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The Evolution of the Insurance Consumer Protection Approach in Hungary

SUMMARY: The evolution of financial markets and the innovations that technology provides often bring about new threats and problems. Consumers often feel that they agreed to unfavourable terms and that only the service provider benefits from the contract they signed. This increases the importance of financial consumer protection, including insurance. Hungary was among the countries that were not satisfied with following international trends and adopting international solutions, it was one of the trailblazers as it independently introduced consumer protection solutions in insurance and finance. We are confident that the solutions introduced in Hungary are interesting for other countries, as well. Regulators usually did not choose textbook solutions, and they often did not take efforts to put them in a general theoretical context. In retrospect, however, we see a certain evolution of the principles and theory of consumer protection solutions in the insurance industry in Hungary. This study aims to explore this evolution through actual, specific solutions. Even though this is constructed retrospectively, we believe that to be able to move forward, this theoretical reflection is essential, and so is our effort to provide a sort of theoretical foundation for consumer protection in the insurance sector in Hungary, and the solutions that have been used to date are useful in this. We rely on these as we try to explore the best potential way forward.¹

KEYWORDS: financial consumer protection, insurance, regulation

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While it has a lot of benefits, the evolution of financial markets often brings about new threats and problems, and average consumers often feel they agreed to unfavourable terms. Just consider the problem of foreign currency loans in Hungary, which was exacerbated by the 2007–2008 financial crisis and which, as many people think, triggered the development of financial consumer protection law (Nagy, 2013). This increases the importance of

financial consumer protection. By financial consumer protection we mean all the solutions – primarily rules, institutions and measures – used by the state (less frequently by non-state entities)² to ensure that consumers of financial services do not suffer any disadvantage while using or as a result of using such services. Insurance consumer protection is a field within financial consumer protection with its specific problems, this is the reason why some particular solutions are only introduced in this field.

Several international organisations collect and recommend good practices from spe-

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cific countries (e.g. World Bank 2012 and 2017). The European Union also creates legislation that is in force in all 28 (27) member states. Hungary was among the countries that were not satisfied with following international trends and adopting international solutions, it was one of the trailblazers as it independently introduced consumer protection solutions in insurance and finance. Regulators usually did not choose textbook solutions, and they often did not take efforts to put them in a general theoretical context. In retrospect, however, we see a certain evolution of the principles and theory of consumer protection solutions in the insurance industry in Hungary. This study aims to explore this evolution retrospectively, through actual, specific solutions.

We believe that to be able to move forward, this theoretical reflection is essential, and so our effort is to provide a sort of theoretical foundation for insurance consumer protection in Hungary, and the solutions that have been used to date are useful in this. It needs to be emphasised that even though this paper does not focus on the consumer protection oversight processes of the Hungarian National Bank (e.g. 2016b and MNB 2015) or on the introduction of the activities of the Financial Arbitration Board (which is independent from the MNB), the activities of these bodies are highly significant. The paper does not discuss it, but it needs to be noted that the MNB provides useful and extremely widespread information on its website (<https://www.mnb.hu/fogyasztovedelem>) to help customers navigate through financial matters. We will not discuss the consumer protection activities of other authorities, either, even though the Hungarian Competition Authority (Gazdasági Versenyhivatal, hereinafter: GVH) and the National Authority for Data Protection and Freedom of Information (Nemzeti Adatvédelmi és Információszabadság Hatóság, hereinafter: NAIH) – and pre-

viously the data protection supervisor – have had major achievements in this field.

Overall, we believe that the economic theoretical foundations of insurance consumer protection and of financial consumer protection in general are mostly incomplete and underdeveloped. It was only in the past few decades, as the latest achievements of psychology have been integrated into economics, that the development of a substantial theoretical background started, through the inventory of our cognitive mistakes (which lead or may lead to poor financial decisions). It is the ever developing field of behavioural economics that may provide this theoretical background in the future (FCA, 2013; Balogh, 2012; Koltay, Vincze, 2009; Zavodnyik, 2014).

The paper mostly discusses insurance consumer protection, but whenever possible, we will provide an overview of financial consumer protection issues, in general. The arguments presented in the study are mostly from economics. However, this field has considerable legal aspects as well, as the findings of economics often serve as the basis of legal regulations. We do not provide an overview of the legal literature of this topic (it has been done, for example by Veres, 2018), and we are aware that in legal literature a lot of elements are included in consumer protection in addition to the ones we discuss – and justifiably so.

THE TARGET GROUP, METHODS AND INSTITUTIONS OF FINANCIAL CONSUMER PROTECTION

Retail vs. corporate clients

Historically speaking, the idea that consumers (not necessarily only consumers of financial products) need to be protected is a relatively new development. As mass production emerged, the close relationship between

customer and producer ceased to exist and for a lot of producers, local reputation was no longer important. New products were introduced to the market in vast numbers, and before customers got to know one, it was replaced by others. New ‘industries’ emerged, like the financial services sector. New developments also brought about a change in the situation of consumers: Unlike for centuries before, now they did not have a symmetric relationship with producers and service providers, many of whom had a much greater economic and intellectual (regarding the product or service concerned) power.

