



Financial Risk & Regulation

Supervisory expectations in the financial sector

Newsletter – December 2021

Towards the end of 2021, for the third time, we analysed how the fines imposed by the Supervisor changed, which sectors were affected by the largest fines, and what the Supervisor called on the financial sector participants. The deficiencies observed are similar to those of previous years. Based on these, institutions should also put greater emphasis on IT security, the prevention of money laundering, the management of credit risk and the correct calculation of capital adequacy, the appropriate information provision to MNB, the handling of complaints and corporate governance aspects.

Supervisor 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 2020](#), the MNB issued a total of 2,790 prudential enforcement and licensing decisions and 164 consumer protection resolutions in 2020. MNB made 27 regulatory decisions in the area of market supervision and 37 in the area of supervision of issuers.

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 2021 have been included in this newsletter.

General observations

MNB discovered several problems 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:

- **IT and information security:** MNB identified deficiencies related to the proper operation which is compliant with the relevant legal provisions, such as logging of events critical to the operation of the IT system, ensuring the self-protection of the IT security system through regular intrusion tests and vulnerability tests, and maintaining the security, integrity and confidentiality of information.
- **Credit risk:** In the area of credit risk, MNB objected the operation of organizations in the following areas and found deficient compliance with relevant legislations: customer rating, customer group forming, collateral management and registration, and limit management policies.



- **Prevention of money laundering and terrorist financing:** In order to ensure full compliance with legal requirements, MNB obliged organizations to improve the filing practice so that reports were forwarded to the financial information unit without delay and in full, for customer due diligence, customer identification, customer identity verification, and compliance with filtering practices and highlighted that additional human resources need to be provided for the area.
- **Complaint handling:** It was a common finding that the complaint handling policy was not properly and sufficiently developed, that complaints were not registered and recorded, and that complaints were answered after the deadline.
- **Capital calculation and adequacy:** In connection with the calculation of capital, MNB expects the calculation of the own funds requirement in accordance with the relevant legal regulations and the classification of exposures in accordance with the relevant CRR expectations.
- **Remuneration:** MNB drew the attention of organizations to the need to design their remuneration policies in a way that it avoids potential conflicts of interest and to include all required mandatory content elements.
- **Monitoring committee:** MNB called on the organizations to ensure that the individual monitoring committees comply with their statutory monitoring obligations, prepare an annual monitoring plan and regularly monitor the consistency of the organisation's revenues and expenditures, assets and liabilities, and the operation itself, as a whole.
- **Supervisory information and supplying data:** MNB drew the attention on the provision of inadequate, incomplete and delayed data supply.

Breakdown of imposed fines by amount

Based on the [MNB's annual reports](#) for 2018, 2019 and 2020, we can see how the distribution of fines changed between sectors and over time. Figure 1 shows that in 2020, money market participants received more than half of the total prudential fines imposed, amounting to approximately HUF 544 million. This was followed by insurers, who had to pay a total of HUF 377.3 million in fines. Among the participants in the capital market sector, the Supervisor imposed a prudential fine of almost HUF 93.7 million, while, as in previous years, the fund sector remained the least affected sector.

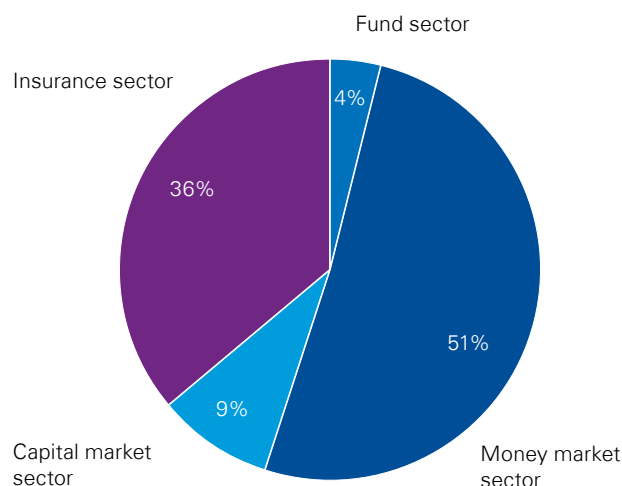


Figure 1 Share of supervised sectors in the amount of prudential fines in 2020

The time series of imposed fines from 2018 to 2020 is demonstrated in Figure 2, which shows that the total amount of fines has been between HUF 0.9 and 1.3 billion in recent years, the majority of which is paid by the money market sector. The share of other sectors is less stable, with a more significant change between years.

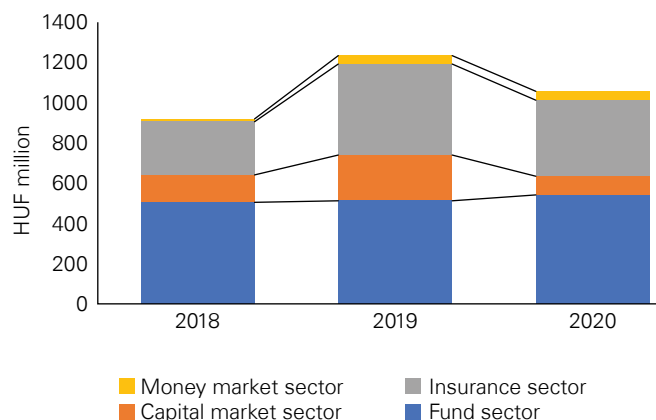


Figure 2 The development of prudential fines between 2018 and 2020

The amount of the fines for 2021 has not yet been published, however, it appears from the publicly available MNB decisions that the highest fines are still imposed on the money market sector. The amount of fines in 2021 is expected to be lower than in previous years because a number of investigations have been rescheduled due to the COVID crisis and the decision is expected to be issued later.

