

THE COMPLIANCE ASSURANCE FUNCTION IN LIGHT OF THE RECOMMENDATION FOR INTERNAL DEFENSE LINES IN HUNGARY

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Abstract

The internal defense lines are closely intertwined with the overall operation and security of financial organizations. Their effective functioning is critically important not only for the organization itself but also for maintaining economic stability and societal trust. Consequently, their establishment and maintenance are indispensable for the sustainable and secure operation of the financial sector. In my study, I aim to provide a descriptive overview of the compliance assurance function, including a brief review of the literature, legal regulations, and the National Bank of Hungary Recommendation No. 12/2022 (VIII. 11.), which pertains to the establishment and operation of internal defense lines, as well as the governance and control functions of financial organizations. The purpose of the study is to present in detail the rules formulated by the recommendation regarding the compliance assurance function, emphasizing the importance of internal defense lines for the stability and integrity of the financial sector.

Keywords: *internal defense lines, compliance assurance, risk assessment, education*

1. Introductory Thoughts

For financial institutions, having a proper internal control system is important, the design of which depends on the organization's risk profile, business model, size, and complexity. Internal control is a fundamental organizational principle that defines and regulates the internal operations and decision-making processes of a company or organization. This system encompasses institutional objectives, strategy, risk management, and operations. One element of this internal control is compliance.

The financial sector is one of the most heavily regulated and closely controlled areas by the state. Banks must ensure that decisions defined by regulations are made in the proper order and documented accordingly. They must also demonstrate internal control mechanisms that validate compliance with regulations and provide institutional assurances that these mechanisms are fully enforced in operations.

Compliance expectations include legal requirements, but their interpretation can vary significantly in many cases. Legal expectations apply to the regulatory framework of each relevant legal area, but it is important to emphasize that in compliance, adherence to legal requirements related to permitted activities should be understood. However, there may still be differing approaches among institutions. In addition to laws, regulatory and market expectations also qualify as compliance requirements, meaning adherence to recommendations, guidelines, management circulars, or opinions formulated by supervisory authorities, or operating in accordance with them, is expected. Market expectations include

compliance with behavioral codes and other standards assumed by the institution. Furthermore, compliance encompasses external, but mostly internal documents containing core values beyond legal requirements, also ensuring the enforcement of ethical principles.

The purpose of the compliance function is to establish an ethical and lawful corporate culture that ensures prudent and ethical operations in the long term. This culture permeates the entire organization and is in line with the values and norms adopted by the institution. Compliance not only ensures compliance with legal requirements but also ensures that the institution's behaviour and operations are aligned with ethical expectations and internal core values.

For banks, preserving and strengthening the trust of customers and other stakeholders is particularly important. To achieve this, legal compliance is essential, but it is not sufficient on its own. The trust of customers and stakeholders depends not only on meeting legal requirements but also on the values represented by the institution, ethical business conduct, and long-term prudent operations. The compliance function plays a key role in this process as it helps establish and maintain a culture and operational framework that ensures the credibility and long-term success of the company.

Compliance with legal requirements is of paramount importance in the financial sector, and banks must have a continuously operating compliance function. In Anglo-Saxon countries, the independent compliance function first emerged as part of the legal field, tasked with ensuring legal compliance. In contrast, in Hungary and the Central and Eastern European region, compliance with anti-money laundering regulations is typically the first area to address compliance risks, expanding its scope to encompass the traditional compliance function over time. (Kovács, Marsi, 2018)

The compliance function of credit institutions primarily focuses on those processes where the risk of regulatory breaches is the highest, and it regularly identifies, measures, assesses, and monitors these risks. Its responsibilities include the prevention of legal and regulatory violations, supporting the development of internal procedures, monitoring regulatory changes, and contributing to the prevention of money laundering, corruption, and fraud.

Effective compliance operations require close cooperation with the legal, HR, quality assurance, and internal audit functions, as well as the establishment of a strong organizational compliance culture, which is maintained through communication, training, and appropriate governance. Compliance expectations extend to areas such as consumer protection, competition rules, ethical conduct, and anti-money laundering measures.

