

THE HUNGARIAN PENSION SYSTEM: THE PRESENT AND A POSSIBLE FUTURE

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I. A CONCEPT ON IMPROVING THE SOCIAL PENSION SYSTEM

1. Challenges of the current pension systems

Demographic changes

In recent decades some demographic processes, rather than have occurred as popular wisdom would assume, instead have gained momentum, and they pose dangers to the future of the pension insurance systems. Decreasing birth rates have become a tendency in Europe from the last third of the last century: based on OECD's data, total fertility has continuously been on the decline since the 1970's in European countries. At the same time, life expectancy both at birth and at the age of 60 has increased, significantly changing the population pyramid: the proportion of older age groups has increased in comparison with younger ones.

In Hungary, this process was delayed slightly, due to social policies of the 1950's: In the first half of the fifties, and as these generations established families, in the seventies, birth rates have been extraordinarily high, but they, together with fertility rates, have been on the decline from the end of that decade. The birth figure of 1979 of 160 thousand dropped to 100 thousand by the mid-nineties, accompanied by a drop of the fertility rate from 2.0 to 1.3.

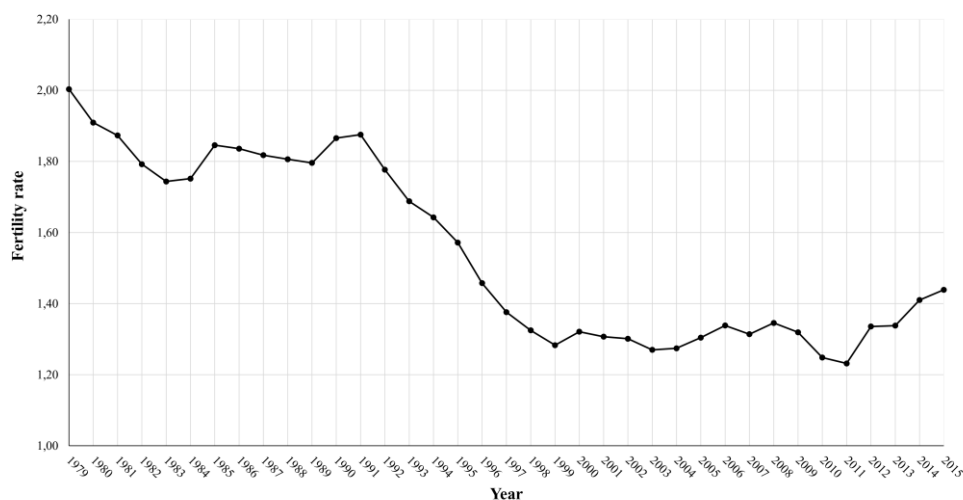


Chart 1. Fertility rate in Hungary, 1975–2015
(Source: Central Office for Statistics)

It is a wide-spread consensus in the literature on the relationship of fertility rates, birth figures and pension systems that a common social security system covering almost the entirety of the society results in a decreasing fertility rate.¹ Other opinions go further and claim that beyond the availability of social security systems, the developed nature of the financial system impacts fertility rates as well.²

Economic challenges

This study is concerned with two sides of economic challenges: globalization and state debt, or the effect on pension system thereof.

By globalization, we usually mean the internationalization of production and capital: as a consequence, states compete each other for investments leading to the decrease of labour costs and consequentially the decrease in contributions acting as income for the pension system. On the flip side, globalization enables labour mobility partly contributing to migrating workforce and partly the change in the structure of the labour market.

Pay as you go pension systems affect the state debt in two points: firstly, by the budget of the state pension funds, secondly, by the hidden (implicit) debt existing in the pension systems. The budget of the pension funds are planned on a yearly basis, meaning the income-expenditure balance needs to be established on a yearly basis. Should the balance fail to be struck and there is lack of income, the lack must be complemented from either the central budget or from other source which may explicitly increase state debt. On a longer term, if the contribution rate is below the rate necessary for the balance, meaning the pension system does not accumulate reserves, the inside, hidden (implicit) debt, i.e. the difference between the present value of the contribution and the pension promises in the future, increases.

