

Financial Risk & Regulation

Supervisory expectations in the financial sector

Newsletter – December 2020

In our [Financial Risk & Regulation newsletter, published in October 2019](#), we summarized the supervisory focus areas of the previous year in the financial sector. Towards the end of 2020, continuing the period presented earlier, we re-examined how the fines imposed in the sector developed and what the focus areas of inspections were over the past year.

Supervisory expectations in the financial sector

Institutions operating in the financial sector must comply with a number of supervisory requirements and legislation. Regulatory compliance is regularly monitored by the MNB, as a competent authority, within the framework of comprehensive, thematic, targeted and ex-post inspections, as well as market surveillance procedures and ongoing supervision. Decisions published on the MNB's website also serve as a good basis for understanding what the focus of supervisory investigations is and which areas are at risk for compliance. In the past year, in addition to the legal regulations and methodological recommendations, the supervisory authority has also imposed significant fines, the legal basis of which is summarized below.

General remarks

MNB revealed a number of problems and shortcomings in its supervisory investigations. Highlighting the most common of the identified shortcomings, the following problems can be identified in several sectors:

– **Consumer protection:** MNB revealed shortcomings in commercial communications, such as financial leasing and retail loans, in the calculation, publication and presentation of total credit fees with a representative example. There

have also been problems with customers' right to prepay, interest on arrears and the provision of cash withdrawals free of charge.

- **IT security:** In several cases, the supervisory authority objected to the protection of IT security systems and made related findings regarding user rights, logging, database security settings, vulnerability management and border protection of the IT environment.
- **Prevention and suppression of money laundering and terrorist financing:** In line with the trend observed earlier, in parallel with the change in the international regulatory environment, MNB also put increasing emphasis on the examination of the standards set for the prevention of financial crime during its audits. Compared to the previous year, the fines imposed in this category were even more significant. In several cases, the supervisory authority made findings in relation to the screening of customers and unusual transactions, internal regulatory documents, the obligation to provide information, and deficiencies related to internal training.
- **Customer complaint handling:** From a consumer / investor protection point of view, there has also been a significant emphasis in the past year on customer complaint handling issues. Among these, the shortcomings of the relevant

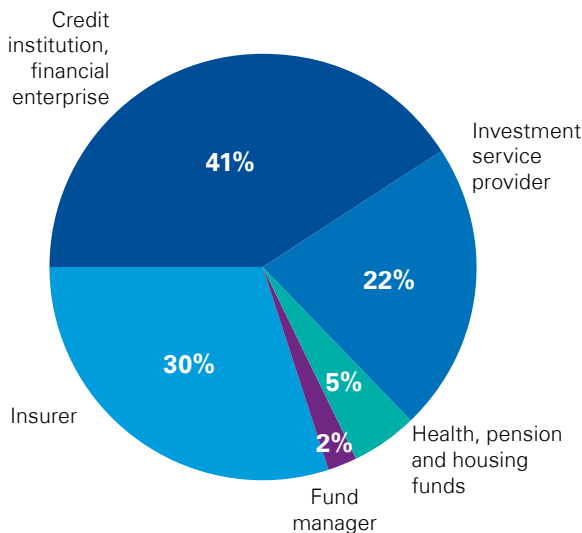
regulations and the minutes of the complaints, the adequacy of the legal remedy to be provided in case of rejection of the complaints, as well as the complete and timely response of the complaints should be highlighted.

- **Capital calculation, risk management:** From the point of view of capital calculation and risk management, the MNB imposed the most fines along the following issues: adequacy of risk weights, calculation of own funds requirement and leverage, calculation of capital requirement for interest rate risk, impairment accounting - IFRS9 impairment model.
- **Supervisory reports:** Inadequate quality of supervisory reports and frequent delays in its submission can be considered as a general finding.

Breakdown of fines by amount

In the following chart, excluding personal fines, we present the most important findings in the MNB’s resolutions issued during the period under review. It can be seen from the distribution that credit institutions and financial enterprises received about 40% of the fines imposed, the amount of which exceeded HUF 400 million. The other significant part of the penalties affected insurers, amounting to approximately HUF 310 million. In addition, the MNB obliged investment service providers to pay a fine of slightly more than HUF 220 million.

Breakdown of fines by amount:



We compared the previous and current period under review on an annualized basis to see how the fines evolved between 2019 and 2020. In our analysis, we focused on where the sectoral focus has shifted in terms of supervisory investigations and fines. From the available data, we have seen that it may be worthwhile for investment service providers to pay more attention to preparing for supervisory inspections, as compared to the previous period,

MNB imposed significantly more fines on these service providers this year than before, an increase of more than 10 percentage points was measurable. In the case of credit institutions, financial undertakings and insurance companies, compliance with supervisory requirements remains key, as in both periods examined, institutions operating in these sectors paid about three quarters of the fines imposed.

Credit institutions, financial enterprises

During the supervisory authority’s investigations, a number of credit institutions and financial enterprises revealed legal deficiencies in the development of internal regulations and processes.

The MNB also issued a number of calls for the internal regulatory framework for creditworthiness and for compliance with the transparent and traceable nature of the credit assessment process. In his warnings, he emphasized that when calculating their certified monthly net income, financial institutions must ensure that their internal procedures and rating system fully comply with the provisions of the JTM Regulation.

In the area of credit risk, credit institutions involved in breaches of the rules need to update their relevant policies, monitor changes in legislation and, in order to achieve this, incorporate checkpoints into their regulatory systems. The supervisory authority also revealed shortcomings in the internal lending regulations, highlighting the need for at least an annual review of the discount factors calculated on the basis of experience rate of return data, determined by type of collateral.

