



Competition and costs in the Hungary 2nd pillar

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Content of this presentation

- Impavido Rocha (2006)
 - Industrial organization of MPFs \checkmark
 - Performance and Fees X/\checkmark
 - Link with capital market development X
 - Decumulation phase X
 - Concluding remarks \checkmark

Industrial Organization

Small number of MPFs

	1998	1999	2000	2001	2002	2003	2004
Second Pillar							
Number of funds	38	39	-	18	18	18	18
Total Assets (% of GDP)	0.3	0.8	1.3	1.9	2.5	3.0	4.0
Number of members (000)	1,347	2,064	2,193	2,253	2,214	2,304	2,402
Share of 6 largest funds (%)	83	84	84	86	87	-	83

- Decreasing number of funds with little impact on concentration
- Immature system covering 50% of labor force
- Low asset growth as % of GDP

The MPF market is concentrated

	Assets (HUF 000,000)	Members (unit)	Contributions (HUF 000,000)
Smallest MPF	1,003	2,840	320.3
Largest MPF	224,161	681,231	57,267.8
Average MPF	48,997	133,456	11,851.4
Market Total	881,944	2,402,210	213,324.9
Share of Largest Six MPFs	83%	87%	83%
Herfindahl Index	1,491	1,638	1,510

- Market is concentrated with 6 largest MPFs representing around 85% of relevant measure
- Small number of funds and concentration typical also of LAC countries

Three types of sponsors

Type of Sponsor		Assets HUF 000	Members (unit)	Contributions HUF 000
Financial Groups (10)	Min	1,003,353	9,141	347,000
	Max	224,161,495	681,231	57,267,822
	Average	76,904,851	214,356	18,605,398
	Total Financial	769,048,517	2,143,569	186,053,986
	% of Market	87%	89%	87%
Employers (5)	Min	4,410,819	8,195	986,141
	Max	16,081,593	21,622	3,836,397
	Average	9,201,794	13,746	2,097,909
	Total Employer	46,008,972	68,733	10,489,545
	% of Market	5%	3%	5%
Independent (3)	Min	1,523,589	2,840	320,274
	Max	34,102,743	106,596	8,348,993
	Average	22,295,590	63,303	5,593,792
	Total Independent	66,886,770	189,908	16,781,376
	% of Market	8%	8%	8%

Fees

Types of fees

- MPFs charge fees on contributions (flow) and fees over assets (stock)
- Fees on contributions fund operational expenses
- Asset management is outsourced to an “external” asset manager
- Asset managers charge an asset management fee on the portion of total assets forming the individual account reserve

CONTRIBUTION FEES / CONTRIBUTIONS		1998	1999	2000	2001	2002	2003	2004
Fund	Sponsor	(%)	(%)	(%)	(%)	(%)	(%)	(%)
Dimenzió	EMP	6.0	6.0	5.9	5.9	6.0	5.9	6.0
HONVÉD	EMP	6.0	6.0	6.0	7.4	7.5	7.5	7.5
Postás	EMP	5.8	5.0	5.0	5.0	5.0	5.0	5.0
Vasustas	EMP	8.0	7.1	6.3	7.0	7.0	7.0	6.9
VIT	EMP	6.0	6.0	6.0	6.0	7.0	7.0	7.0
AEGON	FIN	6.0	6.5	5.4	5.6	6.0	6.0	5.9
AH	FIN	5.0	5.0	4.7	6.9	7.0	7.0	6.5
Budapest	FIN	4.0	4.0	4.2	5.0	6.0	6.0	5.9
CS	FIN	5.5	5.1	5.1	5.5	7.0	7.0	6.6
ERSTE	FIN	5.4	5.5	6.7	5.8	6.0	6.6	6.9
ING	FIN	5.6	6.2	6.0	6.8	7.0	7.0	7.0
MKB	FIN	6.1	5.7	5.4	5.5	5.5	5.5	5.5
OTP	FIN	5.1	5.0	5.9	6.9	7.0	7.0	6.5
Quaestor	FIN	5.0	5.0	4.9	5.0	5.0	7.4	7.0
UNIQA	FIN	-	10.0	4.2	5.3	5.5	5.3	5.5
Aryankor	INDEP	5.6	5.2	4.9	6.4	7.0	7.0	6.8
Életút	INDEP	4.7	6.2	5.9	6.0	6.0	6.0	6.0
Évgyűrűk	INDEP	7.0	6.3	6.6	7.7	8.0	7.6	7.1
Weighted Average	MKT	5.6	5.7	5.5	6.4	6.8	6.8	6.5
Weighted Average	EMP	6.1	5.9	5.8	6.4	6.6	6.6	6.6
Weighted Average	FIN	5.5	5.6	5.5	6.4	6.7	6.7	6.5
Weighted Average	INDEP	6.3	6.0	6.0	7.2	7.5	7.3	6.9

