

**THE SELF-ASSESSMENT OF THE HUNGARIAN
FINANCIAL SUPERVISORY AUTHORITY
AGAINST
THE INSURANCE CORE PRINCIPLES**

November 2005

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Assessment methodology

An essential criterion or an advanced criterion is assessed using five categories: **observed**, **largely observed**, **partly observed**, **not observed**, and **not applicable**.

Under each Principle, the level of observance with each criterion (essential and advanced) is indicated in the column provided [O for *Observed*, LO for *Largely Observed*, PO for *Partly Observed*, NO for *Not Observed*, and NA for *Not Applicable*).

Table of abbreviations

<i>Act on Accounting</i>	Act C of 2000 on Accounting
<i>Act on HFSA</i>	Act CXXIV of 1999 on the Hungarian Financial Supervisory Authority
<i>Act on Insurance</i>	Act LX of 2003 on Insurers and Insurance Activity
<i>Association Act</i>	Act II of 1989 on the right of association
<i>Company Act</i>	Act CXLIV of 1997 on business associations
<i>Bankruptcy Act</i>	Act II of 1991 on bankruptcy, liquidation and winding up
<i>EU</i>	European Union
<i>HFSA</i>	Hungarian Financial Supervisory Authority
<i>Member State</i>	Member state of the European Union
<i>Supervisory Authority</i>	the HFSA as it is referred to in legislation
<i>Third countries</i>	countries not belong to the category of Member States

The Hungarian Financial Supervisory Authority has decided to make the self-assessment every year taking into account the changes in the legislation and in the supervisory practice. The present self-assessment – following the one in 2004 – was closed on the 15th of November 2005.

Summary Self-assessment

It should be noted that the level of observance for each Principle reflects the assessments of the essential criteria **only**. Assessment of advanced criteria are not included in assessing observance with Principles.

Core Principle	Title	Level of Observance (Please tick one for each Principle)				
		O	LO	PO	NO	NA
1	Conditions for effective insurance supervision	x1				
2	Supervisory objectives	x				
3	Supervisory authority		x2			
4	Supervisory process	x				
5	Supervisory cooperation and information sharing	x				
6	Licensing	x				
7	Suitability of persons			x3		
8	Changes in control and portfolio transfers	x				
9	Corporate governance	x				
10	Internal control		x4			
11	Market analysis	x				
12	Reporting to supervisors and off-site monitoring	x5				
13	On-site inspection	x				
14	Preventive and corrective measures	x				
15	Enforcement or sanctions	x6				
16	Winding-up and exit from the market	x				
17	Group-wide supervision	x				
18	Risk assessment and management			x		
19	Insurance activity		x7			
20	Liabilities	x8				
21	Investments			x9		
22	Derivatives and similar commitments			x10		
23	Capital adequacy and solvency		x11			
24	Intermediaries	x				

1 Criteria c), e), f) are LO.

2 Criteria b) and c) are PO.

3 Criterion b) is LO, f) is NO.

4 Criterion c) is LO, Criteria d) and e) are PO.

5 Criterion c) is LO.

6 Criterion d) is LO.

7 Criterion a) is PO, e) is LO.

8 Criterion f) is LO.

9 Criteria c) and i) are LO, d), j) and k) are PO.

10 Criteria d) and i) are LO, criteria e) and f) are PO, criteria c), g) and h) are NO.

11 Criterion d) is LO, b) is PO.

25	Consumer protection		x12			
26	Information, disclosure and transparency towards the market	x				
27	Fraud	x				
28	Anti-money laundering, combating the financing of terrorism (AML/CFT)	x				

* (O-Observed, LO-Largely Observed, PO-Partly Observed, NO-Not Observed, NA-Not Applicable)

12 Criteria b) and e) are LO.

Principle 1: Conditions for effective insurance supervision

Principle 1: Conditions for effective insurance supervision	
Insurance supervision relies upon	
<ul style="list-style-type: none"> • a policy, institutional and legal framework for financial sector supervision • a well developed and effective financial market infrastructure • efficient financial markets. 	
	O/LO/PO/NO/NA *
<p>Financial sector policy framework</p> <p><i>Essential criteria</i></p> <p>a. The government establishes and publicly discloses a policy statement aimed at ensuring financial stability, including the provision of effective financial sector supervision covering the insurance and other financial sectors.</p>	O
<p>b. An institutional and legal framework – comprising public institutions, laws and regulations – exists for financial sector issues, including those pertaining to insurance, to address system-wide issues. This framework is well-defined and publicly disclosed.</p>	O
<p>Financial market infrastructure</p> <p><i>Essential criteria</i></p> <p>c. There is a reliable, effective, efficient and fair legal and court system (a body of ethical, professional and trained lawyers and judges) whose decisions are enforceable. Alternative dispute mechanisms operate within an appropriate legal framework.</p>	LO
<p>d. Accounting, actuarial and auditing standards are comprehensive, documented, transparent and consistent with international standards. Accounting and actuarial standards are applied and disclosed in a manner that allows current and prospective policyholders, investors, intermediaries, creditors and supervisors to properly evaluate the financial condition of insurers.</p>	O
<p>e. Accountants, actuaries and auditors are competent and experienced and comply with technical and ethical standards to ensure the accuracy and reliability of financial data and its interpretation. Auditors are independent from the insurer.</p>	LO
<p>f. Professional bodies set and enforce technical and ethical standards. These standards are accessible to the public.</p>	LO
<p>g. Basic economic, financial and social statistics are available to</p>	O

the supervisory authority, the industry and the public.	
Advanced criteria	
h. Laws and regulations are updated, as necessary, to reflect current best practices and industry conditions.	LO
Efficient financial markets	
Essential criteria	
i. Well-functioning money and securities markets exist to support the availability of both long-term and short-term investment opportunities.	O
* (O-Observed, LO-Largely Observed, PO-Partly Observed, NO-Not Observed, NA-Not Applicable)	

Assessment

Financial sector policy framework

a) Section 2 of the Act CXXIV of 1999 on the Hungarian Financial Supervisory Authority and Articles 168-169 of the Act LX of 2003 on the insurers and insurance activities as well as the Act CXX on the Capital Market and the Act CXII of 1996 on Credit Institutions and Financial Enterprises ensure the fulfilment of this criterion.

b) Act CXXIV of 1999 on the Hungarian Financial Supervisory Authority and Act LX of 2003 on Insurers and Insurance Activities serve for legal framework for the supervision of financial issues and the operation and supervision of insurance, respectively. Separate statutes regulate other sub sectors of the financial sectors, e.g. the Act CXX on the Capital Market and the Act CXII of 1996 on Credit Institutions and Financial Enterprises.

Financial market infrastructure

c) Articles 18-37 (on arbitration board) of Act CLV of 1997 on Consumer Protection provide for the rules of the alternative dispute mechanism. As to the decisions of the supervision, its decisions cannot be appealed against through public administration procedures, just at the court. There is a separate statute (Act IV of 1957 on the General Rules of Public Administration Procedures) regulating this field.

d) The Act C of 2000 on Accounting sets the accounting standards. This act was drafted taking the international accounting standards into account. Section 149 of the Act on Insurance provides for the actuarial skills of or the employment of an actuary by the auditor of an insurer.

e) Paragraphs (1) of Sections 85-91, as well as Sections 149 and 150 of the Act LX of 2003 on Insurers and Insurance Activities provide for the criterion of the above professions.

f) Regarding best practices on different fields the Board of the HFSA issues recommendations, published on the home page of the HFSA. The Association of Hungarian Insurance Companies has adopted its Ethical Codex, some professional chambers or associations (e.g. accountants, lawyers, etc.) have their own sets of best practices.

g) The Central Office of Statistics issues reports on the above data every year.

h) Laws are amended regularly to follow the necessary changes (see e.g. amendments of Act CXXIV of 1999 on the Hungarian Financial Supervisory Authority, amendments to the Act XCVI of 1995 on Insurers and Insurance Activities, amendments to the Act CXII of 1996 on Credit Institutions and Financial Enterprises, etc.) Decrees providing for the implementation of regulations (e.g. on reporting, technical rate of interest, etc.) are amended when it deems necessary. Best practice issues are governed by the HFSA; these recommendations are regularly updated.

Efficient financial markets

i) The operation of securities and money markets are regulated by the Act CXX on the Capital Market and Act CXII of 1996 on Credit Institutions and Financial Enterprises, respectively. The Hungarian money market is characterised by its two-tier banking system. The stocks of 50 companies are traded at the Budapest Stock Exchange.

Principle 2: Supervisory objectives

Principle 2: Supervisory objectives	
The principal objectives of insurance supervision are clearly defined.	
	O/LO/PO/NO/NA *
Essential criteria	O
a. Legislation or regulation clearly defines the objectives of insurance supervision.	
b. The key objectives of supervision promote the maintenance of efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders.	O
c. In the event that the law mandates or specifies multiple objectives for insurance supervision, the supervisory authority discloses and explains how each objective will be applied.	O
d. The supervisory authority gives reasons for and explains any deviations from its objectives.	NA
e. Where objectives are contradictory, the supervisory authority initiates or proposes correction in law or regulation.	NA
* (O-Observed, LO-Largely Observed, PO-Partly Observed, NO-Not Observed, NA-Not Applicable)	

Assessment

a) The objectives of the Hungarian Financial Supervisory Authority (hereinafter referred to as HFSA) is clearly defined in Section 2 and 3 of the Act CXXIV of 1999 on Hungarian Financial Supervisory Authority (hereinafter referred to as Act on HFSA), declaring the HFSA's key functions and its scope of powers as follows: to promote the smooth and successful operation of financial markets, to protect the interests of the clients of financial organizations, to assist in providing a clear and accurate picture of market conditions, to improve confidence in the financial markets and to facilitate fair market competition by controlling the operations of the organizations and individuals that provide financial services by assuring that organizations operate prudently and their owners exercise their legal rights diligently.; Section 2, Paragraph (1) of the Act on HFSA). The HFSA is a consolidated organization comprising the supervision of banking, securities, insurance and pension funds market. The scope of the HFSA naturally includes – besides supervision of insurance and insurance intermediation activities – activities defined in Section 1 of the Act LX of 2003 on Insurers and Insurance Activity (hereinafter referred to as Act on Insurance).

A wide range of special scopes regarding the supervision of organisations, persons and activities pursuing insurance, insurance intermediary or other related activities is defined in Section 169 of the Act on Insurance.

b) Refer to criterion a. of the present ICP.

c) The Act on Insurance provides for the rules on application of the each above objective. Proceedings for the execution of such objectives are detailed for the HFSA's employees in internal regulatory documents (regulations, policies, guidances, etc.).

Meanwhile, the HFSA lays special emphasise upon transparency which is guaranteed in several means: the HFSA holds conferences for the representatives of the insurance sector,

issues recommendations, guidelines, opinions, studies, publications and other information of public interest which are available – along with the resolutions of the HFSA – on the official homepage of the HFSA (www.pszaf.hu). Apart from the information of the market participants, the HFSA stresses the importance of consumer's protection, in the frame of which – for example – the HFSA provides with information letters all clients of financial institutions on the HFSA's main duties in the field of consumer protection, and publishes comparative tables of competitive insurance products on the HFSA's internet website.

d) Since each objective of the HFSA is clearly defined in the Hungarian insurance legislation – and as the activity of the HFSA is publicly disclosed and is under continual observance by the Government (see above) – there is no possibility to deviate from them. Consequently, the regulation of such question seems to be needless.

e) Refer to criterion d. of the present ICP.

Principle 3: Supervisory authority

<p>Principle 3: Supervisory authority</p> <p>The supervisory authority:</p> <ul style="list-style-type: none"> • has adequate powers, legal protection and financial resources to exercise its functions and powers • is operationally independent and accountable in the exercise of its functions and powers • hires, trains and maintains sufficient staff with high professional standards • treats confidential information appropriately. 	
	O/LO/PO/NO/NA *
<p>Legal framework</p> <p><i>Essential criteria</i></p> <p>a. The legislation identifies the authority (or authorities) responsible for the supervision of insurance entities.</p>	O
<p>b. The legislation gives the supervisory authorities the power to issue and enforce rules by administrative means (refer to ICP 4 EC a).</p>	PO
<p>c. The legislation grants sufficient powers for the effective discharge of supervisory responsibilities.</p>	PO
<p>Independence and accountability</p> <p><i>Essential criteria</i></p> <p>d. The governance structure of the supervisory authority is clearly defined. Internal governance procedures necessary to ensure the integrity of supervisory operations, including internal audit arrangements, are in place.</p>	O
<p>e. There are explicit procedures regarding the appointment and dismissal of the head and members of the governing body. When the head of an authority or the governing body is removed from office, the reasons are publicly disclosed.</p>	O
<p>f. The institutional relationships between the supervisory authority and executive and the judiciary branches are clearly defined and transparent. Circumstances where executive overrides are allowed are specified.</p>	O
<p>g. The supervisory authority and its staff are free from undue political, governmental and industry interference in the performance of supervisory responsibilities.</p>	O
<p>h. The supervisory authority is financed in a manner that does not undermine its independence from political, governmental or</p>	O

industry bodies.	
i. The supervisory authority has discretion to allocate its resources in accordance with its mandate and objectives and the risks it perceives.	○
j. The supervisory authority has transparent processes and procedures for making supervisory decisions. Supervisory decisions are demonstrably consistent.	○
k. All material changes to the insurance legislation and supervisory practices are normally subject to prior consultations with market participants.	○
Advanced criteria	○
l. Representatives of the supervisory authority publicly explain their policy objectives, and report on their activities and performance in pursuing their objectives.	
m. Subject to confidentiality considerations, information is provided publicly about problem or failed insurers, including information on official actions taken.	○
Powers	○
Essential criteria	
n. When necessary, the supervisory authority has the power to take immediate action to achieve its objectives, especially to protect policyholders' interests (refer to ICP 4 EC e).	
Financial resources	○
Essential criteria	
o. The supervisory authority has its own budget sufficient to enable it to conduct effective supervision. The supervisory authority is able to attract and retain highly skilled staff, hire outside experts as necessary, provide training, and rely upon an adequate supervisory infrastructure and tools.	
p. The supervisory authority publishes audited financial statements on a regular basis.	○
Human resources and legal protection	○
Essential criteria	
q. The supervisory authority and its staff <ul style="list-style-type: none"> – observe the highest professional standards – have the appropriate levels of skills and experience have the necessary legal protection to protect them against lawsuits for actions taken in good faith while discharging their	

<p>duties, provided they have not acted illegally</p> <ul style="list-style-type: none"> – are adequately protected against the costs of defending their actions while discharging their duties – act with integrity. Supervisory staff are subject to conflict of interest rules, such as prohibition on dealing in shares and investing in the companies they supervise. The supervisory authority establishes and enforces a code of conduct that applies to all staff members. 	
<p>r. The supervisory authority has the authority to hire, contract or retain the services of external specialists through contracts or outsourcing arrangements if necessary.</p>	O
<p>s. Where supervisory functions are outsourced to third parties, the supervisory authority is able to assess their competence, monitor their performance, and ensure their independence from the insurer or any other related party.</p>	O
<p>Confidentiality <i>Essential criteria</i></p>	O
<p>t. The supervisory authority maintains appropriate safeguards for the protection of confidential information in its possession. Other than when required by law, or when requested by another supervisor who has a legitimate supervisory interest and the ability to uphold the confidentiality of the requested information, the supervisory authority denies requests for confidential information in its possession (refer to ICP 5).</p>	
<p>u. External specialists hired by the supervisory authority are subject to the same confidentiality and code of conduct requirements as the staff of the supervisory authority.</p>	O
<p>* (O-Observed, LO-Largely Observed, PO-Partly Observed, NO-Not Observed, NA-Not Applicable)</p>	

Assessment

Legal framework

a) The Act on HFSA identifies the HFSA as the only responsible supervisor for the insurance entities. According to Section 2, Paragraph (2) of the above Act, the HFSA shall continually monitor compliance with legal and supervisory regulations governing the operations of financial organizations, and is vested with powers defined in specific other legislation (for the insurance sector, mainly in Act on Insurance) if such regulations are violated, as well as having authorization to initiate proceedings at other agencies of competence (refer to ICP. 2).

b) The Part Eight, Chapter IV of the Act on Insurance defines the measures the HFSA may introduce in order to ensure that the insurer, insurance intermediary and consultant perform their obligations, to protect the interests of clients, and to make sure that insurance, insurance intermediation, consultation and representation activities comply with the provisions of the Act on Insurance, and other legal regulations governing these activities, as well as resolutions of the Supervisory Authority (as it is set out in ICP 15 Enforcement or Sanctions). The HFSA has not the powers to issue rules or other binding regulations but may

express its expectations by recommendations and guidelines on the different fields of the sector, e.g. on insurers' internal audit system, on application of AML/CFA requirements, on application of reinsurance business, on the use of general contract terms and conditions in insurance contract, etc.

c) Refer to criterion b. of the present ICP and ICP 15 Enforcement and Sanctions.

Independence and accountability

d) The operation, internal governance and legal status of HFSA are based on the Act on HFSA, which provides that the HFSA is a national public organisation vested with national jurisdiction, operating under direction of the Government. It is supervised by the Minister of Finance on behalf of the Government [Section 1, Paragraph (1) of the Act on HFSA]. The Supervisory Authority is a budgetary organisation conducting separate financial management but funded from the chapter of the Ministry of Finance [Section 1, Paragraph (2) of the Act on HFSA].

The internal governance procedures of the HFSA are defined in the Operation and Organisation Rules.

e) The HFSA is governed by the Board of the HFSA consisting of maximum five members. The Chairman of the Board of the HFSA is nominated by the Prime Minister from among its members and elected - for a term of six years - and removed by Parliament. Other members of the Board of the HFSA are nominated by the Prime Minister - upon hearing the opinion of the Chairman of the Board of the HFSA - and appointed by the President of the Hungarian Republic for a term of six years, and also removed by him. (Section 9/B and 9/E of the Act on HFSA).

The chief executives of the HFSA are the Director General and two Deputy Directors. The Director General and the Deputy Directors are appointed - for terms of six years - and removed by the Prime Minister. (Section 7 of Act on the HFSA).

The mandate of the above heads of the HFSA shall terminate upon several reasons (e.g. expiration of the term of office, resignation, dismissal, establishment of any conflict of interest, death, etc.). In case of the removal of the above heads, it must be justified [Section 7 and 9/E of the Act on HFSA].

f) Refer to criterion d. and l. of the present ICP.

Against every resolution on the merits of the HFSA the obligor may submit an action before the court in case of violation of law within 30 days from its receiving (administrative action) according to the relevant rules of the Act VI of 1954 on general rules of administrative procedure.

The executive branch may not override the HFSA as the HFSA is independent as regards its supervisory activity.

g) The tasks and duties of the HFSA shall be prescribed on the strength of an act or other legal regulation adopted by authorization of an act.

The HFSA shall not accept any instructions concerning such tasks and duties, other than the supervisory powers and authorization specified in the Act on HFSA, as follows:

- The supervisory competence of the Minister of Finance shall cover the following:

a) to approve the operational rules and regulations of the Supervisory Authority;

b) to evaluate the Supervisory Authority's activities

c) to monitor the Supervisory Authority's everyday operations, such as to receive reports from the chairman of the Board of the HFSA and to order him to eliminate the existing discrepancies, if any.

- The Chairman of the Board of the HFSA shall report to the Government - via the Minister of Finance - by the 31st of May each year concerning its operations, and shall concurrently publish an account of its operations. The Chairman of the Board of the HFSA shall report in

writing to the Minister of Finance quarterly, by the 15th day of the following month, concerning the Supervisory Authority's operations and on the general trends concluded upon the supervision of financial organizations. The Minister of Finance shall analyse this report and shall request additional information when necessary. (Section 1, Paragraph (4), Section 1/A and 6/B of the Act on HFSA.)

h) The HFSA is a budgetary organisation conducting separate financial management but funded from the chapter of the Ministry of Finance [Section 2, Paragraph (1) of the Act on HFSA]. The Act on Insurance sets out that the revenues of the Supervisory Authority (administrative and service charges, supervisory fees and other proceeds) may be used only to cover its operating expenses. Since these proceeds are practically enough to cover the annual expenses of the HFSA, the HFSA does not receive sources from the budget. The HFSA may tie up some of its revenues in reserves up to 15% of those of the year for the operating expenses of the following year (Section 11/B, Paragraph (3) of the Act on HFSA). The remuneration of the HFSA's staff is regulated by the relevant sections of the Act XXIII of 1992 on the legal status of public servants. However, the staff is supplemented by a package of benefits preserving financial independence and keep qualification standard of employees high.

The total annual salaries of the Director General and the deputy Director General, the Chairman and Members of the Board of the HFSA are prescribed in Section 9/A and 9/D, Paragraph (4) of the Act on HFSA. Moreover, the Act on HFSA provide for rules in case of conflict of interest, which prescribes prohibition for officers to acquire different means of investment and ownership in a financial organisation in order to safeguard the independence of decision-making processes.

i) As mentioned above, the HFSA conducts separate financial management. The HFSA shall dispose of the proceeds from fees and charges independently [Section 11/B §, Paragraph (1)-(2) of the Act on HFSA]. It shall use its revenues only to cover it's operating expenses: such revenues may not be used for any other purposes (Section 208, Paragraph (3) of the Act on Insurance). The HFSA may tie up some of its revenues in reserves up to 15% of those of the year for the operating expenses of the following year (Section 11/B, Paragraph (3) of the Act on HFSA).

The HFSA should not use revenues arising from penalties for its own purposes. Fines may only be used for the purpose of training of insurance experts, supporting the compilation and publication of studies related to insurance and supervisory activities, informing customers and reimbursement of non-profit companies for losses originating from liquidation of organisations falling under the scope of the Act on Insurance [Section 208, Paragraph (2) of the Act on Insurance].

The HFSA – being a budgetary organization – is under the financial supervision of the Hungarian State Audit Office and other governmental supervisory bodies (e.g. Governmental Supervisory Office).

j) Internal regulatory documents (rules of supervisory procedures, other regulations, policies, guidelines, etc.) set out the order of decision-making processes for the employees of the HFSA in accordance with the regulations of the Act VI of 1954 on the General Rules of Administrative Procedure.

Meanwhile, the HFSA lays special emphasise upon transparency of decision-making which is guaranteed by several means, mainly on the forum of the HFSA official website (www.pszaf.hu): the criterion of submitting licence applications as well as guidelines on our licensing practice are available there. In addition to this, there are published recommendations, guidelines, opinions, which contains relevant information on the HFSA's practice. The HFSA keeps consultations on a regular basis where market participants are informed on the concerning practices.

The HFSA publishes – among other information – its resolutions containing licensing, resolutions containing measures – in part or in whole, with due respect to insurance secrets – and list of persons and organisations licensed by the HFSA in the official Financial Gazette and on its official internet website in order to, pursuant to Section 6 of the Act on HFSA, protect the interests of insurance market participants and policy holders.

According to the Section 206 of the Act on Insurance stipulates that the Supervisory Authority shall immediately send its resolutions on issued foundation and operating licences, licence modifications and withdrawals to the Minister of Finance, National Bank of Hungary, Court of Registration or capital city (county) courts registering insurance associations, Office of Economic Competition and trade interest representation organisations of the insurers. The Supervisory Authority is obliged to publish the above resolutions in the Official Journal of the European Communities within 15 days from their adoption (Section 206, Paragraph (3) of the Act on Insurance).

