The Hungarian pension sector
and
On/off-site supervision in Hungary

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Pillars

• I. pillar: PAYG

• II. pillar: Mandatory pension funds

• III. pillar: Voluntary pension funds

• Others: insurance policies, individual savings account
PAYG

• Earnings-related
• Changes
  – Parametric
  – Paradigmatic
• Importance
• Planned modifications
Mandatory pension funds

• Legislation in 1997, introduced in 1998
• Part of social security system
• Significant modifications
• Main elements now:
  – defined contribution
  – mandatory for new entrants
  – who is entitled to establish mandatory fund
  – organization of fund
  – service providers
• Main figures of sector: 19 funds,
  total asset € 6,3 billion,
  2,6 million members
Voluntary pension funds

• Legislation in 1993, introduced in 1994
• Not the part of social security system, but an investment option
• No significant modifications
• Main elements now:
  – defined contribution
  – who is entitled to establish voluntary fund,
  – not occupational
  – organization of fund
  – service providers
• Main figures of sector: 68 funds,
  total asset € 2,8 billion,
  1,4 million members
Others

- Insurance policies
- Individual savings account
An example

- Joe Not-member

- Pays to
  - PAYG 8,5 %
- Its employer pays to
  - PAYG 21 %

  Total contribution: 29,5 %

- Gets as a pensioner
  - Pension from PAYG: 100.000

- Jack Member

- Pays to
  - PAYG 0,5%
  - Mandatory fund 8 %
- Its employer pays to
  - PAYG 21%

  Total contribution: 29,5 %

- Gets as a pensioner
  - Pension from PAYG: 75.000
  - Pension from fund: 25.000
  or more, or less
Part II
On/off-site supervision in Hungary
How we supervised - 1.

Purely on-site period

• In the first 5 years (1994-1999)
• Because
  – number of funds made it (almost) possible
  – regulation (mandatory): in every 2 years
  – close control needed in this period
• Not exceptionally almost 200 inspections a year
• Generally comprehensive inspections
• A typical on-site inspection lasted 1 or 2 days
• Methodology: not too detailed schedule
How we supervised - 2.

Off-site enters the stage

- In 1999, 2000
- Not yet integrated supervision
- First attempts to determine the risks
- Lack of
  - overall IT-support
  - exactly determined aims
  - role in the supervision procedure
  - overall methodology
- Inspections’ duration increased
- Not only comprehensive inspections
How we supervise now - 1.

• Integrated supervision from 2000
• Amendments in legislation
• Risk-based approach declared concerning all financial sectors
• Sophisticated resource-management
• Developed IT-support
• Mainly off-site inspection
How we supervise now - 2.

- Priorities determined and published in advance on our web-site in every year

- Our priorities for 2007:
  - Impact of centralized contribution collect
  - Members without paid contributions
  - Life-cycle portfolio system
  - Effects of withdrawal after 10 years membership
  - IT system
How we supervise now - 3.

- Supervision activities planned
  - Both on-site and off-site (from 2007)
  - Quarterly rolling planning, for four quarters
  - Detailed capacity-planning

- Inspections must follow the priorities

- Shorter, specific inspections instead of long, comprehensive ones

- Off-site supervision preferred

- Quarterly report on fulfilment of plan
How we supervise now - 4.

- **Personnel risks** – owners, strategy, management, staff

- **Operational risks** - corporate structure, IT, financial accounting, compliance, internal audit, anti money laundering activity, treating of customers

- **Business risks** – credit risk, market risks, liquidity risk, earnings, capital adequacy, market position, Basel II implementation, other risks
How we supervise now - 5.

What is missing:

• No risk assessment cycle determined
• Risks are not based on the strategical aims of Authority
• Risk assessment not supported by an analytical background, which cover
  • economic environment,
  • financial markets,
  • products,
  • risks can be revealed by analyzing the customers
  • analysis of customer complaints
• The resources are not determined by the identified risks.
How we are going to supervise - 1.

• Strategic project on the complex development of supervisory methods, launched in 2006, introduction in 2008
• Two dimensional risk-based methodology: measuring impact and probability, complex methodology covering all supervised institutions
• Basis: Authority’s duties laid down in the law
  Aim: to identify the risks which endanger these duties
• Risk prioritization: Impact * Probability
• Resources concentrated to reduce risks identified as priorities
How we are going to supervise - 2.

• Theme supervision as a new tool: managing horizontal risks identified in a sector (institution supervision – vertical)

• Risk assessment cycle 1-3 years

• Risk assessment table to be reviewed comprehensively minimum once a year (Impact – probability ranking)

• The Risk assessment table not statical, constantly modified according to the changes in environment, follow-up of risk-reducing programme, monitoring information
How we are going to supervise - 3.

- Constant development of methodology focusing on
  - implementation of risk-based supervision
  - shift further from rule based to principle based supervision
  - strengthening of on-going supervision of large institutions
  - harmonization of our methods to European standards

- Constant training needs – need for highly educated, experienced staff