Operational costs

	2001	2002	2003	2004
Material expenses	0.9	0.6	0.6	0.4
Wages and social security contributions	6.8	8.2	7.9	8.0
Compensations for pension fund officers	1.7	1.4	1.4	1.4
Agent fees related to member recruitment	5.0	3.7	3.5	2.0
Administration and record keeping fees	54.5	61.0	60.3	65.5
Audit fees	0.8	0.7	0.6	0.3
Actuarial fees	0.3	0.4	0.3	0.4
Consulting fees	0.3	0.9	0.5	0.4
Marketing expenses	0.5	1.4	2.0	2.1
Supervision fees	5.1	8.0	8.6	4.7
Guarantee fees	5.9	5.7	6.1	6.4
Other	18.1	7.9	8.2	8.3
TOTAL (HUF millions)	6,763.8	7,141.3	9,352.5	12,651.5
% of contributions (weighted average)	N.A.	6.8	6.8	6.5

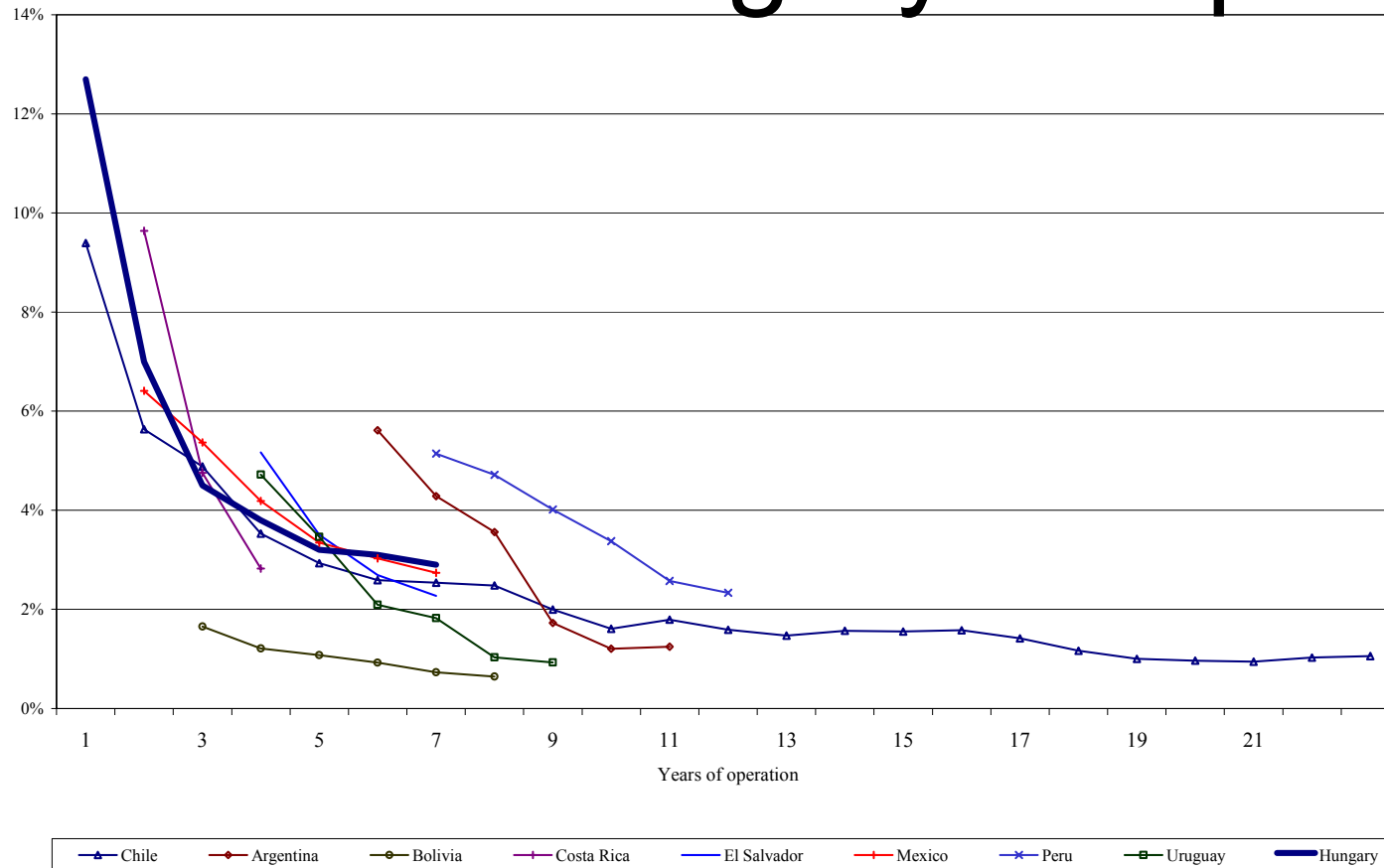
ASSET MANAGEMENT FEES / AV ASSETS		1998	1999	2000	2001	2002	2003	2004
Fund	Sponsor	(%)	(%)	(%)	(%)	(%)	(%)	(%)
Dimenzió	EMP	0.00	0.93	0.71	0.37	0.27	0.29	0.30
HONVÉD	EMP	0.11	0.70	0.56	0.54	0.49	0.24	0.34
Postás	EMP	0.09	0.52	0.33	0.37	0.36	0.33	0.33