Legislation could not keep up with the new developments for a long time, as it had not really covered consumer problems before. In that regard a simple, but for a long time unspoken rule, the Latin saying applied: *‘caveat emptor’* – let the buyer beware –, which became the formal rule in the late 19th century in the United States when consumer problems started to multiply (Akerlof, Schiller,³ 2015).

However, as problems became more and more obvious, this principle was applied in a narrower scope, differentiating, basically, between two groups of consumers. On the one hand, those that were still assumed to be in a symmetric position with large economic organisations (organisations themselves and their wealthy owners), while, on the other hand, those in an obviously different situation (‘ordinary’ customers and very small companies) – from then on there was a differentiation between ‘corporate’ and ‘retail’. Retail customers find it difficult to gather information and they are considered non-professionals in most fields. This phenomenon is often called ‘information asymmetry’ – this term was also introduced by *Akerlof* (Akerlof, 1970), and *Vincze* (2010) reviewed the relevant literature from a consumer protection aspect. Retail customers are usually the weaker parties in transactions, so they need protection.⁴

Methods and institutions of financial consumer protection

The most important key tool of financial (and other) consumer protection is the creation of legislation that protects retail consumers. The so-called protectionist theory (see for example Czajlik, Horváth, Pap, 2012) is based on the assumption, that consumers are in fact victims of the free market, in need of active protection from the government through all available legal means.

If the consumer feels that the financial service provider infringed the regulations, they can seek legal remedy, mostly in court. Here, again, we see an asymmetric situation as consumers are (usually) not aware of the legal regulations providing protection to them (as opposed to the service provider). Usually a lawyer is needed, and finding, hiring one takes time and money, meaning the entry cost/transaction cost is high (Coase, 1990).

This makes compliance with legal regulations crucial, and also monitoring compliance by the financial supervisory authority, which, in Hungary, usually closely follows the latest international trends. 3 separate supervisory authorities were established shortly before the political transition.⁵ These were soon followed by the fourth supervisory authority, according to Act XCVI of 1993 on Voluntary Mutual Insurance Funds. On 1 April 2000, pursuant to Act CXXIV of 1999 on the Hungarian Financial Supervisory Authority and following the establishment of Britain’s Financial Services Authority (hereinafter: FSA), which set an international example. The 4 (3) separate Hungarian supervisory authorities mentioned before were merged into one and the Hungarian Financial Supervisory Authority (Pénzügyi Szervezetek Állami Felügyelete, hereinafter: PSZÁF) was established. This, again following the recent English example⁶, the PSZÁF was merged into the central bank of Hungary, MNB from 1 Oc-

tober 2013, pursuant to Act CXXXIX of 2013 on the Magyar Nemzeti Bank. Here, however, there was an important and for us relevant difference from the English example (which itself followed a previous Australian, etc. example), as the FSA was divided into two supervisory authorities, one for prudential regulation and one for market conduct (consumer protection, basically), and the latter was (remained) independent. One reason for this is that the consumer protection duties of supervisory authorities increased, and another reason is that prudential and consumer protection goals may clash sometimes, and it's best if these different interests are represented by separate authorities. With this, a new model for financial supervision was created.⁷

At first, legislation on consumer protection focused only on contractual terms. Changes started when more detailed regulatory provisions were introduced in consumer protection legislation regarding market behaviour, as well (e.g. provision of information). Monitoring compliance with these required considerably larger resources and the methodology was also different from that of prudential supervision. This was the rise of financial consumer protection oversight by the supervisory authority, which started only in the 2000s, or mostly in this decade.

The methodology of consumer protection oversight by financial supervisory authorities is being developed right now internationally, it is far from being complete and it is not suitable for individual cases, for solving individual problems. This led to the evolution of court-like institutions around the world that actually supplement the court system, and are available to the customers easily and at a low cost: These include financial ombudsman and arbitral tribunal. It was the latter model that Hungary adopted in 2011, when, pursuant to Act CLVIII of 2010 on the Hungarian Financial Supervisory Authority, the Financial Arbitra-

tion Board (Pénzügyi Békéltető Testület, hereinafter: PBT) was established, which operates with relative independence besides the PSZÁF and the MNB.

The PBT provides a convenient solution to consumers, as they do not need to hire a lawyer or pore over legal books; it is enough if they describe, in their own words, the problem with the procedure of the financial organisation.

THE ESTABLISHMENT OF (LEGAL) REGULATIONS PROTECTING INSURANCE CONSUMERS, AND THEIR EVOLUTION IN HUNGARY

Legal regulations and supervisory recommendations protecting the clients of insurance companies came in the following chronological order, following a sort of internal, implicit logic:

- compensating for the dominance of the insurance company,
- compensation for the information asymmetry, which is detrimental to the user,
- correcting previous approaches by taking into consideration the limited cognitive capacity,
- and dealing with conflicts of interests.

