

Competition and fees in the Hungarian 2nd pillar

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Presentation prepared for the seminar:
“Sistemas De Pensiones: La Experiencia Internacional”
Organized by SAFP and CIEPLAN
Santiago de Chile, Chile. May 15th, 2006.

Content of this presentation

- Mainly based on Impavido Rocha (2006)
 - Industrial organization of MPFs
 - Fees
 - International Comparisons
 - Concluding remarks and lessons to be learned

Industrial Organization

Industrial Organization

- System still immature covering 50% of labor force
- Number of funds decreased from 38 to 18
- Largest 6 funds represent 85% of market however measured
- Asset managed around 4% of GDP

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

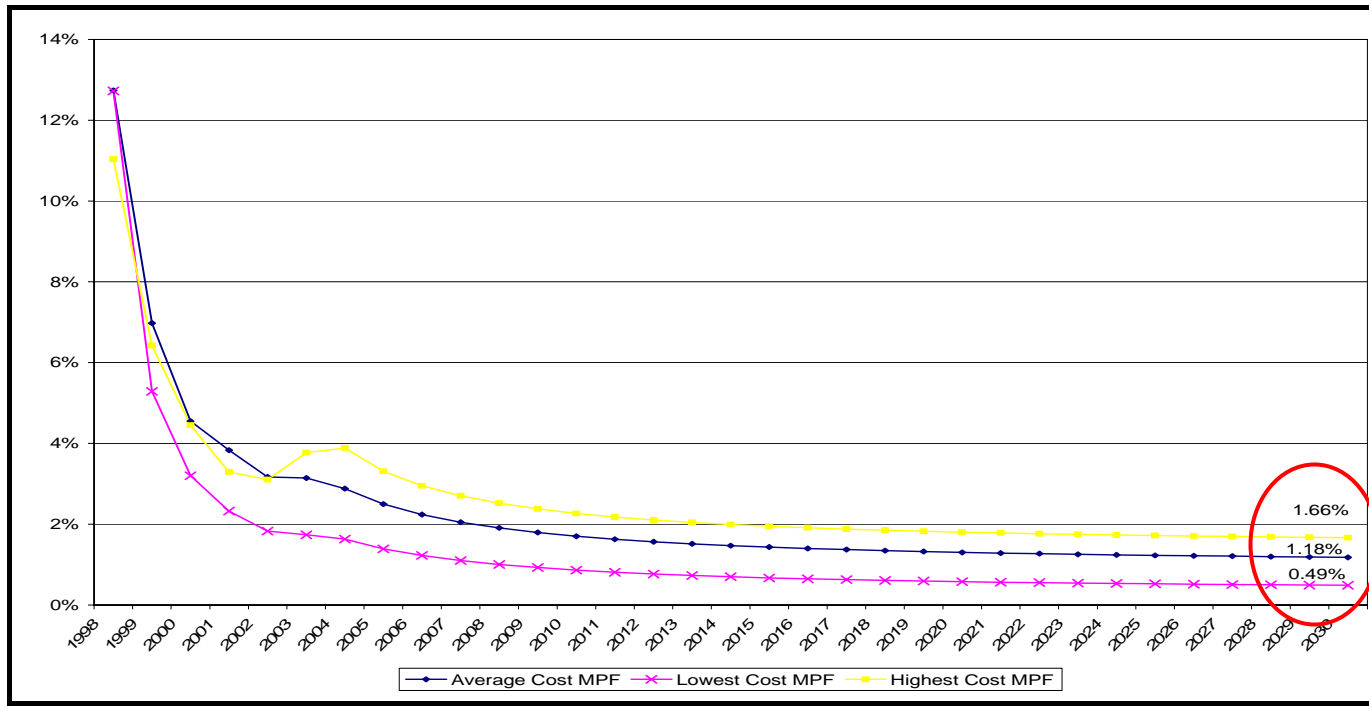
Operational costs