Vasustas	EMP	0.03	0.95	0.40	0.35	0.22	0.17	0.25
VIT	EMP	0.00	0.00	0.00	0.00	0.00	0.00	0.05
AEGON	FIN	2.25	2.93	1.68	1.68	1.36	1.43	1.37
AH	FIN	0.93	0.99	1.41	0.91	1.18	0.78	1.19
Budapest	FIN	1.15	1.34	1.21	1.16	1.17	1.02	1.00
CS	FIN	0.79	0.96	1.09	1.08	0.97	1.28	1.06
ERSTE	FIN	0.17	0.71	0.71	0.72	0.98	1.41	1.44
ING	FIN	1.03	0.90	0.94	0.82	0.90	0.86	0.98
MKB	FIN	0.00	0.00	0.68	0.53	0.53	0.65	0.64
OTP	FIN	1.12	1.50	0.78	0.94	0.71	0.79	0.87
Quaestor	FIN	0.00	0.00	0.01	0.00	0.01	0.01	0.09
UNIQA	FIN	-	0.80	1.90	1.86	1.83	1.34	1.21
Aryankor	INDEP	0.34	0.59	0.62	1.05	1.19	0.58	0.57
Életút	INDEP	0.00	0.53	0.74	0.25	0.20	0.21	0.29
Évgyűrűk	INDEP	0.16	1.15	0.58	0.65	0.54	0.57	0.50
Weighted Average	MKT	1.13	1.42	1.06	1.03	0.95	0.92	0.97
Weighted Average	EMP	0.05	0.62	0.44	0.37	0.32	0.23	0.28
Weighted Average	FIN	1.29	1.51	1.14	1.09	1.00	1.00	1.05
Weighted Average	INDEP	0.21	0.94	0.60	0.81	0.84	0.57	0.53