The National Bank of Hungary (Magyar Nemzeti Bank, furthermore: MNB) classifies the compliance function as part of the banks' lines of defense, assigning it operational tasks. Due to increasing regulatory burdens, compliance must be integrated with risk management, as the compliance program has a direct impact on operational risks. Risk analysis supports the identification of threats, their potential impact, and vulnerabilities that may lead to economic, operational, or reputational damage. The most common corporate risks include technological, financial, operational, and environmental risks, the management of which requires adequate risk management systems. (Pelei, Benedek, 2024)

In a narrow sense, compliance refers to adherence to laws and regulations, while in a broader sense it encompasses ensuring the organization's long-term, ethical, and sustainable operation. Its role is to prevent and detect misconduct, legal violations, and breaches of ethical standards. Compliance management comprises a set of processes that ensure lawful and efficient operations, reliable reporting, and adherence to organizational frameworks. This includes the commitment of management and

employees, the development of internal policies, the operation of control procedures, and the continuous improvement of the system.

In the financial sector, the regulatory foundations of compliance were established by the U.S. SOX Act, introduced in response to major corporate scandals, followed by the EU's MiFID I–II and MiFIR regimes. In Hungary, the establishment of the compliance function is governed by the Credit Institutions Act (Hpt.), recommendations of MNB, and the guidelines of the Hungarian Banking Association. (Pelei, Bognár, Benedek, 2024)

The 2008 financial crisis fundamentally questioned the effectiveness of previous banking risk management practices. In response, EU regulations not only tightened capital adequacy and liquidity requirements but also emphasized the responsibility of senior management in strengthening the risk management function. Following the post-crisis reforms, a risk-conscious banking culture and prudent operations became fundamental elements of the banking business model.

Although CRD IV does not explicitly detail the organizational separation of risk management, it mandates its independence, from which the requirement for functional segregation can be derived. EBA guidelines support the development of a strong risk culture, while the MNB's Recommendation 12/2022 reinforces the principle of internal lines of defense, addressing risk-taking and risk management committees as well as the management of conflicts of interest (Koltai, Tarpatak, 2023).

Today, compliance has become an integrated element of corporate culture, with effective functioning dependent on the unequivocal commitment of senior management. Its role is to ensure that the organization operates in accordance with relevant legal (hard law) and self-regulatory (soft law) requirements. The continuously expanding and increasingly complex regulatory environment—including, among others, competition law, tax and customs regulations, environmental rules, accounting standards, and data protection (GDPR)—creates significant compliance risks for business organizations. The compliance function—particularly in the banking sector, where the so-called compliance function principles also mandate independence—contributes to the prevention of legal breaches and the mitigation of liability by reducing risks. The development of a law-abiding culture within the organization generates long-term resource savings and competitive advantage by mitigating operational and reputational risks arising from regulatory violations (Jacsó, 2019).

2. Provisions of the Act on Credit Institutions and Financial Enterprises

In banking activities, regulatory compliance goes beyond basic tasks, and the law itself mandates the establishment of a separate organizational unit for this purpose, effective from January 1, 2018. Its responsibilities include ensuring that the activities and operations of the financial institution comply with applicable laws and that policies are in line with relevant legal provisions, tracking and regularly auditing the implementation of measures and procedures to ensure proper compliance, identifying any deficiencies in compliance, monitoring measures taken to address compliance deficiencies, and providing assistance to the governing body and employees of the financial institution to ensure compliance with legal obligations related to its activities and operations.

In addition to its responsibilities, the law permits the appointment of a suitably qualified individual to be responsible for compliance if establishing a separate organizational unit for compliance would impose disproportionate burdens on the institution due to the nature, size, and complexity of its

activities. However, it is important for the financial institution to demonstrate that this solution does not impede the effective discharge of compliance tasks. If only one person is responsible for the given tasks, an annual report on their activities must be prepared for the governing and supervisory bodies.

Additionally, the financial institution must ensure that the person responsible for compliance possesses the appropriate professional background and has access to all necessary information and authority to fulfil the tasks. Furthermore, adequate financial resources must be provided for the operation of the organizational unit. It is also important that the appointment of the leader of the organizational unit be reported to the Supervisory Authority to ensure transparency and oversight. (Act CCXXXVII of 2013)

According to the legislative rationale for its introduction, the fundamental objective of the function is to *“ensure compliance with the obligations defined in laws and internal regulations by the financial institution. Its tasks also include monitoring compliance with rules, identifying deviations, reporting them, proposing measures to rectify identified deficiencies, providing financial and other information necessary for decision-making, and safeguarding the assets of the financial institution and the interests of its clients and shareholders.”*

In the case of banks, compliance plays a crucial role in maintaining their internal controls, managing risks, and executing governance tasks. This is not only an internal necessity but also a fundamental interest of regulatory authorities. Compliance must adhere to the guidelines of various financial regulatory authorities and professional associations. Although the requirements vary from country to country, in most EU countries, the establishment of an independent compliance function or the appointment of a compliance officer is recommended as a minimum standard.

