

Recent issues in pension fund governance in Hungary

Róbert I. Gál



Mandate of saving for old age:
on employees or employers? (Vittas, 1998)

- mandate and market concentration
- mandate and restrictions on membership
- mandate and pension fund governance

Mandate and market concentration:

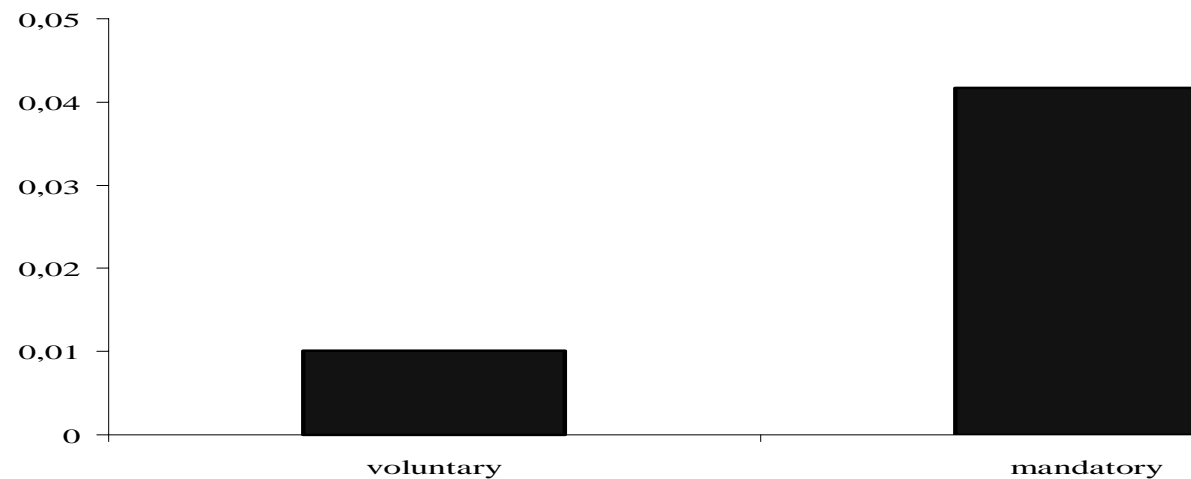
employee mandated systems produce more concentrated markets than employer mandated systems

- in-house occupational schemes
(in particular if self-investment allowed)
- entry costs:
 - recruitment
 - re-recruitment: individuals are more mobile than groups
 - branding

Market concentration in the Hungarian pension market

- voluntary funds are initiated by employer for tax exemptions
- mandatory funds: mandate on the employee

Average market share



Mandate and restrictions on membership

- employer mandated systems: often closed funds
- employee mandated systems: often open funds
ran by actors of the financial market

Open and occupational funds in the Hungarian pension market

(legal structures of open and closed funds are the same in Hungary, yet governance differ in the two types)

		market share by			average
		number of	number of	assets	individual
		funds	members		account
					(th HUF)
mandatory	banks, insurance companies	50.0	91.0	89.5	106.7
	employers	33.3	3.3	6.3	204.3
	other (mixed)	16.7	5.7	4.3	82.0
	total	100.0	100.0	100.0	108.6
voluntary	banks, insurance companies	13.1	68.4	57.2	190.6
	employers, trade unions	86.9	31.6	42.8	308.0
	other (mixed)	-	-	-	-
	total	100.0	100.0	100.0	227.8

Source: PSZÁF (2002)

Mandate and pension fund governance

- governance issues in a fragmented market of closed occupational plans:
 - solvency risks
 - slow feedback to mismanagement
 - theft and fraud
- governance issues in a highly concentrated market of large open funds:
 - reckless competition
 - compliance
 - theft and fraud

Solvency risks

- funding
- insurance against solvency risk
- priority rights for pension schemes in bankruptcy procedures
- limits on self-investment

Slow feedback to mismanagement

- competition lashed up
 - standardization
 - rating
 - “exit” options: portability
- “voice” options: Pensions Ombudsman
- no exclusive asset management
- managerial contract
- independence of trustees

Cost of asset management in Hungary

	fund management		
	competitive	insider	total
number of funds	11	13	24
share in assets (%)	9	91	100
investment return			
gross	7.7	7.4	7.5
net	7.1	5.9	6.0
cost of fund management as percent of			
total value of assets	0.6	1.1	1.1
total amount of gross return	8.5	31.3	29.1

Source: Augusztinovics et al. (ILO, 2002)

Reckless competition

competition under special circumstances:

- consequences realized on the long run
- rates of return are easy to measure, risks are difficult

- alleviated competition
 - investment regulation; risk classes
 - building friction in the switching process

Theft and fraud

- transparency
 - external actors: auditor, actuary, custodian
- reputation building