	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

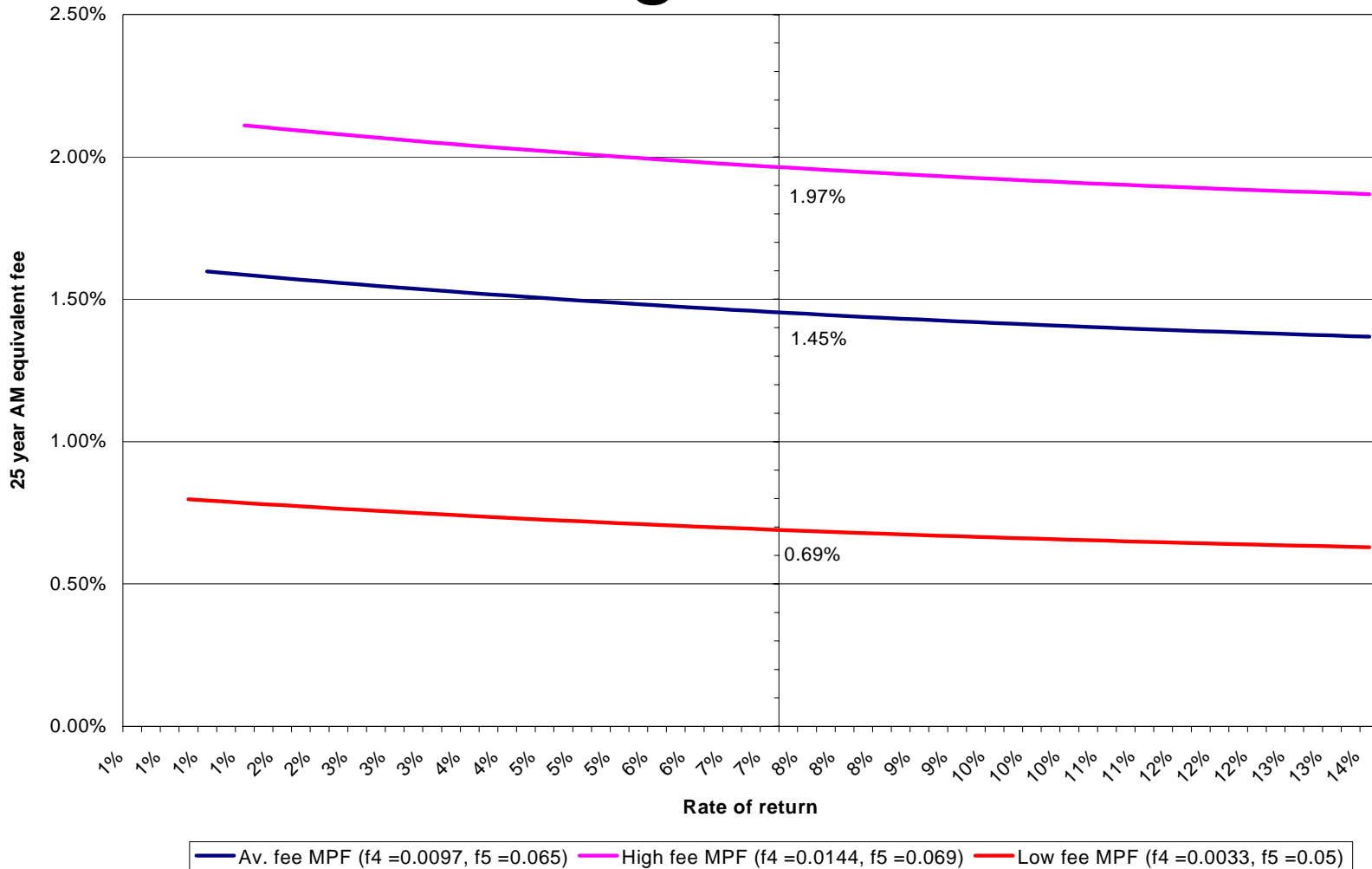
End of period long run fees



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

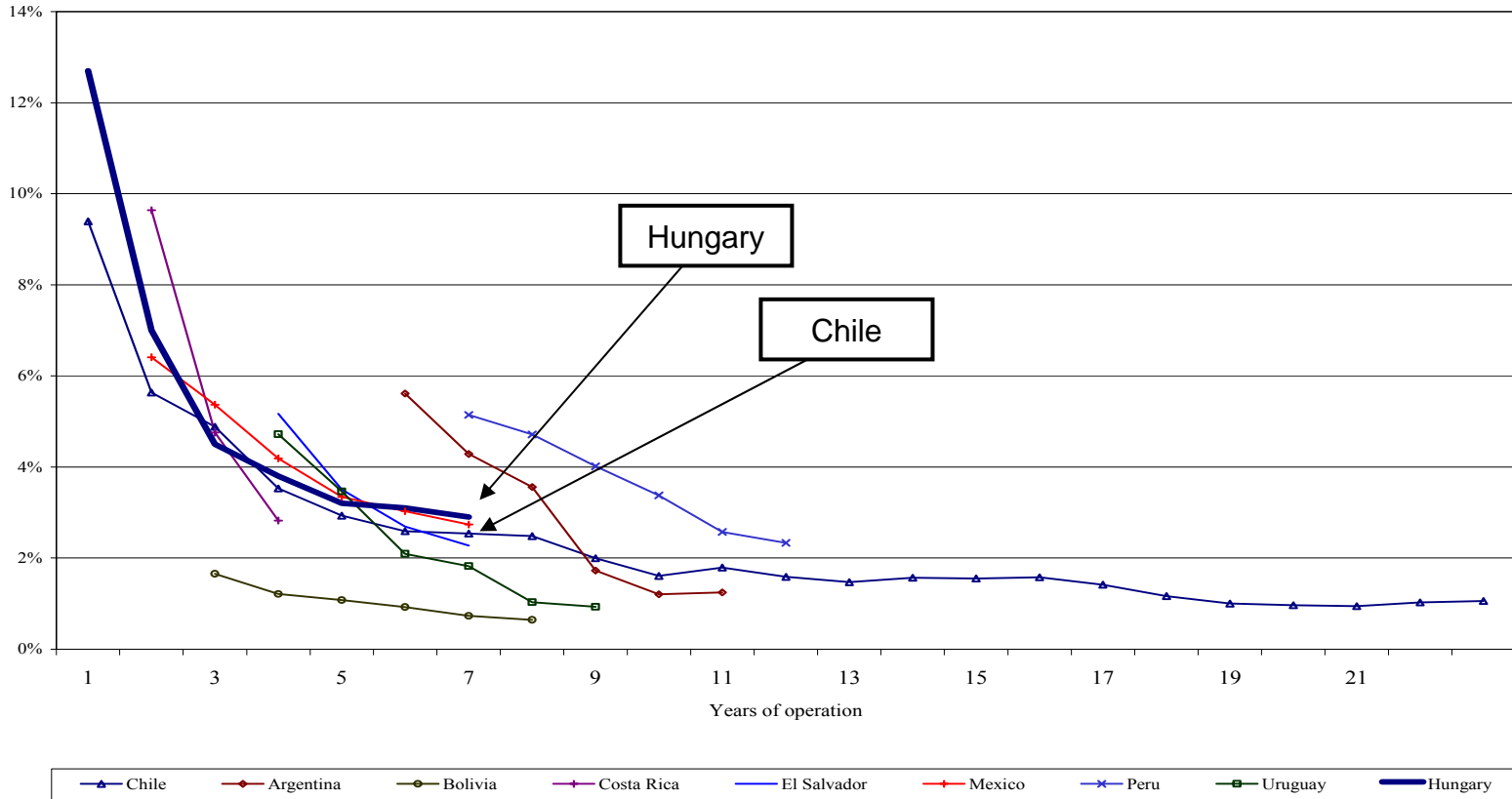
- LR fee of 1.2% for average MPF, 1.7% for highest cost MPF, 0.5% for lowest cost MPF.
- Segmentation is still present: some MPFs are extracting a rent due to lack of readily comparable information on performance and costs