The establishment of a “Core Compliance” as an independent function is typically not a mandatory requirement in the legal regulations of neighbouring countries, like the Hungarian approach concerning anti-money laundering rules or MiFID 2.

The compliance function is a critical component of banks’ internal defense system, aiming to minimize risks and enhance security while reinforcing trust in the financial system. In Hungary, the National Bank of Hungary (MNB) requires all financial organizations to employ compliance officers and establish independent compliance organizational units. Enforcing these expectations necessitates the formulation of mandatory norms, explicitly stated in legislation. (Rationale of Act for the amendment)

3. Recommendations for Internal Defense Lines

MNB recommendations typically target specific, sector-focused areas of the financial system; however, numerous sector-neutral recommendations also exist, which can be applied across banking, insurance, pension, and capital market entities (e.g., expectations regarding the operation of internal lines of defense). The purpose of these supervisory recommendations is to establish normative expectations and best practices that support financial institutions in complying with applicable regulatory requirements. Compliance with these recommendations is regularly monitored and assessed by the Hungarian National Bank through its supervisory and monitoring activities over the regulated institutions, in alignment with European Union supervisory standards and practices (Vig, Seregdi, 2024).

The proper functioning of internal defense lines in financial organizations is crucial for reliability and stability. Prudent and careful conduct is not only a business interest but also a responsibility affecting

the entire economic system. The recommendation formulated by the MNB holds particular importance regarding the adequate operation of these internal defense lines, and its implementation is expected from financial organizations starting from January 1, 2023.

The recommendation incorporates certain aspects of the guidelines published by the European Banking Authority on July 2, 2021, regarding internal governance, the requirements concerning compliance function under the MiFID II directive as outlined by the European Securities and Markets Authority on April 6, 2021, and certain provisions of the joint guidelines published concurrently concerning the assessment of suitability of members of governing bodies and key function holders. This transposition not only provides a legal framework but also promotes predictability in legal application and ensures uniform implementation.

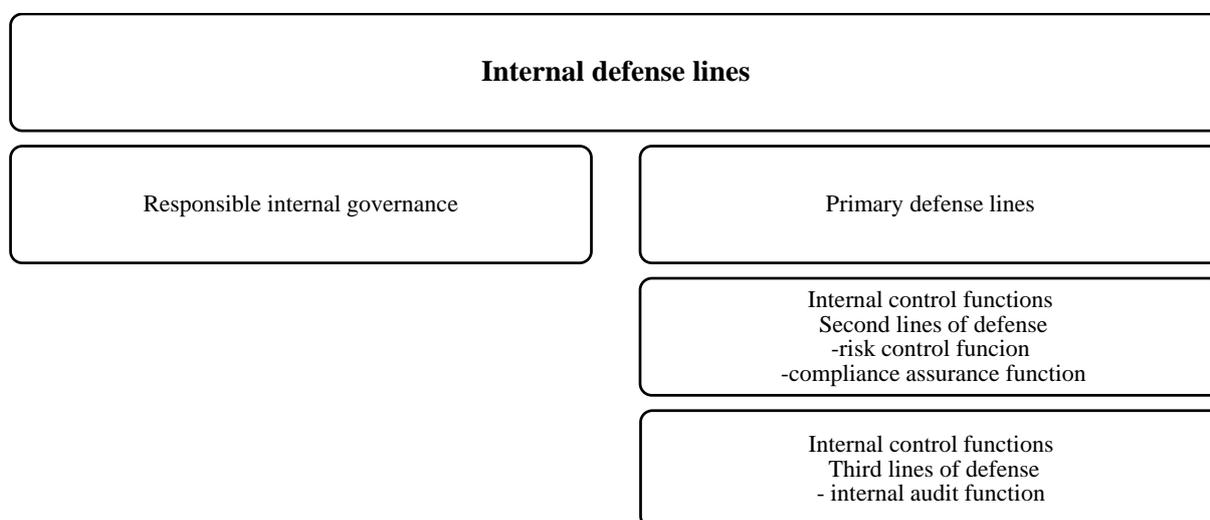


Figure 1. Structure of internal defense lines
 [Source: Annex 2 to MNB Recommendation 12/2022 (VIII. 11.)]

