Conference on PENSION REFORM IN RUSSIA

Supervision of Asset Management and Financial Institutions

Case Study 1.: Hungary

(Room Document N°9, Session 6)
Overview of topics

1. Introduction of Supervision
2. Investments of pension funds
3. Market players
4. Investment limitations
5. On-site supervision
6. Off-site supervision
Introduction of Supervision
Authorities merged in 2000

- Changes effective from 1 April, three previous supervisory authorities (financial markets and securities, insurance, pension funds supervision) were merged.

- The new governmental body supervises all financial institutions, including: banks, insurance companies, brokerage houses, investment companies, pension funds.
The advantages

- Broader perspective for financial actors
- Joined forces: inspection know-how, procedures
- Cross-departmental inspections
- The pension fund supervision can now control the service providers of pension funds, such as: asset managers, custodians, any other related party involved in finances
The objectives of HFSA are...

- to promote the smooth operation of financial markets,
- to protect the interests of clients of financial institutions,
- to improve transparency of markets,
- maintenance of fair and regulated market competition,
- the permanent controlling of the prudent operation of financial organizations
Investment of pension funds
Portfolio allocation of Hungarian pension funds in 2002

- Government papers: 68%
- Stocks: 9%
- Company bonds: 5%
- Notes of investment fund: 6%
- Others: 8%
- Cash: 3%
- Deposits: 1%

Moscow
Changing of portfolio allocation (%) 1998-2002

Moscow
Asset value of pension funds

- 900 billion HUF ≈ 3.6 billion EURO
- 5% of the Hungarian GDP
- Average sum of account per person: 1000-2000 EURO
- Growing rate of total asset value is about 30% per year
Market players in the area of investments
Pension funds

- 18 mandatory pension funds (2.25 million members)
- 82 voluntary pension funds (1.18 million members)
- Growing concentration, decreasing in number of pension funds
- Own or outsourced asset management
- Obligatory Investment Policy
- Obligatory Investment Leader (for mandatory pension funds and for big voluntary pension funds)
- Possibility of optional portfolio system (for example unit-linked system)
- Portfolio limitation
- Publication of portfolio composition and rate of return
Asset managers

- To manage investment transactions, and form portfolio composition
- Licensing of asset management activity
- Typical asset managers:
  - Investment funds (about 60 %)
  - Security trader firms (about 10 %)
  - Own asset management (about 20 %)
  - Insurers, banks (about 10 %)
- Capital requirement (1 million EURO + 1 % of value of assets)
- One fund can have more than one asset manager (for example 4-5)
Custodians

- To control asset managers, to supervise portfolio (checking investment limits, arranging security and money transfers, realization of yields, keeping the security accounts and so on)
- Only banks can be custodians
- One fund can have only one custodian
- A custodian have to be absolutely self-dependent from asset manager(s)
Investment limitations
• Very similar investment limitation on mandatory and voluntary pension funds
• Possibility forms of investment:
  • Cash
  • Deposits
  • Securities
  • Derivatives
  • Real estates
    (but no work of art, gold and so on)
• Liquidity and mobility of portfolio is essential
• Some portfolio limitations:
  – Stocks: maximum 60 %
  – Mortgage bonds: maximum 15 %
  – Real estates: maximum 10 %
  – Foreign investments: maximum 30 %
On-site supervision
On-site inspection

- general audits every 2 years (stipulated by law)
- targeted audits upon complaints or suspicious figures in reports,
- thematic audits
Fields of on-site inspection at funds

1. Personal and material conditions (applications for membership, members records, office space, expertise, staff, bodies)

2. Income and expenditures, costs (service providers’ invoices, split up of member’s contributions)

3. Investments (asset valuation, distribution of earnings, contracts)

4. Accounting and book-keeping, data provision (consistency, supervision fee, procedures)
Fields of on-site inspection at asset managers

- Contracts between funds and asset managers
- Procedures of investment processes
- Prudent allocation of transactions
- Investment limits and portfolio compositions
- Performance of asset managers (rate of returns)
- Fees of asset managers

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Fields of on-site inspection at custodians

- Keeping current and security accounts
- Checking the system of portfolio limitation
- Transferring securities and money
- Realization of yields (interests, dividends)
- Valuation of portfolio
Off-site supervision
Regular off-site supervision

- Quarterly report, annual reports, financial plans
- Investments: limit checks
- Reports are monitored by the fund’s representatives
  - Costs and expenses
  - Cash-flow, liquidity
  - Operational profits
  - Reserves (3 types: operating, liquidity and coverage)
- Membership development, assets
Occasional off-site supervision

Several types of documents have to be sent to HFSA for a review:

- contracts with asset managers, custodians (in 15 days)
- contracts with administration, record keeping organizations
- contracts with other service providers (for example actuary)
- minutes of general meeting
- minutes of the meeting of Board of Directors in some cases
- Statement of Investment Policy (S.I.P.)
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