Compensating for dominance

The first efforts to tackle with the insurance companies' dominant position (and here we use the general meaning of the term not its specific meaning in competition law) involved prescribing asymmetric contractual terms that were more beneficial for the consumers.⁸ This legal solution is also called limping obligation.⁹ An example for this is the 'cooling off' period in life insurance, which was introduced a few years ago.¹⁰

Monitoring compliance with such rules was simple. During the period of insurance monopoly, before 1986, the General Terms and Conditions of life insurance agreements were issued by the Ministry of Finance, which included the relevant provisions of the previous Civil Code, including the provisions on asymmetric termination. After the end of the insurance monopoly and the concurrent establishment of the State Insurance Supervisory Authority, insurance companies could launch new insurance products only after a stringent product authorisation process. Product authorisation was abolished at the end of the 1990s, but the examination of product terms became a routine part of the audits of the supervisory authority.

Why life insurance?

Within insurances, it was first the clients/consumers of life insurance agreements that were protected. It is clear that even later on a disproportionate part of new regulations applied to this segment, which may be seen as a regulatory ‘asymmetry’ of some sort. The reason for this is that, as opposed to ordinary, frequently purchased goods like car or home insurance, life insurances are ‘*experience goods*’ not ‘*search goods*’ (Nelson, 1970). These categories are often used for a justification of consumer protection in case of ‘*experience goods*’ and ‘*credence goods*’.

We buy experience goods infrequently, we find it difficult to navigate among them; here we cannot learn by trial and error as we do with low value, frequently purchased search goods. In case of high value, rarely purchased goods and services, the probability of a non-professional customer making a good choice when committing their significant funds in the long term must be maximised. Consumers need help in this, so that they will not buy a service (e.g. life insurance) that is optimal for the insurance company or the intermediary, not for themselves.

The problem (and consequences) of customer learning was not realised earlier, but one element of it was, namely the information asymmetry between insurance companies and consumers, and compensation methods were devised.

Compensating for information asymmetry

Change in the potential focus of the Hungarian insurance market and consumer protection

In Hungary, the competitive insurance market developed at the time of the political transition, when several large western, multinational insurance companies established subsidiaries in Hungary. The first competitive insurance market was the market of compulsory insurance for civil liability in respect of motor vehicles in the summer of 1991, and soon after it was followed by the life insurance segment. In the life insurance segment, companies were competing for customers on many levels, but, in a seemingly paradoxical way, it did not result in a decrease in prices (Banyár, Regős, 2012). The premium competition that started did not necessarily bring about a decrease in the cost part, i.e. prices, as with a high technical interest rate, it was easy to achieve low premiums with a high cost part (Banyár, Vékás, 2016). Overall, despite the strong premium competition in this period, the cost part of life insurance products on the market increased significantly compared to the costs applied by the State Insurance Company when it had a monopoly (for calculations on the cost part of life insurances, see Banyár, 2013).

It also contributed to the increase in costs that customers bought life insurance products from the insurance company they felt was ‘the coolest’, and they ‘measured’ this by the companies’ advertisements and agents. Well-

dressed, expert agents did not come cheap, as they decided which insurance company to choose based on remuneration, which was another factor that contributed to the increase in the cost part of insurances.

Insurance companies tried to hide costs with increasingly complex product structures, and they went back to their previous tactics and tried to change their products in specific points in such a way that it could not be compared to the products of competitors, since *'sellers have a strong incentive to offer multidimensional products, and to adopt multidimensional pricing schemes'* (Bar-Gill, 2008).

Looking for solutions

These developments also explain how the consumer protection approach got to a new level and why it happened primarily in life insurance. Regulators at the time believed that when customers buy products at high costs and with unfavourable terms, they basically lack sufficient information, i.e. the previously mentioned information asymmetry occurs. This means customers need more information to make informed decisions, so companies were required to provide more and more information to their clients, and the transparency of certain information was also required. This was in line with the view that customers sign suboptimal contracts of their own free will if they are unaware of key features of the product they purchase or if they are unaware of the interests of the intermediary. In theory, a third option is also possible, namely that the intermediary also has insufficient information and as a result recommends inadequate products to the customers.

The 'Agent register'

Starting with this latter problem: It needed to be ensured that only insurance intermediaries with adequate knowledge pursue insurance

intermediation activities, the possibility that some shortcoming in an intermediary's qualifications has a detrimental effect on the consumer needed to be eliminated. For this, qualification (and minimum levels of education) requirements needed to be set. To be able to control this, it was useful to make a list of intermediaries: Before that, no-one ever knew how many people were actually active as intermediaries on the insurance market in Hungary. Eventually, the solution was the Agent register, which the Hungarian supervisory authority started to plan in 2001, and it was launched as a public online platform in 2004.

However, the option that customers now had, i.e. to check in the register if intermediaries that contacted them were really acting on behalf of the financial company they said they were (also emphasised in the EU regulation) was merely a theoretical option for an abstract problem.¹¹ The real benefit of the register for the customers was that uniform requirements were set regarding qualifications. It was partly to protect the clients, but even more importantly to help reduce the number of intermediaries, which had increased too much and had undermined the market opportunities of the intermediaries, who could hardly find a prospective client that had not been visited by 5 different agents of the competitors before. As a result, the time and energy necessary for concluding one deal increased, which led to intermediaries asking for higher commissions, which led to an increasing cost part in the life insurance premiums. The qualification requirements were also meant to reduce this cost pressure.

