Recent issues in pension fund governance in Hungary

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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

![Average market share chart](chart.png)
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)

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

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

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

*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