At the end of the eighties, Hungary opened up towards the capitalistic world economy with the transition. This opening coupled with the accession to the EU has changed both the labour market and the economy enabling the free transfer of both capital and workforce. Migration of skilled workforce has become a phenomenon together with low added value production, at the same time, the hidden debt of the economic system surfaced. These and the expected slowdown of economic growth are going to challenge the Hungarian pension system economically.

Labour market trends

The classic employment structure has gone through a lot of changes in recent decades: the number of employees in the industrial sector has dropped, the number of people undertaking jobs in the service sector has increased. Additionally, the number of people working in part-time, self-employed or in some sort of small enterprise has increased.

In Hungary, the most impactful change on the pension system was the transition period. On the one hand, the labour market narrowed significantly, large numbers of people lost their jobs. On the other hand, a lot of people escaped unemployment by entering the pension system through some kind of early pension or disability pension. This way, the transition posed a dual threat to the pension system: a decreasing number of contributors and the increasing number of beneficiaries.

¹ HOHM, Charles F.: Social security and fertility: An international perspective. *Demography*, 12 (1975), 629.

² CIGNO, A.: *Economics of the Family*. Clarendon Press, Oxford, 1991.

The employment ratio started to improve in the mid-nineties after the shock of the transition period and reached a peak in 2006: at that point, 58% of active residents were deemed to be in employment. Employment ratio starts to rise spectacularly again after 2010: By 2015 it reached almost 64%. However, this upward trend expresses the actual labour market relations only in part: the increase takes place partly because the Central Office for Statistics changed its methodologies, and partly because the extraordinary increase of number of people employed through the public works programme.

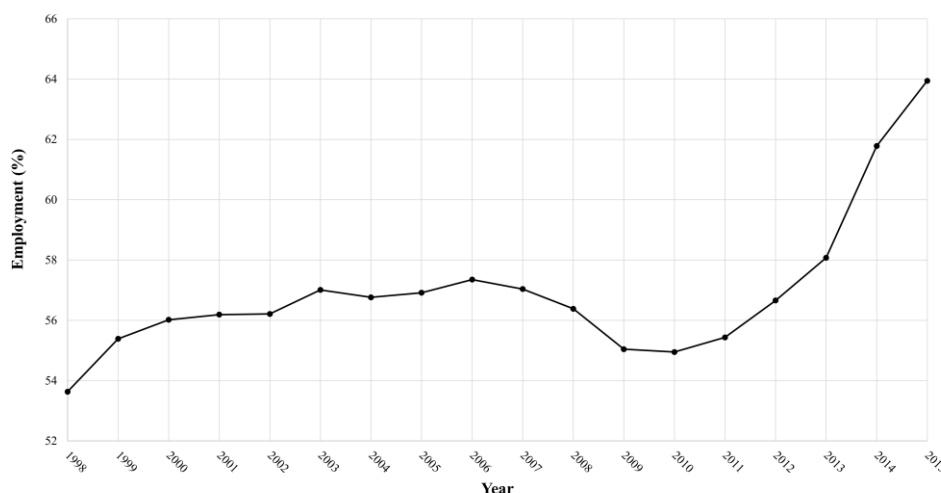


Chart 2. Employment ratio in Hungary, 1998–2015
(Source: Central Office for Statistics)

Today the biggest challenges are posed by minimal wage employment, long-term unemployment and contribution avoidance strategies; these are the sources of the largest gaps in the budget of the pension system. The minimal wage only results in a very low level of service gained even after a long period of service done. The contributions of those working in the black or the grey economy are missing from the current budget of the pension fund, but furthermore, there are fears that persons gaining income but avoiding paying contributions may be excluded from the beneficiaries if they fail to acquire the minimum service period necessary for the old-age pension.

Interestingly, no economic or legal literature is concerned with the presence and the situation of the Roma populace either from a demographic or a labour market standpoint when studying the sustainability of the Hungarian pension system. Yet, this is a minority of relatively high number, in a demographically more favourable position compared to the majority, most of whom are active in the informal economy.³ The inactivity of active age Roma citizens impacts the present and future sustainability of all the social security systems including the pension system. The impact is negative, and amounts to 1–3% of the GDP.⁴

³ KEMÉNY, I.: *Romák/cigányok és a láthatatlan gazdaság*. Osiris Kiadó–MTA Kisebbségkutató Műhely, Budapest, 2000.