In summary, registration and qualification requirements are important, but they did not solve the consumers' problems stemming from the (opposing) interests of intermediaries, and probably these were not the best tools to tackle this problem.

The interests of the agent – Debates over the transparency of commissions

Many clients do not take out a life insurance policy that serves their interest the best, because intermediaries push them to choose the insurance product for which they, the intermediaries, receive the highest commission. This means there is a conflict of interest between the client and the insurance intermediary, and the client is usually not aware of this as the intermediary is usually paid by the insurance company (from the money it receives from the client), and the client is not aware of, and at this stage cannot be aware of the amount of the commission. As a radical solution to the problem, it has come up from time to time that the intermediary should be paid directly by the client, but, at first, with no international example, no decision-maker dared to take this step. It is true, logically, that the fact that the intermediary is paid by the party with opposing interests, i.e. the insurance company, and not the actual client is only a problem in the case of independent intermediaries representing the client. (It is rare that it can be proved that the intermediary, acting on behalf of the client, works for their own benefit, not for the benefit of the client. The Hungarian Competition Authority revealed such a case in 2005.)¹² And there has been a counterexample, too: In case of intermediaries acting on behalf of large companies, it was widespread both in Hungary and abroad that intermediaries were paid directly by the client to manage this issue of conflicting interests. Large companies realised and handled this problem, since they knew that insurance companies paid the intermediaries from their money even when they did not know how much.

Smaller companies and retail clients, however, would be less willing to pay twice for the same insurance: The insurance premium to the insurance company and the commission to the intermediary, so there is some theoretical ba-

sis for insurance companies to pay the commission for retail customers, even in the case of independent intermediaries. On the other hand, it was not justified at all that clients should not know how much of the premium goes to the intermediary, especially to the independent intermediary representing their interests. If, however, independent intermediaries must reveal their commission, dependent ones must, too, otherwise the former cannot survive on the retail market, and this was not the goal.

Because of all this, throughout most of the decade the debate was over the transparency of commissions, not about intermediaries being paid by the clients directly. This means that the attempts to solve the inherent conflict of interest (would have) involved dealing with information asymmetry.

Naturally, insurance companies and intermediaries resisted transparency, presenting two kinds of arguments:

- essential and
- technical.

Essential arguments said the demand was nonsensical, as there is not a single industry where it is mandatory to provide information on the elements of the price, so no such requirement can be imposed in the insurance sector, either. This argument confused the proponents of transparency for a long time, then we realised that the insurance premium is not the price of the insurance service, that is only the cost part of the insurance as a service, so its disclosure to the public is justified. This, however, is higher than the commission, which is only a part of it – in fact a large part, in Hungary about 50 percent. This also means that total cost transparency is more substantiated than the transparency of commissions only (for this, see Banyár, Vékás 2016).

Technical arguments said that it was easy for insurance companies to circumvent this: There is room for ‘tricks’, and instead of paying certain amount as commission, they can pay a

large part of it as support for office rental, education contribution, etc., this way the commission reported is low, but not real. Overall this argument also supported total cost transparency over commission transparency, as the former is more difficult to circumvent, and if it leads to a decrease in total costs, it does not matter what percent of that is paid by the insurance company as commission.

The idea of commission transparency was discarded eventually, but the idea of cost transparency was developed. In retrospect, however, it is interesting that we were trying to handle conflicts of interests by providing information. This would not have worked, probably, as shown by subsequent experiences with the cost indicator.

However, it was not only the commission that we wanted to make public to deal with conflicts of interests. Another such requirement is that intermediaries should provide information as to who exactly they represent (e.g. the agent represents the insurance company). Experience in the US shows that such regulations have the opposite effect: From that point on, the agent feels free to represent their own interests over the interests of the client even more (Cain et. al., 2005, quoted by Ariely, 2012).

Product information – Suggesting cost transparency

Product information is varied as life insurance products are varied, too, and it is clear that clients find it hard to navigate through product terms that include this information. Clients cannot differentiate between important and less important information, and product terms contain a lot of specialist terms that they have never seen before, so there is a chance they will not understand them. Terms and conditions, however, are defined precisely for a reason: In court proceedings, clear language is essential, no matter whether the client understands

it or not. This means there is a seemingly insoluble contradiction between the natural self-defence reflex of the insurance company and between providing information to clients. Internationally, and also in Hungary, the solution that was agreed on was to require an easy-to-understand summary of terms and conditions, i.e. to highlight the key parts. In addition to this, in Hungary, we also required a much more detailed product description, but as this takes us to the next stage of the solution, we will discuss it there.

