to the applicable legislation, and the reporting obligations should be fulfilled in accordance with the relevant data provision regulation.

MNB has also revealed deficiencies among credit institutions in connection with the **payment moratorium**, among which the most common are the payment deferrals provided in order to fulfill the obligation to pay principal, interest and fees arising from the loan agreement linked to the payment account, as well as the payment moratorium arising from consumer credit card contracts related to the violation of the legislation regarding the deadline for the conversion of accumulated debt during the moratorium.

### Insurers

In the case of many insurers, the Supervisory Authority revealed deficiencies in relation to violations of the obligation to provide information to those entitled to the service, as well as in the case of certain products, the adequacy of the content of the information paper, among which it most often objected to the content requirements of the claims settlement information to be prepared in the case of non-life insurance products. In addition, the Authority imposed several significant fines due to the non-compliance of the regulations related to some products, as well as the **non-compliance of the registration, data provider and control systems, as well as the non-compliance of the procedures related to outsourcing**. In one case, the authority decided to impose a significant fine due to the unclear fee calculation principle revealed in the case of some products.

The MNB revealed the most significant part of the deficiencies in connection with **market abuses and the publication of insider information as soon as possible**, during which consumer protection fines were imposed. The sector was also affected in connection with the failure to provide data obligations in 2022.

### Investment service providers

Regarding **money laundering prevention**, the Authority revealed deficiencies in relation to the following: recording of electronic customer due diligence processes (recording quality, retrievability), checking of compliance with customer due diligence requirements, customer due diligence conducted via electronic communication tools.

### Funds

In the case of the funds, corporate governance problems, inadequate management of credit risk, deficiencies related to group impairment calculation and capital adequacy regulations, as well as inadequate information security, were identified.

The Supervisory Authority also imposed fines in relation to data provision deficiencies, inappropriate outsourcing, unfair commercial practices, and violations of the legal provisions on the determination of unpaid debt under the payment moratorium.

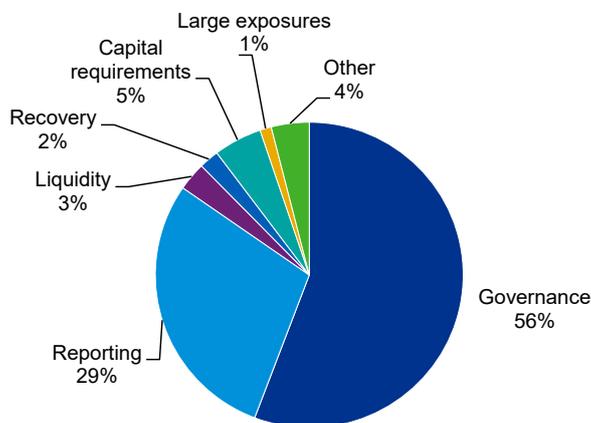
### Investment fund managers

The MNB has identified deficiencies in the fund management sector in a number of cases, of which the most prominent topics were **market abuses**, the **portfolio registration system**, the **calculation of net asset value**, the eligible capital requirement, remuneration policy and practice, incentives, and the management of information security risks.

## International outlook

Analyzing the trends in the supervisory activities, it is worth looking at the EU institutions as well. The European Central Bank (ECB) supervises major financial players, except for 6 EU member states. [Based on the data published by the ECB](#) in the Single Supervisory Mechanism (in which all EU member states except Denmark, Sweden, Poland, the Czech Republic, Hungary, Romania are part), the proportion of prudential fines was as follows:

*Distribution of prudential fines in selected EU countries in 2021:*



It is clear that the ECB focuses more on the internal control environment, reliability and regularity of processes during its prudential supervision activities, more than half of the fines were imposed in connection with this area. This is a difference compared to domestic supervisory practice.

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