⁴ World Bank: *Economic costs of roma exclusion*. Europe and Central Asia Human Development Department, 2010.

Thus, integrating Roma in the society both socially and economically is of significant importance from the point of view of the sustainability of the pension system.

2. Possible directions for further development

Legislators in European countries need to perform reforms due to the problems caused by the ageing society and the decline of contribution-paying citizens. In the case of pay as you go pension systems, if the incomes decrease and the pension expense increases, state budget support becomes necessary in order to upkeep financial balance. The traditional toolset to establish this balance and decrease the need of state support (increase in contributions, cutback of benefits, raise of pension age) may prove to be insufficient in the future. The auxiliary pension systems' may count on a growing role in establishing old-age financial security, thus the sufficient regulation and the optimal connection thereof to the state pension systems is a focal issue in European countries. The European Commission's *Green Book* on the route to the adequate, sustainable and secure *European pension systems* (2010) and the *White Book* on the roadmap of adequate, secure and sustainable *European pensions* (2012) confirm the future emphasis of the significance of auxiliary pension systems in establishing old age security.⁵

The wanted features of pension systems

Inside social security, *pension insurance is insurance* in which the insurance risk is not reaching old age pension age limit as of itself but rather, the uncertainty of the length of the pension age. Reaching old age pension age limit is not risk but an event probably taking place – the real risk is long life, meaning the danger of the individual living longer than what they were able to prepare for with savings.

The main task of a state social security pension system is to establish old age financial security for those living from wages and salary permanently: this can be achieved *only by a pension system based on obligatory participation*. The ambition to extend participation to as wide a range of active age citizens as possible beyond those living off wages and salary, e.g. those living off capital incomes can be accepted.

In the pension systems it is reasonable *to separate the principle of insurance and the principle of solidarity*. The application of the principle of insurance appears primarily in the benefits calculated actuarially correctly, thus establishing a solid, transparent and predictable connection between contributions and benefits. The principle of solidarity appears not primarily in the regroupage of income but rather in uniform rules on calculating and paying contributions.

Financing a social security pension system – with consideration to the challenges in front of us in the coming decades, could be designed in a mixed system, as a symbiosis of a pay as you go system and an auxiliary one also accumulating capital. *Precise record keeping of contributions paid* is an expectation from both the state and the auxiliary system.⁶

⁵ For further details on auxiliary pension systems, see: BARTA, J.: A foglalkoztatói kiegészítő nyugdíj. *Magyar Jog*, Vol. 60, No. 7 (2013), 426–427; BARTA, J.–PRUGBERGER, T.: *A foglalkoztatói kiegészítő nyugdíj megszervezésének és finanszírozásának útjai az Európai Gazdasági Térség államaiban és Magyarországon. Adózási pénzügytan és államháztartási gazdálkodás*. NKE Szolgáltató Kft., Budapest, 2015, 533–534.

⁶ For further details on features of pension systems, see: VARGA, Z.: *A magyar nyugdíjrendszer pénzügyei*. PhD-dolgozat. Deák Ferenc Állam-és Jogtudományi Doktori Iskola, Miskolc, 2012, 135, 139–160.

The private-then-state model

The service structure of the private-then-state model significantly differs from the state pension systems working today: in this model the individual does not get old age pension benefits from both the state and the auxiliary systems parallelly. Instead, the two parts of the pension are separated in time during the pension age. Living is covered by the benefit of the auxiliary system between a lower and a higher old age pension age limit,⁷ and the individual gets the state system pension after reaching the higher age limit. I call the benefit provided by the auxiliary system annuity and the one provided by the state lifetime annuity.

Annuity in its essence is a bank benefit with a maximal duration of the start of payment and the higher age limit. As a main rule, individuals may request to establish their annuity after reaching the lower age limit, calculated from the recorded contributions paid⁸ by the individual. The lower age limit would be flexible: the individual may request their annuity to be paid if it reaches a certain minimal level (minimum annuity). Starting the payment of annuity later than reaching the lower age limit results in a higher amount of benefit as the duration of payment is less. After reaching the higher age limit, the savings not paid out in annuity can be withdrawn in one lump sum or can be left for inheritance in case of early death.

The lifetime annuity is a benefit from the state system closely resembling today's state pension. In the structure of private-then-state model, lifetime annuity can be requested after reaching the higher age limit, when the individual has already received the savings accumulated in the auxiliary system.