In terms of structure, the recommendation addresses general principles, findings regarding responsible internal governance, elements of the internal control system, the relationship between the financial organization and the appointed auditor, specific issues related to the establishment and operation of internal defense lines (with the prevention and management of fraud receiving the highest emphasis), and expectations regarding transparency and disclosure concerning internal defense lines.

Internal defense lines serve as the primary filters in a protective network ensuring the secure operation of the financial intermediary system. These lines consist of responsible internal governance, embedded controls within business processes, and internal control functions. Responsible internal governance encompasses appropriate organizational structure, organizational systems, and board structure, as well as the exercise of management and supervisory functions. This function extends beyond transactional and representational tasks to encompass monitoring, verification, and oversight. It's important to note that while this internal governance is part of responsible corporate governance, it is narrowly defined in terms of not including relationships with owners and other stakeholders.

The internal control functions associated with the second and third lines of defense include risk control, compliance assurance, and internal audit functions. These functions form an additional layer in the internal defense system, aiding the financial organization in managing risks, ensuring compliance with regulatory requirements, and ensuring the efficiency of internal processes. [MNB recommendation 12/2022 (VIII. 11.)]

4. Expectations Regarding Compliance Assurance Function

“The purpose of operating the compliance assurance function is to identify, mitigate, and manage compliance risks.”

Compliance risk refers to the potential legal risks, regulatory or other authority sanctions, significant financial losses, or reputational risks that may arise from non-compliance with laws, regulations applicable to financial organizations, or other non-legal requirements, and internal regulations.

Therefore, the compliance assurance function is not only about financial organizations complying with laws and regulations but also actively managing and minimizing the risks arising from them. To achieve this, financial organizations must continuously monitor the changing regulatory environment and flexibly respond to new requirements and expectations.

Compliance risk may arise in connection with the following:

- Confidentiality and data protection
- Managing conflicts of interest and incompatibility
- Separation of various service activities (both financial and investment)
- Adherence to restrictions on information flow
- Prevention of market abuses
- Prevention and management of fraud (both external and internal)
- Combating money laundering and the financing of terrorism
- Proprietary trading
- Fair treatment of customers, such as complaint handling activities
- Regulatory relations
- Business conduct risk

It is evident that compliance risk can be identified in every area of financial institutions' activities. Therefore, the MNB expects financial institutions to establish and operate a compliance assurance function within the organization and to pay particular attention to the development and maintenance of a compliance culture. To ensure its effective operation, the specific characteristics of the financial institution (or group), such as its service activities, scope, and complexity, must be taken into account, and alignment with internal governance and other internal control functions must be established.

The governing body of the financial institution, which fulfills the governance function, decides on the compliance policy, setting out the purpose, priorities, areas, principles, organizational solutions to be applied, and the method of disclosing this policy. Then, it must address issues such as:

- What are the requirements for risk-based compliance assurance?
- What management functions does the governing body exercise, and what supervisory functions apply?

- Within the organization, where and who is responsible for compliance, compliance officer, and compliance manager?
- Among the risks, which are primarily addressed within the compliance assurance function, and which are examined by other functions? What will be the solution for communication and alignment between different areas?
- What warranty elements ensure the independence of the function?
- How is the performance of the compliance assurance function monitored?
- How (in terms of frequency and scope) is the compliance assurance function exercised? (at the group level, regarding outsourced activities)
- How and under what conditions can external consultants, experts be engaged?
- What mechanisms are in place for reporting violations related to compliance rules?

For every financial organization, the MNB expects the appointment of a compliance officer, compliance manager, or compliance leader. In the case of smaller and simpler operations, the MNB accepts the management of compliance risks within other functions, such as risk control or legal areas, provided it does not compromise the independence of the respective area.

