## Monthly Analysis – October

# Back to social security – market effects

Members of private pension funds who turned 52 years of age by the end of last year have the opportunity until the end of this year to quit their private pension fund and re-enter the state social security system (TB), taking their accumulated assets with them. The final deadline for making a declaration to this effect is the end of the year, but some members have already taken advantage of the opportunity. In the following I will look at how large an item these assets returning to the state will represent and what impact it might have on the market.

Based on the distribution of private pension fund members by age group, the potential proportion of those returning to the state system is approx. 4% of the total, which means around 130,000 of the almost 3 million-strong membership. We're talking about a little more than 6% of total assets, given that older citizens have certainly spent at least 10 years in the mixed system (as opposed to younger people who have entered since 1998), while earnings are typically higher in the older age groups – albeit not by as much as we might expect. Total assets of private pension funds reached around HUF 1,850 million at the end of last year, and we can count on considerable yields and new payments into the funds since then, potentially increasing this figure to HUF 2,400 million by the end of this year. The total affected assets may thus reach somewhere around HUF 150-160 billion at the end of the year.

In order to estimate how many people will eventually return to the TB system, we must weigh a number of factors. This year and from next January, the state is carrying out significant tightening measures on several points, starting with the trimming of the 13th month pension, and on to the tightening of pension indexing rules and the raising of the age limit, which will weaken the appeal of the state pension system. Moreover, further tightening measures cannot be ruled out. At the same time, the loud negative publicity surrounding last year's performance of the private pension funds sector, which has, incidentally, since made up some two-thirds of its losses, is detrimental to the image of funds as a whole. On the other hand, uncertainties surrounding the regulation of allowances (meaning how pensions are paid from fund assets) do not count in favour of individuals remaining with funds.

Research by Tárki shows that for the decisive majority of the affected group it is worthwhile returning to the TB system. The results reveal that only men born in 1956, working in white-collar professions that require degrees, should retain their pension fund membership, while highly educated individuals of a number of other vintages might perhaps be better off under the mixed system. Other groups of those affected have generally not acquired adequate pensions entitlement since 1998 (and thus have not been able to pay sufficient membership fees) which would compensate for the 25% TB pension lost when transferring to the mixed system.

The big question now is whether members are even considering the decision at all. We can take the experience of the temporary option to return to the TB system in 2002 as a starting point, when people left the pension funds sector in significant numbers, though they were not necessarily the people for whom it would have been most worthwhile to do so. By contrast, when the optional portfolio system was launched, only a fraction of members signalled their intentions. At the same time, an important distinction in the present case is firstly that the losses of the pension funds last year received a great deal of press coverage, and secondly, that every affected member will now receive a letter personally addressed to them calling their attention to the serious risk of remaining in the mixed system. All things considered, we can assume that between half and two-thirds of the affected 130,000 persons will return to the TB system.

The present assets of those potentially crossing over to the TB system are made up on average of 80% Hungarian government securities, given that, due to their age, these individuals were most likely assigned conservative or medium-risk portfolios when the optional portfolio system was introduced. In this event, the accumulated assets return to the state, which will use them for reducing the gross public debt. With the reimbursement of assets, the rule is that government securities must be returned without fail to the Government Debt Management Agency (ÁKK) in proportion to the government securities held in the fund portfolio, but up to the entire amount is executable in bonds or discount Treasury bills. Assuming a two-thirds rate of people returning to the TB system, a minimum of HUF 60 billion in securities may thus return to the ÁKK, though it is more probable that the entire amount will be closer to HUF 80-90 billion (while a figure much above HUF 100 billion is unlikely). The effect on the equities market is unlikely to be significant, at least as far as the domestic bourse is concerned, since we're talking about HUF 10-20 billion at most, a significant portion of which is made up of foreign equities. As far as timing is concerned, returns to the TB system are in theory expected to peak by 31 December, but for various technical reasons to do with accounting this may drag on until January or the end of February.

The opening of the door to social security – assuming that at least half of those affected take advantage of the opportunity – may prove to be a factor that cannot be neglected on bond markets in the period to come. In the winter months, the rearrangement of pension fund portfolios, and the reduction or increase in risk exposure, will be facilitated in large part through the appropriate selection of securities that are sent back together with those returning to the TB system. These "repurchases" by the ÁKK may alleviate the fragility of the bond market, since it will become harder for extreme positions to form, while continuing low market liquidity will represent less of a problem.

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