TOTAL FEES / AV ASSETS		1998	1999	2000	2001	2002	2003	2004
Fund	Sponsor	(%)	(%)	(%)	(%)	(%)	(%)	(%)
Dimenzió	EMP	12.5	5.8	3.6	2.4	1.9	2.0	2.0
HONVÉD	EMP	11.8	7.3	4.8	4.2	3.4	2.9	2.6
Postás	EMP	12.7	5.3	3.2	2.3	1.8	1.7	1.6
Vasustas	EMP	17.7	8.6	4.8	3.4	2.5	2.2	2.1
VIT	EMP	11.4	4.9	2.9	2.1	1.9	2.0	2.0
AEGON	FIN	15.7	8.4	4.8	4.1	3.1	3.2	3.0
AH	FIN	11.5	6.1	4.6	3.9	3.5	3.0	3.1
Budapest	FIN	9.3	5.0	3.7	3.2	3.0	3.0	2.8
CS	FIN	11.4	6.0	4.0	3.3	3.1	3.5	2.9
ERSTE	FIN	11.0	6.4	4.4	3.3	3.1	3.8	3.9
ING	FIN	13.6	6.9	4.4	3.7	3.2	3.1	2.9
MKB	FIN	12.4	5.3	4.0	2.6	2.0	2.5	2.2
OTP	FIN	11.1	7.0	4.9	4.2	3.2	3.3	2.9
Quaestor	FIN	10.2	4.5	4.2	3.1	2.5	3.5	3.5
UNIQA	FIN		5.9	5.4	4.8	3.8	3.3	2.9
Aryankor	INDEP	11.0	5.8	3.8	3.6	3.4	2.9	2.7
Életút	INDEP	9.0	5.7	3.7	2.4	1.8	1.9	1.8
Évgyűrűk	INDEP	11.3	8.7	5.1	4.3	3.3	3.1	2.6
Weighted Average	MKT	12.7	7.0	4.5	3.8	3.2	3.1	2.9
Weighted Average	EMP	12.5	6.1	3.8	3.0	2.4	2.3	2.1
Weighted Average	FIN	12.9	7.0	4.6	3.9	3.2	3.2	2.9
Weighted Average	INDEP	11.1	7.6	4.6	3.9	3.3	3.0	2.6

Are current fees high or low?

- Today fees are 2.9% of Av. Assets for managing a buy and hold laddered portfolio of government bonds.
- The contribution collection system is inefficient.
- Marketing costs have not soared yet
- The use of average assets for Hungary inflates total fees over assets

How does Hungary compare?