Credit institutions, financial enterprises

During the supervisory inquiries, MNB called on several credit institutions and financial enterprises to fill the gaps and restructure their processes.

MNB identified violations in the area of **credit risks** at a number of credit institutions and called on the institutions to amend their internal regulations. A particularly large number of deficiencies can be identified in the monitoring regulations, the internal regulations for client group forming and in the coverage valuation regulations. In addition, credit institutions need to amend their internal procedures, rating methodologies in line with the findings, and MNB drew their attention to the development of procedures in accordance with the relevant regulations of IFRS 9, the appropriate definition of provisions and impairments, and changes in certain macro-model testing.

In the field of **deposit insurance**, credit institution must ensure that the KBB data file complies with the description and guidelines of the current Consolidated Data Record structure at all times in order to provide the OBA with adequate information. MNB called on the institutions to review the actuality of their data, to supplement missing customer data and to comply with information obligations regarding deposit insurance to customers.

With regard to the **provision of information to the Supervisory**, MNB called on credit institutions to comply with the regulations of supervisory information at all times, in accordance with the elements of the instructions for completion specified in the resolution. The reporting rules should refer to the legislation in force and comply with reporting obligations in accordance with the relevant reporting regulations.

MNB also identified shortcomings in the **payment moratorium** among credit institutions. MNB drew their attention to the timely processing of statements made by customers, the repayment of unduly collected items and the updating of the credit registration system.

Insurers

The Supervisor revealed deficiencies in the field of **IT security** for a number of insurers again in this year and in several cases had to warn those concerned to review their IT system so that it can log operationally critical processes. It also obliges many insurers to conduct regular vulnerability testing at workstations and regulate the handling of vulnerability and intrusion test results.

Regarding the **accounting procedure**, the Supervisor called on the concerned insurers to specify in their accounting policies what the accounting accounts consider to be material and non-material revenue, costs and expenses. In addition, MNB required insurers to prepare their Solvency II data in accordance with the relevant legal requirements.

In connection with the **outsourcing** of certain activities, several insurers are required to set up and operate a registration system that allows for the complete record of outsourcing. If the organization outsources a key task, it must pay particular attention to setting out in the contract the criteria for assessing priority and the mandatory content of the contract.

In connection with insurance products, MNB obliged insurers to always indicate the required content of the **terms and conditions of the contract** in accordance with the relevant legislation.

In the context of the **remuneration policy**, the Supervisor required insurers to have a remuneration policy in the form of a written regulation that contains the required mandatory content elements, including measures to avoid conflicts of interest.

Investment service providers

MNB drew the attention of investment service providers to comply with relevant legislations related to their primary **data reporting** and data provision obligations, and to review their reporting practices and establish stronger internal control functions.

In the area of **credit risk**, the Supervisor identified deficiencies in the internal regulations related to the followings: restructuring, management of receivables, management of collateral, impairment and provisioning.

Funds

A common problem with the funds was the incomplete **complaint handling policy**, which did not comply with the applicable legal regulations. There were also shortcomings in the area of complaint handling as regards the registration and proper handling of complaints.

In the case of **membership relationships and membership fee payments**, the Supervisor called on the funds to take the necessary measures at the beginning and termination of the membership and to include in the articles of association the consequences of the non-payment of the membership fee.

Investment fund managers

In several cases, MNB has called on fund managers to modify their risk management processes, in particular the limit controls in the electronic portfolio management system prior to the implementation of investment decisions. In addition, MNB warned stakeholders to comply with the requirements for documenting risk management activities.

Personal penalties

MNB also imposed fines totalling HUF 95 million on individuals, mainly among members of the Monitoring Committee and among the Board of Directors.

The CRD proposal re-regulates the imposition of fines in the EU

The CRD6 proposal, published in October 2021, was supplemented by a list of infringements for which financial actors face administrative or periodic penalty payments.

Contrary to the previous regulation, the fines that could be imposed for certain infringements would be divided into administrative and periodic fines. In the cases of legal persons, the administrative fine can reach a maximum amount of 10% of the total annual net turnover, while the periodic penalty payment may not exceed 5% of the average daily net turnover.

The number of infringements would be extended to 11 cases, including non-compliance among others with the followings:

- Requirements for the composition, conditions, adjustments and deductions related to own funds;
- Requirements for large exposures to a client or group of connected clients;
- Data collection and governance requirements;
- Requirements for calculating risk-weighted exposure amounts or own funds.

Article 70 of the proposal has also been amended, requiring Member States to regulate cooperation between competent and judicial authorities due to the duplication of criminal and administrative proceedings and sanctions. The proposal draws the attention of the competent authorities to the need to coordinate their actions in order to avoid overlaps and the accumulation of fines. This is to ensure that natural or legal persons who commit an offense do not pay undue penalties.

However, the authorities may impose sanctions for the same infringement in certain cases. In such cases, the cumulation of penalties must be strictly necessary and proportionate to the seriousness of the infringement.

Please note that the CRD amendment is currently a proposal which has not been adopted yet and that subsequent actual implementation could lead to significant practical differences among Member States!

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