In order to cover both the annuity and the lifetime annuity, the individual shall contribute a sum proportional to their income strictly and precisely recorded by both the state and the auxiliary system. The pension contributions are divided between the state and the auxiliary system, the state finances the lifetime annuities for the present year in a pay as you go system, the auxiliary system accumulates capital from the contributions paid and invests it with accordance to the rules of the model.

The investment policy of the capital accumulated in the auxiliary system is one of the main particularities of the private-then-state model: the capital may be invested mainly into humane instruments. Augusztinovics was the one who first claimed that pension savings should be invested in human resources, raising and educating the younger generations.⁹ Berlinger argues convincingly in the same topic to connect the pension system to the student loan system, and the return of the student loans provided by pension savings.¹⁰ The private-then-state model follows suit and invests the capital accumulated into the raising and education to the growing generations to pay contributions.

The relations of this model to present-day Hungarian pension system and EU trends

In the private-then-state model detailed above, the pension insurance is insurance, and it treats longer than expected life as a risk to be managed by the social security system instead of meeting a predetermined pension age. Those living off wages and salary are the insurees paying percentile contributions (insurance fees) from their income. The model is financed

⁷ The higher age limit is established to be around the statistical life expectancy date.

⁸ Savings equal the contributions paid to the auxiliary system and its yield over the active period.

⁹ AUGUSZTINOVICS, M.: Egy értelmes nyugdíjrendszer. *Közgazdasági Szemle*, Vol. 40, No. 5 (1993), 415–431.

¹⁰ BERLINGER, E.: A nyugdíjrendszer és a diákhitelrendszer összekapcsolása. *Közgazdasági Szemle*, Vol. 52, No. 9 (2005), 631–647.

from multiple sources: the pension system provides pay-as-you-go (state) benefits to those surpassing the average life expectancy as well, but it operates a flexible and transparent (auxiliary) capital accumulating system based on state regulations and compulsory participation. This structure, rather than the parallel system of today provides sequential benefits from the auxiliary and the state systems.

In this private-then-state system the insurance principle is separated from the solidarity principle, thus establishing a close connection between contribution and benefit of the pension system, creates a system that is transparent and incentivises contributions. Paying Contributions (and earning the right to benefit) during the active years is assessed linearly and additively, meaning twice as much contribution results in twice as much benefit. Solidarity always means a kind of redistribution: in today's pension systems, redistribution takes place primarily from men towards women and from low-salary towards high-salary individuals. Instead, it is reasonable and justified if solidarity is expressed in uniform contribution rates and benefit calculation formulae for everybody, despite differences in income, demographic and other conditions.

In order to establish actuarially correct benefits, precise recording of paid contributions is important in both the state and the auxiliary system. In the Hungarian auxiliary pension systems it has been a legal requirement from the start and has been implemented. In the state system, individual accounts to keep precise records of contributions have been established in recent years,¹¹ but their sense is questionable: firstly, because only the pension payments submitted since 2013 are recorded (and only the individual pension contribution, one third of the total pension contribution, on the other hand, the benefit is not calculated based on the paid contribution but rather the gross income.¹²

Beyond unfavourable demographic and economic relations, labour market trends also have significant role with regards to financing pension systems from challenges of the current pension systems: masses are missing from the labour market in addition to the problem of an ageing society. This study mentions the Roma populace in this regard: involving them in the labour market would perceptibly improve the long-term financing situation of a pension systems. This is made possible by the private-then-state system's student loan feature, where the capital is provided for by the auxiliary pension system.

When introducing the compulsory private pension fund system, the legislation in Hungary was motivated by an intention to help the economy recover and decrease long-term expenses of the pension system, and when it was terminated in 2011,¹³ the legislation was motivated by cutting back on state debt. The investment policy of the pension funds was quite limited: they could invest in treasury bonds and domestic securities primarily.¹⁴ In the private-then-state model's auxiliary system, investing capital following Augusztinovics's (1993) gestation loan theory into human resources (mainly in education), a new structure of generation distribution occurs that can contribute to the economic and social integration of those living in deep poverty and Roma, something that entails economic growth, improvement of employment ratios, and is of key importance with regards to the sustainability of the pension system.