The supervisory authority called on the parties concerned to ensure that financial institutions meet the statutory capital requirements for all exposures in the future by transforming processes and incorporating control points during the capital calculation.

In the area of market risks, the supervisory authority has issued an instruction to determine the exposure and capital requirements for counterparty risk bearing transactions at least annually, and expects the process steps and responsibilities for measuring the source and impact of credit valuation adjustment risk (CVA) to be set out in regulations.

In the areas of supervisory compliance of credit institutions, the MNB found deficiencies in the work plan supported by the annual risk analysis and the preparation of the annual report, as well as in the process of examining the proper functioning of the fraud prevention mechanism. MNB called on stakeholders to establish the necessary procedures for the immediate implementation of decisions aimed at preventing money laundering and terrorist financing and for the fulfillment of the relevant education and reporting obligations in accordance with the law.

In the area of corporate governance, many financial companies lacked consistency between job descriptions and the actual scope of work contained in the Organizational and Operational Regulations.

Regarding the security risk analysis of the IT system, many credit institutions had deficiencies in the lack of an appropriate action plan for the management of non-assumed risks, including those responsible and deadlines. The supervisory authority uncovered the lack of complete and expected security classification of IT system elements on the basis of confidentiality, integrity and availability as deficiencies in many cases.

In addition to the above, the MNB also imposed significant fines for the provision and intermediation of financial intermediation services without a license.

Insurers

The MNB revealed shortcomings in the regulations for calculating the reserve and solvency capital requirements under the Solvency II regulatory system. The supervisory authority's expectation that the methodological description of the calculation of the own funds requirement will in practice enable the reproduction of the calculation of the own funds requirement and the full understanding of the applied methodology includes the methodology for calculating the group-level own funds requirement and the reserve calculation methodology. The supervisory authority warns that in estimating technical provisions, insurers always use assumptions substantiated in accordance with legal regulations, in particular with regard to the mortality factor.

In the case of several insurers, the MNB also required that the internal regulations set out the processes designed to meet supervisory requirements and their deadlines.

Based on the decisions, the supervisory authority had to warn several insurers to review and update the security risk analysis of the IT system within the two-year period prescribed by law. In the field of IT security, the supervisory authority also revealed deficiencies in the complete and up-to-date register of the administrative and business software tools that make up the IT system. In several cases, the supervisory authority had to be warned about the comprehensive development of business continuity plans, the inclusion of the service providers used in this framework in the relevant regulations, and the assessment of emergencies and catastrophes.

In connection with its remuneration procedures, the supervisory authority has on several occasions called on the parties concerned to prepare and enforce a consolidated remuneration policy in accordance with legal requirements, setting out the mandatory content elements.

MNB has also identified several shortcomings with regard to always providing clear and complete information to customers.

Investment service providers

A common problem for investment service providers is the breach of legal requirements for the development and publication of a complaint handling policy. In the case of complaint handling by telephone, the supervisory authority also revealed shortcomings in connection with the recording of telephone communications with the customer by voice recording. In addition, the decisions published by MNB also reveal in several places the deficiencies of the internal regulations concerning the handling of situations causing conflicts of interest or conflicts of interest.

In addition, MNB strongly sanctioned the pursuit of intermediation and subcontracting activities for unannounced financial services.

Investment fund managers

In several cases, MNB called on stakeholders to ensure that their risk management systems are reviewed at least once a year. The supervisory authority has set a similar expectation for the review of liquidity management regulations, and has also required stakeholders to ensure the application of stress tests that fully cover risks in accordance with the law. MNB also called on several fund managers to comply with legal requirements for the calculation of net asset value.

Based on the decisions, several investment fund managers failed to provide MNB with the obligation to provide data and to report master data on outsourced activities. The supervisory authority warns that the provision of investment fund management and closely related activities by third parties constitutes outsourcing.

Due to the deficiencies in the conflict of interest, MNB called on the relevant fund managers to establish processes so that the relevant persons engaged in various business activities involving a risk of conflict of interest carry out these activities with sufficient independence.

MNB made findings due to the lack of full compliance with the legal provisions on business continuity policy, expecting the functional separation of the risk management function and the internal control area, and that the employee responsible for risk management have the necessary qualifications, knowledge and expertise to perform the assigned responsibilities.

Health, pension and housing funds

The supervisory authority called on the funds concerned to review their business impact analysis, which is the basis of the risk analysis, to ensure its completeness and to develop a comprehensive

action plan in accordance with the extent and resource requirements of the risks identified during the risk analysis.

MNB revealed several shortcomings in the audit processes of the audit committees of the funds concerning the management, accounting and administration of the funds. The supervisory authority has repeatedly called on the funds to meet the deadlines for reimbursing costs.

The supervisory authority called on the parties concerned to comply with the rules of the Law on the Prevention and Suppression of Money Laundering and Terrorist Financing concerning the identification of members and the prohibition of payments to members who have not been fully screened.

Personal fine

MNB also imposed personal fines on individuals in several cases, including on the basis of the personal liability rules of the supervised institutional group. The main reasons for the penalties were unauthorized portfolio management, unannounced dependent agency activity, and breaches of the ban on market manipulation and insider dealing.

The topics of the findings typically found in decisions are illustrated in the attached word cloud. However, please note that the figure does not necessarily reflect the highlighted risks, as a relatively less common deficiency may be considered critical and may result in high fines.

KPMG's expertise is available before, during and after supervisory investigations to assist in the detection, assessment and resolution of deficiencies.



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