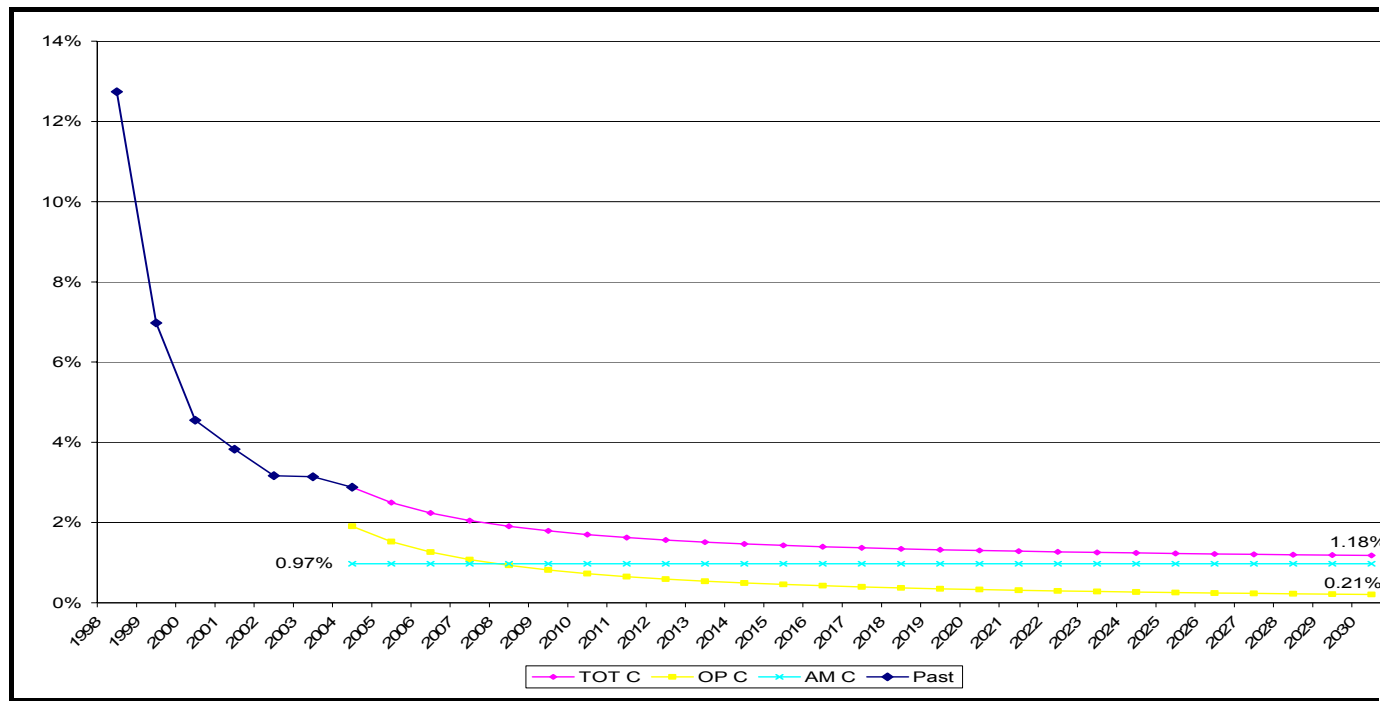
- Hungary fares worse than most countries in terms of total current fees over assets at their 7th year of operation. Only Argentina and Peru fare worse.

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2006

Maybe LR fees are better than current fees

- Current fees appear high due to the current small asset base (4% of GDP)
- Current total fees are not relevant because it ignores the fixed/variable fee mix and therefore, how quickly fees over assets are likely to fall over time (high fix fee -> fast decay)
- Then let's project current fee structure over time