As we have seen, arguments over making commissions public also led to the conclusion that it was costs that needed to be made public. But how? In a typical life insurance contract there are several cost elements, and the calculation of each of them is based on various principles. If insurance companies were required to disclose every cost element they charge to the client, the client could probably do nothing with this pile of information. This needed to be made more compact, which led to the idea that costs should be presented as a kind of internal rate of return, or as the difference between the internal rate of return calculated for net premium and the actual internal rate of return, as clients understand the concept of interest rate margin. It must be pointed out that at this time there was no such cost indicator in any financial sector internationally. In 2007, the supervisory authority issued a recommendation (PSZÁF 2007) for insurance companies and independent insurance intermediaries regarding the introduction of a cost indicator (described in detail in the recommendation) for life and savings insurance products. The professional community reacted to the recommendation after 2 years; in a self-regulatory manner, coordinated by the Association of Hungarian Insurance Companies (Magyar Biztosítók Szövetsége, hereinafter: MABISZ), they introduced the Total Cost Indicator (hereinafter: TCI) for unit-linked insurance prod-

ucts only, and every Hungarian insurance company selling life insurance products voluntarily agreed to use it (MABISZ 2009).¹³

The expected result of the cost indicator was that clients would not be willing to buy insurance above a certain cost, meaning the costs of insurance companies will be limited, which will limit the specific costs, including the commission. Experience showed, however, that it did not work this way. Clients are willing to buy life insurance products with very high TCI (over 10 percent) if this is what the intermediary recommends. Experience revealed a very different mode of action of cost decrease, which was twofold. On the one hand, product developers were now less likely to launch products with high TCI, and on the other hand, some intermediaries selling products with lower TCI than the competitors informed the clients about this, and as a result the agents of the competitors started to demand low TCI products from their product developers. As a result, products with extremely high TCI disappeared from the Hungarian insurance market very soon.

The problem of the concrete solution

In retrospect we can say that measures to eliminate information asymmetry were useful and positive, but three important problems need to be mentioned in this context:

① as new information obligations were introduced, legal regulations stipulated that clients must sign the documents, acknowledging they were provided information before the conclusion of the insurance contract. This means, however, that if the client makes a complaint, the insurance company can immediately prove that information was provided, which immediately puts the client at a disadvantage as compared to the insurance company;

② it is obvious that the more information insurance companies are required to provide to their clients, the longer the process of con-

cluding a contract is, which leads to an increase in administrative tasks, makes contracting and thus the insurance product more expensive, and this additional cost will eventually be paid by the clients.

③ finally, as more and more facts and data are compulsorily provided, it will become unproductive after a while, as clients are overwhelmed by the information. This means that above a certain level, it may become counterproductive, and clients cannot focus on key information.

With the most important piece of information, the cost indicator, this was avoided, and this leads us to another path, one we gradually moved on to. One of the key solutions of this other path was the cost indicator.

Correction: Taking limited cognitive capacity into consideration

This shift was gradual and careful. It became more and more obvious that too much information is (almost) as harmful as too little. You can hide behind information overflow and you can use it to confuse clients. Even though we did not realise it theoretically at the time, in retrospect we can say that the starting point of the theory, the image of the *homo economicus in microeconomics* was not correct. This assumes that everyone has an almost infinite capacity for analysis. We gradually realised that this was not true. Thanks to *Daniel Kahneman's* (Kahneman, 2011) research of the use of cognitive systems, we now have the theoretical basis. Kahneman differentiates between two systems:

System ①: fast, works without effort. Here we make instinctive choices, basically, using simple rules of thumb,

System ②: slow and energy-consuming. This is our logical thinking, and we use it less frequently than microeconomics assumes.

The conclusion is that we are easy to manipulate, we are not ‘econs’ but ‘humans’ (terms used by Thaler and Sunstein, 2008). However, when limited cognitive capacity is taken into consideration, we can picture two consumer protection strategies:

① we should try to activate the ‘lazy’ system 2, or

② the process must be simplified to a level where we can make good decisions even with the simple system 1.

Even at first glance, it seems probable that it is the second strategy we can expect visible results from, but we first tried the first strategy, in line with international trends. This can be interpreted as a kind of rearguard action to protect the notion of *homo economicus*.

Trying to activate system 2

As the operation of system 2 requires time (and effort), it is logical to try to slow down and divide the process of contracting into parts, providing a schedule to the client, pointing out the important elements of the insurance product so that they will focus their valuable mental resources there. In Hungary, the regulatory solution for this was the compulsory needs assessment and product information, introduced in life insurance in the mid-2000s (PSZÁF 2006). This stipulates that before a life insurance policy is taken out, there must be a needs assessment exploring and recording the important circumstances of the client, and the insurance company must refer to this when recommending a life insurance product, and it must provide the client with written product information that includes the parameters of that product.

It is easy to see that if insurance companies launch complicated products (which they try to do, logically), the effects of this strategy may be limited, just like the effects of educating clients.

The education of clients can be seen as

the solution of this strategy on a non-regulatory level. From the early 2000s, the supervisory authority published brief, colourful booklets about several product types from different financial areas to provide information to the clients (Financial Navigator Booklets: <https://www.mnb.hu/fogyasztovedelem/penzugyi-navigator-fuzetek>). These booklets were available through the customer services of financial institutions. The MNB supports the Pénziránytű Alapítvány (<https://penziranytu.hu/>), a foundation that develops trainings and coursebooks to improve financial awareness (Szebelédi, 2019).