¹¹ Section 96/A of Act LXXXI of 1997.

¹² Section 22 of Act LXXXI of 1997.

¹³ The compulsory private pillar is not absolutely non-existent though, but the more than 3 million headcount dwindled down to a few tens of thousands.

¹⁴ The investment policy of other existing voluntary pension saving schemes is more lax: the person making the savings can choose an investment portfolio based on their intention to bear risk.

The founding thought of the private-then-state system's financing structure meets the special policy intentions of both the Hungarian pension system and the Hungarian government's welfare intentions: they leave room for capital accumulating schemes. The institutional system of the private-then-state model, on the other hand, significantly deviates from that of the Hungarian pension system: the model inserts a compulsory capital accumulation pillar before, and not next to, the pay as you go state system – and the existing compulsory capital accumulation scheme in the Hungarian pension system was in fact terminated by the Hungarian government just a few years ago. The Hungarian pension system is not experiencing any urgency to reform now but subsidizing auxiliary schemes with tax reductions, the parent benefit's appearance in the legal system all show towards the eventual necessity of a comprehensive pension reform.

The latest EU pension policy trends show that the role of the auxiliary pension is not to complement the state pension to the income level of the active age anymore, instead, it is to provide an income level sufficient to cover the costs of living in old ages. This means that, apparently, not only will state pension be unable to retain an active age income, but it will not be able to protect the insurees from old age poverty either. The private-then-state model's concept suits this trend, as state benefits will be paid only to people surpassing the statistical average life expectancy, meaning the collateral contribution necessary can be significantly reduced compared to today's needs, and the contributions thus made available can be regrouped into the compulsory auxiliary system. With this step, the service level can be proportional to the active age income, and the model stays transparent, correct and incentivising contributions by not requiring surplus payments from the insurees compared to the current system.

II. THE CURRENT STATE OF THE ADDITIONAL PENSION PILLAR IN HUNGARY

1. The development of the additional pension pillar in Hungary

In Hungary, the first law introducing institutional voluntary retirement savings was *born in 1993*, allowing the foundation of *so-called voluntary mutual pension funds*. It was followed by *a mandatory private pension fund system based on the principle of full funding*,¹⁵ which was dominating the additional pillar for more than a decade.

In the mid-1990s, the situation was ripe for the government in power at the time to set out to restructure the pension system. Due to the huge debt accumulated toward the World Bank, it had a substantial impact on the process of transformation by promoting and encouraging the reduction of pension-related expenses with the introduction of a more moderate version of the so-called Chilean model.

Hungary was the first among the Central Eastern European countries to introduce a mandatory pay-as-you-earn private pension system as an additional pillar, with the others following suit, except Slovenia and the Czech Republic. In 1997, the Hungarian Government adopted the three laws that implemented the transformation. As a result of the changes, the pension system became a three-pillar system, with the inclusion of a

¹⁵ The essence of the pay-as-you-earn principle is that the monthly payments of private pension fund members are reserved and invested by the fund during the so-called accumulation or waiting period (its minimum duration is 15 years as determined by law), creating the financial basis for future pension services. Biometric, investment risks and the risk of untimely death or becoming disabled are all taken by pension fund members.

mandatory two-pillar pension system consisting of a pay-as-you-go state pension system and a pay-as-you-earn private pension system. The third pillar included several voluntary pension saving forms such as the voluntary mutual pension funds mentioned above and occupational pension scheme providers. As a result of the compulsory implementation of the Directive of the European Parliament and the Council of Europe 2003/41/EC, Act CXVII of 2007 on Occupational Retirement Provisions and the Institutions was adopted in Hungary which has facilitated the foundation of occupational pension scheme providers since 2008.¹⁶

In September 1997, the first mandatory private pension funds appeared in Hungary. The private pension fund members *paid a membership fee mandatorily deducted by their employer from their taxable income* as the base of pension contribution as well as *a pension contribution to the Pension Insurance Fund*.

Members of the state pension fund system paid a pension contribution of 8% while private pension fund members paid only 2% to the central Pension Insurance Fund and another 6% as a membership fee so the greater part of their pension contributions was received by the private pension funds. As a consequence, the revenue of the state Pension Insurance Fund decreased in proportion to the number of entrants to the private pension funds. The lack of missing pension contributions due to membership fees was compensated from the revenues of the state budget. No one expected, however, that instead of the projected two hundred thousand people, more than three million would enter the private pension fund system, thus causing an enormous shortage in the Pension Insurance Fund, which constantly had to be compensated from the state budget.