Moreover, the Supervisory Authority is obliged to, in case of certain measures taken by it, immediately notify the supervisory authorities of all Member States on such procedures (Section 206, Paragraph (4) of the Act on Insurance).

k) Insurers and insurance intermediaries participate in legislation through their interest groups in relation with their protected interests, in accordance with the Section 20 of the Act XI of 1997 on the Legislation. In the field of issuing new supervisory recommendations or guidelines, consultations may be kept for market participants on request where expected effects of these documents on the insurance sector can be discussed.

l) The Chairman of the Board of the HFSA reports to the Government, and informs the competent parliamentary committee concerning its operations on an annual basis. The Chairman of the Board of the HFSA reports to the Government - via the Minister of Finance - by the 31st of May each year concerning its operations, and concurrently publishes an account of its operations. The Chairman of the Board of the HFSA reports in writing to the Minister of Finance quarterly, by the 15th day of the following month, concerning the Supervisory Authority's operations and on the general trends concluded upon the supervision of financial organizations. The Minister of Finance analyses this report and requests additional information when necessary.

The annual report is available on the HFSA's website as well.

The HFSA holds consultations and press conferences, publishes communiqués, etc. when a decision of the HFSA requires further comments towards the public.

m) Relating to information obligations of the HFSA see criterion j. and l. of the present ICP. The HFSA – on publishing its resolutions in the Financial Gazette and on its homepage – pays due regard to data protection regulations, which safeguard personal data and business secrets, thus these data are eliminated from the text of resolutions before publishing. Explanatory part of resolutions are not published in order business secrets of the supervised institution be safeguarded.

Powers

n) Refer to criterion e. of ICP 4 and ICP 15.

Financial resources

o) As regards the sufficient conditions of conducting effective supervision see criterion g) and i) of the present ICP.

Proceeds from administrative and service charges shall be sufficient to cover the continuous operation of the HFSA. As regards the rate of such fees and charges the Minister of Finance shall decree, but before deciding upon any increase or reduction of the fees and charges the Minister of Finance must consult with the chairman of the Board of the HFSA. (Section 11/A, Paragraph (2) of the Act on HFSA).

p) The Supervisory Authority shall dispose of the proceeds from fees and charges independently, and shall dispose of the sums of penalties to the extent laid down in specific other legislation. The Supervisory Authority shall use its revenues, apart from those arising from the penalties, to cover its operating expenses. Such revenues may not be used for any other purposes (refer to criterion i. of the present ICP).

The HFSA is budgetary organisation, however, since 1 January 2002 has been financed fully by its own revenues. The HFSA prepares financial budgetary statements on an annual basis, which are sent by means of the Ministry of Finance to the Parliament for reviewing and approving in the frame of parliamentary debates on the Final Accounts Act according to the relevant sections of the Act XXXVIII of 1992 on the Public Finances. The HFSA is not obliged to – apart from health insurance funds and pension funds – have its financial statements audited.

Human resource and legal protection

q) The Act XXIII of 1992 on the Legal Status of Public Servants defines the obligation of administrative organisations to make written efficiency appraisals about each civil servant employed by them. The method of the appraisal is set up in accordance with the recommendation of the Minister of the Interior. Requirements concerning professional abilities, work-related characteristics, discipline, personal development, quality of work, etc. are evaluated on an annual basis by the exerciser of the employer rights (in the HFSA the Chairman). According to the result of the evaluation, the exerciser of the employer rights shall decide on the increase or decrease of the basis salary of the civil servant in an extent of 20-20 % plus or minus from its salary rate (Section 34 of the above Act). Moreover, the HFSA offers a competitive premium on a quarterly basis in charge of its revenues originating from the supervised companies.

The Rules on Employment of Public Servants contains provisions on the procedure of admission of civil servants. Minimum requirements in the field of skills and experience are defined for each department of the HFSA. Requirements differs, however, higher qualification from the required field is essential.

The Act IV of 1978 on the Criminal Code defines crimes may be committed against official persons. According to Section 229 of the above Act, any person who attempts to prevent a public official in his lawful proceedings by force or by threat of force, or takes certain action, or assaults him during or because of his proceedings, is guilty of a felony punishable by imprisonment not to exceed three years (violence against an official person).

The protection is ensured in the Act IV of 1959 on the Civil Code of the Republic of Hungary, in Section 339, which stipulates that a person who causes damage to another person in violation of the law shall be liable for such damage. He shall be relieved of liability if he is able to prove that he has acted in a manner that can generally be expected in the given situation.

Conflict rules are stipulated in Section 10 of the Act on HFSA.

Internal regulations (e.g. Regulation on Supervision of the Insurance Sector) define regulations concerning the conduct of administrative members of the staff.

r) According to Section 177 of the Act on Insurance, the Supervisory Authority, in justified cases, may also assign external experts with the supervisory audit in accordance with the provisions of its tendering regulations. The expert must be included in the list of experts compiled by the Supervisory Authority. The Act on Insurance specifies the conditions of being added to the list of experts.

Apart from the above-specified possibility of assigning external supervisory experts, the HFSA – regarding the lack of further legal provisions in this issue – may contract with external organisations for supplying training and legal services as well.

s) According to Section 177, Paragraph (4) and (6) of the Act on Insurance, the external

expert, in the field of its supervisory audit activity by the authorisation of the Supervisory Authority is considered its official. As the external auditor is obliged by confidentiality and incompatibility regulations of Act on HFSA, the Supervisory Authority is obliged to review the expert's membership and executive officer's positions in economic organisations for three calendar years prior to the assignment.

Moreover, confidentiality and incompatibility rules binds those experts the HFSA engages for special professional duties as it is set out in criterion t. and u. of the present ICP.

Confidentiality

t) The Act on HFSA defines strict conditions of dealing with confidential information for currently employed individuals and individuals following the termination of their employment. These employees – engaged in any other work-related legal relationship with the HFSA on consignment or otherwise – shall maintain confidentiality with regard to all insurance secrets, which they obtain in the course of discharging their duties at the HFSA. The aforementioned individuals shall maintain confidentiality with regard to all of the information, data and facts of which they gained knowledge in connection with supervisory activities and which the HFSA is not legally obliged to disclose to the public or other authorities, nor shall they use or disclose them without proper authorization. (Section 10 of the above Act)

According to Section 5 of the Act on HFSA the HFSA may enter into cooperation agreements with foreign financial supervisory organizations. In the case the HFSA release data or information to a foreign supervisory authority, it must convince that foreign supervisory authority guarantees equivalent or better legal protection of such data and information than the protection afforded under Hungarian law. Any data and information supplied or received under cooperation between the supervisory authorities may not be disclosed to third parties without the prior written consent of the source of such data or information.

u) External specialists are subject to the same confidentiality requirements as staff members, pursuant to the sections referred to at the above criterion.

Principle 4: Supervisory process

Principle 4: Supervisory process	
The supervisory authority conducts its functions in a transparent and accountable manner.	
	O/LO/PO/NO/NA *
Essential criteria	O
a. The supervisory authority adopts clear, transparent and consistent regulatory and supervisory processes. The rules and procedures of the supervisory authority are published and updated regularly.	
b. The supervisory authority applies all regulations and administrative procedures consistently and equitably, taking into account the different risk profiles of insurers.	O
c. The administrative decisions of the supervisory authority can be subject to substantive judicial review. However, such action must not unduly impede the ability of the supervisory authority to make timely interventions in order to protect policyholders' interests.	O
d. The supervisory authority makes information on its role publicly available.	O
e. The decision-making lines of the supervisory authority are so structured that action can be taken immediately in the case of an emergency situation (refer to ICP 3 EC n and ICP 15).	O
f. The process to appeal supervisory decisions is specified and balanced to preserve supervisory independence and effectiveness.	O
g. The supervisory authority publishes a regular report – at least annually and in a timely manner – on the conduct of its policy, explaining its objectives and describing its performance in pursuing its objectives.	O
Advanced criteria	O
h. The supervisory authority provides and publishes information about the financial situation of the insurance industry and observations on major developments in the insurance or financial market.	
* (O-Observed, LO-Largely Observed, PO-Partly Observed, NO-Not Observed, NA-Not Applicable)	

Assessment

a) The Supervisory Authority has principles for operation, and policies, and strategic, and procedure guidelines.

Policies:

- a. Management Policy

- b. Penalty policy
- c. Sanction policy
- These are found on the homepage of Supervisory Authority
- d. Communication policy
- e. IT (Information Technology) policy
- f. Security policy
- g. Examination policy

Strategies:

- h. IT Strategy
- i. IT Security Strategy

Procedure guidelines

- j. Administration Guideline
- k. The Guideline on planning and carrying out on-site inspections

The Supervisory Authority has developed sectoral Examination Manuals for different type of financial undertakings; i. e. credit and security institutions, institutions of bourse, investment companies, insurance companies and pension funds. The Supervisory Authority has worked out the Examination Manual of Financial Groups as well.

All these Manuals are harmonized in their structure and in their substance, however they contain some differences because of sectoral specifications.

The Supervisory Authority discloses its resolutions. These can be found on the homepage of the Supervisory Authority and in the Financial Official Journal.

The Supervisory Authority complies with standard of ISO 9001:2001 and CAF-2003.

Sections 168-170 of Act on Insurance define the legal status, operation, and supervision activities of the Supervisory Authority.

b) Respect the interest of customers/policy holders and insurance secret the Supervisory Authority has to publish its conclusions. These are found on the homepage of Supervisory Authority.

Quarterly risk assessment based on supervisory returns and other qualitative information. The result of the risk assessment means the basis of the on-site, off-site inspections. The issues and the depth of inspections are appointed on that basis.

Paragraphs section 170, sections 175-177, sections 194-199, of Act on Insurance require that.

c) Claim for damages may be enforced against the Supervision - on account of its resolutions made by the Supervision as an authority - only if the resolution or failure of action on the part of the Supervision has violated the law and the damage suffered by such claimant has been directly caused by the resolution or failure of the Supervision.

Subparagraph (6) Paragraph 4 of Act No. CXXIV of 1999 on the Hungarian Financial Supervisory Authority requires that.

d) The Supervisory Authority operates Internet website, where several actual information can be found about the Supervisory Authority and the Hungarian Financial Sector.

It covers:

- Introduction
- Laws and regulations
- Supervised Institutions
- Guidelines

- Reports
- Studies
- Press Releases
- Anti-Money Laundering

The Supervisory Authority has to publish the foundations permits of insurance undertakings and authorizations of insurance activities and their amendments or withdraws. Considering the permits and authorizations the Supervisory Authority shall publish its resolutions.

Paragraphs 6 and 10/A of Act CXXIV of 1999 on the Hungarian Financial Supervisory Authority and section 206 of Act on Insurance require that.

e) Quarterly risk assessment based on supervisory returns and other qualitative information. The management of Supervisory Authority talks over that. The supervisor is responsible to collect all information about insurance undertakings. The Supervisory Authority worked out standard measures.

Section 175 of the Act on Insurance includes the regulations.

The supervisory authority can take measures in case of emergency situations. These measures are listed in sections 129-131 and section 216 of the Act on Insurance.

f) Claim for damages may be enforced against the Supervision - on account of its resolutions made by the Supervision as an authority - only if the resolution or failure of action on the part of the Supervision has violated the law and the damage suffered by such claimant has been directly caused by the resolution or failure of the Supervision.

Subparagraphs (1)-(6) of section 4 of Act CXXIV of 1999 on the Hungarian Financial Supervisory Authority require that.

g) The chairman of Board of the HFSA shall report to the Government about the Supervision's authorities by the 31 May of each year, and will publish information on the Supervision's operation at the same time. This can be found on the homepage of the Supervisory Authority. The Supervisory Authority publishes quarterly flash-reports. The Supervisory Authority regularly keeps press conferences.

section 6/A and section 6/B of Act CXXIV of 1999 on the Hungarian Financial Supervisory Authority require that.

h) The chairman of Board of the HFSA shall report to the Government about the Supervision's authorities by the 31 May of each year, and will publish information on the Supervision's operation at the same time. This can be found on the homepage of the Supervisory Authority. The Supervisory Authority publishes quarterly flash-reports. The Supervisory Authority regularly keeps press conferences. Information can be found on the homepage of the Supervisory Authority.

Subparagraph (1) section 6/B of Act CXXIV of 1999 on the Hungarian Financial Supervisory Authority and sections 171, 172 of Act on Insurance require that.

Principle 5: Supervisory cooperation and information sharing

Principle 5: Supervisory cooperation and information sharing	
The supervisory authority cooperates and shares information with other relevant supervisors subject to confidentiality requirements.	
	O/LO/PO/NO/NA *
Essential criteria	O
a. The existence of a formal agreement with another supervisor is not a prerequisite for information sharing.	O
b. The supervisory authority, at its discretion, can enter into agreements or understandings with any other financial sector supervisor (“another supervisor”) to share relevant supervisory information or to otherwise work together.	O
c. When reasonably requested and with appropriate safeguards, the supervisory authority is able to exchange with another supervisor (refer to ICP 7 EC e) the following: <ul style="list-style-type: none"> – relevant supervisory information, including specific information requested and gathered from a supervised entity – relevant financial data – objective information on individuals holding positions of responsibility in such entities. 	O
d. Information sharing, whether carried out under formal or informal arrangements, allows for a two-way flow of information without requiring strict reciprocity in terms of the level, format and detailed characteristics of the information exchanged.	O
e. The home supervisory authority provides relevant information to the host supervisor.	O
f. The supervisory authority is required to take reasonable steps to ensure that any information released to another supervisor will be treated as confidential by the receiving supervisor and will be used only for supervisory purposes.	O
g. The supervisory authority consults with another supervisor if it proposes to take action on the evidence of the information received from that supervisor.	O
h. The home supervisory authority informs relevant host supervisors of any material changes in supervision that may have a significant bearing on the operations of foreign establishments operating in their jurisdictions.	NA
i. Where possible, the home supervisory authority informs the host supervisor in advance of taking any action that will affect the foreign establishment in the host supervisor’s jurisdiction.	O

j. Where possible, the host supervisory authority informs the home supervisor in advance of taking any action that will affect the parent company or headquarters in the home supervisor's jurisdiction.	O
* (O-Observed, LO-Largely Observed, PO-Partly Observed, NO-Not Observed, NA-Not Applicable)	

Assessment

a) Section 5, Paragraph (1) of Act CXXIV of 1999 on the Hungarian Financial Supervisory Authority provides for the right of the HFSA to share information with foreign supervisory authorities.

Regarding information sharing within the EU the Helsinki Protocol is guiding.

b) The Hungarian Financial Supervisory Authority is an integrated authority covering banking, securities, insurance and pension affairs, thus there is no need for entering into agreements to share supervisory information or to work together with the domestic supervisors of other sub sectors in the financial sector

As to sharing information with foreign insurance supervisors Section 5, Paragraph (1) of Act CXXIV of 1999 on the Hungarian Financial Supervisory Authority provides for the right of the HFSA to enter into international co-operation agreements.

c) As the HFSA is an integrated authority there is no need for exchanging information with other supervisory authorities within the country (see explanation under essential criterion b).

Regarding exchanging information with foreign supervisory authorities Section 5, Paragraph (5) of Act CXXIV of 1999 on the Hungarian Financial Supervisory Authority is guiding.

d) Section 5 of Act CXXIV of 1999 on the Hungarian Financial Supervisory Authority providing for the right of the HFSA to exchange information with foreign supervisory authorities does not include any condition referring to reciprocity. However, Article 182, Paragraph (4) of the Act LX of 2003 on insurers and insurance activities mentions the assessment of reciprocity, but not the obligation in respect of exchanging information with the competent authorities of third countries:

“(4) The Supervisory Authority may hand over reports, data and information required for consolidated supervision to the competent authorities of third countries on the basis of the assessment of reciprocity, and effective agreement between competent authorities.”

e) Article 182 of the Act LX of 2003 on insurers and insurance activities provides for the forms and ways of co-operation in that respect. The framework and content of such co-operation within the EU are specified in the Helsinki Protocol.

f) Section 5, Paragraph (5) of Act CXXIV of 1999 on the Hungarian Financial Supervisory Authority provides for the obligation of the HFSA to ascertain that the information released to another supervisory authority is treated as confidentially as it is handled in Hungary.

g) Section 182, Paragraphs (5) and (6) of the Act LX of 2003 on insurers and insurance activities provide for the rights of the HFSA in this respect. In addition to this the Helsinki Protocol serving for basis of cooperation regarding insurance groups in the EU is governing.

h) Section 182, Paragraphs (2)-(4) of the Act LX of 2003 on insurers and insurance activities provide for it plus the Helsinki Protocol serving for basis of cooperation regarding insurance groups in the EU is governing.

i) There is no special regulation available in this respect, however, the Helsinki Protocol

serving for basis of co-operation regarding insurance groups in the EU is governing here.

j) There is no special regulation available in this respect, however, the Helsinki Protocol serving for basis of co-operation regarding insurance groups in the EU is governing here.

Principle 6: Licensing

Principle 6: Licensing	
An insurer must be licensed before it can operate within a jurisdiction. The requirements for licensing are clear, objective and public.	
	O/LO/PO/NO/NA *
<p>Essential criteria</p> <p>a. The insurance legislation:</p> <ul style="list-style-type: none"> – includes a definition of insurers – requires licensing of insurers, and prohibits unauthorised insurance activities – defines the permissible legal forms of insurers – allocates the responsibility for issuing licences. <p>b. Clear, objective and public licensing criteria require:</p> <ul style="list-style-type: none"> – the applicant’s board members, senior management, auditor and actuary both individually and collectively to be suitable, as specified in ICP 7 (1) – the applicant’s significant owners (refer to ICP 8 EC a) to be suitable, as specified in ICP 7 (2) – the applicant to hold the required capital (3) – the applicant’s risk management systems including reinsurance arrangements, internal control systems, information technology systems, policies and procedures to be adequate for the nature and scale of the business in question (4) – Information on the applicant’s business plan projected out for a minimum of three years. The business plan must reflect the business lines and risk profile, and give details of projected setting-up costs, capital requirements, projected development of business, solvency margins and reinsurance arrangements. The business plan must present information regarding primary insurance and inward reinsurance separately (5) – information on the products to be offered by the insurer (6) – information on contracts with affiliates and outsourcing arrangements (7) – information on the applicant’s reporting arrangements, both internally to its own management and externally to the supervisory authority (8) – input from the applicant’s home supervisory authority when the insurer or its owners are not domestic and a home supervisory authority exists (refer to ICP 5). (9) 	<p>O</p> <p>O</p>

c. The supervisory authority requires that no domestic or foreign insurance establishment escape supervision.	O
d. All insurance establishments of international insurance groups and international insurers are subject to effective supervision. The creation of a cross border establishment should be subject to consultation between the host and home supervisor.	O
e. The insurance legislation determines the method by which a foreign insurer can carry on business in the jurisdiction. This may be by way of a local branch or subsidiary that must be licensed, or on a services basis only.	O
f. If a foreign insurer is allowed to carry on business in the jurisdiction the supervisory authority must be provided with the following data: <ul style="list-style-type: none"> – confirmation from the home supervisory authority that the insurer is authorised to carry on the types of insurance business proposed – information from the home supervisory authority that the insurer is solvent and meets all the regulatory requirements in the home jurisdiction – in the case of a branch office: the name and address of the branch – the name of the authorised agent in the local jurisdiction in the case of insurance offered on a services basis (i.e., where a local branch or subsidiary is not established) – the information and documentation normally required to be licensed in the local jurisdiction, when appropriate <p>These information requirements might be waived if insurance is offered on a services basis only.</p>	O
g. An insurer licensed to underwrite life insurance business must not also be licensed to underwrite non-life insurance business, and vice versa, unless the supervisory authority is satisfied that the insurer has satisfactory processes requiring that risks be handled separately on both a going-concern and a winding-up basis.	O
h. The supervisory authority imposes additional requirements, conditions or restrictions on an applicant where the supervisory authority considers this appropriate. This might include restrictions on non-insurance activities.	NA
i. The supervisory authority assesses the application and makes a decision within a reasonable time. No licence is issued without its approval. The applicant must be informed of the decision without delay and, if the licence is denied or conditional, be provided with an explanation.	O

j. The supervisory authority refuses to issue a licence where it considers the applicant not to have sufficient resources to maintain the insurer's solvency on an on-going basis, where the organisational (or group) structure hinders effective supervision, or where the application is not in accordance with the licensing criteria.	O
k. As necessary, after an insurer has been licensed, the supervisory authority evaluates and monitors the degree to which the insurer satisfies the relevant licensing principles and requirements of the jurisdiction.	O
* (O-Observed, LO-Largely Observed, PO-Partly Observed, NO-Not Observed, NA-Not Applicable).	

Assessment

a) The term "insurer" defined in Section 3 Point 10 in the Act on Insurance as follows: an organisation which is eligible to insurance and directly related activities in accordance with the effective Hungarian legislation or the effective legislation of a Member State.

In the territory of the Republic of Hungary, insurance and insurance related activities may be conducted with a licence from the Supervisory Authority with the exception of insurers, having their head office in a Member State. The latter ones may perform their activities in the territory of the Republic of Hungary as a cross-border service, or through a branch office in Hungary if they are licensed for the same activity in their own Member States [Section 5, Paragraph (1)-(2) of the Act on Insurance]. Third-country insurers may only perform their activities in the territory of the Republic of Hungary through a branch office established in Hungary [Section 5, Paragraph (3) of the Act on Insurance].

The Supervisory Authority may prohibit insurance activities conducted without a licence with immediate effect [Section 169, Paragraph (4), Subparagraph b) of the Act on Insurance].

Insurers may be established in the territory of the Republic of Hungary as a company limited by shares, co-operative, mutual association, or the Hungarian branch office of a third-country insurer pursuant to Section 10, Paragraph (1) of the Act on Insurance.

Regarding the allocation of responsibility for issuing licences, see above. The HFSA is the solely responsible for issuing licenses for pursuing insurance and insurance related activities.

b)

(1) Hungarian insurance legislation requires licence from the Supervisory Authority equally for the foundation of an insurer and for the commencement and termination of insurance activities [Section 57, Paragraph (1) of the Act on Insurance].

In order to enter the insurance market as an insurer, the applicant shall certify that it meets all criterion defined in Section 58-62 of the Act on Insurance relating to foundation license and Section 63 of the Act on Insurance relating to operation license. Moreover, considering the criterion of issuing operation license of a branch office established by an insurer with a head office in a third country, Section 70 of the Act on Insurance stipulates.

The suitability criterion in the case of board members, senior management (executive officers), actuary, senior legal counsel, manager responsible for accounting, senior physician and internal auditor (other managers) shall be proved by the applicant as one part of the proving the personal conditions are in place (Section 63, Paragraph (2), Subparagraph c) of the Act on Insurance). In case of application for a branch office operating license, only the general representative of the branch office shall be suitable as specified in Section 70, Paragraph (3), Subparagraph b) of the Act on Insurance.

(2) If there is an individual (natural or legal person) among the founders of an insurance company limited by shares who intends to acquire an influential share in the insurer to be

founded, documents must be attached to the licence application regarding its suitability according to Section 60 of the Act on Insurance

(3) The application for operating license shall contain a certificate of availability of the minimum guarantee fund and the minimum solvency margin as it is specified in Section 63, Paragraph (2), Subparagraph a) and Paragraph (3), Subparagraph a) of the Insurance Act .

(4) The application for operating license shall contain the different risk management systems as it is set out in Section 63, Paragraph (2), Subparagraph b), e), f), g), j), Section 65, Subparagraph b), c) and Section 67 of the Act on Insurance .

(5) The business plan of the applicant must meet the above criterion, as it is set out in Section 67 of the Act on Insurance.

(6) Control of products does not constitute a condition of licensing in accordance with the relevant EU directives. Products are controlled exclusively on the occasion of on-site inspections or dealing with complaints.

(7) Outsourcing contracts are controlled as an evidence of the existence of the appropriate physical conditions according to Section 63, Paragraph (2), Subparagraph c) of the Act on Insurance. However, the Act on Insurance does not provide for submission of information on contracts with affiliates.

(8) Regarding external reporting system, Section 63, Paragraph (2), Subparagraph e) of the Act on Insurance stipulates.