These are useful supplements that sometimes help certain groups of clients, but their full impact will only be seen decades later. Yet it seems that educating clients and spreading ‘financial literacy’ has become one of the most important consumer protection approaches of the decade (OECD, 2011, Atkinson, Messy, 2012 and Lusardi, Mitchell, 2011), and various financial industries embraced this solution (see for example Insurance Europe 2017). We, however, have an uneasy feeling about this: It seems as if they are doing this to divert regulators from the more important areas of consumer protection. Spreading financial literacy is indeed important, but it probably will not have tangible results in the coming decades, which means if financial industries take very visible steps in this area, they can avoid implementing substantial changes for a long time.

We believe that the second option, the strategy of simplification is much more important.

Simplifying information

The elements stemming from this strategy, in retrospect, were present in previous solutions, but this time it was not in Hungary but in the EU that they were defined in relation to Packaged Retail and Insurance-Based

Investment Products (PRIIPs). (Haraszti et al., 2017, and Lencsés, Paál, 2015)

The PRIIPs regulation stipulates that clients must be provided with consolidated and simplified information on packaged retail investment products. The products are basically from 3 financial sectors: banking, securities and insurance. Basic requirements:

① a product summary, the so-called ‘*Key Information Document*’ (KID) must be drawn up about the key product features and product terms in a standardised, no more than 3-page-long summary using clear and understandable language,

② the risks of the product must be summarised in a comparable manner, using simple risk indicators,

③ the costs of the product must be presented in a standardised manner with cost indicators that allow for comparison.

Here, again, the essence of the strategy is to provide information, but, as opposed to the simple strategy of eliminating information asymmetry, here it is the quality and not the quantity of the information that is important. This means the key elements of the strategy are searching for and identifying key information and drawing up brief and comprehensible documents so that clients can make a decision using system 1.

However, experience with TCI in Hungary, which was introduced much earlier than PRIIPs, shows that even TCI is not simple enough for most people to make the right decision. Positive experience with TCI suggests a mode of action very different from what was expected from the PRIIPs. This implies that we should continue in this direction. Moreover, it can also be established that the provision of information is not suitable for effectively handling market failure that results from conflicts of interest and that is eventually paid for by the consumers, so other methods are needed for that, too.

Dealing with conflicts of interest and market failures

Experience shows that cost transparency only decreases the costs (and thus the ‘price’) of financial products because it eliminates the products with extremely high costs from the market. But when the available products are similar as far as costs are concerned, clients have nothing to rely on to assess what is high and what is low. An analysis of the price of Hungarian life and savings insurances reveals that they are high (Banyár, 2013). The reason for this is the high number of cancellations, as the insurance intermediary is fundamentally interested in the conclusion of the insurance contract, not in its long-term existence, as the key part of the compensation of insurance intermediaries in Hungary is customer acquisition commission, the proportion of the ongoing commission is much smaller. This is a result of the high turnover of intermediaries, i.e. many people see their career as an insurance intermediary as a short-term and involuntary detour, and they cannot wait until they have brokered enough insurance policies to live on ongoing commissions. As a result, for them it is not worth investing too much in this activity (acquiring knowledge, building a reputation), and this leads to a situation where it is in the interest of a large number of insurance intermediaries to broker agreements, that are not beneficial for the clients in the long term, and this is a problem that cannot be solved by providing information.

Another problem is that without active persuasion by the intermediaries, clients, of their own volition, would not take out a significant part of their insurance policies in the first place. These efforts taken by insurance intermediaries, including the many unsuccessful ones, are eventually paid for by the clients who were persuaded to take out life insurance policies. From the insurance companies compet-

ing for customers the winner will be the one that attracts the most insurance intermediaries with good performance. The size of the commission is a major factor in this. This led to a paradoxical phenomenon where competition for clients on the life insurance market is primarily a direct competition for insurance intermediaries through increasing commissions and thus increasing prices, not the other way round (Banyár, Regős, 2012).

The MNB realised this when in 2014 it recommended, at first for pension insurances (which were introduced that year with a reduced tax rate to promote them), that a maximum value should be set for the TCI (MNB, 2014, and Banyár, Nagy, Szebelédi, Windisch, Zubor, 2014), then it was expanded to all life and savings insurances (MNB, 2016a). The ‘Ethical Life Insurance’ recommendations in 2016 also included spreading the commission, and this was strengthened by setting a minimum surrender value. The aim of this is to make the customer acquisition commission less and less dominant, making it worth for insurance intermediaries to think in the long term. All this together means that commissions decrease, and as a result the market can sustain fewer insurance intermediaries. On the other hand, people choosing this profession will find that it is worth thinking in the long term and investing in their training and reputation. Measures to increase entry barriers (e.g. raising qualification requirements) also contribute to this, as they help decrease the pressure to increase the costs of insurance.

Developments in international regulation, e.g. tightening the Insurance Mediation Directive (hereinafter: IMD), i.e. the implementation of the IDD (Insurance Distribution Directive) (2016) also work in this direction (Lencsés, 2016).

However, it is clear that dealing directly with conflicts of interest still has a potential

as a consumer protection strategy, especially in insurance products other than life insurance.