In return for the payment of shared pension contributions, private pension fund members were entitled to receive only three-fourths of the entire social security pension and they would have received the remaining one-fourth, or even more in an ideal case, from the private pension funds. Therefore the members of the so-called mixed pension system would have received three-quarters of their pensions from the state and a quarter from the private pension funds.

After the accession and with the expiry of the given grace period, the European Union began to resent the serious budget deficit indirectly generated due to the introduction of the mandatory private pension fund system. As a consequence, in the summer of 2010, not only in Hungary but also all the other EU member states that had previously introduced an additional pay-as-you-earn pension system turned to the European Commission with the request of changing the rules of calculating state deficit and national debt. On the one hand, their goal was to achieve that the EU would not take the budget deficit generated by the introduction of the private pension fund system into consideration in the accounts, on the other hand, they also wanted to achieve that the mandatory membership fees paid to the private pension funds could be recorded as budget revenue. If the request had been accepted, the budget deficit in Hungary would have been only 2.4% on paper instead of the existing 3.8% which, in turn, would have met the required maximum of 3%.

Eventually, the EU rejected the request so the Hungarian government resolved the situation with administrative means, intervening in the private pension fund system by quick and successive law amendments. The greatest change was brought about by the law adopted on December 13th, 2010. The members of mandatory private pension funds had to

¹⁶ Only one institution of the kind was established in Hungary in 2010. It was acquired by the Allianz Group in 2015, turning the name of the company into Allianz Foglalkoztatói Nyugdíjszolgáltató Zrt. It consisted of only 3 employers in 2014.

decide whether they wanted to remain in the private pension funds or return to the state pension system until January 31st, 2011. Those who did not return to the social security pension scheme, with effect from December 1st, 2011 onwards, could not gain any additional period of service in the social security pension system and lost their entitlement to receiving any state pensions. The accumulated capital on the individual accounts of those who decided to return to the state pension system was transferred to a fund specially created for this reason. They were allowed to make a decision on what to do with their return on investment above the inflation rate. According to the data released at the beginning of February 2011, 98% of private pension fund members decided to return to the state pension system.

The law was attacked by several people at the Constitutional Court, presumably it was also the reason why the Hungarian Parliament adopted another law in 2011, amending the previous one. *This law terminated the mandatory payment of membership fees to private pension funds, the members were allowed to pay voluntarily a so-called contribution deducted from their taxed income, the amount of which was not determined by the law any longer but by the private pension funds themselves. Thus the mandatory retirement provision schemes ceased to exist in Hungary.*

It was made possible for private pension fund members to return to the state pension system again, the membership of those who decided to return to it terminated on May 1st in 2012. The strict provision, according to which those who had previously chosen membership in any of the private pension funds lost their entitlement to receiving state pension in the future, was also repealed.

The termination of mandatory membership and the mandatory payment of membership fees to the private pension funds as well as providing the opportunity to return to the purely state pension system in two stages were not left without serious consequences: the number of private pension fund members was drastically reduced, forcing several private pension funds to close down.¹⁷

On a systemic approach, the Hungarian pension system has turned back to its former two-pillar structure again: the first pillar is a mandatory pay-as-you-go state pension system and the second pillar is a voluntary, additional one, including all institutional forms of pension savings such as pay-as-you-earn private pension funds, voluntary mutual pension funds, occupational pension schemes, the so-called. tax assisted pension savings account (NYESZ account) and life insurance policies designed for pension savings.

2. The characteristics of individual institutions

Voluntary mutual pension funds and private pension funds

Voluntary mutual pension funds and private pension funds operate on a pay-as-you-earn principle. Two periods are distinguished in these systems: the *so-called the accumulation period* and the *so-called service or annuity period*.