Regarding internal reports, Section 58, Subparagraph c) of the Act on Insurance stipulates.

(9) As to the insurer's licensing criterion, the Act on Insurance does not contain the obligation of obtaining such inputs, but the Supervisory Authority, on request, have the opportunity to contact foreign insurance supervisions (Section 194 of the Act on Insurance) in order to get further information. Regarding application for branch office operation licence originating from an insurer having its seat in a Third Country, the applicant shall obtain the statement of the supervisory authority of the country of the head office as it is specified in Section 70, Paragraph (1) Subsection b) of the Act on Insurance. Section 60/A of the Act on Insurance provides for the information exchange within the EU regarding insurance groups or financial conglomerates

c) Refer to criterion a. of the present ICP.

d) Refer to criterion a. of the present ICP.

Regarding supplementary supervision of insurance groups and of financial conglomerates, rules are harmonised with the relevant EU directives (Sections 178-189 and 189/A-189/M of the Act on Insurance, see ICP 15 – Enforcement and sanctions – criterion I).

Rules of carrying insurance business in the territory of the Hungarian Republic differ in the case of establishing a branch office or operating within the frame of cross-border activity. In case of an insurer from the territory of the EU, both activities are carried out, while in case of an insurer from a Third Country, only branch office is allowed.

- Conditions of pursuing **cross-border insurance activity** by individuals from the Member State in the territory of Hungary or by Hungarian individuals in the territory of the Member State are both set forth, as it is defined in Section 81-82 of the Insurance Act
- In the case of a **branch office with registered seat is in a Member State**, (reporting) criteria of conducting insurance activities are set forth in Section 79 of the Act on Insurance

- In case of a **branch office with registered seat in a Third Country**, Section 70 of the Act on Insurance stipulates on the licensing criteria.

In each case, effective supervision and consultation between the supervisory authorities is insured (see criterion f. of the present ICP).

e) Refer to criterion a. and d. of the present ICP.

f) Refer to criterion d. of the present ICP.

In this field, Act on Insurance and the Siena Protocol on the collaboration of EU supervisors regarding the execution of life and non-life directives stipulates.

Regarding the confirmation from the home supervisory authority that the insurer is authorised to carry on the types of insurance business proposed,

- in the case of a **branch office with registered seat in a Third Country**, the application shall contain a statement of the supervisory authority of the country of the registered seat that the foundation of a branch office in the territory of the Republic of Hungary does not violate the legislation of the country of the head office, and it does not impose a risk for the operation of the applicant insurer of the supervisory authority of the country of the head office [Section 70, Paragraph (1), Subsection b) of the Act on Insurance];
- in case of a **branch office with registered seat in a Member State**, such condition is not required;
- in case of **cross-border insurance activity by individuals from the Member State**, the Hungarian legislation does not contain rules since it is regulated in the legislation of the Member State of the insurer's registered seat. The Act on Insurance only contains the above criterion in the case of a home insurer who intends to operate in another Member State (Section 81, Paragraph (2), Subparagraph a) of the Act on Insurance).

Regarding the information from the home supervisory authority that the insurer is solvent and meets all the regulatory requirements in the home jurisdiction,

- in case of a **branch office with registered seat in a Third Country**, the supervisory authority grants an operating license if the applicant insurer possesses assets equivalent to the amount of minimum solvency margin defined in Section 126, Paragraph (6) of the Act on Insurance, and shall deposit 25 per cent of it as a security according to Section 70, Paragraph (2), Subparagraph h) of the Act on Insurance. Conditions of the deposit are specified in Section 70, Paragraph (4)-(5) of the Act on Insurance. As to the criterion of meeting all the regulatory requirements in the home jurisdiction, see above.
- as to **branch office with registered seat in a Member State** and **cross-border activity**, the Hungarian legislation does not contain rules since it is regulated in the legislation of the Member State of the insurer's registered seat. However, in the case of a home insurer who intends to operate in another Member State like that, Section 79 and 81 of the Act on Insurance stipulates on the solvency and regulatory requirements.

In the case of a branch office: the name and address of the branch and the name of the authorised agent in the local jurisdiction in the case of insurance offered on a services basis (i.e., where a local branch or subsidiary is not established)

- In the case of a **branch office with registered seat in a Member State**, only the address of the branch office is required (Section 79, Paragraph (2), Subparagraph f) of the Act on Insurance). In case of a **branch office from a Third Country**, the formal license contains the name and address of the applicant.
- The precise name of the branch office with registered seat in a Member State, and the name of the authorised agent in case of a **cross-border activity** are not regulated in the Act on Insurance, however, the Siena Protocol stipulates.

Regarding the information and documentation normally required to be licensed in the local jurisdiction, when appropriate: only in case of a **branch office of an insurer with a registered seat in a Third Country**, shall contain the operating licence application the certification of licensing requirements laid down for local insurers, as it is specified in Section 70, Paragraph (1) of the Act on Insurance.

g) According to Section 59 of the Act on Insurance no insurer may be founded for pursuing both life and non-life insurance lines together with the following exceptions:

- reinsurers (Subsections Section 59 of the Act on Insurance),
- insurers possessing an operating licence for life assurance may be licensed to operate the accident and diseases branches in non-life insurance line with the provision that the insurer is not eligible for the operation of other non-life assurance branches. [Subsection (3) of Section 64 of the Act on Insurance],
- insurers possession an operating licence only for the operation of the accident and diseases branches in non-life insurance line may be licensed to operate all life insurance branches. [Section 64, Paragraph (4) of the Act on Insurance].

The above prohibition exists since 1st of January 1996. Insurers having got its license for conducting both life and non-life insurance activities before the above time may continually operate but – among other restrictions safeguarding the security of the above separation – must apply for a license from the Supervisory Authority in the case of the elimination of a shortage in solvency margin from the other insurance line as defined in Section 57, Paragraph (1), Subparagraph I) of the Act on Insurance.

h) To impose additional licensing requirements is not regulated in the Act on Insurance, however, the HFSA have the opportunity to require any further data or document from the applicant.

i) The Supervisory Authority is obliged to judge licence applications received by it within 90 and, whenever additional information is submitted, within 90 days from the receipt of a licence application complying with the provisions of the Act on Insurance (with the exceptions stated in this act). The chairman of the Supervisory Authority may extend the above deadline with maximum 90 days on one occasion (Section 192 of the Act on Insurance).

The Supervisory Authority gives a detailed reasoning for all licenses concerning the operation of an insurer (except for licenses determine personal conditions), whether license approves or denies activity, however, the Act IV of 1957 on the general rules of the administrative proceeding stipulates that the reasoning of resolutions adopting an application may be disregard.

The HFSA does not issue conditional licenses.

j) As to sufficient resources in maintaining appropriate solvency, Section 63, Paragraph (3), Subparagraph a)-b) of the Act on Insurance stipulates.

As to hindering effective supervision, Section 63, Paragraph (4), Subparagraph b) of the Act on Insurance stipulates.

As to correspondence to licensing requirements, Section 62, Subparagraph b) of the Act on Insurance stipulates expressively regarding foundation licenses. Regarding operation licenses, Act on Insurance does not contain such expressed regulation, but the criterion can be considered observed, since the lack of realization of any of the licensing requirements leads to the refusal of issuing the license.

k) The HFSA monitors and evaluates on a regular basis, on-site and off-site the maintenance of licensing requirements at an insurer (branch office).

Principle 7: Suitability of persons

Principle 7: Suitability of persons	
<p>The significant owners, board members, senior management, auditors and actuaries of an insurer are fit and proper to fulfil their roles. This requires that they possess the appropriate integrity, competency, experience and qualifications.</p>	
	O/LO/PO/NO/NA *
Essential Criteria	O
a. Legislation identifies which key functionaries must meet fit and proper requirements. The key functionaries identified may differ depending on the legal form and governance structure of the insurer.	
b. In cases where significant owners no longer meet fit and proper requirements, the supervisory authority must be able to take appropriate action, including requiring that the owners dispose of their interests.	LO
c. The supervisory authority disqualifies the appointment of key functionaries including auditors and actuaries of insurers that do not comply with fit and proper requirements.	O
d. The insurer should be required to demonstrate to the supervisory authority the fitness and propriety of key functionaries by submitting documentation illustrating their knowledge, experience, skills and integrity upon request, or where there are changes in key functionaries. The knowledge and experience required depends on the position and responsibility of the functionary within the insurer.	O
e. The supervisory authority exchanges information with other authorities inside and outside its jurisdiction where necessary to check the suitability of persons. The supervisory authority uses this information as an additional tool to effectively assess the fitness and propriety of, or to obtain information on, a key functionary of an insurer (refer to ICP 5).	O
f. The supervisory authority disallows actuaries, auditors, directors and senior managers, from simultaneously holding two positions in an insurer where this could result in a material conflict.	NO
g. Where the insurer becomes aware of circumstances that may be relevant to the fitness and propriety of its key functionaries, it is required to notify the supervisory authority as soon as possible.	NA
Advanced criteria	PO
h. Criteria to assess the fitness and propriety of auditors' and actuaries' include qualifications, professional proficiency, appropriate practical experience and updated knowledge on developments within their profession and membership of	

professional bodies.	
i. In the case of auditors and actuaries, the supervisory authority may give regard to or rely on professional bodies that set and enforce standards of professional conduct.	PO
* (O-Observed, LO-Largely Observed, PO-Partly Observed, NO-Not Observed, NA-Not Applicable)	

Assessment

a) Insurer may appoint individuals (individuals may be elected as) **executive officers** that the Supervisory Authority has given its permission. The application shall contain the evidence on meeting professional skills and a reliable business conduct requirements (= fit and proper requirements) pursuant to Section 83, Paragraph (1) and (3) of the Act on Insurance.

Executive officers are as follows:

- in the case of insurers operating as a company limited by shares, cooperatives and mutuels having more than 100 members throughout one calendar year the members of the board of directors, the supervisory board and the senior manager;
- in the case of insurers operating as a co-operative or association, the chairman of the board of directors and the supervisory board, and the senior manager, or individuals holding positions corresponding to these positions irrespective of the title specified in the Articles of Association;
- in the case of insurers operating as a branch office of a third-country insurer, general representative and senior manager.

Insurer shall employ individuals as **other managers** [senior insurance mathematician (actuary), a senior legal counsel, a manager responsible for accounting, an internal audit manager (internal auditor), and a senior physician] who have to possess fit and proper requirements according to Section 85, Paragraph (1) of the Act on Insurance.

b) In the proceedings for licensing foundation and acquisition influential share in an insurer, the significant owner is required to prove its fitness and propriety (Section 60, Paragraph (1) and Section 111, Paragraph (3), Subparagraph b) of the Act on Insurance).

In cases significant owners no longer meet fit and proper requirements, the Act on Insurance does not set forth any special measures against significant owners, apart from the general measures specified in Section 195, Paragraph (1) of the above Act (see ICP 15 Enforcement and Sanctions). The Hungarian insurance legislation does not require that the owners dispose of their interests in cases where significant owners no longer meet fit and proper requirements.

c) Section 91, Paragraph (4) of the Act on Insurance sets forth special criterion in case of which key functionaries may not obtain fitness and propriety. In this respect, the Supervisory Authority is entitled to monitor the activity of the key functionary after it has been licensed, and propose the exemption of them (including the external auditor), and – in cases of employees - may also propose that the employee concerned should be held liable (Section 195, Paragraph (1), Subparagraph f) of the Act on Insurance)

Regarding (external) **auditors** the Act on Insurance does not requires being fit and proper. These requirements are defined in the relevant sections of the Act LV of 1997 on the Hungarian Auditor Chambers and Auditor Activity. The Supervisory Authority keeps a register of insurance auditors, into which those auditors may be entered who are registered in the Hungarian Auditor Chambers as well, and meets all requirements the Act on Insurance sets out accordingly. According to Section 150, Paragraph (2) of the Act on Insurance, the

Supervisory Authority shall delete the auditor from its register of insurance auditors with a resolution if the auditor no longer meets the requirements of inclusion in the register or the auditor fails to meet its obligations laid down in legislation. In this respect, fit and proper regulations for (external) auditors are more severe than the general.

d) As to knowledge and experience, the Act on Insurance defines clearly the conditions of obtaining license of the Supervisory Authority.

In case of **executive officers**, only individuals may take the position at an insurer who (among others)

- Have a clean criminal record,
- Have at least 5 years of managerial experience in insurance or company operation, or financial or economic areas of public administration (the completion of the required professional experience cannot be earlier than 10 years before the submission of application for permission),
- Possess higher qualifications,
- Does not operate as an auditor at the insurer

according to Section 83, Paragraph (3), Subparagraph a), c)-e) of the Act on Insurance).

In case of **other managers**, only individuals may take the position at an insurer who (among others)

- Has a clean criminal record,
- Possess a required university or college degree,
- Possess at least 5 years of professional experience in the relevant areas of professional life (e.g. financial or economic areas of public administration, the trade interest representation agency of insurers, insurance intermediaries or consultants, etc.)

but it depends on the position and responsibility of the functionary within the insurer (e.g. senior legal counsel shall possess a legal special exam and insurance lawyer's exam, the senior physician shall possess basic medical qualifications and at least 5 years of professional experience in insurance, etc)

Additionally, as to fit and proper requirements, Act on Insurance sets forth special criterion in Section 91 of the above Act. From practical side the HFSA issues a standard questionnaire both for individuals and for legal entities (the latter is used for the purpose of foundation and acquisition licenses, if the applicant is not a private individual). The applicant fulfils its obligation of certifying by responding these questions, but the HFSA may require other way to make its fitness and property proved.

e) Section 91, Paragraph (5) of the Act on Insurance sets out that in order to establish professional skills and reliable business conduct, the Supervisory Authority may also directly contact competent foreign authorities.

Possibility of requesting information from other authority inside the jurisdiction is set forth in Sections 10-12 of the Act IV of 1957 on the General Rules of the Administrative Proceeding.

f) This question is basically not regulated in the Act on Insurance. Regarding members of the board of directors and supervisory board the general incompatibility rule is applied according to Section 25, Paragraph (3) and Section 38, Paragraph (2) of the Act CXLIV of 1997 on Business Associations as follows: a member of the board of directors and his close relatives may not be elected as a member of the supervisory board at the same company limited by shares (and vice versa, refer to ICP 9. Corporate Governance).

g) There is no obligation for the insurer to notify such information pursuant to the Act on Insurance. The insurer is obliged to report the Supervisory Authority only the fact of changes in key functionaries without reasoning. Naturally, if information reveals on such circumstances (e.g. through a notice or on the occasion of an audit), the HFSA shall

examine.

h) In case of actuaries, the Act on Insurance requires qualifications, professional proficiency and appropriate practical experience to be certified in Section 86, Paragraph (1) of the Act on Insurance. Requirements of having updated knowledge on developments within its profession and membership of professional bodies are not regulated in the Act on Insurance, however, there exists a non-obligatory private professional association of actuaries in Hungary, called the Hungarian Actuarial Society. Anyone contributing to the actuarial profession through his/her practical or scholarly activities may become a member of the Hungarian Actuarial Society, provided that he/she satisfies the professional and ethical standards and accepts the Articles of the Society, and provided that the general assembly of the Society admits him/her as a member. The Society keeps trainings for its members on an on-going basis.

In case of (external) auditors, such requirements are stipulated in Sections 149-150 of the Act on Insurance and in the relevant sections of the Act LV of 1997 on the Hungarian Chamber of Auditors and Audit Activities (see criterion c. of the present ICP). Membership is obligatory to the Hungarian Chamber of Auditors. Fitness and propriety does not constitute an expressed criterion of being engaged at an insurer as an auditor, however, through the above criterion fitness and propriety is monitored. The Chamber sets and enforces standards of professional conduct.

i) In case of auditors this requirement is realized indirectly. Only those auditors may be entered into the Supervisory Authority's register on insurance auditors who are simultaneously members of the Hungarian Chamber of Auditors as well as it is referred in Section 150, Paragraph (1), Subsection a) of the Act on Insurance. By this way, the Supervisory Authority considers professional bodies' standards as a pre-criterion of being registered at the Chamber of Auditors.

In case of actuaries – since membership of a professional body is not required for being engaged at an insurer, which may set up professional and ethical standards – this criterion is not applied.

Principle 8: Changes in control and portfolio transfers

<p>Principle 8: Changes in control and portfolio transfers</p> <p>The supervisory authority approves or rejects proposals to acquire significant ownership or any other interest in an insurer that results in that person, directly or indirectly, alone or with an associate, exercising control over the insurer.</p> <p>The supervisory authority approves the portfolio transfer or merger of insurance business.</p>	
	O/LO/PO/NO/NA *
<p>Changes in control</p> <p>Essential criteria</p> <p>a. The term “control” over an insurer is defined in legislation and it addresses:</p> <ul style="list-style-type: none"> – holding of a defined number or percentage of issued shares or specified financial instruments (such as compulsory convertible debentures) above a designated threshold in an insurer or its intermediate or ultimate beneficial owner – voting rights attached to the aforementioned shares or financial instruments – power to appoint or remove directors to the board and other executive committees. <p>b. The supervisory authority requires that the potential controlling owners apply for approval for the acquisition, or change in control, of the insurers. The insurer must inform the supervisory authority of any acquisitions or changes in control.</p> <p>c. The supervisory authority approves any significant increase in shareholdings above the predetermined control levels in an insurer by legal or natural persons, whether obtained individually or in association with others. This also applies to any other interest in that insurer or its intermediate or ultimate beneficial owners.</p> <p>d. The requirements in criteria b and c above also refer to the acquisition or change of control where the intermediate or ultimate beneficial owner(s) of an insurer is (are) outside the jurisdiction where the insurer is incorporated. Supervision of changes in control may require coordination with supervisors in other jurisdictions (refer to ICP 5).</p> <p>e. The supervisory authority must be satisfied that those seeking control meet the criteria applied during the licensing process. The requirements in ICP 7 – Suitability of persons – will apply to the prospective owners in control of insurers.</p>	<p>O</p> <p>O</p> <p>O</p> <p>O</p> <p>O</p>

f. The supervisory authority requires that the structures of the financial groups containing potential controlling owners of insurers be sufficiently transparent so that supervision of the insurance group will not be hindered (refer to ICP 17).	O
g. The supervisory authority rejects applications of proposed owners to control insurers if facts exist from which it can be deduced that their ownership will be unduly prejudicial to policyholders. The supervisory authority should know who is the intended beneficial owner.	O
h. To assess applications for proposed acquisitions or changes in control of insurers the supervisory authority establishes requirements for financial and non-financial resources.	O
Advanced criteria	O
i. Upon request insurers provide the supervisory authority with information on their shareholders and any other person directly or indirectly exercising control. The supervisory authority determines the content and format of this information.	
Portfolio transfer	O
Essential criteria	
j. The supervisory authority requires that insurers get approval from the authority before they transfer all or any part of their insurance business.	
k. The supervisory authority establishes requirements to assess insurers' applications to transfer all or any part of their insurance business.	O
l. The supervisory authority requires that the interests of the policyholders of both the transferee and transferor be protected when insurance business is transferred (refer to ICP 15 EC c).	O
* (O-Observed, LO-Largely Observed, PO-Partly Observed, NO-Not Observed, NA-Not Applicable)	

Assessment

Changes in control

a) The Act on Insurance defines the term of “**influential share**” as follows: direct or indirect participation of a party in an undertaking, or a relationship between a party and an undertaking on the basis of which the party

a) Holds at least 10% of ownership or voting rights, or

b) Is able to appoint or remove at least 20% of the members of the decision-making, management or supervisory bodies of the undertaking, or

c) On the basis of the charter, deed of foundation or contract the party may exercise decisive influence on the operation of the undertaking.

During the establishment of the size of influential share direct and indirect participation should be taken into account together (Section 3, Paragraph (1), Point 5 of the Act on Insurance).

b) According to Section 111, Paragraph (1) of the Act on Insurance, those who intend to acquire participation in an insurance joint stock company with which they reach or exceed the limit for an influential share, or intend to modify their influential share as a result of which their participation or voting rights shall reach or exceed the 20, 33, 50 or 75 per cent limits, must apply to the Supervisory Authority for a preliminary permission for the conclusion of the contract. Agreements providing advantages in relation to ownership or voting right in excess of their proportion may only be concluded with the permission of the Authority.

In case of acquisition, sale or modification of participation or voting rights in the above limits, the insurer joint stock company is obliged to notify the Supervisory Authority in writing within 15 working days if it learns about the above fact (Section 114, Paragraph (2) of the Act on Insurance).

In case of acquisition of participation in the insurer exceeding 5 per cent, but not requiring permission pursuant to the provisions of Section 111 Paragraph (1), the insurer is obliged to report it to the Supervisory Authority within 30 days:

c) Specified above in essential criteria a. and b. of the present ICP.

d) Rules of acquisition of the Act on Insurance are equally applicable for direct or indirect participation of domestic or foreign applicants. Pursuing to Section 111, Paragraph (5) of the Act on Insurance, if there is a foreign insurer, credit institution or investment company intending to acquire an influential share, a certificate or statement of the supervisory authority of the head office must also be attached to the licensing application for foundation that the undertaking operates in compliance with the regulations governing the activity.

According to Section 112, Paragraph (2) of the Act on Insurance, the Supervisory Authority may turn to the authorities competent according to the head office or home address of the party intending to acquire control to certify or check the requirements attached to the application for licence.

e) The HFSA must ascertain that applicants satisfies all requirements set forth in Section 111, Paragraph (2)-(5) and Section 111/A of the Act on Insurance.

Fit and proper requirements are essential for prospective owners of the insurer as specified in Section 111, Paragraph (3), Subparagraph b) of the Act on Insurance.

f) According to Section 111, Paragraph (4), Subparagraph g) of the Act on Insurance, an application for the authorization of acquisition shall also contain a detailed description of the applicant's ownership structure.

Moreover, the Supervisory Authority shall refuse permission for executing a contract aimed at the acquisition if the applicant has an unclear ownership structure, or it cannot be established (Section 112, Paragraph (1), Subparagraph c) of the Act on Insurance).

g) According to Section 112, Paragraph (1) of the Act on Insurance, the Supervisory Authority shall refuse to grant authorization for the conclusion of the acquisition contract, if the applicant has been previously convicted (if a natural person); the applicant's legal status is uncertain; the applicant's ownership status is uncertain or cannot be established; the applicant's financial and business status is not sufficiently stable; the applicant has seriously and repeatedly violated the provisions of this Act or any other legal regulation pertaining to insurance companies; the applicant does not have the appropriate professional qualifications and a good business reputation; the applicant's financial and economic position is deemed inadequate for the size of the ownership interest he intends to acquire; and the applicant is unable to prove the legitimacy of the funds to be used for purchasing the ownership interest or the authenticity and veracity of the data pertaining to the person named as the owner of such funds.

Regarding the establishment of the intended beneficial owner, refer to criterion f. of the present ICP.

h) Apart from criterion referred to in Section 111 of the Act on Insurance (see Annex), the insurance legislation does not contain further regulation as to evaluation requirements of financial and non-financial resources. However, the Supervisory Authority framed practical rules regarding evaluation of financial requirements.

i) Apart from insurer's reporting obligation defined in criterion b. of the present ICP, Section 114, Paragraph (3) of the Act on Insurance prescribes that in the framework of annual internal data supply (regulated by Decree of the Financial Minister 56 of 2001 on the Annual Data Supply of Insurers), an insurer joint stock company is obliged to report to the Supervisory Authority the name of shareholders with a participation ratio defined in Section 111 (see at essential criterion a. of the present ICP), and the amount of capital owned by them.

In addition to this, as the insurer is obliged to, according to Section 170, Paragraph (2) of the Act on Insurance, make available for the Supervisory Authority – upon its instruction – all data defined in legal regulations applicable to such activities, the Supervisory Authority is provided with information on their shareholders and any other person directly or indirectly exercising control.