For controlling financial organizations, the MNB expects the designation of a group-level compliance officer, compliance manager, or compliance leader. This leader is responsible for ensuring compliance assurance at the group level. Their tasks may include:

- Identification and analysis of group-level risks.
- Development of standardized compliance assurance procedures and dissemination of methodologies.
- Coordination of activities among group leaders.
- Provision of group-level training and education.

If the local regulations of subsidiaries or branches hinder the implementation of group-level principles and procedures, it is expected that these organizations inform the relevant leaders about the situation. The MNB recommends in its guidance that the compliance assurance function should undertake the following tasks:

a) Regulatory tasks:

- Define the compliance rules and relevant information to be applied by the financial organization or group.
- Analyze the potential impacts of changes in compliance regulations.
- Participate in the development of the financial organization's business policies and procedures, and initiate modifications as necessary.
- Prepare the compliance policy, manual, and related internal regulations, procedures, and update them as required.

b) Operational tasks:

- Monitor compliance with compliance rules and continuously monitor compliance risks.
- Provide advice to the leadership of the financial organization on compliance issues and regularly report.
- Educate the human resources of the financial organization on compliance matters and assist in addressing employee queries.
- Maintain records of compliance information and ensure regular updates of data.

- Fulfill reporting obligations to authorities, such as those regarding conflicts of interest, money laundering, and insider information.
- Provide opinions before the introduction of new products and document compliance considerations.
- Continuously monitor and utilize information from complaint handling.
- Identify and manage conflicts of interest and assist in identifying and managing conflicts of interest of external service providers.
- Establish, operate, and review the system against market abuses, taking into account EU regulations.
- Review communications directed to the financial organization's customers, such as client information and marketing materials.

In addition, it is important to conduct compliance risk assessment, based on which the compliance risk map or matrix is created (at the organization or group level), determining compliance assurance objectives, activity priorities, and focal points accordingly. This informs the work plan, tools, and methods of compliance activities.

During risk assessment, it is considered best practice to employ a measurement and management methodology based on severity and frequency estimation, where the identification of risk events and estimation of their probable financial impact can be achieved. This may involve self-assessment by business areas or data collection via questionnaires, assuming the use of objective, historical data alongside the results obtained during evaluation. Risk assessment should take into account the regulatory environment, whether external or internal, relevant changes, potential risks arising from expected new regulations, complaints, ongoing and closed litigation cases, the nature, number, and volume of regulatory measures and sanctions, as well as the frequency and significance of negative media appearances affecting reputation.

During monitoring activities, various tools and methods can be employed, such as the use of aggregated risk metrics (risk indicators), ad hoc reporting, observation of procedures, review of documents, and potentially direct inquiries to relevant employees or external parties. Investigations should also extend to assessing how relevant policies, regulations, and procedures are implemented in practice.

If deficiencies are identified, recommendations must be formulated for their rectification, specifying the responsible party, the deadline for implementation, and establishing monitoring obligations regarding the completion of the proposed actions. In addition to ad hoc notifications about significant deficiencies, the responsible leader must also have regular reporting obligations. In the case of a credit institution, the governing body must inform the supervisory body on a quarterly basis, and the supervisory body at least annually, providing a summary report on the following:

- a) Summary of the organizational structure of the compliance function and presentation of any changes since the last reporting period.
- b) The latest results of the risk assessment, changes compared to the previous period, the methodology of the risk assessment, and any changes made in the past period.
- c) Evaluation of the effectiveness of the financial organization's and group-level control environment concerning compliance risk.
- d) Changes in the regulatory environment and the measures already taken or yet to be taken due to these changes.

- e) Summary of the monitoring activities carried out by the compliance function area, highlighting any deficiencies, risks, and violations identified.
- f) Presentation of measures taken to address identified deficiencies, their results, and expected impacts, including proposed sanctions.
- g) Presentation of any deviations of the financial organization from recommendations or suggestions made by the compliance area.
- h) Evaluation of the work of the compliance assurance network (if such exists in the financial organization or group).
- i) Number of complaints received during the reporting period, payments made based on these complaints, and presentation of relevant issues based on complaint analysis.
- j) Report on the results of compliance-focused training/education during the reporting period.
- k) Summary of communication with authorities relevant to compliance.
- l) Presentation of other significant issues related to compliance that have arisen since the last report.