FUTURE OPPORTUNITIES

One potential path: Taking limited cognitive capacity into consideration

As for the future, considering the above, we can say that it is not necessarily true that only information needs to be simplified, and it is not necessarily possible to sufficiently simplify information. It is in the interest of insurance companies and other financial service providers to develop more and more complex insurance products. Customer satisfaction is not their only motivation in this (while, of course, this is what they emphasise), but they also try to hide their costs and try to make comparison between their products and their competitors’ products more difficult and to achieve some kind of relative monopoly. This means complexity and diversity is not necessarily good for the client (Schwartz, 2004). While most areas of insurance are mature markets where clients should not face surprises. 150 years ago there was a competition between alternating current and direct current, and different service providers had different voltage. We do not have this competition now, it has become pointless, even though it could have persisted, but it is better for the clients that there is a state standard that suits almost all cases, and special demands are treated separately. This means standardisation is justified on a mature market. Not only information, but choices and products could be simplified as well.

The simplification of choices already has its own theoretical literature (Thaler, Sunstein, 2008). According to this, regulators as ‘choice architects’ must, in a ‘libertarian paternalistic’ approach, provide good defaults for the most important choices, including the selec-

tion of financial products, insurance products and their parameters, so that if clients simply rely on these defaults, they are highly likely to make good decisions.

To make this possible, it is best to simplify the available products themselves (naturally only on the retail insurance market), and there are at least two possible phases for this:

① the standardisation of product terms in the market within specific retail product groups (e.g. home insurance, term life insurance, comprehensive motor own damage insurance, etc.),

② defining a basic product or basic product package within these product groups.

There are different potential degrees of product standardisation. In the lightest version, only the structure of the terms and conditions is set, i.e. the specific provisions have a set order. This is to make it easier for clients to compare similar products of different insurance companies, as they can find what they are interested in the same section in all terms and conditions. It also makes the work of product comparison sites easier, which increases competition among insurance companies. Before it was merged into the MNB, PSZÁF was experimenting with this approach, and at its request MABISZ created the Standard Product Sheet for home insurance products (MABISZ, 2013), and every Hungarian home insurance provider joined voluntarily. Their first undertaking was rather moderate: The terms and conditions of any new home insurance product in the future must follow the structure of the standard product sheet.¹⁴ Nowadays there is a similar MNB initiative regarding the terms and conditions of so-called consumer-friendly products.

Another degree of standardisation is when certain key concepts have a common definition, and the highest degree is when the same terms and conditions are used on the whole market. An existing example of standardised

product terms is compulsory insurance for civil liability in respect of motor vehicles, and it is not a coincidence that despite some recent decline this is still the most competitive insurance submarket in Hungary.

Standardisation would provide an opportunity to make the financial literacy strategy effective, as it would provide clients with a comprehensible amount of information that would also be detailed enough.

However, the second solution, i.e. defining basic products, would help choice planning and setting defaults more. This would mean that as opposed to the standardisation of General Terms and Conditions on the market, there would be a basic product in every retail product group that is simple, that covers the most common needs and that is uniform on the whole market. The state could encourage this with providing tax reductions specifically for the basic products.

Another potential path: Dealing with conflicts of interest and market failures

Knowing that one of the strategies insurance companies use to decrease competition and increase prices is to bundle different basic insurance services in one product package, it is a logical step to implement an *unbundling* strategy to deal with this. This *unbundling* strategy has been successfully used for network products (e.g. electricity) as a means to increase competition. In this case it meant the separation of the electricity provider and the network, i.e. the accessibility of the networks for other electricity providers, which eliminated local monopolies. In a broader sense, from the aspect of the client, this means the separation of electricity and the transport of electricity as a service. Applying it for insurance, the mandatory unbundling of insurance packages would allow clients to select the best offer for

every item of the package. Now that there are great online intermediation and product comparison platforms, this is easy to achieve as far as technology is concerned. In this sense, unbundling can be interpreted as taking the standardisation strategy one step further.

SUMMARY

We have described the situation of consumer protection in insurance in Hungary today. We believe that after various attempts, consumer protection in Hungary has gotten quite far, there have been several measures that came ahead of international trends and solutions, and Hungary has set an example for other countries as well – even though the insurance market in Hungary is not a big one, it is a medium-developed market.

However, we cannot stop here, we should keep moving forward. Moreover, we have become increasingly aware of the theoretical basis of our actions, and scientific advancement – especially in behavioural economics – has provided more space and opportunities for this.

The tools of insurance consumer protection in Hungary have been refined gradually, and this process reveals an increasingly deep understanding of this field, yet this knowledge has not been organised theoretically, there has been a lack of theoretical reflection on the subject – with this study, we intended to contribute to this.

In addition to trends in economics, sufficient attention needs to be paid to international market practices and legal frameworks, and the consumer protection recommendations of EIOPA need to be transposed. In our

paper we described how the (single) EU regulation was evolving parallel to member state regulations, and how Hungarian regulations were even ahead of this process sometimes. Now these are not separated, the two complement and support each other – on different levels and at different depths – in protecting the consumers.

However, it might be an important finding that certain international trends in consumer protection (e.g. *financial literacy*), while promoting consumer protection, may help divert attention from key issues, so what seems to be the trendiest is not always the best solution as there are very strong, conflicting interests in this field. This is why it is essential to explore these conflicts of interests in detail and to resolve them systematically, in a way that is beneficial to the consumers (in the long term). Dealing with conflicts of interests may set out new directions, directions we are only testing now and which can radically change the industry in the medium term.