Portfolio transfer

j) According to Section 93 and Section 94, Paragraph (5) of the Act on Insurance an insurance portfolio may be transferred to another insurer with a head office in the territory of the Republic of Hungary, an insurer with a head office in another Member State, its branch office, or the branch office of an insurer with a head office in a third country, established in a Member State in possession of the license of the Supervisory Authority. However, the insurance portfolio of a Hungarian branch office of an insurer with head office in another Member State may be transferred with a permission of the supervisory authority of its home Member State. The Supervisory Authority may give its permission for portfolio transfer after the consent of the competent authorities of the Member State where risks are assumed.

k) Criterion of assessing insurer's applications to transfer its insurance portfolio is regulated in Section 94 of the Act on Insurance.

l) Regarding protection of policyholders' interests during portfolio transfer, the Act on Insurance contains several provisions:

- portfolio may be transferred without changing the terms and conditions of the insurance contracts [Section 93, Paragraph (1) of the Act on Insurance],
- in case of a portfolio transfer application, the Supervisory Authority assess insurance terms and conditions of the portfolio subject to transfer [Section 94, Paragraph (1), Subparagraph a) of the Act on Insurance],
- the portfolio transfer shall not require the consent of the insured or contractual parties [Section 94, Paragraph (1) of the Act on Insurance], however, after the insurance contract portfolio is transferred the insurer is obliged to notify all contractual parties concerned in writing, in the same language in which the contract has been executed, on the transfer within 30 days from the receipt of the permitting resolution or, in the case of insurance associations, from the entry into the register of the court of registration or county (capital city) court. The contractual party may terminate the contract with a 30-day termination period with a written declaration addressed to the insurer taking over the portfolio within 30 days from the receipt of the notice [Section 95, Paragraph (2) of the Act on Insurance].

Principle 9: Corporate governance

<p>Principle 9: Corporate governance</p> <p>The corporate governance framework recognises and protects rights of all interested parties. The supervisory authority requires compliance with all applicable corporate governance standards.</p>	
	O/LO/PO/NO/NA *
<p>Essential criteria</p> <p>a. The supervisory authority requires and verifies that the insurer complies with applicable corporate governance principles.</p> <p>b. The board of directors:</p> <ul style="list-style-type: none"> – sets out its responsibilities in accepting and committing to the specific corporate governance principles for its undertaking. Regulations on corporate governance should be covered in general company law and/or insurance law. These regulations should take account of the size, nature and complexity of the insurer. (1) – establishes policies and strategies, the means of attaining them, and procedures for monitoring and evaluating the progress toward them. Adherence to the policies and strategies are reviewed regularly, and at least annually. (2) – satisfies itself that the insurer is organised in a way that promotes the effective and prudent management of the institution and the board’s oversight of that management. The board of directors has in place and monitors independent risk management functions that monitor the risks related to the type of business undertaken. The board of directors establishes audit functions, actuarial functions, strong internal controls and applicable checks and balances. (3) – distinguishes between the responsibilities, decision-making, interaction and cooperation of the board of directors, chairman, chief executive and senior management. The board of directors delegates its responsibilities and establishes decision-making processes. The insurer establishes a division of responsibilities that will ensure a balance of power and authority, so that no one individual has unfettered powers of decision. (4) – establishes standards of business conduct and ethical behaviour for directors, senior management and other personnel. These include policies on private transactions, self-dealing, preferential treatment of favoured internal and external entities, covering trading losses and other inordinate trade practices of a non-arm’s length nature. The insurer has an ongoing, appropriate and effective process of ensuring adherence to those standards. (5) – appoints and dismisses senior management. It 	<p>O</p> <p>O</p>

<p>establishes a remuneration policy that is reviewed periodically. This policy is made available to the supervisory authority. (6)</p> <ul style="list-style-type: none"> – collectively ensures that the insurer complies with all relevant laws, regulations and any established codes of conduct (refer to EC f). (7) – has thorough knowledge, skills, experience and commitment to oversee the insurer effectively (refer to ICP 7). (8) – is not subject to undue influence from management or other parties. The board of directors has access to information about the insurer, and asks and receives additional information and analyses that the board sees fit. (9) – communicates with the supervisory authority as required and meets with the supervisory authority when requested. (10) – sets out policies that address conflicts of interest, fair treatment of customers and information sharing with stakeholders, and reviews these policies regularly (refer to ICP 25). (11) 	
<p>c. Senior management is responsible for:</p> <ul style="list-style-type: none"> – overseeing the operations of the insurer and providing direction to it on a day-to-day basis, subject to the objectives and policies set out by the board of directors, as well as to legislation. – providing the board of directors with recommendations, for its review and approval, on objectives, strategy, business plans and major policies that govern the operation of the insurer. – providing the board with comprehensive, relevant and timely information that will enable it to review business objectives, business strategy and policies, and to hold senior management accountable for its performance. 	O
<p>Advanced criteria</p> <p>d. The board of directors may establish committees with specific responsibilities like a compensation committee, audit committee or risk management committee.</p>	O
<p>e. The remuneration policy for directors and senior management has regard to the performance of the person as well as that of the insurer. The remuneration policy should not include incentives that would encourage imprudent behaviour.</p>	NA
<p>f. The board of directors identifies an officer or officers with</p>	O

responsibility for ensuring compliance with relevant legislation and required standards of business conduct and who reports to the board of directors at regular intervals (refer to EC b).	
g. When a “responsible actuary” is part of the supervisory process, the actuary has direct access to the board of directors or a committee of the board. The actuary reports relevant matters to the board of directors on a timely basis.	LO
* (O-Observed, LO-Largely Observed, PO-Partly Observed, NO-Not Observed, NA-Not Applicable)	

Assessment

a) Corporate governance rules are defined partly in Act on Insurance, and partly in sectoral acts regulating the different types of insurers.

In the Act on Insurance corporate governance rules can be found from Section 83 to 91. Rules refer to detailed corporate structure according to the types of insurers, the licensing prerequisites and (partly) the responsibilities of the different types of the officers nominated thereof (members of the board of directors and the supervisory board, the senior manager, the actuary, the senior legal counsel, the chief accountant, the director of internal control and the chief medical officer). In the above respect, the Supervisory Authority has the powers to initiate the dismissal of the executive employees, other executives of insurers, or disciplinary action against employees (Section 195, Paragraph (1), Subparagraph f) of the Act on Insurance).

Sectoral acts are as follows:

- Act CXLIV of 1997 on Business Associations in the case of insurance companies limited by shares (hereinafter Company Act);
- Act CXLI of 2000 on New Co-operatives in the case of insurance co-operatives;
- Act II of 1989 on the Right of Association in the case of mutual associations (hereinafter Association Act),
- Act CXXXII of 1997 on Hungarian Branch Offices and Commercial Representation Offices of Undertakings Having Their Head Office Abroad regarding branch offices

With regard to the individual types of insurers these acts must be applied with the differences stated in the Act on Insurance. As – in relation to the insurance sector – the HFSA is entitled to proceed under the scope of the Act on Insurance, in case of violation of law under the effect of the above sectoral acts, the Supervisory Authority is obliged to request for the prosecutor responsible for judicial supervisory oversight on the insurers.

Regarding the fact, that there is no existing insurance co-operative on the Hungarian insurance market, hereinafter we disregard the description of the concerning regulation. Considering also, that insurance mutuals are typically self-organizations of the members without profit orientation but for satisfying a special need (e.g. mutuals in the field of agriculture or animal husbandry or the mutuals for hunters’ or attorney-at-laws’ liability insurance) some of the criteria defined in the present ICP cannot be applied.

b)

(1)-(3) For the **board of directors**, general corporate governance principles and responsibilities are set forth in the Company Act regarding insurance companies limited by shares and Association Act regarding insurance mutuals.

As the board of directors controls the working organisation of the insurer , it is entitled to establish and monitor policies and strategies of the insurer on a regular basis, as well as prudent (risk) management system of the insurer (Section 21 of the Company Act, Section 3. Paragraph (4) of the Association Act).

Although the Act on Insurance does not contain expressed rules that chief accountant, chief

legal counsel and chief actuary's functions be under the scope of the board of directors, the direction realises through the above-mentioned regulation. The operation of internal control is under the scope of the supervisory board, however, the director of internal control shall send his reports to both the supervisory board and the board of directors (Section 89 of the Act on Insurance).

(4) The board of directors may (and in cases defined in the Act on Insurance, shall) delegates its duties to the chairman, the senior management or the committees, but such delegations may not have effect on the responsibility of the board of directors towards the general meeting of shareholders. These entities shall report on its activity to the board of directors.

(5) In case of insurance companies limited by shares, Section 28 of the Company Act stipulates that the member of the board of directors may not acquire interest in another business association pursuing an activity identical to that of the business association, furthermore, may not be an executive officer in another economic organization pursuing an activity identical to that of the business association, unless rendered possible in the business association's deed of foundation (statutes), or the business association's supreme body grants its consent. Furthermore, a member of the board of directors and his close relatives may not conclude transactions falling within the scope of activities of the business association in his own name or to his own benefit, unless specifically permitted in the deed of foundation (statutes). In case of insurance mutuals, standards on business conduct and ethical behaviour are not related in the Association Act.

Regarding keeping insurance secret and incompatibility at an insurer (joint stock company or mutual), Section 115 and 116 of the Act on Insurance stipulates.

(6) Section 28 of the Company Act stipulates expressly that, for (insurance) companies limited by shares, employer's rights shall be exercised by the board of directors within the framework set forth in the deed of foundation (statutes) In the frame of this the board of directors shall appoint and dismiss senior management and establish their remuneration. In case of mutuals, such expressed rule does not exist, however, as the board of directors controls the working organisation of the insurer (see above), and employer's right is considered to be part of such control, this criterion can be considered observed. Remuneration policy is not monitored by the HFSA.

(7) Section 29 of the Company Act stipulates that board of directors shall conduct the management of the business association with the increased care generally expected from persons occupying such positions, and give priority to the interests of the business association. Board of directors shall be liable to (insurance) companies limited by shares in accordance with the general rules of civil law for damages caused to such by violation of the law, or breach of the deed of foundation (statutes), the resolutions of the business association's supreme body, or their management obligations. Liability for such damages shall be joint and several. If such damage is caused by a resolution of the board of directors of a company limited by shares, no liability shall lie with a member of the board of directors who did not take part in the decision or voted against the resolution, and informed the supervisory board thereof in writing within fifteen days after passage of such resolution. (Insurance) companies limited by shares shall be liable for damages caused to third parties by the board of directors acting within his sphere of competence as such. In case of mutuals, neither the Association Act nor the Act on Insurance contains regulation regarding the liability of the board of directors, however, in practice, rules of the Company Act are applied.

(8) Members of the board of directors at an insurer shall possess the required degree in higher education, 5 year of leading experience and professional skills and a reliable business conduct (= fit and proper requirements) according to Section 83, Paragraph (3) of the Act on

Insurance.

(9) In case of insurance company limited by shares, the board of directors acting in capacity as such may not be instructed by the shareholders or the employer of the insurance company limited by shares according to Section 22, Paragraph (2) of the Company Act. As the board of directors exercises employer's rights over the management, the management shall not imply undue influence over the board of directors and has access to all information it sees fit. In case of mutuals, as general liability rules are not regulated, consequently, exclusion of undue influence on the board of directors is not applied either.

(10) The HFSA stresses the importance of communicating with market participants when necessary. Communication may be realized by means of a member of the board of directors or other employee entitled to represent the insurer.

(11) The board of directors may set forth policies on several issues. In case of insurance companies limited by shares, the board of directors shall prepare a report on the management's activity, the financial situation and the business policy of the company at the regular intervals set forth in the deed of foundation (statutes), but at least once every year for the general meeting according to Section 242, Paragraph (2) of the Company Act. In case of insurance mutuals, the general meeting of the members is obliged to accept the annual account of the mutual according to Section 12, Paragraph (1), Subparagraph c) of the Association Act. Regarding fair treatment of costumers see ICP 25 Consumer Protection.

c) The definition and responsibility of senior manager is set out in Section 3, Point 64. of the Act on Insurance as follows: the manager is the **chief executive officer** assigned for the day-to-day management of an insurance company employed by the insurer, and his deputies. The **chief executive officer** of the insurer is responsible for the working organisation of the insurer.

The main duty of the **chief executive officer** is to provide the daily direction of the insurer and inform the board of directors on his activity in order the board of directors be enable to elaborate new business strategies. Moreover, it is responsible for ensuring compliance with relevant legislation and required standards of business conduct. The **chief executive officer** is obliged to report to the board of directors.

d) The board of directors may establish committees as neither Company Act nor the Act on Insurance contain such prohibition. Responsibility of such committees may not have effect on the responsibility of the board of directors towards the general meeting of shareholders. The committee shall report on its activity to the board of directors.

e) This question is not regulated in the insurance legislation since this is considered an internal affair of the insurer.

f) See criterion c. of the present ICP.

g) According to Section 86 of the Act on Insurance the **senior actuary** of the insurer has to bear the responsibility for all actuarial issues defined in the above section (e.g. the accuracy of allocation and amount of reserves included in the annual report, the accuracy of calculation of solvency margin calculation, the allocation of the investment yield of the life assurance line, the professional accuracy of premium calculations, and in every other case that the available data were sufficient, complete and integrated, and the applied methods corresponded to the nature of risks). The Act on Insurance does not regulate the responsibility of the senior actuary towards the board of directors, however, in practice, general direction of board of directors is realised over senior actuary according to Section 21

of the Company Act.

Principle 10: Internal control

Principle 10: Internal control	
<p>The supervisory authority requires insurers to have in place internal controls that are adequate for the nature and scale of the business. The oversight and reporting systems allow the board and management to monitor and control the operations.</p>	
	O/LO/PO/NO/NA *
Essential criteria	O
a. The supervisory authority reviews the internal controls and checks their adequacy to the nature and the scale of the business and requires strengthening of these controls where necessary. The board of directors is ultimately responsible for establishing and maintaining an effective internal control system.	O
b. The framework for internal controls within the insurer includes arrangements for delegating authority and responsibility, and the segregation of duties. The internal controls address checks and balances; e.g. cross-checking, dual control of assets, double signatures (refer to ICP 9 EC b).	LO
c. The internal and external audit, actuarial and compliance functions are part of the framework for internal control, and must test adherence to the internal controls as well as to applicable laws and regulations.	PO
d. The board of directors must provide suitable prudential oversight and establish a risk management system that includes setting and monitoring policies so that all major risks are identified, measured, monitored and controlled on an on-going basis. The risk management systems, strategies and policies are approved and periodically reviewed by the board of directors (refer to ICP 18).	PO
e. The board of directors provides suitable oversight of market conduct activities.	O
f. The board of directors should receive regular reporting on the effectiveness of the internal controls. Internal control deficiencies, either identified by management, staff, internal audit or other control personnel, are reported in a timely manner and addressed promptly.	O
g. The supervisory authority requires that internal controls address accounting procedures, reconciliation of accounts, control lists and information for management.	O

h. The supervisory authority requires oversight and clear accountability for all outsourced functions as if these functions were performed internally and subject to the normal standards of internal controls.	O
i. The supervisory authority requires the insurer to have an ongoing internal audit function of a nature and scope appropriate to the business. This includes ensuring compliance with all applicable policies and procedures and reviewing whether the insurer's policies, practices and controls remain sufficient and appropriate for its business.	O
j. The supervisory authority requires that an internal audit function: <ul style="list-style-type: none"> – has unfettered access to all the insurer's business lines and support departments – assesses outsourced functions – has appropriate independence, including reporting lines to the board of directors – has status within the insurer to ensure that senior management reacts to and acts upon its recommendations – has sufficient resources and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing – employs a methodology that identifies the key risks run by the institution and allocates its resources accordingly (refer to ICP 18). 	O
k. The supervisory authority has access to reports of the internal audit function.	O
l. Where the appointment of an actuary is called for by applicable legislation or by the nature of the insurer's operations, the supervisory authority requires that actuarial reports be made to the board and to management.	O
* (O-Observed, LO-Largely Observed, PO-Partly Observed, NO-Not Observed, NA-Not Applicable)	

Assessment

a) Section 85 (1) c) of the Act on Insurance prescribes the obligation for the insurers to employ an internal audit manager (internal auditor). The HFSA lays special emphasis on checking internal control system of insurers during on-site inspections and the rules are controlled in details by the Internal Rules of Procedures for the on-site inspections. Supervisory Recommendations on Internal Control counsel preparing yearly audit plan for internal audits considering the risks certain areas of insurer's activity face. During on-site inspections HFSA often crosses the situation that internal control activities are pro-forma, the owner's internal control department exercises the effective control.

b) Recommendations of the HFSA on internal control state that internal procedures and regulation should promote the functioning of an adequate internal control.

c) Tasks of internal auditor are listed at Section 89 (3). The main issue is compliance, however in practice, bigger insurers employ a compliance officer, as well. The task list includes – however implicitly - the actuarial functions, too. As smaller insurers employ one person as an internal auditor, it should be accepted, that they are not able to handle e.g. actuarial and IT area.

d) This issue is not regulated legally, but it is a basic requirement for an insurer. According to Hungarian legislation the named tasks are the responsibility of the supervisory board. The existence of the risk management systems is being checked during on-site inspections, but there is no regulation in place concerning the approval and review of these systems by the board of directors or supervisory board.

e) According to on site inspections experiences insurers meet the requirement, however the need for the regulation of this issue remains.

f) According to the Section 89 (5) of the Act on Insurance the internal auditor is obliged to send his report to the supervisory board and board of directors of the insurer. Practical experience shows defectiveness on this field. (e.g. Summarized extract of reports about a whole year activity are prepared, reports sometimes are available only in Hungarian, and all the supervisory board members are foreign nationals, it means that the information of the reports does not reach them.) During on-site inspections internal auditors' reports are checked and compared with the experiences of the inspection. When deficiencies are found, the report on investigation includes this kind of findings, too. However, we should note, that due to our experiences, internal auditors work is not reconsidered within the insurance company, itself.

g) According to Section 145 (2) of the Act on Insurance the business records and controlling system are sufficient if, in addition to the requirements stated in accounting regulations, it supports prudent management of the insurer, internal audit for the management of the insurer, audit conducted by the HFSA, and also assists the insurer in complying with its obligations imposed by legislation. Supervisory Recommendations give detailed guidance.

h) According to Section 77 of the Act on Insurance the HFSA may inspect the outsourced activity at the third party conducting the activity with the same methods and instruments as if the insurer conducted the activity. The insurer shall be held liable for all losses and damages caused to third parties by the outsourced activity. See below paragraph j.

i) According to Section 85 (1) of the Act on Insurance the insurer must employ an internal auditor. This function is not allowed to be outsourced. The Recommendations of the HFSA on Internal Control describe that the internal audit function should correspond the size, activity and the risks taken by the institution.

The policies and procedures of the insurers are subject of on-site investigations. The exact number and scope of policies an insurer is supposed to adopt are clearly defined in the Investigation's Manual.

j) According to Section 78 (1) of the Act on Insurance the outsourcing contract must govern consent of the party conducting the outsourced activity to the inspection of the outsourced activity by the internal auditor of the insurer or the Supervisory Authority. However, on-site audit findings show that outsourcing contracts sometimes do not meet this requirement.

According to Section 89 (5) of the Act on Insurance the internal audit auditor is obliged to send his report to the supervisory board and board of directors. (However, on-site audit

findings show, that relation between supervisory board and internal auditor is often formal.) This status of internal auditor is not ensured legally but the findings of internal auditors should be taken into consideration. This is being checked during on-site inspections by the HFSA. (The requirement is in the Inspection's Manual.)

Section 89 (2) of the Act on Insurance lists requirements for the individuals who apply for internal auditor positions of an insurer. The Recommendations on Internal Auditing include that HFSA requires an internal auditing organisation at the insurers, which matches the size and nature of the enterprise.

The methodology is not regulated legally. The HFSA issued detailed Recommendations on the most important principles and methods internal control of financial institutions are supposed to apply. The adoption of the recommended methods are checked during on-site inspection, however, the recommendations are not binding.

k) According to Section 89 (5) of the Act on Insurance the internal auditor is obliged to prepare his reports in Hungarian language too, and make them available for the auditors in the case of supervisory audits.

l) According to Section 85 of the Act on Insurance insurer must employ an actuary, while Section 86 declares conditions that a senior actuary should meet. The senior actuary is considered as belonging to the management.

Section 172 declares obligation of submitting the actuary report of the insurer once a year to the HFSA.

According to Section 98 in the case of all products intended for distribution, the insurer must prepare a product plan which must contain signatures of the manager, senior legal counsel, senior actuary and head of the insurance line concerned.

Principle 11: Market analysis

Principle 11: Market analysis	
Making use of all available sources, the supervisory authority monitors and analyses all factors that may have an impact on insurers and insurance markets. It draws conclusions and takes action as appropriate.	
	O/LO/PO/NO/NA *
Essential criteria:	O
a. The supervisory authority conducts regular analysis of market conditions.	
b. The market analysis not only includes past developments and the present situation, but also aims to identify trends and possible future scenarios and issues, so that the supervisory authority is well prepared to take action at an early stage, if required.	O
c. The market analysis is both quantitative and qualitative and makes use of both public and confidential sources of information.	O
d. The supervisory authority or others, such as the insurance industry, publish aggregated market data that is readily and publicly available to the insurance industry and other interested parties.	O
e. The supervisory authority requires market-wide systematic reporting to analyse and monitor particular market-wide events of importance for the financial stability of insurance markets.	O
Advanced criteria:	PO
f. Insofar as international relationships affect internal insurance and financial markets, the analysis is not limited to the home market, but also includes developments elsewhere.	
g. The supervisory authority monitors trends that may have an impact on the financial stability of insurance markets. It assesses whether macro-economic risks and vulnerabilities are adversely impinging on prudential safeguards, financial stability or consumer interests.	O
*Note: O = observed; LO = largely observed; PO = partly observed; NO = not observed; NA = not applicable.	

Assessment

f) We think we should develop our system in this field. The cross-country effects are not dealt with deeply enough in the systematic analyses we make. However, we have already carried out special analyses concerning related and recently emerged issues.

Principle 12: Reporting to supervisors and off-site monitoring

Principle 12: Reporting to supervisors and off-site monitoring	
<p>The supervisory authority receives necessary information to conduct effective off-site monitoring and to evaluate the condition of each insurer as well as the insurance market.</p>	
	O/LO/PO/NO/NA *
<p>Essential criteria:</p> <p>a. The supervisory authority:</p> <ul style="list-style-type: none"> – sets the requirements for the submission of regular and systematic financial and statistical information, actuarial reports and other information from all insurers licensed in the jurisdiction – defines the scope and frequency of those reports and information, including any requirement that reports and information be audited – requires, as a minimum, an audit opinion should be provided annually (refer to ICP 1 EC e) – requests more frequent and more detailed additional information whenever there is a need. <p>b. If making a distinction between the financial reports and requirements of companies incorporated in the jurisdiction and branches, or between private entities and government-sponsored insurers that compete with private enterprises, the supervisory authority should not distort the market in favour of or against any particular form of enterprise.</p> <p>c. The supervisory authority:</p> <ul style="list-style-type: none"> – requires insurers to submit information about their financial condition and performance on both a solo and a group-wide basis. It may request and obtain financial information on any subsidiary of the supervised entity. – sets out the principles and norms regarding accounting and consolidation techniques to be used. The valuation of assets and liabilities should be consistent, realistic, and prudent (refer to ICP 21 EC b). – requires insurers to report any off-balance sheet exposures. – requires insurers to report on their outsourced functions. – requires that the appropriate level of an insurer's senior management is responsible for the timing and accuracy of these returns. – requires that inaccurate information be corrected and 	<p>O</p> <hr/> <p>O</p> <hr/> <p>LO</p>

has the authority to impose sanctions for deliberate misreporting.	
– based on this information, maintains a framework for on-going monitoring of the financial condition and performance of the insurers.	
Advanced criteria	O
d. From time to time, the supervisory authority reviews its regular and systematic reporting requirements to ensure they still serve their intended aims and are carried out in an efficient and effective manner.	
e. The supervisory authority requires insurers to report promptly material changes that affect the evaluation of their condition.	O
*Note: O = observed; LO = largely observed; PO = partly observed; NO = not observed; NA = not applicable..	