In the financial sector, compliance assurance plays a key role in maintaining stable and secure operations. Accordingly, it is expected that employees in the compliance assurance area possess excellent qualifications, skills, and expertise. Their responsibility is critical for the sustainability and credibility of financial institutions as a whole. The compliance officer is a particularly important figure in this context because they bear the responsibility of ensuring that the institution meets the professional qualifications required for key positions.

Financial institutions must prepare and continually develop the employees in the compliance area. As part of this, they should establish training programs tailored to the specific needs of the institution or group. These programs should ensure that employees have adequate opportunities for participation, timing, as well as the necessary budget and resources.

In addition to onboarding new employees, regular professional development training sessions are also necessary, occurring at least annually. These training sessions should cover the latest compliance risks and expectations. It is crucial that the knowledge of compliance area employees remains up-to-date and that they become capable of quickly and effectively understanding new methodologies and expectations.

The MNB expects financial institutions to provide compliance-related training to external service providers performing outsourced functions as well. This ensures that outsourced activities also comply with prescribed rules and standards, thereby enhancing the stability and security of the entire financial system.

Among the best practices supported by the MNB, particular importance is placed on establishing and operating a network aimed at assisting the compliance assurance function within financial institutions. This network consists of employees who do not necessarily work in the compliance assurance area but support the management of compliance risks and monitor compliance expectations within specified timeframes and percentages.

The tasks of these network members include risk assessment, fraud prevention and detection, and support for compliance assurance investigations. It is important to note that the operation of the network does not diminish the responsibility and main role of employees in the compliance assurance area in carrying out these tasks. When establishing such a network, it is essential for the financial institution to provide adequate training and education to the involved employees so that they can effectively perform their assigned tasks. Additionally, these tasks need to be included in the job descriptions of the relevant

employees to ensure they are aware of their responsibilities and duties. The performance evaluation of network members should also play an important role for the compliance assurance function leader. This helps ensure that the support and contribution of those involved in compliance assurance processes are properly recognized and that the entire system operates effectively.

The expectation is that in the section of the investment service provider's annual report concerning product governance rules, consideration should be given to the compliance assurance function regarding:

- a) The role of the compliance assurance function in the development, monitoring, and review of product governance policies and procedures.
- b) Whether the monitoring conducted by the compliance assurance function complied with various requirements, including the analysis of product governance policies, breaches, and corrective actions.
- c) Evaluation of the information provided by the investment service provider, including the characteristics of the products, approval process, distribution strategy, and market accessibility.

In accordance with these expectations, the compliance assurance function can examine and assess the work, reports, and methods of the product governance area, taking into account the principle of proportionality. [MNB recommendation 12/2022. (VIII. 11.) Sections 128–152.]

The compliance assurance function serves as a secondary line of defense, aiming to provide solution-oriented and continuous support to business areas. Thus, it efficiently assists in fulfilling obligations arising from regulatory, supervisory, internal policies, and ethical standards. A key strategic objective of the compliance assurance function is to simultaneously meet management and shareholder interests while adhering to supervisory expectations. To achieve this, it ensures effective and preventive compliance activities. [9]

5. Supervisory issues and some statement

Based on the Central Bank Act, the Central Bank of Hungary (MNB) exercises continuous supervision over entities and individuals operating in the financial sector. As part of this oversight, it conducts prudential supervision to assess business reliability, while through market supervision and consumer protection tools, it monitors the activities of institutions in the money and capital markets, pension funds, insurance companies, and institutions forming the financial infrastructure. If necessary, the MNB takes action to preserve the stability of the system and maintain trust in the financial intermediation framework.

The MNB continuously evaluates institutions to identify and manage risks in a timely manner and based on this assessment, determines the approach and intensity of its supervisory activities.

The MNB also monitors activities related to the prevention and detection of money laundering and terrorist financing and carries out IT supervision. It conducts targeted or thematic inspections if immediate action is needed.

The central bank is also committed to financial consumer protection and takes action against unauthorized financial service providers operating without a license or registration. It protects consumer rights and encourages financial service providers to act responsibly and fairly. The MNB swiftly identifies and eliminates consumer-unfriendly practices to prevent their recurrence. Consumer protection inspections focus on broad, systemic issues. [10]

In the course of its supervisory activities, the MNB conducted inspections at six commercial banks in 2020 to assess the effectiveness of their anti-money laundering (AML) and counter-terrorist financing (CTF) measures. The review covered the period from January 1, 2018, until the conclusion of the inspection, with a particular focus on the risks associated with cash-intensive activities, their identification and management, as well as the internal control processes within the institutions.