During the accumulation period, savers collect the cover of their future pension, the minimum duration of accumulation is stipulated by the relevant laws (it is 10 years in the case of voluntary mutual pension funds and 10 years in the case of private pension funds). During this period, the members perform so-called payments to *their individual account*,

¹⁷ The number of the members of the private pension funds exceeding 3 million decreased to 99.299 persons by the end of 2011 and dropped to 74,400 persons by the end of March, 2012. By 2014, only four pay-as-you-earn private pension funds were standing with approximately 61,000 members.

which amounts are invested in by the pension funds in accordance with their investment policy in the framework of a portfolio investment scheme chosen by the members and the yields achieved are credited to their account. After the expiration of the accumulation period and receiving the entitlement to state pension, members are also entitled to the additional pension service which is calculated based on the amounts accumulated in their individual accounts, mostly in the form of annuity. The pension or annuity is provided by the pension fund itself or it enters into a contract with an insurance company and purchases insurance annuity.

Savers pay their contribution deducted from their pre-tax income to both forms of institutions.

During the accumulation period, the amount accumulated in the individual account is in the ownership of the members but their freedom to act is restricted only to the designation of beneficiaries. In preparation for the possible event of their death during the accumulation period, *pension fund members are allowed to designate a beneficiary* with regard to their individual accounts for whom the amount accumulated in the individual account should be paid. If a beneficiary is already designated, the amount in the deceased pension fund member's account cannot be inherited, it is paid to the beneficiary as part of the service the pension fund provides. It depends on the choice of a fund member to designate a beneficiary who can be not only a heir but anyone else. More than one beneficiary can be designated up to different levels of entitlement, the designation of beneficiaries can be either withdrawn or changed.

During the service or annuity period, a beneficiary could not be designated to receive the amount not yet paid, which resulted in some criticism because the amount accumulated over the decades (up to tens of millions of Hungarian forints) remained at the private pension fund in the case of the untimely death of the member during the annuity period. In 2015 the laws on voluntary mutual pension funds and private pension funds were amended which facilitated the payment of the remaining amount on the service or annuity account to the designated beneficiary even in the case of a member's death during the annuity period. If the deceased pension fund member does not designate any beneficiaries, the rules of inheritance must be applied. The possibility of a beneficiary designation or heritability need to be provided even if it is not the pension fund that provides the annuity service but it "buys" that from a private insurance company, that is, it enters into a contract with a private insurance company for providing annuity service.

Voluntary mutual pension funds and private pension funds provide annuity services only for their members, their relatives or beneficiaries are not entitled to them. This possibility was earlier provided by the mandatory private pension funds. For relatives, the possibility of a beneficiary designation or heritability provide "care".

Occupational pension scheme providers

The unique feature of this form of saving for retirement is that it is focused on the employer's engagement and not that of the saver's. The employer makes a decision about the introduction of an occupational pension scheme, if there is no such scheme offered by the employer, the employees can only collectively put pressure on the employer. One can become a member if they have an employment contract with the founder of the scheme and their contract includes the employer's commitment to paying contributions. The terms of pension services are determined by the employer within the framework of the related rules and regulations.

The occupational pension scheme basically operates according to two models:

- It can be financed *by the principle of pre-defined levels of retirement service (fully funded pension scheme)* where the financial and biometric risks are borne by the employer or
- it can be defined *by payment (partially funded pension scheme)* where the retirement service is not determined, it depends on the magnitude of the contributions and the yields of their investment. The employer is obliged to pay a certain amount of contributions, the risks of investment falls on the employee.

Employers in Hungary mostly prefer fully funded pension schemes, that is, retirement services determined by paid contributions.

Retirements service is provided by accumulation during *the waiting period* which is primarily paid by the employer in the form of regular payments and investments of pension contributions. The waiting period starts from the beginning of membership, although the employer determines its duration, it is maximized in 10 years by legal provisions. Pensions can be provided after the waiting period. The employee may decide to pay *supplements to the contribution* paid by the employer. The employer has the right to stipulate that the employee has to pay a supplement as well.

*The amount credited to members' accounts*¹⁸ and its yields are the property of the member. In the case of both pension schemes – in order to bond employees – a period of conditional acquisition of rights can be determined which is the shortest period of time spent in employment, after which the employer gets the ownership of the employer contributions and the yields credited to their account. The period of conditional acquisition of rights can range from 0 to 3 years.

