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 priorization: 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