Assessment

c) We require insurers to send reports mainly on their “solo” performance. However, due to the accession of Hungary to the EU we’ve harmonised our legislation, which includes the treatment of the insurance groups as well and the reporting system concerning the transactions and exposures in insurance groups came into force in May 2004, we do think that on the basis of the work of Insurance Group Supervision Working Group (IGSWG), we should develop our system on monitoring of insurance groups’ activities

Principle 13: On-site Inspection

Principle 13: On-site Inspection	
The supervisory authority carries out on-site inspections to examine the business of an insurer and its compliance with legislation and supervisory requirements.	
	O/LO/PO/NO/NA *
Essential criteria:	O
a. By law, the supervisory authority has wide-ranging powers to conduct on-site inspections and gather information deemed necessary to perform its duties.	
b. The supervisory authority, external auditors or other suitably qualified parties verify information in regulatory returns periodically through on-site inspections. Where parties other than the supervisory authority verify information, then arrangements for communication with the supervisory authority should be established.	O
c. The supervisory authority may conduct on-site inspections on either a full scale, or a focussed basis investigating areas of specific concern.	O
d. The supervisory authority promptly discusses findings and any need for corrective action with the insurer and obtains appropriate feedback from the insurer.	O
e. The supervisory authority follows up with the insurer to ensure that any required action has been taken.	O
f. The supervisory authority can extend on-site inspections to obtain information from intermediaries and companies that have accepted functions outsourced by the supervised insurer.	O
*Note: O = observed; LO = largely observed; PO = partly observed; NO = not observed; NA = not applicable.	

Assessment

a) The HFSA is authorized by Section 170 of Act on Insurance to conduct inspections on-site and off-site.

The HFSA may carry out on-site inspections upon request by a foreign supervisory authority under a valid supervisory agreement.

According to Section 170 (2) of Act on Insurance at the request of the HFSA, supervised institutions shall furnish to the HFSA in Hungarian language any data, report, statement and other inspection documents specified in legal regulation to the extent that pertains to their activities as well as their accounting records, regulations, documents of transactions, the proposals of their executive and supervisory board and the general meeting, including the relevant minutes, internal control reports and records as well as the written statements of the auditor, the audit report, and the reports and records of their internal control procedures.

According to Section 174 (1) of Act on Insurance supervised institutions shall cooperate with and provide assistance to the HFSA for its inspections, and they shall provide access to any data and information that may be necessary for the inspection.

According to Section 175 of Act on Insurance to the extent required for its duties, the HFSA

may request the supervised institution to furnish account statements in a specific form and breakdown and an audit report; the HFSA may request information on any and all business transactions from the supervised institutions, and it may inspect their books, documents and records.

The HFSA has an internal regulation (Rules of Procedures and a Handbook) defining the details, methods and ways of conducting inspections, on-site and off-site ones, as well. A yearly plan is prepared according to the proposals of the departments of the HFSA assessing the risks of supervised institutions. A detailed plan shall be made – in every two years full scale on-site inspection, which shall be based on the risk profile of the inspected institution – which is based on the information collected and analysed during the two years or focussed basis investigations conducted, adding all available market information. The composition of the inspection team depends on the characteristics and risks of the supervised institution. If the supervised institution belongs to a financial group, the on-site inspection of the group members shall be carried out at the same time.

The above-mentioned internal Rules of Procedures gives a set of stereotyped form of questionnaires the team members shall fill out at each step of the investigation (on-site and off-site, as well).

b) According to Section 170(3) of Act on Insurance the HFSA shall devise an inspection plan and an inspection program adjusted to the risks typical to the activities insurance companies, on the basis of which they shall conduct full-scale inspections at least every two years. According to Section 177 (1) the HFSA may contract the services of an expert to carry out inspections. The expert must be registered in the HFSA's register of experts.

c) According to Section 170 (3) of Act on Insurance the HFSA shall conduct full-scale inspections at least every two years at insurers, and insurance co-operations. For insurance mutuals it is not compulsory to carry on the full-scale inspection, but permitted, according to the risk measurement of off-site monitoring.

The HFSA may conduct focussed-basis investigations in connection with a specific problem at one supervised institution (called „targeted inspection”), or it may conduct an overall inquiry if the same problem arises at several institutions („theme inspection”). Special type of focussed basis investigations is the follow-up inspection, when implementation of regulatory measures is being checked.

According to the HFSA's internal Rules of Procedures a full-scale on-site inspection includes all those activities listed in paragraph 13.5. and 13.6 of IPC listed .

d) According to Section 176 (4) of Act on Insurance HFSA shall record its findings in writing within sixty days following completion of the inspection, and it shall furnish a copy of this report to the inspected institutions prior to taking any regulatory measures. According to the HFSA's internal Rules of Procedures when finishing the on-site inspection, the leader of the inspection team may give preliminary information to the representatives of the inspected institution, expect if there is a suspect of a criminal case or giving the information might endanger other inspections.

The inspected institution may make a written response to the findings within fifteen days of receiving it.

The inspection team members shall evaluate the written response from the inspected institution. Findings have to be based by written documents signed, or declarations given by the representatives of the inspected institutions.

e) As mentioned the HFSA follows-up the implementation of regulatory measures. It can be performed on-site or off-site, depending on the characteristics of the obligations prescribed for the insurer.

f) According to Section 77 (1) of Act on Insurance the HFSA may check the activities

performed by an outsourced service provider of an insurer in the same manner and with the same means as if the insurer performed them.

Principle 14: Preventive and Corrective Measures

Principle 14: Preventive and Corrective Measures	
The supervisory authority takes preventive and corrective measures that are timely, suitable and necessary to achieve the objectives of insurance supervision.	
	O/LO/PO/NO/NA *
Essential criteria:	O
a. The supervisory authority has available and makes use of adequate instruments to enable timely preventive and corrective measures if an insurer fails to operate in a manner that is consistent with sound business practices or regulatory requirements.	O
b. There should be a progressive escalation of action or remedial measures if the problems become worse or if management of the insurer ignores more informal requests from the supervisory authority to take corrective action.	O
c. The supervisory authority has the capacity and standing to communicate with insurers, and insurers comply with such communications, to ensure that relatively minor preventive or corrective measures are taken.	O
d. If necessary the supervisory authority requires the insurer to develop an acceptable plan for correction of problems. Corrective plans include agreed and acceptable steps to be taken to resolve the issues raised and an acceptable timetable.	O
e. The supervisory authority initiates measures designed to prevent a breach of the legislation from occurring, and promptly and effectively deals with non-compliance with regulations that could put policyholders at risk or impinge on any other of the authority's objectives.	O
*Note: O = observed; LO = largely observed; PO = partly observed; NO = not observed; NA = not applicable.	

Assessment

- a) The Act on Insurance is containing rules on **financial and restoration plan**. (Act on Insurance, Section 129 and 130). The HFSA obliges the insurer to prepare a financial plan if:
- the solvency margin of the insurer is lower than the required solvency margin,
 - the insurance technical provisions of the insurer are lower than the required amount or the cover for insurance technical provisions is not sufficient or
 - the insurer's liabilities originating from bond issue, credit and other non-insurance-related transactions, with the exception of subordinated debt, together exceed 25 per cent of its equity (own funds).

If the solvency margin of the insurer has fallen below the minimum required solvency margin defined in the Annex No. 8 and the general meeting has not decided on a schedule of achieving the solvency margin in less than one year, the Supervisory Authority shall oblige the insurer to prepare a **restoration plan for achieving the minimum solvency margin requirement**. The restoration plan shall cover a maximum period of one year, and it shall

specify the manner and timetable for restoring the minimum requirement.

The Act on Insurance describes the concept of **financial recovery plan** (Section 131).

If the operation of the insurer represents risks for the interests of the insured, the Supervisory Authority obliges the insurer to prepare a three –year **financial recovery plan**

(2) The financial recovery plan must contain the following items:

- a) Estimated management expenses,
- b) Detailed plan for estimated revenues and expenses of insurance activities, including active and passive reinsurance,
- c) Preliminary draft balance sheet,
- d) Estimated financial resources intended to cover underwriting liabilities and the required solvency margin,
- e) The overall reinsurance policy

The provisions concerning a financial recovery plan are expected to be good preventive instrument for the Supervisory Authority.

b) The Act on Insurance contains legislation for measures taken by the Supervisory Authority. According to the Section 195 (Measures).

In order to ensure that the insurer perform their obligations, protect the interests of customers, and to make sure that insurance activities comply with the provisions of this Act, and other legal regulations governing these activities, as well as resolutions of the Supervisory Authority, the **Supervisory Authority may introduce measures**. E.g.: It may oblige parties to comply with terms and conditions laid down in this Act, other legal regulations applicable to insurance activities, as well as contained in the resolutions of the Supervisory Authority, **setting an adequate deadline**. The Authority may **oblige the party to convene a general meeting** (members' meeting) with an agenda set by the Authority or it may **oblige a party to pay a regulatory fine** (Sections 196-198). Furthermore it may **suspend issued operating licences in part or in full, or withdraw issued operating/foundation licences**.

c) From the second half of 2002 the structure of the supervision regarding the insurance sector has been changed. According to the duties of the off-site supervision each supervisor's task is to supervise 4-5 insurance companies and about 30 insurance intermediaries, furthermore taking part in the on-site inspections The task of the supervision is also to analyse all the information and events concerning the institutions. **If necessary, the supervisor has to take an initiative measure**.

Quarterly, insurance institutions are rated in the framework of an internal supervisory system.

The subjective element of this rating system is based on the supervisors' experiences (including off-site and on-site supervision). The objective element of the rating system is based on the monitoring of data submitted to the HFSA from the institutions. Summarizing of these, two mentioned values give the final rating category.

Before the „full-scale on-site supervisions“ the supervisors elaborate a so-called preparing summary for colleagues who are carrying out the relevant on-site supervision. This summary contains all the important information concerning the audited institution. These are: **capital condition, investments, insurance reserves, reinsurance** and the rating category.

Currently, the new standardised measures are to be introduced concerning the different risk exposures of the insurers in order to take measures as soon as possible, to prevent any financial crisis.

Consequently, **the HFSA has enough power to take preventive measures if it is necessary.**

d) The Supervisory Authority has the power to perform it. (See above subparagraph a.)

e) See above subparagraph b.

Principle 15: Enforcement or sanctions

Principle 15: Enforcement or sanctions	
The supervisory authority enforces corrective action and, where needed, imposes sanctions based on clear and objective criteria that are publicly disclosed.	
	O/LO/PO/NO/NA *
Essential criteria:	O
a. The supervisory authority can issue formal directions to companies to take particular actions or to desist from taking particular actions. Failure to comply with a formal direction issued by the supervisory authority has serious consequences for those that take such a step.	
b. The supervisory authority has the power to prevent the insurer issuing new policies.	O
c. The supervisory authority can arrange for compulsory transfer of the obligations under the policies from a failing insurer to another insurer that accepts this transfer (refer to ICP 8 EC I).	O
d. The supervisory authority can require capital levels to be increased, restrict or suspend dividend or other payments to shareholders, restrict asset transfers and restrict an insurer's purchase of its own shares. It can also initiate action to restrict the ownership or activities of a subsidiary where, in its opinion, such activities jeopardise the financial situation of the insurer.	LO
e. The supervisory authority has effective means to address management problems, including the power to have controlling owners, directors, and managers replaced or their powers restricted. More generally the supervisory authority in extreme cases, imposes conservatorship over an insurer that is failing to meet prudential or other requirements. The supervisory authority has the power to take control of the insurer, or to appoint other specified officials or receivers for the task, and to make such arrangements for the benefit of the policyholders as are necessary.	O
f. Once action has been taken or remedial measures have been imposed, the supervisory authority periodically checks to determine that the insurer is complying with the measures.	O
g. The insurance legislation provides for sanctions by way of fines against individuals and insurers where the provisions of the legislation are breached.	O
h. The insurance legislation provides for sanctions against individuals who withhold information from the supervisory authority, provide information that is intended to mislead the supervisory authority or fail to provide information to the	O

supervisory authority in a timely fashion.	
i. Individuals can be barred from acting in responsible capacities in the future.	O
j. The process of applying sanctions should not delay necessary preventive and corrective measures and enforcement.	O
k. The supervisory authority takes action to withdraw the license of an insurer where appropriate.	O
l. The supervisory authority has the powers to protect one or more insurers within its jurisdiction that belong to a group from the financial difficulties in other parts of the group.	O
m. The supervisory authority, or another responsible body in the jurisdiction, takes action to enforce all the sanctions noted above.	O
n. The supervisory authority ensures consistency in the way insurers are sanctioned, so that similar violations and weaknesses attract similar preventive and corrective measures.	O
o. The supervisory authority or other authority takes action against those individuals or entities that are operating an insurance business without a licence.	O
*Note: O = observed; LO = largely observed; PO = partly observed; NO = not observed; NA = not applicable.	

Assessment

a) Section 195, Paragraph (1) of the Act on Insurance stipulates that the Supervisory Authority may introduce measures in order to ensure that the insurer perform their obligations, protect the interests of customers, and to make sure that insurance activity comply with the provisions of this act, and other legal regulations governing these activities, as well as resolutions of the Supervisory Authority. (Measures are listed in Sections 195-196 of the Act on Insurance) Measures are introduced by means of resolutions.

Those who fail to comply with resolutions issued by the Supervisory Authority may impose a regulatory fine (Section 196 of the Act on Insurance). Moreover, the Supervisory Authority may withdraw both foundation or operation licence of an insurer if the insurer has repeatedly or severely violated the legal regulations applicable to insurers and the measures defined in Sections 195-196 of the Act on Insurance have not been successful. (Operating licence of an insurer may be withdrawn only with a preliminary consent from the Minister of Finance.)

b) Supervisory Authority may suspend or prohibit the distribution of certain insurance product according to Section 195, Paragraph (1), Subparagraph h)-i) of the Act on Insurance.

c) Supervisory Authority may oblige an insurer to transfer its insurance portfolio, providing that there is another insurer willing to take over a portfolio according to Section 195, Paragraph (1), Subparagraph o) of the Act on Insurance.

d) The Supervisory Authority may (in the field of financial problems)

- oblige parties to comply with terms and conditions laid down in the Act on Insurance, other legal regulations applicable to insurance activity, as well as contained in the resolutions of the Supervisory Authority, setting an adequate

- deadline,
- oblige the party to convene a general meeting (members' meeting) with an agenda set by the Supervisory Authority,
- suspend payment of due dividend in a joint stock company or a co-operative,
- require the submission of a reorganisation plan, financial plan or financial recovery plan,
- restrict or prohibit the right of disposal of the insurer over its insurance technical reserves and solvency margin,
- assign a supervisory commissioner in an emergency situation.

according to Section 195 Paragraph (1) Subparagraphs a), b), e), g), j) and n) of the Act on Insurance.

As to requiring of capital levels to be increased, Section 124, Paragraph (1) of the Act on Insurance stipulates as follows: the Supervisory Authority may change the valuation of solvency margin of the insurer, especially if the market value of assets covering it has reduced significantly since the end of the previous business year. It is to be noted, that regarding the rate and the calculation of capital levels, Solvency Subcommittee of the EU is now elaborating more sophisticated requirements in the frame of Solvency II. Project which will naturally be authoritative for Hungary as well.

As to restriction of an insurer's purchase of its own shares, the Company Act (Section 189) defines general rules for obtaining own shares in a company limited by shares. (Own shares may be acquired from its assets in excess of share capital; shares must not be acquired if the face value or issue value thereof is not paid up; the sum of the joint face value of own shares may not exceed ten per cent of the share capital; a company limited by shares may not exercise voting rights on the basis of the own shares acquired, and shall alienate such shares within a period of one year, etc.) Act on Insurance does not contain further restriction on obtaining insurer's own shares, however, in practice, the Supervisory Authority – mainly by assigning a supervisory commissioner – is able to control such situations.

As to restriction the ownership or activities of a subsidiary the Act on Insurance does not contain any prohibition, however, in practice, the Supervisory Authority – mainly by assigning a supervisory commissioner – is able to control such situations.

Moreover, in case of a withdrawal of foundation or operation licence, the Supervisory Authority is obliged to take all measures simultaneously, which are aimed at the protection of the interests of the insured. In this context, it may limit or prohibit free disposal over the assets of the insurer. [Section 203, Paragraph (3) and Section 204, Paragraph (4) of the Act on Insurance].

e) Supervisory Authority may (in the field of management problems)

- oblige parties to comply with terms and conditions laid down in the Act on Insurance, other legal regulations applicable to insurance activity, as well as contained in the resolutions of the Supervisory Authority, setting an adequate deadline,
- oblige the party to convene a general meeting (members' meeting) with an agenda set by the Supervisory Authority,
- propose the exemption of executive officers and other managers, as well as the auditor of the insurer, and may also propose that the employee concerned should be held liable,
- assign a supervisory commissioner in an emergency situation,
- order the hearing of the chief executive officer,

according to Section 195, Paragraph (1), Subparagraph a), b), f), n) and q) of the Act on Insurance.

The supervisory commissioner is responsible for compliance and causing compliance with the provisions of the Act on Insurance The supervisory commissioner is appropriate for imposing conservatorship over an insurer that is failing to meet prudential or other

requirements (Section 199 of the Act on Insurance).

The Act on Insurance does not restrict controlling owners to exercise its powers over the insurer, but in practice the Authority – mainly by assigning a supervisory commissioner – is able to control such situations.

f) Pursuing to Section 170 of the Insurance Act the Supervisory Authority is entitled to regularly audit, on-site and off-site, compliance with legal regulations and resolutions issued by the Supervisory Authority concerning the foundation, licensing and operation of insurers defined in the Act on Insurance and other legal regulations, protection of the interests of the insured, and successful, reliable exercising of shareholders' rights, free of any undesirable influence as it is described thoroughly in ICP 13.

In case of resolutions of comprehensive inspections containing provisions, the HFSA organises post-audits on-site or off-site according to the weight and volume of the lawsuits.

g) The Supervisory Authority may impose a regulatory fine on the insurer, insurer's manager, and those who perform activities specified in the Act on Insurance without a licence if the party acts as it is defined in Section 196, Paragraph (1) of the Act on Insurance.

h) The Act on Insurance sets out that in case of false statement in any licence application or report, or supply of false data suitable to deceive the Supervisory Authority shall be considered severe violation of obligations included in this act. As the amount of fine must be defined taking into account the weight of deviation, such severe violation lead to imposing regulatory fine as set out in Section 197 of the Act on Insurance.

Regarding withdrawal of operating licences the Supervisory Authority may dispose on it if the insurer has obtained the operating licence by deceiving the Supervisory Authority, or in any other manner, violating the legislation (compare essential criterion k. of the present ICP).

i) Refer to criterion e) of the present ICP.

j) Regarding sanctions may be applied jointly and repeatedly as well, application of a sanction do not delay necessary preventive and corrective measures or enforcement (Section 195, Paragraph (2) of the Act on Insurance).

k) Cases when a foundation licence of an insurer may be withdrawn are specified in Section 203 of the Act on Insurance.

Cases when an operation licence of an insurer may be withdrawn are specified in Section 204 of the Act on Insurance.

l) The Act on Insurance contains rules regarding supplementary supervision of insurance groups and of financial conglomerates (Sections 178-189 and 189/A-189/M of the Act on Insurance), which are harmonised with the relevant EU directives (98/78/EC and 2002/87/EC). Regulations are also in accordance with provisions of the Helsinki Protocol of the EU, which sets forth the method of cooperation between supervisory authorities of the Member States. In case of insurers falling under the scope of the Supervisory Authority, general measures defined in Section 195 of the Act on Insurance may be applied in order to safeguard prudent operation.

m) In order to enforce sanctions noted above, the Supervisory Authority undertakes them in the form of resolution according to the relevant sections of the Act IV of 1957 on the general rules of the administrative proceedings. General rule, that resolutions shall be executed unless judicial review may be requested. Section 190 of the Act on Insurance stipulate that in case a lack of immediate actions severely jeopardised the interests of the insured, the Supervisory Authority's resolution must be executed immediately without any consideration to a request for legal remedy. This condition must be specified in the resolution.

n) The HFSA applies internal regulatory documents (supervisory policies) for the insurance sector which contains provisions on keeping registers in the form of comparative tables composing all kinds of measures (Policy of Sanctions) and an other separate table for supervisory fines (Policy of Fines). Principle of equal treatment is one of the guiding principles of both the Policy of Sanctions and Policy of Fines.

o) The Supervisory Authority have the powers to prohibit any unauthorized entities to further engage in insurance activity as it is defined in Section 195, Paragraph (1), Subparagraph k) of the Act on Insurance. .

Principle 16: Winding-up and exit from the market

<p>Principle 16: Winding-up and exit from the market</p> <p>The legal and regulatory framework defines a range of options for the orderly exit of insurers from the marketplace. It defines insolvency and establishes the criteria and procedure for dealing with insolvency. In the event of winding-up proceedings, the legal framework gives priority to the protection of policyholders.</p>	
	O/LO/PO/NO/NA *
<p>Essential criteria:</p> <p>a. The legal and regulatory framework provides for the determination of the point at which it is no longer permissible for an insurer to continue its business.</p>	O
<p>b. The procedures for dealing with insolvency and the winding-up of the insurer are clearly set forth in the law.</p>	O
<p>c. A high legal priority is given to the protection of the rights and entitlements of policyholders and other policy beneficiaries in the event of an insurer becoming insolvent and winding-up. This priority ensures that, as far as is practical, there is limited disruption to the provision of benefits to policyholders.</p>	O
<p>*Note: O = observed; LO = largely observed; PO = partly observed; NO = not observed; NA = not applicable.</p>	

Assessment

a) The liquidation and winding up process against an insurer joint stock company or insurer co-operative is governed by the provisions of Act II of 1991 on bankruptcy, liquidation and winding up (hereinafter referred to as “Bankruptcy Act”) with differences specified in the Act on Insurance.

Section 219, Paragraph (2) of the Act on Insurance provides for that the Supervisory Authority is obliged to withdraw the operating licence of the insurer within effect **from the initial date of the liquidation or winding up procedure** as soon as it learns about the court decision ordering liquidation or winding up. (As to the initial date of the liquidation or winding up procedure the Bankruptcy Act sets out precise regulations.)

Section 222 of the Act on Insurance determines legal consequences involved by the initial date of liquidation or winding up as follows:

- the insurance contracts shall be terminated with the exception of portfolio transfer in progress;
- in the case of terminated insurance contracts, the due insurance premium cannot be collected;
- insurance contracts may not be executed or extended, insurance portfolios may not be transferred or received based on the party’s own decisions.

