Hungary Country Report 2007

1. Economic and Financial Background

Table 1: Key Economic and Financial Indicators		
	2005	**2006**
Population (million)	10.1	10.1
GDP (EUR billion)	87.2	93.4
Real GDP growth (%)	4.1	3.9
Inflation rate (%)	3.6	3.9
Unemployment rate (%)	7.2	7.5
Stock market capitalisation (EUR billion)	27.6	31.7
Stock market capitalisation (% of GDP)	31.7	33.9
Bond market capitalisation (EUR billion)	40.0	44.2
Bond market capitalisation (% of GDP)	45.9	47.3
Household gross savings ratio (%)	4.2	2.7
Household financial wealth (EUR billion)	52.9	57.2
Average per capita financial wealth (EUR)	5,240	5,664

2. Key Trends in the Global Market

Table 2: Net Assets by the Fund Industry in Hungary (EUR billion)					
	2002	**2003**	**2004**	**2005**	**2006**
Home-domiciled UCITS	3.86	3.12	3.63	5.81	6.36
Home-domiciled non-UCITS	0.17	0.35	0.70	1.95	3.71
Total AuM	4.03	3.47	4.33	7.76	10.07

Table 3: Net Sales of Investment Funds in Hungary (EUR million)					
	2002	**2003**	**2004**	**2005**	**2006**
Home-domiciled UCITS	-	-	-104.64	1,523.3	482.38
Home-domiciled non-UCITS	-	-	-	1,133.7	1,518.50
Total net sales	-	-	-104.64	2,657.0	2,000.88

The year 2006 was going to be a slow year – with general and local elections, steadily declining macro-economic figures and experts urging quick austerity measures and restrictions in fiscal policy. Consequently investors for most of the year proved cautious. After the election however, the old-new government introduced a number of restrictions, one of which was the introduction of a 20 % tax on interest and capital gains. The law entered into force on 1st September, therefore all investments made until 30th August were exempt. This resulted in a huge influx of money to investment funds (as well as long-term bank deposits and unit-linked insurance products) in the last days of August. Though there was a slight correction in the last quarter, in the year 2006 total assets of investment funds increased by 35.3 % in Hungarian Forint terms.

Funds that invest in real estate, that are non-public or use leverage that is not open to other security funds like guaranteed or derivative funds are classified as non-UCITS. These funds have showed a more dynamic growth in 2006, and real estate and guaranteed fund units outsold other fund types as well.

Though BAMOSZ have no direct information on foreign-domiciled funds, it is safe to say that the introduction of interest and capital gains tax resulted in a similar dynamisation of inflows as described for domestic funds. The general trend is the registration of an increasing number of foreign funds though, and a steady growth on assets under management.

3. Key Trends in the UCITS Market

Table 4: UCITS Assets by Fund Type (EUR billion)					
	2002	**2003**	**2004**	**2005**	**2006**
Equity	0.237	0.292	0.297	0.646	0.876
Bond	2.717	2.098	1.725	2.210	1.082
Balanced	0.059	0.065	0.033	0.258	0.117
Money market	0.788	0.664	1.466	2.333	3.108
Fund-of-funds	0.051	0.048	0.104	0.331	0.947
Other	0.004	-	0.004	0.030	0.228
Total	3.856	3.167	3.628	5.808	6.358
of which					
➢ **Guaranteed**	-	-	-	0.341	1.047
➢ **ETFs**	-	-	-	-	0.005

Table 5: Net Sales of UCITS by Fund Type (EUR million)					
	2002	**2003**	**2004**	**2005**	**2006**
Equity	-	-	-10.59	98.99	279.58
Bond	-	-	-426.27	385.36	-1.185.01
Balanced	-	-	-2.52	38.46	29.98
Money market	-	-	334.74	783.29	607.23
Fund-of-funds	-	-	-	194.32	559.57
Other	-	-	-	22.89	191.02
Total	-	-	-104.64	1,523.32	482.38
of which					
➢ **Guaranteed**	-	-	-	154.99	662.91
➢ **ETFs**	-	-	-	-	4.77

The key trends in the Hungarian market were the fast decline of bond funds as well as traditional money market funds in parallel with the rise of alternative low-risk vehicles (liquidity or short-term money market funds as well as guaranteed and real estate funds) on the one hand, and a steady increase of more risky products such as primarily “portfolio funds” (funds of funds constructed of the fund manager’s own funds to represent differing risk profiles) and equity funds, but to a lesser extent balanced funds and absolute return funds as well.