In the event of death, members may designate a beneficiary in a public document (death beneficiary). More beneficiaries can be designated, a member may also appoint a new beneficiary at any time. It is also possible to withdraw a beneficiary designation. If the member does not designate a beneficiary or the designation is repealed, the member's natural heir or heirs should be considered as beneficiary, in the share of their inheritance. The beneficiary becomes the exclusive owner of the account at the time of the member's death.

The pension scheme might contain a provision that in the event of a member's death no beneficiaries can be appointed. In this case the amount in the account is transferred to the member's occupational pension provider at the time of death of the member, and it is further transferred to member accounts of the pension scheme, calculated in proportion to the credit balances. If the employer payment of members' contributions is subjected to the payment of supplements by the employee, the pension scheme cannot contain any provision on the exclusion of beneficiary designation.

In the case of fully funded pension schemes, the law allows for designating a beneficiary for providing reversionary pension.

¹⁸ Contributions paid by the employer. membership payments and investment yields are credited to a member account. After reaching retirement age, the pension service is calculated based on the amount held in the member account.

Pension savings accounts

Pension savings accounts (NYESZ account) can be opened by any individual who is not entitled to a pension yet and puts at least 5,000 forints in the account. The required period of savings qualifying as a pension service is a minimum of three years but getting full tax benefit becomes possible only after 10 years of savings. There can be two types of pension savings accounts: money accounts or securities accounts. The account manager is not obliged to pay interest for the retirements savings placed in the money account because the goal is to invest the money primarily into securities. The discounts are therefore mainly related to the securities account when the saver invests the retirement savings in securities. The state supports the opening of NYESZ accounts in a way that an amount specified in the personal income tax (PIT) is returned to the NYESZ account of the individual in a form of benefit (savings support). The National Tax and Customs Administration (NTCA) transfers a maximum of 100,000 forints or 20% of the amount in the pension savings account after paying taxes in a given tax year.

An additional benefit is that the profits and yields (interest, capital gains etc.) of the transactions of investment assets in the securities account are exempt from taxation – except for stock dividends – and pension services paid from the account are also tax-free. Income tax is to be paid for the interest on financial assets held in the account. The amount of money paid by the saver is accumulated in the money account together with its potential interests and the part of income tax returned by the NTCA; in the securities account, however, the yields of investment assets and the part of income tax returned by the NTCA are collected. The account manager may charge a fee for managing the account and providing investment services.

Payment from a NYESZ account is considered a *tax-free pension service* if, in the case of the termination of the account, the account holder is entitled to receive pension, or, in exceptional cases, after 10 years following the opening of account, if the account holder is declared permanently disabled and becomes entitled to receive invalidity pension.

Payment from a NYESZ account is considered a *taxable pension service* if the account holder becomes entitled to receive pension, saves for at least three years but the termination of the account happens in no more than 10 years after opening the account. In this case, the account holder can keep the savings support but the overall yield achieved on the entire portfolio until the date of terminating the account – money and securities – qualifies as other income for which income tax and health contributions are to be paid.

In the case of payment not qualifying as a pension service, the payment support has to be paid back to the NTCA increased by 20% as a self-employed tax payer and income tax has also to be paid if any income is generated by the investment.

The assets held in the securities account – according to the rules of the inheritance of ordinary securities accounts – are a part of the inheritance. The inheritors can choose between the options of asking for selling the existing securities and receiving their yield or, if they have a securities account, of deferring the securities in the NYESZ account. The inheritors are exempt from taxation in terms of the yields or return in the NYESZ account regardless of the number of passed tax years and the entitlement to receive pension.

In respect of the amount held in the money account the situation is similar, the only difference is that a beneficiary can be designated in the event of death by applying the specific statutory rules to this type of payment account.

Conclusions

In Hungary, the types of voluntary pension savings have become more diverse recently, new institutions receiving state support have also appeared such as occupational pension schemes and pension savings accounts, furthermore insurance companies offer more and more of these types of products, the number of insurance contracts has been growing thanks to the tax subsidies provided by the state. The system of voluntary mutual pension funds works well but the prominent role of the pay-as-you-earn pension funds has been almost entirely ceased. The institutions of the current second pillar still ensure the opportunity to pay voluntary supplements to old-age pensions provided by the state as it is also preferred by the European Union but it does not seem to be enough in the long term. The majority of the Hungarian population does not take advantage of voluntary pension savings so new reform solutions are needed to be found.