No bankruptcy procedure can be filed against insurer joint stock companies, branch offices or insurance co-operatives [Subsection (3) of Section 217 of the Act on Insurance].

b) The Act on Insurance defines the term of and procedure in case of emergency situation (defined in Section 216 of the Act on Insurance) and the common rules for winding-up and liquidation of an insurer including the specification of the governing law, the Supervisory Authority’s publishing and information obligations, the personality and procedure of the winding up/liquidation agent and the legal effect of liquidation/winding-up. Moreover, special

rules contains sequence of satisfaction of claims in case of liquidation, and the insurer's obligations towards the Supervisory Authority in case of winding-up.

c) **Liquidation** rules provide protection for policyholders as it defines the sequence of satisfaction of claims (in accordance with Bankruptcy Act) as follows:

Liabilities of the insurer originating from insurance contracts must be paid right after the satisfaction of claims originating from liquidation expenses and claims secured by lien or collateral, preceding any other claims defined in Bankruptcy Act. The insurer pays its liabilities originating from insurance contracts in the following order:

1. Liabilities originating from life assurance and health insurance contracts, and annuity payment liabilities originating from accident insurance contracts and liability insurance contracts,
2. Services recognised on the basis of events occurring by the commencing date of liquidation, and reported within the deadline specified in the Bankruptcy Act,
3. Reimbursement liabilities originating from prepaid insurance premium,
4. Other liabilities.

(Section 224 of the Act on Insurance and Section 57 of the Bankruptcy Act.

In case of a **winding-up** process, a resolution stating the termination of the insurer without a legal successor requires a preliminary consent from the Supervisory Authority. The insurer may ask for preliminary consent if all of its liabilities originating from insurance activities has paid. The satisfaction of such liabilities can equally be fulfilled by transfer of portfolio, termination of insurance contracts or agreement with the insured. Simultaneously, the Supervisory Authority shall withdraw the insurance company's operating license. (Sections 225 and 226 of the Act on Insurance).

Assets shown under mathematical provisions or serving as coverage for the provisions of unit-linked life assurance policies shall be handled separately, from which to satisfy the insurance company's underwriting liabilities to policyholders (beneficiaries), before satisfying any other liabilities. If the assets under mathematical provisions are insufficient to cover underwriting liabilities, the remaining portion shall be satisfied from other assets of the insurance company as appropriate (Sections 222, Paragraph (2)-(4) of the Act on Insurance).

Principle 17: Group-wide supervision

Principle 17: Group-wide supervision	
The supervisory authority supervises its insurers on a solo and a group-wide basis.	
	O/LO/PO/NO/NA *
Essential criteria:	O
a. What constitutes an insurance group and financial conglomerate is clearly defined so that supervisors and insurers can determine: <ul style="list-style-type: none"> – which groups are considered to be insurance groups or financial conglomerates – which group or groups an insurer belongs to – the scope of the supervision. 	O
b. The supervisory authority ensures effective and efficient group-wide supervision. The supervisory authorities co-operate to avoid unnecessary duplication.	O
c. Where different supervisory authorities are responsible for different parts of a group or conglomerate appropriate co-operation and co-ordination exists. The supervisory responsibilities of each authority are well-defined and leave no supervisory gaps.	O
d. At a minimum, group-wide supervision of insurers which are part of insurance groups or financial conglomerates includes, as a supplement to solo supervision, at a group level, and intermediate level as appropriate, adequate policies on and supervisory oversight of: <ul style="list-style-type: none"> – group structure and interrelationships, including ownership and management structure – capital adequacy – reinsurance and risk concentration – intra-group transactions and exposures, including intra-group guarantees and possible legal liabilities – internal control mechanisms and risk management processes, including reporting lines and fit and proper testing of senior management. 	O
e. Host supervisory authorities avoid uncooperative behaviour with home supervisory authorities so as not to hinder effective supervision of groups and conglomerates (refer to ICP 5 EC i).	O
f. The supervisory authority requires that insurance groups and financial conglomerates have reporting systems in place that	O

adequately meet the supervisory information demands.	
g. The supervisory authority may deny or withdraw the license when the organisational (or group) structure hinders effective supervision (refer to ICP 6 and ICP 15).	O
*Note: O = observed; LO = largely observed; PO = partly observed; NO = not observed; NA = not applicable.	

Assessment

a) The Directive 98/78/EC of the European Parliament and of the Council of 27 October 1998 on the supplementary supervision of insurance undertakings in an insurance group was adapted in Act No LX of 2003 on Insurer and Insurance Activities (Paragraph 178-189, 189/A). The 189/A section of the Act on Insurance requires which groups are considered to be financial conglomerates and 189/B, 189/C, 189/D section of the Act determines the activities of the additional supervision.

Subparagraphs a)-c) of paragraph (1) of section 178 of the Act on Insurance require which groups are considered to be insurance groups.

Subparagraphs a)-c) of paragraph (2), paragraph (3), paragraph (4) of section 178 of the Act on Insurance require that.

The members of insurance groups in Hungary were identified according to the list of the Helsinki Protocol Working Group.

According to subparagraph (6) section 189/A of the Act on Insurance was identified the OTP-Group as a financial conglomerate. The HFSA notified the EU Mixed Technical Group of the OTP-Group. (The market share of OTP-Bank Company exceeds 5% in Hungary, measured in terms of the balance sheet total in the banking sector and the market share of OTP-Garancia Insurance Company exceeds 5% in Hungary, measured in terms of gross premiums written in the insurance sector.)

The Supervisory Authority keeps a record of insurers falling under the scope of consolidated supervision and supervises them.

The insurer has to notify the supervisory authority about the modification or termination of their relationship with other insurance companies.

Paragraphs (1)-(5) of Section 179 of Act on Insurance

The Supervisory Authority is entitled to supervise all undertakings, falling under the scope of consolidated supervision.

Section 181 of Act on Insurance

b) The Hungarian Financial Supervisory Authority is an integrated authority. The Supervisory Authority is entitled to carry out both, on-site inspections and off-site examinations as solo and a consolidated basis, as well.

Actually the Supervisory Authority conducts inspections and examinations by financial groups.

The Supervisory Authority concludes bilateral agreements and co-operates closely with the competent authorities of the Member States.

Section 170, section 181 and paragraphs (1)-(2)-(3)-(4) of section 182 of Act on Insurance

c) In Hungary an integrated financial supervision exists i.e. a single agency is supervising the banking, security, insurance and pension funds sector. The competent departments based on examination procedure guidelines carry out examinations of undertakings operating in these sectors.

An Examination Manual of Financial Groups was elaborated and the respective parts of examination procedure guidelines will be adapted in order to incorporate group and conglomerate supervision. The decision is made at this point whether permanent group supervisors are appointed or they are given a mandate only for the time of comprehensive examinations.

The identification process of insurance groups has already been finished.

d) Supervisory Authority developed the Examination Manual of Financial Groups. The Manual contains the methodology of the inspection of group structure, management and ownership structure.

Paragraphs (1)-(4) of section 178 of Act on Insurance determine, which insurers and companies fall under the scope of consolidated supervision and the section 189/A of Act determines which companies fall under the scope of the financial conglomerates.

Sections 184, 185, 186, 187, 188 and paragraphs (1)-(2) of section 189 of Act on Insurance determine the solvency margin and its calculation. Section 189/F determines the the solvency margin and its calculation of the financial conglomerates.

Reinsurance and risk concentration are taken into account in the calculation of the solvency margin.

The HFSA analyses the reinsurance and risk concentration. The Examination Manual of financial Groups (and for Insurers) declares how to carry out the examination of the calculation of the solvency margin, reinsurance and risk concentration.

Section 183 of Act on Insurance requires this subject.

Section 180

(3) Insurers falling under the scope of consolidated supervision must have an information system suitable to supply data and information required for the consolidated supervision, and internal controls ensuring the reliability of the information system.

The HFSA elaborated the Examination Manual of financial Groups (with examination program included) and a document on the methodological aspects of group and conglomerate supervision.

The Supervisory Authority may also refuse a licence application if it learns about facts, data or conditions on the basis of which it can be assumed that effective supervision over the insurer cannot be exercised.

Paragraph 4 of section 63, section 83, section 89 and section 189/G of Act on Insurance, decree of the Minister of Finance's on the data supply for the supplementary supervision of insurance undertakings in an insurance group

e) The Supervisory Authority co-operates with other supervisory authorities hands over reports, data and information and expect the same cooperative behaviour from other supervisory authorities in order to have the necessary inputs for consolidated supervisions.

Paragraphs (3)-(6) of section 182, section 189/J, 189/K, 189/L of Act on Insurance

f) Insurers falling under the scope of consolidated supervision must have an information system suitable for supplying data and information required for consolidated supervision.

The section 180 and paragraph 2 section 189/F of Act on Insurance and the decree of the Minister of Finance's on the data supply for the supplementary supervision of insurance undertakings in an insurance group order this.

g) The Supervisory Authority can deny or withdraw the license when the organisational (or group) structure hinders effective supervision.

Supervisors must recognize the situations, when the organisational (or group) structure hinders effective supervision and the necessary of the withdrawal of licence occurs.

Paragraph 4 of section 63, Paragraph 6 of section 179 and paragraphs 3-4 of section 189 of Act on Insurance

Principle 18: Risk assessment and management

Principle 18: Risk assessment and management	
The supervisory authority requires insurers to recognise the range of risks that they face and to assess and manage them effectively.	
	O/LO/PO/NO/NA *
Essential criteria	LO
a. The supervisory authority requires and checks that insurers have in place comprehensive risk management policies and systems capable of promptly identifying, measuring, assessing, reporting and controlling their risks (refer to ICP 10 EC d).	
b. The risk management policies and risk control systems are appropriate to the complexity, size and nature of the insurer's business. The insurer establishes an appropriate tolerance level or risk limit for material sources of risk.	PO
c. The risk management system monitors and controls all material risks.	PO
d. Insurers regularly review the market environment in which they operate, draw appropriate conclusions as to the risks posed and take appropriate actions to manage adverse impacts of the environment on the insurer's business.	PO
Advanced criteria	PO
e. Larger insurers establish a risk management function and a risk management committee.	
*Note: O-Observed; LO-Largely Observed; PO-Partly Observed; NO-Not Observed; NA-Not Applicable.	

Assessment

a) This criterion is included in the mission of the HFSA. We produce guidance papers to promote these practices. In the case of off-site investigations and monitoring the risks taken by the companies we are developing more and more complex systems. We try to measure the risks the insurers are exposed to. However due to the specificities of the insurance business there are many issues which cannot be measured and quantified, such as adequacy of reinsurance programs (you have to see the products, the liabilities to be able to decide on the adequacy of the reinsurance cover). These fields as well as the nowadays-famous corporate governance issues are only highlighted, but not built into our evaluation system in a very detailed way. In the process of on-site investigation is more emphasis is put on the question whether the insurer fulfils every requirements set by law than to see whether it effectively manages its risks.

b) We have guidance on these issues and procedures to evaluate the insurers' systems during on site investigations. However, should move forward in this field.

c) We have guidance on these issues and procedures to evaluate the insurers' systems during on site investigations. However we should move forward in this field, taking into account the guidance papers, standards developed in international fields.

d) Some companies have in place well developed systems, cooperation with the asset manager company and they do take into account market risks deciding on actions should be taken to manage possible adverse effects. In the same time there are companies, which would do this practise as well, but their parent companies set up strict rules sometimes not applicable to the Hungarian market and making such burden on the Hungarian subsidiary, which results in competitive disadvantages. Finally there are companies, which are not at that level of consciousness to make any effort to examine threats and opportunities of the external market impacts. So the market is quite complex in this question as well.

e) We have guidance on these issues and procedures to evaluate the insurers' systems during on site investigations. We should move forward in this field. The picture of the market is the same as we highlighted in point d) above.

Principle 19: Insurance activity

Principle 19: Insurance activity	
<p>Since insurance is a risk taking activity, the supervisory authority requires insurers to evaluate and manage the risks that they underwrite, in particular through reinsurance, and to have the tools to establish an adequate level of premiums.</p>	
	O/LO/PO/NO/NA *
Essential criteria	PO
a. The supervisory authority requires insurers to have in place strategic underwriting and pricing policies approved and reviewed regularly by the board of directors.	
b. The supervisory authority checks that insurers evaluate the risks that they underwrite and establish and maintain an adequate level of premiums. For this purpose, insurers should have systems in place to control their expenses related to premiums and claims, including claims handling and administration expenses. These expenses should be monitored by management on an on-going basis.	O
c. The supervisory authority is able to review the methodology used by the insurer to set premiums to determine that they are established on reasonable assumptions to enable the insurer to meet its commitments.	O
d. The supervisory authority requires that the insurer has a clear strategy to mitigate and diversify risks by defining limits on the amount of risk retained and taking out appropriate reinsurance cover or using other risk transfer arrangements consistent with its capital position. This strategy is an integral part of the insurer's underwriting policy and must be approved and regularly monitored and reviewed by the board of directors.	O
e. The supervisory authority reviews reinsurance arrangements to check that they are adequate and that the claims held by insurers on their reinsurers are recoverable. This includes that: <ul style="list-style-type: none"> – the reinsurance programme provides coverage appropriate to the level of capital of the insurer (taking into account the real transfer of risk) and the profile of the risks it underwrites – the reinsurer's protection is secure. This might be addressed through different means, such as relying on a system of direct supervision of reinsurers or obtaining collateral (including trusts, letters of credit or funds withheld). 	LO
f. The supervisory authority checks that risk transfer instruments are properly accounted for in order to give a true and fair view of the insurer's risk exposure.	O

***Note: O-Observed; LO-Largely Observed; PO-Partly Observed; NO-Not Observed; NA-Not Applicable.**

Assessment

a) There is no legal requirement for insurers to have in place strategic underwriting and pricing policies approved and reviewed by the board of directors. However, business plans are regularly reviewed during on-site supervisory inspections.

b) Annex 4 to Act on Insurance LX of 2003 requires that insurance product plans include a premium calculation and supplementary data. According to section 3. of Annex 4:

„The supplementary data must be estimated for 3 years in advance and must contain the following items, broken down for each year:

3.1 Number of policies planned for the portfolio and portfolio premium,

3.2 Expected costs of the product, acquisition, claim settlement and administration costs,

3.3 Estimated premium revenues,

3.4 Estimated claim payments.”

Although section 2 of Annex 4, which lists the mandatory elements of the written premium calculation, does not include the calculation of expenses, the general understanding and practice of both the supervisory authority and the industry is that the margin for expenses should be part of the premium calculation.

Expenses related to premiums and claims, the supervisory authority via annual and quarterly reporting, regularly monitors including claims handling and administration expenses. The supervisory authority reviews through on-site inspections whether an insurer has systems in place to control its expenses, and that the management on an on-going basis monitors the expenses.

c) Annex 4 to Act on Insurance LX of 2003 requires that insurance product plans include a premium calculation. Premium calculations must meet the requirements laid down in to section 2 of Annex 4; which include the description of the methodology used to set up premiums.

A number of product plans are routinely reviewed during each on-site inspection by the supervisory authority. Via these inspections the supervisory authority is able to review the methodology used by the insurer to set premiums.

d) The supervisory authority regularly reviews the reinsurance or other risk transfer strategy of insurers during on-site inspections and also via annual actuarial reporting. In particular, Decree of the Minister of Finance on the Actuarial Reporting of Insurers 7/2001 requires in Section 8 (1) b) that the summary of the annual actuarial report “include an assessment of the adequacy of reinsurance agreements, the transfer of large risks by reinsurance and any other risk whose lack of transfer may imperil the stability of the insurer”.

Recommendation No 6/2001 of the HFSA (concerning the handling of reinsurance) contains guidance along lines based upon IAIS principles. According to the Inspection Manual of the supervisory authority, compliance with this recommendation shall be reviewed within the framework of the supervisory inspections.

There is no legal requirement for a written risk mitigation strategy that must be approved and reviewed by the board of directors. The supervisory authority has no power to explicitly require reinsurance cover except in the case of associations (aka. mutuals) where, according to Section 25 (1) of the Act, “in order to ensure the sound operation of an insurance

association, the Competent Authority may require a maximum 90 per cent reinsurance obligation.” In the case of insurers other than associations, the supervisory authority has other tools for intervention if it perceives inadequate management of risks. In particular, Section 131 (1) of the Act provides that “If the operation of the insurer represents risks for the interests of the insured, the Competent Authority obliges the insurer to prepare a financial recovery plan for a period of up to three years.” The financial recovery plan, among others, must contain, as per Section 131 (2) e), “comprehensive plans for reinsurance”.

e) As part of its on-site inspection programme, the supervisory authority regularly checks the adequacy of reinsurance arrangements and whether they are appropriate to the level of capital of the insurer; although no quantitative benchmark has been set. Regarding the recoverability of reinsurance claims, the rating of reinsurers, when applicable, is reviewed. Direct supervision of reinsurers is currently not possible as the reinsurers of Hungarian insurers are, almost exclusively, foreign companies. Legal provisions do not allow requiring collaterals.

Recommendation No 6/2001 of the HFSA (concerning the handling of reinsurance) contains guidance along lines based upon IAIS principles. . According to the Inspection Manual of the supervisory authority, compliance with this recommendation shall be reviewed within the framework of the supervisory inspections.

f) The on-site inspection programme of the supervisory authority includes regular checking of the proper accounting of risk transfer instruments, particularly that of reinsurance.

Principle 20: Liabilities

<p>Principle 20: Liabilities</p> <p>The supervisory authority requires insurers to comply with standards for establishing adequate technical provisions and other liabilities, and making allowance for reinsurance recoverables. The supervisory authority has both the authority and the ability to assess the adequacy of the technical provisions and to require that these provisions be increased, if necessary.</p>	
	O/LO/PO/NO/NA *
Essential criteria	O
a. Legal provisions are in place for establishing adequate technical provisions and other liabilities based on sound accounting and actuarial principles.	
b. The supervisory authority prescribes or agrees to standards for establishing technical provisions and other liabilities.	O
c. The supervisory authority in developing the standards considers: <ul style="list-style-type: none"> – what is to be included as a liability – the procedure and the internal control system that are in place to ensure reliable data (refer to ICP 10) – the methods and assumptions for assessing, on a reliable, objective, transparent and prudent basis, technical provisions to cover all expected and some unexpected claims and expenses. 	O
d. The supervisory authority reviews the sufficiency of the technical provisions through off-site monitoring and on-site inspection (refer to ICPs 12 and 13).	O
e. The supervisory authority requires the technical provisions to be increased if they are not sufficient.	O
f. The supervisory authority ensures that standards stipulate: <ul style="list-style-type: none"> – general limits for the valuation of the amounts recoverable under reinsurance arrangements with a given reinsurer for solvency purposes, taking into account the ultimate collectability and the real transfer of risk – sound accounting principles for the booking of the amounts recoverable under reinsurance arrangements – the credit for technical provisions for amounts recoverable under reinsurance arrangements. In that case, the amount recoverable is disclosed in the financial statement of the insurer by reporting the respective gross and net figures in 	LO

the accounts.	
Advanced criteria	LO
g. The supervisory authority requires that insurers undertake regular stress testing for a range of adverse scenarios in order to assess the adequacy of capital resources in case technical provisions have to be increased (refer to ICP 21 AC k and ICP 23 AC j).	
*Note: O-Observed; LO-Largely Observed; PO-Partly Observed; NO-Not Observed; NA-Not Applicable.	

Assessment

a) Act on Insurance LX of 2003 requires in Section 117 (1) that “in order to have sound operation, an insurer must set aside insurance technical reserved to cover its liabilities prevailing on the balance sheet date, fluctuation of claims, and estimated insurance losses.” Further legal provisions are included in Sections 118–120. Actuarial principles regarding the establishment of provisions are elaborated in Decree of the Minister of Finance on Insurance Technical Provisions 8/2001, and the related accounting principles in Decree of the Government on the Accounting of Insurers 192/2000. Unfortunately, the breakdown of technical provisions into categories in the latter decree is not completely consistent with the categories specified in the Act and the former decree. Both decrees are currently under review to match the requirements of the new Act on Insurance and those of EU directives.

b) The supervisory authority does not set up standards, other than the legal requirements, for establishing technical provisions. However, the supervisory authority has an instrumental role in the drafting of those legal provisions. It is also required in Section 1 (2) of the Decree on Insurance Technical Provisions that the insurer regulate its own standards for establishing technical provisions. The supervisory authority regularly review the insurers’ own regulations on technical provisions during on-site inspections.

c) As was said above, the supervisory authority does not set up standards, other than the legal requirements, for establishing technical provisions. In the procedure of drafting those legal provisions, however, the supervisory authority considers what is to be included as a liability, and the methods and assumptions for assessing, on a reliable, objective, transparent and prudent basis, technical provisions to cover all expected and some unexpected claims and expenses. Regarding the procedure and internal control system that are in place to ensure reliable data, the current requirement included in the Decree on Insurance Technical Provisions is that “the insurer must record unambiguously the methods and data used for the establishment of technical provisions” (Section 1 (6)) and that “wherever this decree requires the establishment of provisions on an individual basis, the provisions must be recorded and archived in a way that allows identification on an individual basis” (Section 1 (6)).

d) Off-site monitoring of technical provisions is performed mainly via the financial statement of the insurer and the annual actuarial reporting, but also through quarterly reporting. The Decree on the Actuarial Reporting of Insurers specifies the data and the scope of actuarial assessment to be submitted within the annual actuarial report. Technical provisions are one of the main areas to be covered by the actuarial reporting.

On-site inspections at each insurer are performed every other year, and the review of the sufficiency of technical provisions and the adequacy of the methods for setting up technical

provisions is invariably one of the main areas of such inspections. Lately these inspections concentrate on those types of technical provisions that form the largest part of the insurer's liabilities (most likely life provisions and provisions for outstanding claims).

e) Section 216 (1) *b*) of the Act on Insurance enables supervisory intervention if the technical provisions are insufficient or they are insufficiently covered by assets. Section 129 also stipulates that the supervisory authority require the insurer to submit a short-term (half-year) financial plan if the technical provisions are insufficient or they are insufficiently covered by assets. Section 195 defines the powers of the supervisory authority in such a case; including subparagraph a) of paragraph (1) according to which "It may oblige parties to comply with terms and conditions laid down in this act, other legal regulations applicable to insurance, insurance broker, consultation and representation activities, as well as contained in the resolutions of the Competent Authority, setting an adequate deadline".

Hence the supervisory authority may require the technical provisions to be increased if they are insufficient. Such interventions have been rare in the past, partly because there have been only a few insurers with such problems, but also because the valuation of technical provisions involves many unknown variables, thus any intervention requiring that technical provisions be increased is likely to be challenged in court.

f) There are currently no standards that stipulate general limits for the valuation of the amounts recoverable under reinsurance arrangements with a given reinsurer for solvency purposes, taking into account the ultimate collectability and the real transfer of risk. However, Section 131 (6) of the Act on Insurance provides that:

"The Competent Authority may require the reduction of inclusion of reinsurance in the calculation of minimum required solvency margin insurer in accordance with Annex No. 8 if

- a) The quality of reinsurance cover has deteriorated significantly compared to the previous business year, or
- b) The reinsurance contracts of the insurer do not actually share the risks, or do not share risks sufficiently."

There has been yet no supervisory intervention along these lines, since this is a new provision in the Act that entered into force in May 2004.

Sound accounting principles for the booking of the amounts recoverable under reinsurance arrangements are required and regularly reviewed by the supervisory authority through on-site inspections.

Regarding the credit for technical provisions for amounts recoverable under reinsurance arrangements, the relevant regulation is Section 118 of the Act.

The amount of provisions recoverable under reinsurance is disclosed in the financial statement of the insurer by reporting the respective gross and net figures in the accounts.

g) No stress-testing requirement has been implemented yet. The supervisory authority is in the early stage of studying these methods.