Bond funds lost over half of their assets due to withdrawals, but all other fund types attracted new investments in 2006. Equity funds and fund of funds attracted significantly more new investments in 2006 than the previous year, as did non-categorised funds. Most of the new investments still targeted money market funds, but there was a slight decrease compared to last year. Though achieving the slowest growth in 2006, money market fund assets still grew by one third.

The first exchange traded fund (ETF) was launched in December 2006.

4. Key Trends in Other Nationally Regulated Funds

Table 6: Assets of Other Nationally Regulated Funds (EUR billion)					
	2002	**2003**	**2004**	**2005**	**2006**
Real estate	0.07	0.25	0.41	1.421	2.270
➢ **Open-ended**					2.252
➢ **Listed closed-ended**					0.018
➢ **Unlisted closed-ended**					-
➢ **REITS**					-
Alternative management	-	-	-	0.012	0.071
Special funds	0.06	0.06	0.13	0.175	0.309
Guaranteed funds	0.04	0.04	0.16	0.341	1.047
Other					0.013
Total	0.17	0.35	0.70	1.949	3.709

Table 7: Net Sales of Other Nationally Regulated Funds (EUR million)					
	2002	**2003**	**2004**	**2005**	**2006**
Real estate	-	-	-	959.34	696.96
➢ **Open-ended**					713.88
➢ **Listed closed-ended**					-16.92
➢ **Unlisted closed-ended**					-
➢ **REITS**					-
Alternative management	-	-	-	11.51	53.29
Special funds	-	-	-	7.88	90.68
Guaranteed funds	-	-	-	154.99	662.91
Other					14.66
Total	-	-	-	1,133.72	1,518.50

As mentioned before, assets of non-UCITS funds showed faster growth in 2006. The most impressive increase was that of derivative funds (listed under alternative management, the closest thing to hedge funds available in Hungary), the total assets of which sextupled in 2006. Guaranteed funds also trebled, while institutional funds grew by almost 80 % as their number increased from 7 to 11.

Real estate funds attarcted most of the new investments in 2006, although less then the year before, and the total assets of real estate funds grew by 60 %. The vast majority of real estate funds are open-ended funds or fund of funds, there is 1 closed-end fund representing less than 1 % of real estate fund assets (there was one more in 2006 that reached the end of its term and was liquidated). There are no REITS in Hungary.

The first fund of funds investing in commodities was launced in 2006.

5. Trends in the Number of Funds

Table 8: Number of Funds					
	2002	**2003**	**2004**	**2005**	**2006**
Home-domiciled UCITS	-	-	-	-	
➢ **Funds**	92	92	97	108	128
➢ **Units**	92	92	97	108	128
➢ **Classes**	92	92	97	109	132
Home-domiciled non-UCITS	11	23	40	62	109
Foreign funds registered for sales	-	-	-	68	220
Fund launches	-	-	32	37	81
Fund liquidations	-	-	6	3	13
Fund mergers	-	-	2	1	1
Average fund size (median)					
➢ **Equity**					14.92
➢ **Bond**					11.20
➢ **Balanced**					9.84
➢ **Money market**					25.99
➢ **Real estate**					29.65
➢ **Special**					20.61

The number of domestic funds is steadily increasing, mostly due to the boom in (generally closed-ended) guaranteed funds. The number of publicly offered open-ended security funds also increased significantly as more and more fund managers introduced "portfolio funds". There are also some funds with two unit classes, but the majority of funds are single class (and umbrella funds are not allowed under Hungarian law).

The registration of foreign funds also sped up in 2006, as many Hungarian banks introduced the products of their parent companies, primarily for private banking clients.

Of the 81 new funds launched in 2006, over half were guaranteed funds, and another 14 were "portfolio funds". A number of derivative funds, some liquidity, equity and absolute return funds were also launched, alongside the first ETF and the first commodity fund of funds.

There was one fund merger, while most fund liquidations concerned closed-ended guaranteed funds that reached the end of their term, as well as one closed-ended real estate fund.

The average fund size was calculated as the median of funds (fund of funds were included in the category that they invest in, i.e. fund of equity funds in the equity fund group), the figures are given in million Euros. It is obvious from the figures, that money market funds and real estate funds are not only large in terms of total assets, but in terms of average fund assets as well (with the exception of balanced funds, figures are even higher without funds of funds).