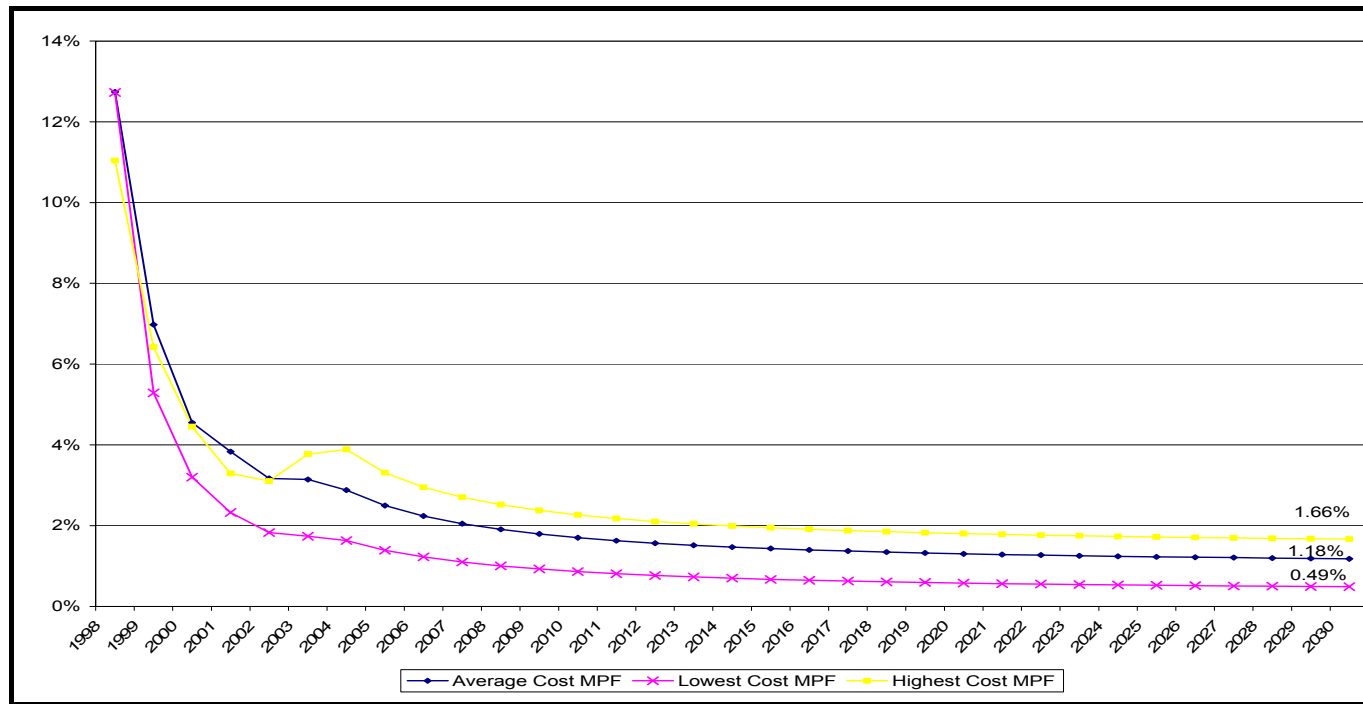
LR total fees over Av. Assets



Note: Real wage growth = 4%, rate of return = 8%, asset management fees = 0.97% of assets, and operating fees = 6.49% of contributions.

- LR fee of 1.2% is still high
 - Especially since this projection ignores maturation of system and likely lower growth of assets starting with 2014