Principle 21: Investments

Principle 21: Investments	
<p>The supervisory authority requires insurers to comply with standards on investment activities. These standards include requirements on investment policy, asset mix, valuation, diversification, asset-liability matching, and risk management.</p>	
	O/LO/PO/NO/NA *
<p>Essential criteria</p> <p>a. Requirements regarding the management of investments are in place, either in the law or in supervisory rules. These requirements address, but may not be limited to, the following:</p> <ul style="list-style-type: none"> – the mixture and diversification by type – limits or restrictions on the amount that may be held in particular types of financial instruments, property, and receivables – the safekeeping of assets – the appropriate matching of assets and liabilities – the level of liquidity. 	O
<p>b. Investments are valued according to a method prescribed by or acceptable to the supervisory authority.</p>	O
<p>c. The supervisory authority requires insurers to have in place an overall strategic investment policy, approved and reviewed annually by the board of directors, that addresses the following main elements:</p> <ul style="list-style-type: none"> – the risk profile of the insurer – the determination of the strategic asset allocation, that is, the long-term asset mix over the main investment categories – the establishment of limits for the allocation of assets by geographical area, markets, sectors, counterparties and currency – the extent to which the holding of some types of assets is restricted or disallowed, for example illiquid or volatile assets or derivatives – the conditions under which the insurer can pledge or lend assets – an overall policy on the use of financial derivatives and structured products that have the economic effect of derivatives 	LO

<p>(refer to ICP 22)</p> <ul style="list-style-type: none"> – clear accountability for all asset transactions and associated risks. 	
<p>d. The risk management systems must cover the risks associated with investment activities that might affect the coverage of technical provisions and/or solvency margins (capital). The main risks include:</p> <ul style="list-style-type: none"> – market risk – credit risk – liquidity risk – failure in safe keeping of assets (including the risk of inadequate custodial agreements). 	PO
<p>e. The supervisory authority checks that insurers have in place adequate internal controls to ensure that assets are managed in accordance with the overall investment policy, as well as in compliance with legal, accounting, and regulatory requirements. These controls should ensure that investment procedures are documented and properly overseen. Normally the functions responsible for measuring, monitoring, settling and controlling asset transactions are separate from the front office functions (refer to ICP 10).</p>	O
<p>f. The supervisory authority requires that oversight of, and clear management accountability for, an insurer's investment policies and procedures remain ultimately with the board of directors, regardless of the extent to which associated activities and functions are delegated or outsourced.</p>	O
<p>g. The supervisory authority requires that key staff involved with investment activities have the appropriate levels of skills, experience and integrity.</p>	O
<p>h. The supervisory authority requires that insurers have in place rigorous audit procedures that include full coverage of their investment activities to ensure the timely identification of internal control weaknesses and operating system deficiencies. If the audit is performed internally it should be independent of the function being reviewed.</p>	LO
<p>i. The supervisory authority requires that insurers have in place effective procedures for monitoring and managing their asset/liability position to ensure that their investment activities and asset positions are appropriate to their liability and risk profiles.</p>	LO
<p>j. The supervisory authority requires that insurers have in place contingency plans to mitigate the effects of deteriorating conditions.</p>	PO

<p>Advanced criteria</p> <p>k. The supervisory authority requires that insurers undertake regular stress testing for a range of market scenarios and changing investment and operating conditions in order to assess the appropriateness of asset allocation limits (refer to ICP 20 AC g and ICP 23 AC j).</p>	<p>PO</p>
<p>*Note: O-Observed; LO-Largely Observed; PO-Partly Observed; NO-Not Observed; NA-Not Applicable.</p>	

Assessment

The Supervisory Authority requires insurers to comply with standards on investment activities prescribed by the third Chapter of the Act on Insurance.

a) According to Section 132 (1) of the Act on Insurance, the assets of an insurance company covering technical provisions shall be invested with a view to the class of insurance in which it is engaged and the maturity of liabilities in such a manner as to guarantee liquidity at all times while providing the highest yield under the safest conditions attainable. Section 132 (2) of Act on Insurance declares the principle to achieve secure investments, an insurer must select several investment forms at the same time and, within a particular investment form, it should also aim at mitigating investment risks and sharing investment risks. Section 134 gives a detailed list of possible assets insurer may keep their insurance technical reserves.

A) Investments

- a) debt securities, bonds and other money and capital market instruments,
- b) loans,
- c) shares and other variable yield securities and participations,
- d) units in companies for collective investment in transferable securities and other investment funds,
- e) land, buildings and incorporeal rights in property;

B) Debts and claims

- f) debts owed by reinsurers, including the reinsurers' shares of technical provisions created on risks covered by reinsurance,
- g) deposits with and debts owed by ceding companies,
- h) debts owed by policyholders and intermediaries arising out of direct and reinsurance operations in so far as they have been outstanding for not more than three months,
- i) life assurance policy loans,
- j) tax recoveries,
- k) claims against security capitals;

C) Others

- l) tangible fixed assets, other than land and buildings, valued on the basis of prudent amortization,
- m) cash at bank and in hand, deposits with credit institutions and any other bodies authorized to receive deposits,
- n) accrued interest and rent,
- o) deferred acquisition costs.

Limits or restrictions on the amount that may be held in particular types of financial instruments, property, and receivables: Act on Insurance 71; 132; 133; 134; 135; 136; 137; 139; 140; 141; 142.

HFSA issued a Supervisory Guide on Asset-Liability Management.

b) Act on Insurance requires that insurers should prepare Policies on Evaluation of Assets. During on-site inspections these policies and the actual practice of evaluation is investigated.

According to Section 2 (6) c) of Government Decree No 192 of 2000 on the Accounting of Insurers, insurers should set up their procedures for evaluating their investment portfolios and the methodology of continuous control of investments of reserves and security capital. The Act on Accounting obliges to set up evaluation methods of investments.

According to Section 72 (2) of the Act on Insurance if an insurer executes unit-linked life assurance contracts, it is obliged to report to the HFSA on its funds offered to such life assurance products within 15 working days from their establishment. The report must contain the title of such funds and their investment policy. Preparation of investment policy for the investment of other reserve is not legally prescribed, however required by the HFSA and examined thoroughly during on site inspections.

c) The risk profile of the insurer and the determination of the strategic asset allocation, that is, the long-term asset mix over the main investment categories are not regulated directly, however Section 132 (1)-(2) of Act on Insurance states the basic principles for them. Reinsurance schemes are inspected during on-site inspections, as they should match the risk accepted by the insurer.

The Supervisory Guide on ALM of HFSA deals with this issue, however there is only little experience of the use of the Supervisory Guide being recently published.

The issues in connection with geographical and other limits are regulated by Sections 136 (1); 132 (3) of the Act on Insurance (details are given in the Appendix 9. of the Act).

Section 134 of Act on Insurance gives the list of the allowed assets.

See Sections 136 (2)-(5); 139 (3); 140 (2); 141 (2) of Act on Insurance for the conditions of pledging or lending assets.

The use of financial derivatives is regulated by Section 138 of the Act on Insurance.

The last issue is related in Act on Accounting Section 15.

d) A broad idea is given about these in Section 132 of Act on Insurance. HFSA has a Supervisory Guide on ALM, where HFSA sets requirements for management of these risks.

e) Section 85 (1) and 89 of the Act on Insurance prescribe the responsibilities of internal auditor, however details and tools of controlling assets are not defined. The Supervisor checks how the insurers meet the above-mentioned requirements when having on-site inspection at the supervised institution.

f) According to Section 76 of the Act on Insurance an insurer may outsource any of its business activities, with the exception of those specified in Annex No 6 Section (1). The requirement for outsourcing business activities is that the management and controlling rights should remain with the insurer.

g) This issue is not regulated in the Act on Insurance. During on-site inspection it is a sub-item when investments of insurers are examined.

h) According to Section 2 (6) c) of the Government Decree No 192 of 2000 insurers should set up their procedures for evaluating their investment portfolios and the methodology of continuous control of investments of reserves and security capital. During on-site inspections HFSA inspects these control procedures.

i) Section 132 (1) of the Act on Insurance describes the main principles and Supervisory Guide on ALM sets more detailed requirements.

j) Not regulated for insurance business in general, only IT contingency plans are required to be in place according to the COBIT principles, which are applied by IT system audits.

k) However not regulated in Act on Insurance, the Supervisory Guide on ALM deals with this

issue.

Principle 22: Derivatives and similar commitments

Principle 22: Derivatives and similar commitments	
<p>The supervisory authority requires insurers to comply with standards on the use of derivatives and similar commitments. These standards address restrictions in their use and disclosure requirements, as well as internal controls and monitoring of the related positions.</p>	
	O/LO/PO/NO/NA *
Essential criteria	O
a. Requirements regarding the use of derivatives are in place, either in the law or in supervisory rules. The requirements consider the risks in the use of derivatives and similar commitments.	O
b. The supervisory authority establishes disclosure requirements for derivatives and similar commitments.	O
c. The supervisory authority requires the board of directors to satisfy itself that collectively the board has sufficient expertise to understand the important issues related to the use of derivatives, and that all individuals conducting and monitoring derivatives activities are suitably qualified and competent.	NO
d. The supervisory authority requires insurers using derivatives to have in place an appropriate policy for their use that must be approved and reviewed annually by the board of directors. This policy should be consistent with the insurer's activities, its overall strategic investment policy and asset/liability management strategy, and its risk tolerance. It addresses at least the following elements: <ul style="list-style-type: none"> – the purposes for which derivatives can be used – the establishment of appropriately structured exposure limits for derivatives taking into account the purpose of their use and the uncertainty caused by market, credit, liquidity, operations and legal risk – the extent to which the holding of some types of derivatives is restricted or not authorised; for example, where the potential exposure cannot be reliably measured, the closing out or disposal of the derivative could be difficult due to its lack of marketability (as may be the case with over-the-counter instruments) or the illiquidity of the market, or where independent (i.e. external) verification of pricing is not available – the delineation of lines of responsibility and a framework of accountability for derivatives transactions. 	LO

<p>e. The supervisory authority requires that insurers have in place risk management systems, covering the risks from derivatives activities to ensure that the risks arising from all derivatives transactions undertaken by the insurer can be:</p> <ul style="list-style-type: none"> – analysed and monitored individually and in aggregate – monitored and managed in an integrated manner with similar risks arising from nonderivatives activities so that exposures can be regularly assessed on a consolidated basis. 	<p>PO</p>
<p>f. The supervisory authority requires that insurers have in place adequate internal controls to ensure that derivatives activities are properly overseen and that transactions have been entered into only in accordance with the insurer's approved policies and procedures, and legal and regulatory requirements. These controls ensure appropriate segregation between those who measure, monitor, settle and control derivatives and those who initiate transactions (refer to ICP 10).</p>	<p>PO See e.</p>
<p>g. The supervisory authority requires that insurers have in place personnel with appropriate skills to vet models used by the front office and to price the instruments used, and that pricing follows market convention. These functions should also be separate from the front office.</p>	<p>NO</p>
<p>h. The supervisory authority requires that the board of directors ensure that the insurer has the appropriate capability to verify pricing independently where the use of 'over-the-counter' derivatives is permitted under the insurer's policy.</p>	<p>NO</p>
<p>i. The supervisory authority requires that insurers have in place rigorous audit procedures that include coverage of their derivatives activities to ensure the timely identification of internal control weaknesses and operating system deficiencies. If the audit is performed internally it should be independent of the function being reviewed.</p>	<p>LO</p>
<p>*Note: O-Observed; LO-Largely Observed; PO-Partly Observed; NO-Not Observed; NA-Not Applicable.</p>	

Assessment

a) Act XCVI of 1995 (the Act on Insurance which was in force until the EU accession,) gave the definition of derivative transaction as a transaction whose value depends on the value of the financial instrument or reference rate (base product) on which it is based or which it can be derived from and which may itself be traded.

According to this legislation and apart from the insurance activities described in Section 4 and the activities directly associated therewith, **insurance companies not allowed to pursue** any other business activities, with the **exception of**

c) the management and investment of the insurer's own assets, management of its own financial affairs, **including derivative transactions for hedging purposes.**

The renewed legislation is in compliance with relevant rules of the other Hungarian financial acts with special regard to the Capital Market Act.

From the EU accession the regulation concerning derivative instruments became less rigorous than the earlier rules. However it is important to highlight that the provisions of renewed Insurance Act are giving adequate safety as regards the regulation of derivative

instruments.

According to the Act of LX of 2003 (Section 3 point 54) the definition of derivative transaction is the same, which was earlier specified by the Capital Market Act, Section 5, point 92: derivative instrument shall mean an instrument whose value depends on the value of underlying investment instrument, foreign exchange, commodity or reference rate (base product) and which may itself be traded.

According to the current Act on Insurance **Section 5 paragraph (6)** especially the following activities are considered activities directly related to insurance:

a) Management and investment of the assets of the insurer by the insurer, asset management activities of the insurer, **including derivative transactions relating to the insurance technical provisions for hedging purposes, establishing an efficient portfolio, and for arbitrage purposes.**

The Section 135 paragraph (3) states that the cover of insurance technical reserves of the insurer cannot include investment bonds issued by an investment fund **investing into derivative transactions** defined in Section 278 of the Capital Market Act.

According to the **Section 136 paragraph (4)** the combined market value of derivative of derivative instruments that were offset by netting calculated in accordance with the asset valuation procedures and Section 272 Paragraph (5) of the Capital Market Act **cannot exceed 15 per cent of the market value of securities** covering the gross insurance technical provisions of the insurer.

(See other detailed rules in **Section 137 paragraph (5) and (6)**, referring to the **Section 272 Paragraph (5) of the Capital Market Act. Moreover the Section 138 of the Act on Insurance**, which prescribes that derivative instruments must be valued on a prudent basis and may be taken into account in the valuation of the underlying assets. Furthermore the insurance companies shall, at all times, have liquid assets of sufficient offset value to cover the entire balance between all contract prices of derivative long positions and existing variable deposits in addition to the liquid assets required for regular business operations.

b)-c) Section 9. § of Decree of the Government on the Accounting of Insurers 192/2000. modified by 235/2003 sets the rules of evaluating investment incomes for derivatives, for fair value and book-value evaluation cases. **Insurers should disclose details on derivative transactions** in their annual report Section 14/A. g.)

The amendment to the Act on Accounting sets new rules about derivatives. Section 59/D declares that open derivative transactions appear in balance sheet as off-balance sheet items, and these each of these transactions should be disclosed in Notes (Section 90).

According to this Act the fair valuation shall be applied to annual reports made for the financial year commencing in 2004.

d) The investment rules of the Act of LX 2003. contain regulations for use of derivative instruments. As the investment policy of insurers is a requirement and checked by HFSA (see ICP 21), the use of derivatives should be part of it.

Section 135 paragraph (3) Section 136 paragraph (4) Section 137 paragraph (5) and (6), regulate the use of derivative instruments. According to the Section 137 (5) the combined market value of derivative instruments that were not offset by netting, calculated in accordance with the asset valuation regulations or with Subsection (5) of Section 272 of the Capital Market Act, **may not exceed five per cent of the market value of instruments covering mathematical provisions.**

The Decree of the Government on the Accounting of Insurers 192/2000 modified by 235/2003 Decree of the Government on the Accounting of Insurers gives detailed rules on accounting principles of derivative transactions. These give the basic limits together with the Act on Insurance.

e) However the legislation has been changed the insurers do not use derivatives in practice

as it is shown by their quarterly reports to the HFSA. Until now it is considered to be the main reason why there was not need for more detailed regulation (mentioned at the criteria) as regards the derivative instruments and transactions.

f) See the assessment of the ICP 10.

i) In generally the rules on internal control are subject to investment transactions, as well.
(See ICP 10)

Principle 23: Capital adequacy and solvency

Principle 23: Capital adequacy and solvency	
<p>The supervisory authority requires insurers to comply with the prescribed solvency regime. This regime includes capital adequacy requirements and requires suitable forms of capital that enable the insurer to absorb significant unforeseen losses.</p>	
	O/LO/PO/NO/NA *
Essential criteria	O
a. The solvency regime addresses in a consistent manner: <ul style="list-style-type: none"> – valuation of liabilities, including technical provisions and the margins contained therein – quality, liquidity and valuation of assets – matching of assets and liabilities – suitable forms of capital – capital adequacy requirements. 	
b. Any allowance for risk mitigation or transfer considers both its effectiveness and the security of any counterparty.	PO
c. Suitable forms of capital are defined.	O
d. Capital adequacy requirements are sensitive to the size, complexity and risks of an insurer's operations, as well as the accounting requirements that apply to the insurer.	LO
e. The minimum capital adequacy requirements should be set at a sufficiently prudent level to give reasonable assurance that policyholder interests will be protected.	O
f. Capital adequacy requirements are established at a level such that an insurer having assets equal to the total of liabilities and required capital will be able to absorb significant unforeseen losses.	O
g. Solvency control levels are established. Where the solvency position reaches or falls below one or more control levels, the supervisory authority intervenes and requires corrective action by the insurer or imposes restrictions on the insurer. The control level is set so that corrective action can be taken in a timely manner (refer to ICP 14).	O
h. Inflation of capital – through double or multiple gearing, intra-group transactions, or other financing techniques available as a result of the insurer's membership in a corporate group – is addressed in the capital adequacy and solvency calculation (refer to ICP 17).	O

i. The solvency regime addresses the requirements placed upon an insurer operating through a branch.	O
Advanced criteria	
j. The solvency regime provides for periodic, forward-looking analysis (e.g., dynamic solvency/ stress testing) of an insurer's ability to meet its obligations under various conditions (refer to ICP 20 AC g and ICP 21 AC k).	NO
k. The supervisory authority assesses the structure of its solvency regime against structures of a peer group of jurisdictions and works towards achieving consistency.	O
*Note: O-Observed; LO-Largely Observed; PO-Partly Observed; NO-Not Observed; NA-Not Applicable.	

Assessment

a) The current solvency regime (as specified in Sections 121–128 and Annex No. 8 of the Act on Insurance) implements the EU solvency regime (Solvency I.) as laid down in the various Life and Non-life directives, in particular, 2002/83/EC and 73/239/EEC as amended by 2002/13/EC.

b) Partner risk is currently no factor either in the calculation of capital requirement or in the valuation of provisions. Section 131 (6) of the Act on Insurance provides that:

“The Competent Authority may require the reduction of inclusion of reinsurance in the calculation of minimum required solvency margin insurer in accordance with Annex No. 8 if

- a) The quality of reinsurance cover has deteriorated significantly compared to the previous business year, or
- b) The reinsurance contracts of the insurer do not actually share the risks, or do not share risks sufficiently.”

c) Suitable forms of capital are defined in Section 123 of the Act.

Section 124 (1) of the Act also stipulates that “the Competent Authority may change the valuation of solvency margin of the insurer, especially if the market value of assets covering it has reduced significantly since the end of the previous business year.”

d) Capital adequacy requirements are sensitive to the size, complexity and risks of an insurer's operation although, as with the current EU solvency regime, not all risks of an insurers operation are taken into account (e.g. asset risk is not included). Solvency II is expected to improve the risk-sensitivity of the solvency regime.

There has been one significant inconsistency between capital adequacy requirements and accounting: Section 123 (1) of the Act requires that “the solvency margin must be defined [...] separately for the life and non-life insurance line.” That life and non-life solvency margin was to be separated was also implicit in the predecessor to the Act. Yet under the Decree of the Government on the Accounting of Insurers 192/2000, separation of life and non-life solvency margin is still largely unresolved, and should be dealt with in the accounting regulation.

e) The capital adequacy requirements are not based on a Hungarian statistical database but were adopted from the EU; it is supposed that they are as good as in the EU. There has been no insurer failure since the implementation of the solvency regime.

f) There have been no cases when an insurer had failed to absorb losses because of the weakness of the capital adequacy requirement. However, this has been mainly done to the

willingness of parent companies to cover losses rather than the capital requirement itself. There have been some concerns regarding the strength of the current EU solvency margin requirement.

g) If the available solvency margin of an insurer is less than the required solvency margin, the supervisory authority requires the insurer to submit a reorganization plan (in the EU directives also known as plan for the restoration of sound financial situation) for a maximum term of one year. If the available solvency margin of an insurer falls below the guarantee fund, the supervisory authority requires the insurer to submit a short-term (half-year) financial plan. If the insurer fails to implement corrective action, the supervisory authority may employ the full range of its intervening powers. In addition to the above two control levels, the supervisory authority has the power to require the insurer to submit a financial recovery plan if its operations present a danger to the interests of the policyholders.

The relevant sections of the Act are Sections 129–131.

h) The issue is addressed under Consolidated Supervision and Adjusted Solvency Margin. Sections 178–189 of the Act on Insurance implement Directive 98/78/EC of the European Parliament and of the Council of 27 October 1998 on the supplementary supervision of insurance undertakings in an insurance group.

i) The Act addresses the issue in a manner consistent with EU law. According to the EU directives, the solvency situation of an insurer operating through a branch is reviewed by the supervisory authority of the home Member State. Separate provisions apply to branches of Third Country insurers, as specified in Section 70 Paragraph (2) of the Act.

j) No forward-looking analysis or dynamic solvency testing is included in the current solvency regime.

k) The supervisory authority works towards achieving consistency with the solvency regime of the European Union. Via the EU IC solvency subcommittee and the working groups of CEIOPS, the supervisory authority is actively participating in the development of the new European solvency regime (Solvency II).

Principle 24: Intermediaries

Principle 24: Intermediaries	
The supervisory authority sets requirements, directly or through the supervision of insurers, for the conduct of intermediaries.	
	O/LO/PO/NO/NA *
Essential criteria	O
a. The supervisory authority requires intermediaries to be licensed or registered.	
b. The supervisory authority requires intermediaries to have adequate general, commercial and professional knowledge and ability as well as having a good reputation.	O
c. If necessary, the supervisory authority takes corrective action, including applying sanctions, directly or through insurers, and cancelling the intermediary's licence or registration, when appropriate.	O
d. The supervisory authority requires an intermediary who handles client's money to have sufficient safeguards in place to protect these funds.	O
e. The supervisory authority requires intermediaries to give customers information on their status, specifically whether they are independent or associated with particular insurance companies and whether they are authorised to conclude insurance contracts on behalf of an insurer or not.	O
f. The supervisory authority or other authority must have powers to take action against those individuals or entities that are carrying on insurance intermediation activity without license or registration.	O
*Note: O-Observed; LO-Largely Observed; PO-Partly Observed; NO-Not Observed; NA-Not Applicable.	

Assessment

a) A **licence** is required from the Supervisory Authority for performance of independent insurance intermediary or lead agent activities according to Section 57, Paragraph (1), Subsection c) of the Act on Insurance. Apart from the above categories, insurance intermediaries shall be **reported** to the Supervisory Authority. These are: tied insurance intermediaries and insurance consultants.

The Supervisory Authority keeps a register of insurance intermediaries licensed or reported on the basis of the provisions of the Act on Insurance. Only individuals, who are included in the register kept by the Supervisory Authority, can conduct insurance intermediary or consultation activities – excluded exceptions stated in this Act [Section 34 and Section 36, Paragraph (1) of the Act on Insurance].

b) According to Section 48, Paragraph (3) of the Act on Insurance, **insurance intermediation** (both independent and tied ones) can only be pursued by private individuals (or individuals engaged in economic organisations pursuing insurance intermediation activities) who do not have a criminal record, and possess higher qualifications or

qualification defined in a separate legal regulation.

In addition to this, in case of independent insurance intermediaries, the Act on Insurance defines special requirements regarding the **executive of the independent insurance intermediary** additional to the above-mentioned as follows:

- in case of higher qualifications, executive shall hold an insurance-related executive position earlier (usually in an insurer, economic organisation pursuing insurance intermediary activities, public administration, financial or economic areas, or an adequate trade representation agency) for 3 years or worked as an insurance consultant, or has held in total 5 years of employment, public service or other legal relations involving work in such organisations; or
- in case of secondary education executive shall hold an insurance-related executive position in an insurer, or an economic organisation pursuing insurance intermediary activities of at least 7 years (Section 38, Paragraph (6) of the Act on Insurance).

c) Supervisory Authority may take the following measures in connection with intermediaries:

- oblige parties to comply with terms and conditions laid down in this act, other legal regulations applicable to insurance intermediary, consultation and lead agent activities, as well as contained in the resolutions of the Supervisory Authority, setting an adequate deadline,
- prohibit the performance of independent insurance intermediary and lead agent activities without a licence, or consultation activities conducted by parties that included in the register of the Supervisory Authority,
- order the deletion of an insurance intermediary from the register,
- require an increase of the capital of an independent insurance intermediary economic organisation to the minimum specified in this act,
- order the hearing of individual controlling independent insurance intermediary or consultation activities,
- suspend issued operating licences in part or in full,
- withdraw issued operating licences,

according to Section 195, Paragraph (1), Subparagraph a), k), l), m), q), r) and s) of the Act on Insurance (for further information, see ICP 15 Enforcement and Sanctions).

d) As to safeguards in handling client's money the regulation differs in case of the independent or dependent insurance intermediaries.