6. Household Savings Allocation

Table 9: Main Assets of Households (EUR billion)					
	2002	**2003**	**2004**	**2005**	**2006**
Currency & deposits	21.96	22.58	26.23	28.58	30.87
Debt securities	4.27	4.21	5.29	4.75	5.21
Quoted shares	0.66	0.60	0.81	1.05	1.22
Life & pension funds	6.09	6.66	9.36	11.47	15.37
Investment funds	-	-	-	-	
➢ **Direct ownership**	3.16	2.63	3.16	5.51	6.92
➢ **Via life ins. policies**	-	-	-	-	
Other	19.00	18.80	22.43	23.86	24.35
Total financial assets	55.13	55.48	67.29	75.22	83.93

Table 10: Net Asset Acquisition by Households (EUR million)					
	2002	**2003**	**2004**	**2005**	**2006**
Currency & deposits	2,355	2,738	2,378	2,867	2,393
Debt securities	247	425	723	-405	457
Quoted shares	-63	-90	-165	0	-156
Life & pension funds	1,403	1,351	1,766	2,055	2,728
Investment funds	697	-149	328	2,078	1,388
Other	831	257	1,162	793	609
Total financial assets	5,470	4,532	6,192	7,388	7,420

data is for households only and in EUR billions

Data for household savings is from the National Bank of Hungary. It includes all financial assets of households, including any ownership in non-listed companies. Apart from cash and deposits, these make up the largest portion of household savings. When considering life and pension funds, it has to be noted that Hungary has a mandatory second pillar pension system since 1998, therefore it is not surprising that the ratio of pension savings is on the increase, and will most probably be growing further until at least 2013, the date for the first major payouts from these mandatory pension funds. Households are generally very risk-averse, the ratio of shares in household savings is limited, and their rise is only due to stock market performance, not growing interest.

The ratio of investment funds in household savings varied between 5 and 7 % through the years 2001-2005, however, with both the new acquisitions and the growth in value investment funds accounted for over 8 % of household savings at the end of 2006. There has been a change in the investment funds household prefer: the majority of funds redeemed in 2006 were bond funds, while the big increase in new household investments to funds was yet again to money market, real estate and guaranteed funds.

According to National Bank of Hungary data, 70,4 % of investment funds in Hungary is owned by households, 28,4 % by Hungarian institutions and companies and 1,2 % is foreign owned.

There are no NBH data on indirect investment fund unit ownership of households, but as an extrapolation of some data by NBH, HFSA and BAMOSZ, it can be estimated that approximately EUR 0.85 billion is held in investment funds via unit-linked products, and a further EUR 1.1 billion via pension funds.

7. Regulatory and taxation issues

7.1 **Capital Requirements Directive**:

The CRD has not yet been implemented in Hungary, but it is expected to be adopted by the second half of 2007. It will not be applicable to fund and asset managers in Hungary.

7.2 **MiFID implementation**:

MiFID Level 1 legislation has not yet been implemented in Hungary. The first draft of the law is expected at the end of May, according to the Ministry of Finance. According to the agenda of the Ministry the law could be adopted in Autumn 2007. The Hungarian Financial Supervisory Authority has organized regular consultation meetings with market representatives to discuss open questions.

MiFID Level 2 legislation has not yet been implemented in Hungary. It will be implemented in the same process as Level 1 legislation.

The Hungarian Financial Supervisory Authority informs market players regularly about the development of Level 3 guidelines.

7.3 **Pensions:**

The legislation of pension funds has changed substantially in 2006, especially for mandatory pension funds. In the next three years all mandatory pension funds will have to set up three separate portfolios, one risky, one balanced and one low-risk (the law stipulates minimum and maximum equity ratios, currency exposure and set levels for other risky investments such as real estate and derivatives). Pension fund members will have to choose between the three portfolios, and those who do not will be transferred to the portfolio suiting their age (i.e. those with more than 15 years until retirement will be in the risky portfolio). The law also eliminates the limits on investment fund holdings of pension funds, but requires costs to be “comparable” for direct and indirect investments.

The first Personal Pension Accounts were created in 2006, these are a mixed security and deposit accounts, onto which investors can place securities such as equities, bonds or investment funds and receive a tax incentive of up to 30 % for the investments as long as those investments remain on the account until retirement.