High variance still present in the LR



Note: Real wage growth = 4%, rate of return = 8%.

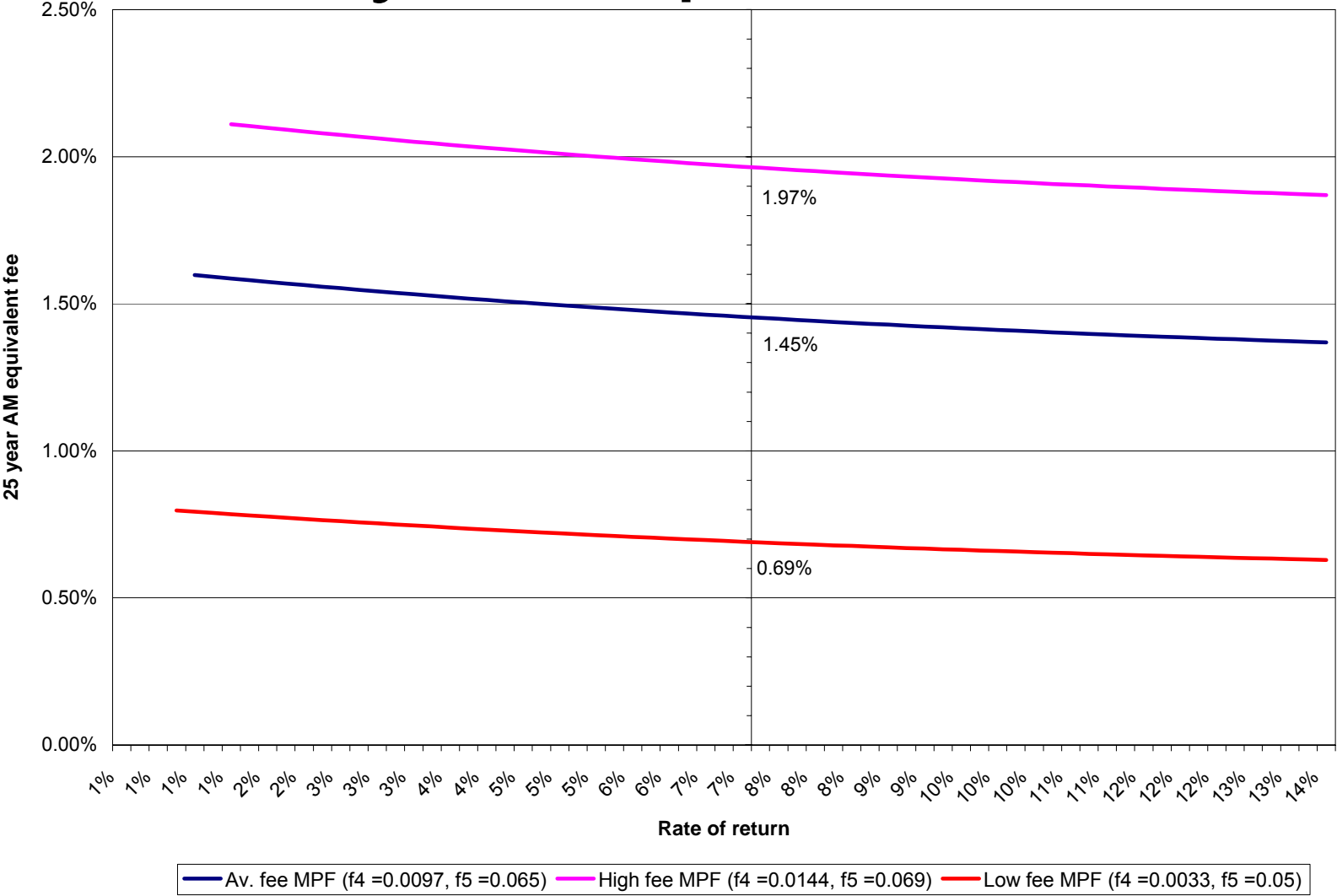
- LR fee of 1.2% for average MPF, 1.7% for highest cost MPF, 0.5% for lowest cost MPF.
- Segmentation is still present: some MPFs are extracting a rent due to lack of readily comparable information on performance and costs