Independent insurance intermediary must proceed in its activities in compliance with the regulations of the insurance trade. An independent insurance intermediary shall be held liable for failing to meet such an obligation (independent insurance intermediary's fault), including especially wrong advice, irregular premium management, or late transfer of statements. This liability shall also extend to the activities of individuals proceeding on its behalf.

Independent insurance intermediary is obliged to keep amounts paid by customers due to the insurer, and amounts paid by insurers due to customers, in separate customer accounts. The amounts kept in customer accounts may not be used to satisfy other creditors even in the case of a bankruptcy or liquidation procedure (Section 42 of the Act on Insurance).

In addition to this, independent insurance intermediary shall maintain a professional liability insurance of at least 250 million in the case of each claims, or in total at least HUF 375 million a year, with a scope covering the entire territory of the EU, or a financial security of HUF 375 million, in order to insure liability for its activities.

In case of **tied insurance intermediary (agent)** the insurer shall be held liable for all losses and damages causing during the intermediary activity of the agent and individuals employed assigned by it or having another legal relationship with it aiming at work, involved in intermediation pursuant to Section 48, Paragraph (2) of the Act on Insurance. Tied insurance intermediary is not obliged to maintain professional liability insurance.

e) Prior to the execution of an insurance contract, - unless provided for differently by law – the insurance intermediary is obliged to provide information in the official language of the state where risks are assumed or in a different language, agreed with the customer, on the following:

- Name (company name), permanent residential address (head office), indicating the state and competent authority of its head office,
- Whether he acts as a dependent or independent insurance intermediary,
- If he is a dependent insurance intermediary, the insurers on behalf of whom he proceeds,
- All direct and indirect participations, which he holds in the insurer, other insurance intermediaries and insurance consultants,
- The party performing with regard to losses and damages caused by him in his professional activities,
- The possibilities for complaint and agencies entitled to judge complaints,
- The register of insurance intermediaries kept by the Supervisory Authority, and a certificate that the insurance intermediary is included in the register of the Supervisory Authority, indicating also methods of verification.

This information must be provided for individuals who take the position of the insured (reinsured) in the case of insurance (reinsurance contract) or the position of the contractual party with regard the insurer (Section 37 of the Insurance Act).

f) See above at criterion c.

Regarding prohibition of pursuing intermediary and consultant activities without license or registration, see Section 195, Paragraph (1), Subparagraph k) of the Act on Insurance Regarding supervisory fine see Section 196, Paragraph (1) of the Act on Insurance

Principle 25: Consumer protection

Principle 25: Consumer protection	
<p>The supervisory authority sets minimum requirements for insurers and intermediaries in dealing with consumers in its jurisdiction, including foreign insurers selling products on a cross-border basis. The requirements include provision of timely, complete and relevant information to consumers both before a contract is entered into through to the point at which all obligations under a contract have been satisfied.</p>	
	O/LO/PO/NO/NA *
Essential criteria	O
a. The supervisory authority requires insurers and intermediaries to act with due skill, care and diligence in their dealing with consumers.	
b. The supervisory authority requires insurers and intermediaries to have policies on how to treat consumers fairly and to have systems and provide training to ensure compliance with those policies by their employees and other sales collaborators.	LO
c. The supervisory authority requires insurers and intermediaries to seek the information from their consumers that is appropriate in order to assess their insurance needs, before giving advice or concluding a contract.	O
d. The supervisory authority sets requirements for insurers and intermediaries with regard to the content and timing of provision of information: <ul style="list-style-type: none"> – on the product, including the associated risks, benefits, obligations, and charges – on other matters related to the sale, including possible conflict of interest to existing or potential policyholders. 	O
e. The supervisory authority requires insurers and intermediaries to deal with claims and complaints effectively and fairly through a simple, easily accessible and equitable process.	O
	O
Advanced criteria	
f. The supervisory authority requires insurers and intermediaries to set rules on the handling of customer information paying due regard to the protection of private information of customers.	
g. The supervisory authority gives information to the public about whether and how local legislation applies to the cross-border	LO

offering of insurance, such as e-commerce. The supervisor issues warning notices to consumers when necessary in order to avoid transactions with unsupervised entities.	
h. The supervisory authority promotes the consumers' understanding of the insurance contracts.	O
*Note: O-Observed; LO-Largely Observed; PO-Partly Observed; NO-Not Observed; NA-Not Applicable.	

Assessment

a) Beyond the general obligation to act in due diligence stated by the Civil Code, independent insurance intermediaries are required

- to check if the persons hired or entrusted to sell insurance products are registered at the supervisory /Act LX. of 2003 on Insurance – hereinafter: Act on Insurance – 41.§ (1)/
- to meet certain educational and skill level defined in the relevant regulation /Act on Insurance – 41.§ (2)/
- to conduct its activity according to the professional rules of the insurance business, keeping of those they are liable for, exclusively for misleading advices, improper premium handling and late administration /Act on Insurance – 42.§ (1)/

Since 15th of December, 2004 HFSA operates the central register of insurance intermediaries and agents.

b) As to the Act on Consumer Protection (38. §) insurers are required to operate a consumer help service dedicated for informing consumers, help in their needs and handling their complaints. The service's operating order and hours shall be defined in accordance with consumer interests and the service has an obligation to cooperate with civil consumer organisations. As for the fair treat of consumers rules are set out by the Competition Act. As a part of supervision HFSA surveys how the insurers get along with their clients complaints too.

c) Insurance brokers are required to precisely identify consumers' needs and necessities, and the arguments which supports the advice on a specific insurance product /Act on Insurance – 46.§ (4)/.

Furthermore, in case of life insurance insurer and/or its sale collaborator shall measure, or based upon the information provided by the client even precise the needs of her/him /Act on Insurance – 166.§ (1)/.

d) In the relevant legislation, there is a huge number of example on how, when and of what to inform consumers. E.g.: the intermediary about her/his relationship with the insurer, the details of the insurance contract, the special details of the life insurance contract /Act on Insurance 33.§, 166-167.§/.

e) HFSA issued a guide for financial service providers on how to deal with consumer complaints. It covers all financial areas, including insurers and its sale collaborators. The document offers model terms for consumer complaints procedure, and contains a complaint form using the pattern proposed in the EU.

f) Act on Insurance sets out several prescriptions to ensure the personal data protection, from the foundation (licensing) of an insurer through its daily operation, at outsourcing areas of its activity, till the exemptions of insurance secrecy. Consumer privacy is strongly protected by other relevant legislation, like the Data Protection Act.

g) HFSA issued a guide on the consumer protection requirements to be followed by financial service providers in the Hungarian financial market. Warning notice is an ordinary measure to take to make the public being aware of unsupervised entities offering tempting investments or extraordinary incomes. HFSA has published several warning advertisements in the recent years.

h) HFSA made a clear commitment to promote public understanding of financial services in schools and consumer education as well. HFSA continuously publishes through its web-site insurance product comparative tables, issues leaflets on widespread type of insurance to explain ordinary people the main features, risks and liabilities, using a simple terminology.

Principle 26: Information, disclosure & transparency towards the market

Principle 26: Information, disclosure & transparency towards the market
 The supervisory authority requires insurers to disclose relevant information on a timely basis in order to give stakeholders a clear view of their business activities and financial position and to facilitate the understanding of the risks to which they are exposed.

	O/LO/PO/NO/NA *
<p>Essential criteria</p> <p>a. Insurers are required to disclose information on their financial position and the risks to which they are subject. Specifically, information disclosed should be:</p> <ul style="list-style-type: none"> – relevant to decisions taken by market participants – timely so as to be available and up-to-date at the time those decisions are made – accessible without undue expense or delay by the market participants – comprehensive and meaningful so as to enable market participants to form a well-rounded view of the insurer – reliable as a basis upon which to make decisions – comparable between different insurers – consistent over time so as to enable relevant trends to be discerned. 	O
<p>b. Information includes quantitative and qualitative information on:</p> <ul style="list-style-type: none"> – financial position – financial performance <p>and a description of:</p> <ul style="list-style-type: none"> – the basis, methods and assumptions upon which information is prepared (and comments on the impact of any changes) – risks exposures and how they are managed – management and corporate governance. 	O
<p>c. Insurers are required to produce, at least annually, audited financial statements and make them available to stakeholders.</p>	O
<p>d. The supervisory authority monitors the information disclosed</p>	O

by insurers and takes the necessary actions to ensure the compliance with disclosure requirements.	
Advanced criteria e. Information includes quantitative information of relevant risk exposures.	PO
*Note: O-Observed; LO-Largely Observed; PO-Partly Observed; NO-Not Observed; NA-Not Applicable.	

Assessment

a) The Act on Accounting defines the basic criterion of disclosure for all market participants, including insurers in Hungary.

Discussing disclosure requirements it should be mentioned that insurance companies in Hungary are not listed at the Budapest Stock Exchange. Therefore they are not subject to the advanced disclosure requirements set for the consolidated accounts of listed companies.

According to Section 4 (1) of the Act on Accounting economic entities shall prepare an annual report on their operation, as well as their financial and earnings positions.

Information disclosed should be relevant to decisions taken by market participants.

Section 4 (2) of the Act on Accounting prescribes that the annual report must give a true and fair view of the holdings of the economic entity and its contents, of its financial standing and profit or loss. Different sections of the law refer to the requirement of a true and fair view. In addition Section 4 (3) contributes to the compliance with the above-mentioned principle.

Governing the specialities of the annual reporting of insurance companies Government Decree No 192 of 2000 contributes to the disclosure of relevant information. (Section 6 (1) of the Act on Accounting prescribes that the accounting system and the annual reporting of insurance companies shall be governed by a government decree.)

The principle of true and fair view and the principle of importance should be also mentioned by relevant disclosure. The principle of true and fair view is described in Section 15 (3), the principle of importance in Section 16 (4) of the Act on Accounting.

The Hungarian regulation ensures **timely information** by defining the balance sheet date and the compulsory date of publication. It is prescribed in Section 17 (1) of the Act on Accounting that an undertaking keeping double-entry books shall prepare an annual report on the financial year described under Section 11, with a balance sheet date of the last day of the year, or may, if the conditions prescribed in Paragraph (2) of Section 9 prevail, prepare a simplified annual report.

The requirement of **accessible information** can be connected with the basic accounting principle of cost-benefit, defined in Section 16 (5) of the Act on Accounting. The requirements of publication and deposition prescribed in sections 153 and 154 of the Act on Accounting should be mentioned as a basis for accessible information. The basic principle of true and fair view (Section 15 (3) of the Act on Accounting), the principle of clarity (Paragraph (4)) and the principle of consistency (Paragraph (5)) are in connection with the above-mentioned part of ICP. However the failure or delay of deposition and publication is not supervised by the HFSA.

The requirements for the content of the annual report set by the Act on Accounting and Government Decree No 192 of 2000 ensure the **disclosure of comprehensive information**. Section 18, 19, Section 88 to 95 of the Act on Accounting and Section 14 and 15 regulate the content of the annual report. The HFSA has not discovered any need for publishing wider range of information.

The requirement set by the Act on Accounting for auditing the annual report and consolidated annual report ensures **information being reliable**. Sections 149 – 152 of the Act on Insurance define the special, supplementary requirements set towards the auditors and audit

report of insurance undertakings. There are Sections 15 and 16 of the Act on Accounting to ensure **comparability** between different insurers required. The basic accounting principles serve to ensure comparability as well. According to Section 19 (2) of the Act on Accounting the comparability of the annual reports of consecutive financial years shall be provided for by the structure, division and contents of the balance sheet and the profit and loss account, as well as by the constancy of the valuation principles and procedures of balance sheet items. Speaking about **consistency** Section 19 (3) should be mentioned. The Act on Accounting aims to ensure consistency by prescribing the basic accounting principles in Section 15 and Section 16. However by looking at long-term tendencies some difficulties may arise from the different versions of the Act on Accounting and of the Government Decree No 192 of 2000.

b) The information required to be disclosed is prescribed by the Act on Accounting and the Government Decree No 192 of 2000. According to Section 88 (1) the notes on the accounts shall include all numerical data and explanatory information prescribed by this Act. The notes on the accounts shall also contain information - as prescribed by other legal regulations - on any unique or special activities. According to Paragraph (3) the consistent parts of the accounting policy, any change thereof, and the consequence of any change on the profit or loss figure shall be separately illustrated in the notes on the accounts. According to Paragraph (4) explanations for any difference influencing the profit or loss, arising from procedures departing from those applied in the previous year and applied in respect of the individual balance sheet items, as well as the effect thereof on the financial and earnings position, and the profit or loss shall be detailed in the notes on the accounts.

According to Section 95 (4) of the Act on Accounting, the risk management policy, the price, credit, interest, liquidity and cash flow exposures – in connection with the fair valuation of financial instruments - shall be disclosed in the business report. Concerning risk exposures the Section 88 (2) of the Act on Accounting should be mentioned prescribing the disclosure of the assessment of the undertaking's financial and earnings position, the trends in liquidity, solvency and profitability.

According to Section 89 management and corporate information should be shown in the notes, however the need for information about corporate governance remains.

c) The same requirements are set in Section 4 (1) of the Act on Accounting as mentioned by part a) of the essential criterion of ICP 26.

For the regulation of deposition with the Court of Registration see Section 153 (1) of the Act on Accounting. According to Section 153 (4) the annual report deposited with the Court of Registration is open to the public.

According to Section 154 (1) of the Act on Accounting the annual report should be published, and, in the case of a compulsory audit of books, also containing the auditor's seal of approval or the auditor's refusal to grant such approval, simultaneously upon depositing such.

According to Paragraph (7) the obligation of publication is fulfilled once an original or a certified copy of the annual report has been - simultaneously upon deposit - forwarded to the Company Registration and Information Service of the Ministry of Justice.

According to Paragraph (10) the business report is not part of the annual report, the consolidated business report shall be available for review to all interested parties without discrimination, and for making copies thereof, at the registered office of the undertaking, or at the registered office of the company.

d) According to Section 147 (1) of the Act on Insurance companies shall, within 150 days of the balance sheet date, send the Supervisory Authority and the NBH a duplicate of their annual report, as approved by the general meeting - endorsed by the auditor and deposited with the Court of Registration - as well as their business report, the minutes of the general meeting and the resolutions adopted. Paragraph (2) regulates the filing of the consolidated annual report. Paragraph (4) prescribes the filing of the financial reports on the reinsurance contracts they conclude with foreigners.

As the annual report of the supervised institution is received, it has to be checked against current laws and regulations. The Internal Rules of Procedures regulates the detailed method of the inspection of the annual report. If an annual report does not meet the disclosure or other requirements set by laws or regulations, the Supervisory Authority contacts the management or the auditor of the company according to the current practice. In case of delay a penalty can be imposed.

Checking the annual report is part of the inspection schedule of every full-scale inspection conducted by the Supervisory Authority. In case of relevant discrepancy the supervised institution is being forced to prepare its financial statements according to laws and regulations. Section 151 (10) and Section 152 of the Act on Insurance may contribute to the compliance with disclosure requirements as well.

The HFSA is not entitled to control the deposition and publication of the annual report. The Registry and the Ministry for Justice are entitled to oversight disclosure; HFSA can cooperate with them.

e) According to Section 14 g) of the Government Decree No 192/2000 the requirement is met but only in connection with derivatives. For additional information see point b.

Principle 27: Fraud

Principle 27: Fraud	
The supervisory authority requires that insurers and intermediaries take the necessary measures to prevent, detect and remedy insurance fraud.	
	O/LO/PO/NO/NA *
Essential criteria	O
a. The supervisory authority has the powers and resources to establish and enforce regulations and to communicate as appropriate with enforcement authorities, as well as with other supervisors, to deter, detect, record, report and remedy fraud in insurance.	
b. Legislation addresses insurer fraud.	O
c. Claims fraud is a punishable offence.	O
d. The supervisory authority requires insurers and intermediaries to ensure high standards of integrity of their business.	O
e. The supervisory authority requires that insurers and intermediaries allocate appropriate resources and implement effective procedures and controls to deter, detect, record and, as required, promptly report fraud to appropriate authorities. This function is under the responsibility of senior staff of the insurer and intermediary.	O
f. As required, the supervisory authority ascertains that insurers take effective measures to prevent fraud, including providing counter-fraud training to management and staff. The supervisory authority promotes the exchange of information between insurers with respect to fraud and those committing fraud including, as appropriate, through the use of databases.	O
g. The supervisory authority co-operates with other supervisory authorities including, as appropriate, in other jurisdictions in countering fraud.	O
*Note: O-Observed; LO-Largely Observed; PO-Partly Observed; NO-Not Observed; NA-Not Applicable.	

Assessment

a) The Supervisory Authority has the power to communicate with other authorities (tax authority and police) to remedy and prevent fraud actions as regards the insurance and the whole financial sector.

b) In Hungary the fraud actions and the relevant punishment are regulated by the **Act IV of 1978 on Criminal Code**. The Act on Insurance does not contain legislation for such actions. The act on Criminal Code does not define exact provisions for the insurer fraud but the other rules are subject to these criminal actions, as well. Consequently, the provisions of Criminal Code are containing the regulation concerning all the crimes violating economic obligations

and the order of economy.

c) See subparagraph d.

d) The insurers are expected to carry out their business with integrity in full measure. Departments of the integrated Supervisory Authority (HFSA) co-operate with each other in order to disclose all the infringement of rights in the business of the supervised financial institutions, with special regard to money laundering.

Relevant punishable actions are in the Act of 1978 on Criminal Code, Title I, Crimes Violating Economic Obligations and Order of Economy:

Section 289: Infringement of Accounting Regulations

Section 290: Crime of Bankruptcy

Section 296/A: Deception of Consumer

Section 297/A: Credit Fraud

Section 298/A: Illegal Conduct by Senior Employees of Business Associations and Cooperatives

Section 298/C Indication of Untrue Value

Section 298/F: Unauthorized Insurance Activity

Section 299: Failure to Supply Economic Data

Section 299/B: Fraud Regarding Capital Investment

Section 303, 303/A, 303/B

Money Laundering Section 303, Section 303/A

Non-performance of Reporting Obligation in Connection with Money Laundering

Section 303/B

Section 310 - Tax and Social Security Fraud

e) f) The Supervisory Authority has no regulatory power to carry out legislation but by organising meetings and conferences for insurers the Authority is promoting the exchange of information between insurers with respect to prevent fraud and money laundering.

g) There are agreements containing such cooperation with other supervisory authorities.

Principle 28: Anti-money laundering, combating the financing of terrorism (AML/CFT)

Principle 28: Anti-money laundering, combating the financing of terrorism (AML/CFT)

The supervisory authority requires insurers and intermediaries, at a minimum those insurers and intermediaries offering life insurance products or other investment related insurance, to take effective measures to deter, detect and report money laundering and the financing of terrorism consistent with the Recommendations of the Financial Action Task Force on Money Laundering (FATF).

	O/LO/PO/NO/NA *
Essential criteria	O
a. The measures required under the AML/CFT legislation and the activities of the supervisors should meet the criteria under those FATF Recommendations applicable to the insurance sector ¹³ .	O
b. The supervisory authority has adequate powers of supervision, enforcement and sanction in order to monitor and ensure compliance with AML/CFT requirements. Furthermore, the supervisory authority has the authority to take the necessary supervisory measures to prevent criminals or their associates from holding or being the beneficial owner of a significant or controlling interest or holding a management function in an insurer or an intermediary.	O
c. The supervisory authority has appropriate authority to cooperate effectively with the domestic Financial Intelligence Unit (FIU) and domestic enforcement authorities, as well as with other supervisors both domestic and foreign, for AML/CFT purposes.	O
d. The supervisory authority devotes adequate resources - financial, human and technical - to AML/CFT supervisory activities.	O
e. The supervisory authority requires insurers and intermediaries, at a minimum those insurers and intermediaries offering life insurance products or other investment related insurance, to comply with AML/CFT requirements, which are consistent with the FATF Recommendations applicable to the insurance sector, including: – performing the necessary customer due diligence (CDD) on customers, beneficial owners and beneficiaries	O

13 See FATF Recommendation 4-6, 8-11, 13-15, 17, 21-23, 25, 29-32 and 40 as well as Special Recommendations IV, V and the AML/CFT Methodology for a description of the complete set of AML/CFT measures that are required.

- taking enhanced measures with respect to higher risk customers
- maintaining full business and transaction records, including CDD data, for at least 5 years
- monitoring for complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose
- reporting suspicious transactions to the FIU
- developing internal programmes (including training), procedures, controls and audit functions to combat money laundering and terrorist financing
- ensuring that their foreign branches and subsidiaries observe appropriate AML/CFT measures consistent with the home jurisdiction requirements.

***Note: O-Observed; LO-Largely Observed; PO-Partly Observed; NO-Not Observed; NA-Not Applicable.**

Assessment

a) Act XV of 2003 on the Prevention and Impeding of Money Laundering provides for the rules intending to prevent the laundering of money obtained from criminal activity through the money and capital market system(s) or through other activities vulnerable to money laundering and to promote combating the financing of terrorism. Paragraph (1)) of Section 1 contains the list of activities falling under the scope of the Act („(1) This Act shall apply – within the territory of the Republic of Hungary – to c) insurance, insurance brokerage or insurance consulting service providers”).

Paragraph 1 of Section 3 of the same Act deals with the identification requirements. Paragraphs 6-9 of Section 3 include the special rules in respect of insurance, while Section 21 refers to the EU regulations.

b) Section 2, Paragraph (2) of the Act XV of 2003 on the Prevention and Impeding of Money Laundering provides for the responsibility of the professional supervisory body. The conditions of issuing a licence for an insurer or intermediary, stipulated in the Act on Insurance also include such aspects.

c) As to domestic co-operation with other supervisors, it is solved „in-house”, as HFSA is an integrated supervisory authority. Section 5, Paragraph (1) of Act CXXIV of 1999 on the Hungarian Financial Supervisory Authority provides for the right of the HFSA to share information with foreign supervisory authorities. An employee of the HFSA was appointed the AML commissioner, there is an intradepartmental committee set up for AML/CFT questions. If any breach of AML rules is suspected, HFSA informs the FIU forthwith.

d) The supervisory authority participates in the work of the interdepartmental committee set up for the prevention of money laundering. Supervised entities are obliged to have anti-money laundering regulations elaborated on the basis of the Act on Money Laundering and on-site inspections include the overview of the compliance with these regulations. Special targeted inspections on the subject are also performed time to time.

e) The Hungarian Financial Supervisory Authority’s Recommendation No. 3 of 2002 has been issued to promote the prevention and fight against terrorism and money laundering. It gives guidance to the supervised entities when elaborating their own anti-money laundering

regulations. Regulations of entities already existing at the time of the adoption of the Act on Money Laundering are approved by the HFSA, in case of new licensing procedures such regulations belong to the preconditions of licensing. These regulations cover among others CDD questions, identification and also the tasks if suspicious or unusual transactions are experienced. HFSA holds also conferences on this subject to keep the professional public informed. The supervisory authority participates in the work of the interdepartmental committee set up for the prevention of money laundering. Act XV of 2003 on the Prevention and Impeding of Money Laundering provides also for the reporting obligations of financial institutions to the FIU (Sections 8-13).