7.4 **Other regulatory developments**:

The Capital Market Act was modified to include broadened real estate fund disclosure requirements and real estate valuation rules have become stricter.

7.5 **Tax rules**:

The most important change was the introduction of a 20 % tax on capital gains and interest (or more accurately the raising of a 0 % tax to 20 %). This includes tax on investment fund returns for private individuals as well, for all instruments purchased after September 1 2006.

8. Investment management governance

The Hungarian Financial Services Authority issued Recommendations on client reporting for asset managers, investment decision rules and risk management, real estate fund management and on custody.

9. Fund Standards and Distribution

The Professional Standard Committee of BAMOSZ has modified and updated the asset valuation and performance measurement rules, and they came into effect in 2006.

The Ethics Committee of BAMOSZ has worked on the performance presentation and advertising norms, and they have also been finalized and adopted in 2006.

The Hungarian Financial Services Authority also issued Recommendations regarding the calculation of returns and benchmark returns, as well as on performance presentation. Investment fund TER was calculated last year and published by HFSA.

10. Trends in product development and level playing field issues

10.1 Real Estate Funds

Real estate funds make up almost 23 % of the Hungarian fund industry. The vast majority is open-ended funds and funds of funds, while we have some listed closed-ended funds and special, non-public funds. There are no REITS and all closed-ended funds have to be listed on the Stock Exchange by law. The Capital Market Act that regulates investment funds has some special rules regarding real estate funds. Real estate funds can invest in real property, bank deposits and OECD government bonds. Regarding infrastructure, should it be a separate real property (such as a building, offices etc.), real estate funds can invest in such infrastructure (but not in bridges, motorways etc.). There are risk spreading rules as well: a single real estate cannot account for more than 20 % of the portfolio of a real estate trader fund or 30 % of a real estate developer fund. Real estate under development cannot account for more than 25 % of the portfolio of a real estate trader fund or 60 % of a real estate developer fund. Liquidity requirements have been re-introduced during the modifications to the Capital Market Act in 2006. Real estate funds will have to have at least 15 % of their portfolio in liquid instruments as of mid-2007. There are also real estate valuation rules – valuation has to be done by an independent valuer or appraiser at least quarterly, while the new modifications to the Act specify the applicable methods and the necessary documentation of the valuation.

10.2 Funds of Hedge Funds

Funds of Hedge Funds do not exist in Hungary, and there is no special legislation regarding such funds.

10.3 Private Placement

There is a private placement regime in Hungary. It applies to all kinds of instruments, including investment funds (called closed or non-public funds). Non-public funds can be offered to all sorts of investors, based either on the number of investors, the minimum investments by one investor or investor qualification (institutional investors). The rules changed with the adoption of the Prospectus Directive, and are not likely to be modified by the adoption of MiFID.

10.4 Structured Products

Apart from guaranteed funds, other structured products (structured notes, bonds, etc.) have not yet picked up in Hungary. There is no exact data on the size of the market, but there is growing interest among banks and the market will probably grow in 2007. There is no regulation regarding structured products, which may at one point raise level playing field issues, but as the market is barely there yet, investment funds have not encountered the problem yet.

11. Other activities of the association

At the center of the lobbying activities of BAMOSZ was the Capital Market Act – improving real estate fund rules, allowing fund distributors to use sub-agents, etc.

BAMOSZ in association with Portfolio.hu (the largest on-line economic media) has organized a full-day conference on asset management and investment fund trends. BAMOSZ also sponsored a Portfolio.hu conference on the pension system.

BAMOSZ, CFA Society of Hungary and the Hungarian Financial Services Authority organized a half-day conference on GIPS for institutional investors, asset managers and the industry in general.

BAMOSZ, in association with Öngondoskodás Foundation, has assisted in the preparation of the curriculum of a secondary school financial knowledge course. A number of lectures were given on investment funds to teachers who will be teaching the course later.

BAMOSZ together with the International Training Centre for Bankers has been organizing a very successful asset management training course since 2003, which achieved wide popularity among the domestic asset management professionals and is accepted as a professional exam by the Financial Supervisory Authority.

Apart from monthly data on investment funds (published in a monthly newsletter on our website and circulated to the press), quarterly data regarding the asset management activities of BAMOSZ members are also collected and published in our Quarterly Report. We have published an Annual Report in 2006 as well.

The BAMOSZ website is a source of information and data on investment funds both in Hungarian and in English.