The MNB found that several banks failed to report suspicious transactions promptly to the authorities. Due to issues related to internal control and IT systems, the legally required screening processes were not carried out effectively, and alerts generated by the screening systems were not processed within the prescribed time limits.

In some cases, the screening of transactions exceeding HUF 10 million for clients subject to enhanced due diligence, as required by the central bank regulation, was also found to be inadequate. Furthermore, deficiencies were identified in the functioning of internal lines of defense and in the internal policies governing the approval of management decisions. The procedures for obtaining information on the source of funds were also found to be non-compliant with current legal requirements at several credit institutions.

These deficiencies not only affect the internal processes of the banks but also have a broader impact on the stability and integrity of the entire financial system. The Central Bank of Hungary (MNB) emphasized the areas where banks must make more significant efforts in the fight against money laundering and terrorist financing, so they can manage these risks more effectively in the future and comply with legal requirements.

As a result of the targeted inspections and the identified violations of law, the MNB imposed the following fines:

- HUF 48.2 million on MagNet Bank,
- HUF 20 million on UniCredit Bank,
- HUF 19 million each on Erste Bank and Sberbank,
- HUF 11 million on OTP Bank, and
- HUF 7 million on K&H Bank. [11]

As part of a comprehensive inspection, the Central Bank of Hungary (MNB) imposed a fine of HUF 53.5 million on KDB Bank Európa Zrt. in a decision dated January 19, 2024. [12] The inspection revealed various deficiencies in corporate governance, internal control lines, risk management, handling of operational and credit risks, as well as IT security. While these issues do not pose an immediate threat to the reliable operation of the bank, their prompt resolution is essential.

The bank's cooperative attitude and its efforts to implement corrective measures were viewed positively. However, the amount of the fine was determined by taking into account the high-risk nature of the identified violations and previous shortcomings. The MNB set a deadline by which KDB Bank must report on the steps taken to address the identified issues.

To ensure full compliance with the legal requirements related to compliance activities, the following actions had to be implemented by March 31, 2024, at the latest:

- The compliance function must be structured in a way that allows all tasks within its scope to be carried out thoroughly and in detail, and responsibilities must be delegable to appropriately qualified professionals in case of substitution.

- A compliance risk assessment and work plan must be developed. Based on these, compliance audits should be performed, necessary actions must be assigned to address any identified deficiencies, and the implementation of those actions should be monitored and evaluated.
- Reporting obligations to the management body with governance and supervisory authority must be fulfilled. The content of these reports should be defined in accordance with MNB recommendations to meet supervisory expectations.
- The controls specified in the internal regulations must be applied with respect to conflict-of-interest declarations. [13]

The compliance assurance function, as a second line of defense, aims to provide solution-oriented and continuous support to business areas. In doing so, it offers effective assistance in fulfilling obligations arising from legal, regulatory, internal policy, and ethical standards. A key strategic objective of the compliance assurance function is to simultaneously meet supervisory expectations while serving the interests of both management and ownership. To achieve this, it ensures effective and preventive compliance activities.

6. Summary

Compliance with regulations is not just a bureaucratic burden; it's an essential part of the business culture. Adhering to rules is not just about avoiding penalties or fines. Encouraging ethical business conduct plays an important role in ensuring that companies, particularly financial institutions, operate sustainably in the long term and build a good reputation.

Banking compliance is not just a regulatory obligation; it's a crucial element in maintaining banking operations and preserving trust. Banks must continuously enhance their compliance function and culture to effectively meet the constantly evolving regulatory requirements and customer expectations.

With the formulation of the recommendation, the MNB fills in the main elements with content, highlights expected and desirable points, and in addition to detailed descriptions, specifically formulates best practices in various areas to assist the operation of established systems.

The findings underline the importance of a compliance framework as a second line of defense within financial institutions. While no systemic threat was found, the identified weaknesses pose serious long-term risks to financial stability and integrity. MNB's actions highlight the need for proactive, well-resourced compliance functions that meet both legal requirements and supervisory expectations. Strengthening these areas is essential not only for regulatory compliance but also for maintaining public trust in the Hungarian financial system.

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