Naturally, consumer protection will not necessarily be the factor or the only factor fueling these changes, as the great digital transformation that affects financial industries (as well) is in progress, and it might radically change stakeholders, solutions and problems which have not really been discussed in our study.

Taking all this into consideration, we believe financial consumer protection still has a long way to go, as consumers need to be protected from the side of the law and also from the side of economics, and the tools of this are not always the same as the tools of the government. The consumer protection activities of civil society organisations and interest groups are becoming increasingly important, but this is something to discuss in another article.

NOTES

- ¹ The authors would like to thank *Károly Szász*, the former President of the Hungarian Financial Supervisory Authority (Pénzügyi Szervezetek Állami Felügyelete, hereinafter: PSZÁF) and *József Zavodnyik*, Head of Consumer Protection at the State Insurance Supervisory Authority (Állami Biztosításfelügyelet, hereinafter: ÁBIF) and earlier at PSZÁF for their valuable comments and help. The authors were involved professionally in insurance consumer protection in Hungary for years. *Petra Turi* was a legal counsel at the Department of Consumer Protection at PSZÁF then at the Central Bank of Hungary, Magyar Nemzeti Bank (hereinafter: MNB). Economist *József Banyár*, as senior adviser to the former President of the PSZÁF for insurance (with some interruptions, for over a decade), had the opportunity to put several of his consumer protection ideas into practice. Both authors represented Hungary in international and European Union committees for extended periods, which provided them with an international insight into the development of regulations regarding consumer protection.
- ² In Hungary, the role of non-state entities in insurance consumer protection is not yet significant, so we will not discuss them here, even though we consider this an important aspect of the issue. The INDRA Biztosítottak és Pénzintézeti Ügyfelek Országos Érdekvédő Egyesülete, the association representing the interests of insured persons and of the clients of financial institutions was established in the early 1990s, and it was granted support by the PSZÁF and the MNB several times. Its website (www.indrabizt.hu), however, is not available. It seems that consumer protection organisations in other areas of finance also rely mostly on support from supervisory authorities, e.g. the MNB, and they have more or less been integrated into the consumer protection system of the MNB through the Financial Advisory Office Network (Pénzügyi Navigátor Tanácsadó Irodahálózat, <https://www.mnb.hu/fogyasztovedelem/tanacsado-irodak>), which is currently run by the MNB through its NGO partners.
- ³ The book is a remarkable piece of work on this topic, as it tries – but we believe it fails – to provide a sort of general theory of consumer protection. To this end, as they say, the authors ‘go beyond’ the findings of behavioural economics to date, but the framework they create, though interesting, is not really revelatory – this is an opinion several critics share and even the authors quote.
- ⁴ Information asymmetry occurs when in a transaction one of the parties has significantly more or more comprehensive information than the other party.
- ⁵ The structure was created according to the following legal regulations: Act LXIX of 1991 on Financial Institutions and Financial Activities, Act VI of 1990 on the Public Offering of and Trading in Certain Securities and on the Stock Exchange, Decree of the Council of Ministers No. 56/1986 (XII. 10.) on the State Supervision of Insurance Activities and Act CXIV of 1996 on the State Financial and Capital Market Supervisory Commission.
- ⁶ The FSA, which politicians thought were responsible for the crisis, was abolished by the Financial Services Act of 19 December 2012, which came into force on 1 April 2013. Instead of the FSA, by splitting up its structure, the independent Financial Conduct Authority and the Prudential Regulation Authority were created. The latter operates under the Bank of England.
- ⁷ For more details see Nagy, Csiszár (2016)
- ⁸ For more details see the chapter on insurance of Act IV of 1959 on the Civil Code.

- ⁹ Limping obligation: Derogation is only permitted by law in one direction, for the benefit of one party.
- ¹⁰ See Section 157 of Act LXXXVIII of 2014 on the Business of Insurance (hereinafter: Old Insurance Act) .
- ¹¹ A different type of register, however, which was recommended following a similar train of thought by the European Insurance and Occupational Pensions Authority [hereinafter: EIOPA, EIOPA (2013)], and which has not yet been introduced in Hungary, can actually help insurance clients. This would be a register of existing life insurance policies, which would help heirs to find life insurance policies that their deceased relatives had forgotten to mention. On this topic, see Banyár, Nagy (2015).
- ¹² See Resolution No. Vj-51-/2005/184 (Hungarian Competition Authority, 2005).
- ¹³ For the differences between cost indicators and about potential cost indicators for investment funds and life insurances in general, their problems and connections, see Banyár (2015).
- ¹⁴ MABISZ still uses this and is proud of it: In an interview in early 2019, the Secretary General laid special emphasis on this solution (Molnos, 2019). The MNB also builds on this standard product sheet, as it announced in early 2019 that the second certified consumer-friendly product where the expectations of the MNB will be built on this standard product sheet will be home insurance (after home loans) (see <https://minositetthitel.mnb.hu/>). (oral communication Szebelédi, 2019)

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