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What are the LR costs for an individual?

- 1% AM fee over 40 years of contributions amounts to 20% of contribution fees or final cash balance fee (25% compensation fee on contributions - APPENDIX B)
- Charge Ratios for average MPF in Hungary are worse than for most LAC countries (Whitehouse 2000) and Australia (Mitchell Bateman 2003).
- Important Caveat: exercise is mechanistic.

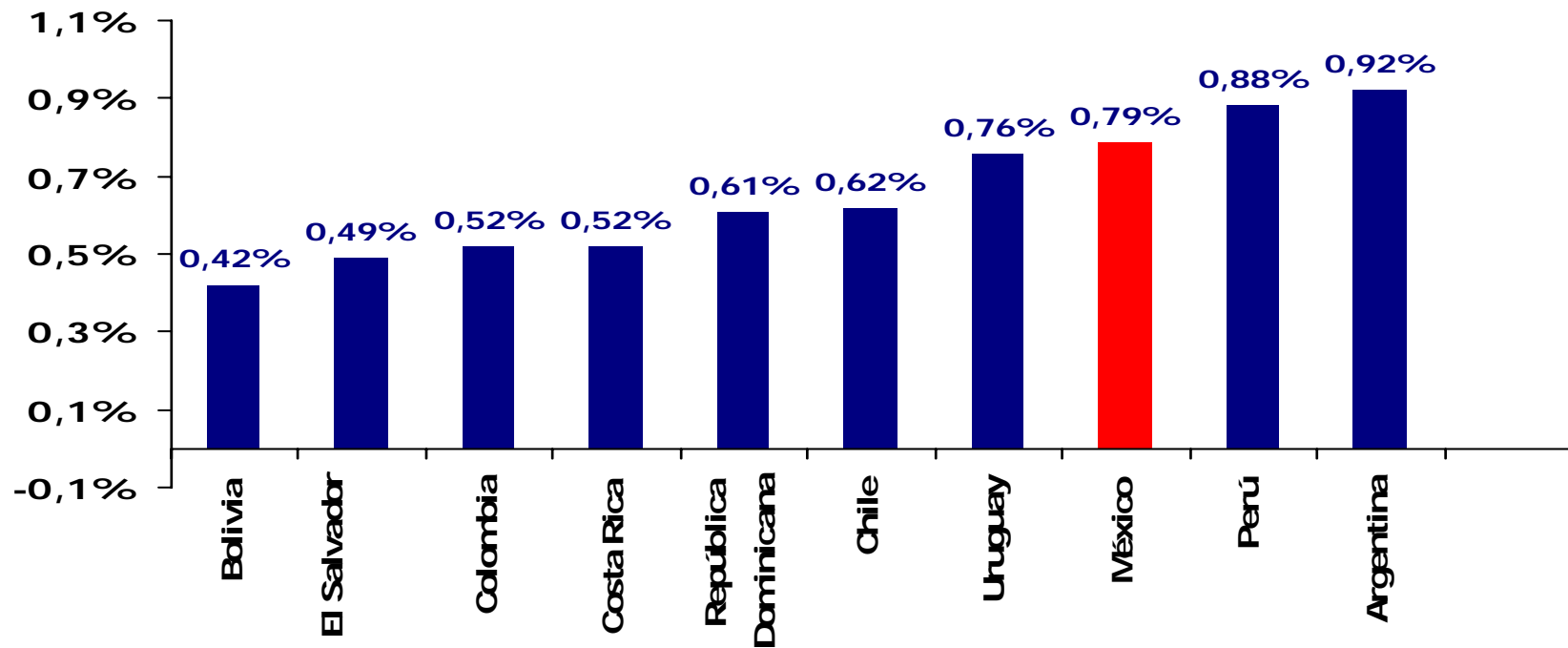
25 year equivalent fee



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Equivalent fees over assets in LAC

Equivalent Fees Over Assets



- Source: CONSAR (2006)

Why are fees high?

- Competition does not work, otherwise we would not have segmentation.
- Competition does not work because data on fees and returns are not compared and comparable.
- The market is not contestable and the automatic assignation rule is badly designed.

Concluding remarks and policy recommendations

Concluding remarks (1/3)

- 2nd pillar in Hungary is small, concentrated and segmented
- The non-profit nature of the 2nd pillar has exposed funds to influence of “sponsors”.
- Funds charge fees on the flow and on the assets that are considered high however measured (current, LR, equivalent).
- Funds outsource asset management but tend to do in-house all the rest (collection of contributions, record keeping, et cetera).

Concluding remarks (2/3)

- While MPFs charge similar fees over contributions, MPFs sponsored by financial groups tend to charge AM fees that are on average 275% and 98% higher than fees charged by MPFs sponsored by large employers and MPFs considered independent. Nevertheless, they manage the same type of portfolio and are not associated with higher performance.

Concluding remarks (3/3)

- Competition does not work due to lack of readily available comparable information on fees (members do not switch).
- Lack of comparable information on investment performance also limits competition but not as severely as the lack of costs comparability.
- The market is not contestable with inefficient collection of contributions and automatic allocation of undecided new entrants.

Policy Recommendations (1/3)

- Publish comparable data on fees and returns
- Reform accounting standards and move to unit accounting used by mutual funds
- Change automatic allocation rule for undecided members and base it on low cost funds
- Promote adoption of fees only on assets
- Promote switching to low fee funds.

Policy Recommendations (2/3)

- Require public competition for selection of external asset managers.
- Reform collection system of contribution by centralizing such function in a monopoly provider.
- At a later stage, unbundle functions with economies of scale and centralize them. Challenge of regulating a monopoly provider.

Policy Recommendations (3/3)

- If competition is not increased through information disclosure and comparability of information, governance structure may need reforming.
- Challenge: increased competition may/will spark marketing war.
- Competition should be based on net (risk adjusted) rates of return but Hungary is far from being able to focus on this.

¿Preguntas?