25 year equivalent asset management fee



International comparisons

Fees over assets in select countries

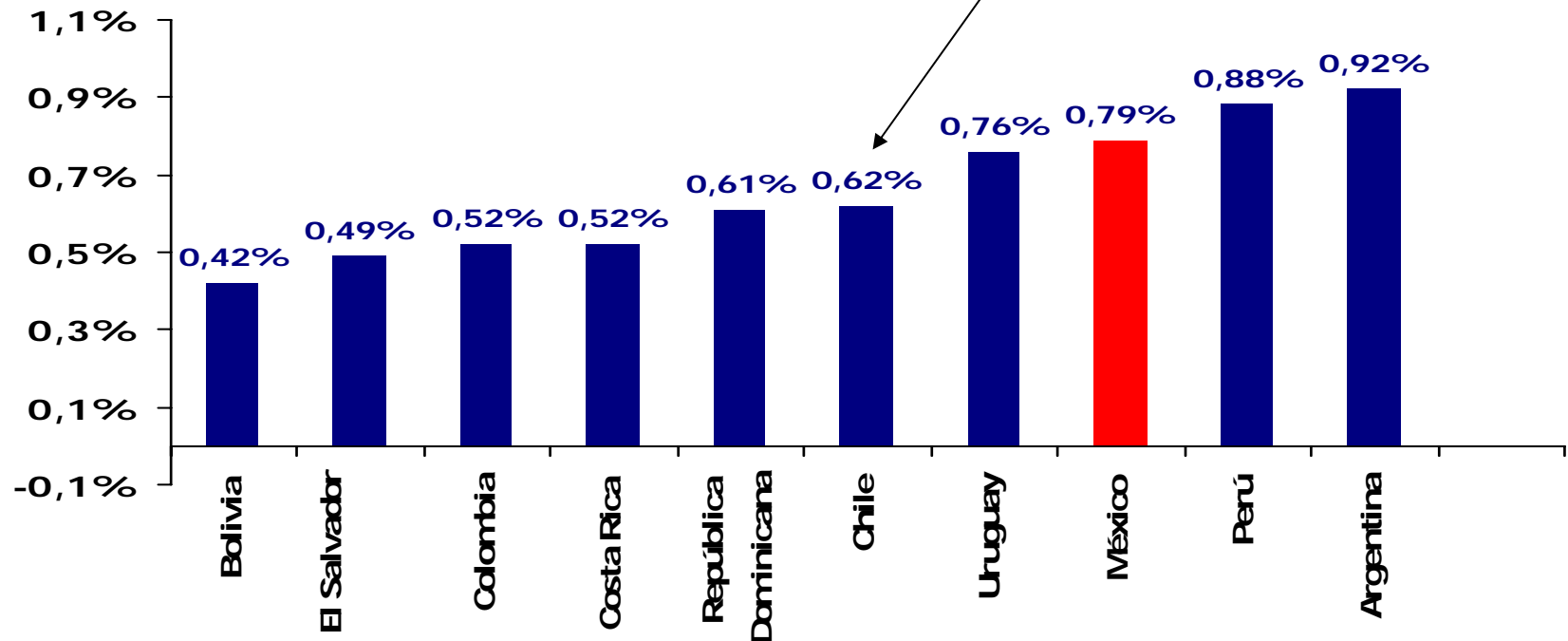


- Hungary fares worse than most countries in terms of total current fees over assets at their 7th year of operation. Only Argentina and Peru fare worse.

Equivalent fees over assets in LAC

Should we add 30 bps?

Equivalent Fees Over Assets



- Source: CONSAR (2006)

LR fees in Poland

- The pension fund sector is concentrated and has ownership links with the insurance sector.
- The private pension system has been able to operate with relatively low costs, by centralizing collection of contributions and allowing outsourcing of other basic services.
- Caps on fees over stock and flow, decreasing
- Current fees over assets 160 bps decreasing to 50-60 bps the next decade

The 2nd pillar in Sweden

- 2nd pillar designed to minimize costs, especially in view of small contribution of 2.5%
- Achievement of economies of scale and competition simultaneously through: (i) single basic service provider; (ii) blind accounts/blind quotation system; (iii) several asset managers; (iv) system of fee rebates

Charges of Administration of the PPM System

Year	2002	2005	2008	2011	2014	2017	2020
PPM charge	0.30%	0.23%	0.18%	0.15%	0.12%	0.08%	0.04%
(% of assets)							
Fund charge*	0.41%	0.36%	0.32%	0.29%	0.27%	0.25%	0.24%
(% of assets)							
Total charge	0.71%	0.59%	0.50%	0.44%	0.39%	0.33%	0.28%
(% of assets)							

Concluding remarks and lessons learned

Concluding remarks (1/3)

- 2nd pillar in Hungary is small, concentrated and segmented. This is similar to many other countries
- 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).

Concluding remarks (2/3)

- Funds outsource asset management but tend to do in-house all the rest (collection of contributions, record keeping, et cetera)
- Members are unable to vote with their feet and this reinforces segmentation
- High fee funds manage the same type of portfolio and are not associated on average with higher performance

Concluding remarks (3/3)

- Competition does not work in Hungary 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 fees comparability.
 - The market is not contestable with inefficient collection of contributions and automatic allocation of undecided new entrants.
 - Economies of scale are not exploited through the use of centralized monopoly providers.

Lessons that can be learned (1/3)

- **Fees and returns should be readily comparable**
 - Comparable data on fees and returns need to be published systematically, ideally at the individual level
 - Promote adoption of fees only on assets
 - Accounting standards may distort comparison
 - Unit accounting used by mutual funds promotes comparison of rates of return

Lessons to be learned (2/3)

- **Barriers to entry can be lowered**
 - Automatic allocation rule for undecided members based on low cost funds would lower barrier to entries (Mexico)
 - Facilitate switching (CONSAR)

Lessons to be learned (3/3)

- **Economies of scale can be exploited**
 - Sweden (PPM, SSA and Tax Authority)
 - Mexico (PROCESAR)
 - Poland (ZUS)

end