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STRUCTURE OF THE HUNGARIAN PENSION SYSTEM AND THE MOST IMPORTANT FEATURES OF THE CERTAIN PILLARS WITH REGARD TO THE EXPECTATIONS OF THE EU*

Abstract: *Europe is facing a major demographic crisis, because longer life-span, declining birth rates and an ageing society. This situation affects the state pension systems as well, which operation on the pay-as-you-go basis, because fewer and fewer young people will support more pensioner for a longer time. In addition to decreasing contribution and increasing payments, budget support will be needed. However, this has EU limitations. In the final case, this situation could lead to the reduction of the amount of state pensions, which could degrade the previous replacement rate. According to predictions in most Member States an supplementary pension will be required to ensure old-age living. In this regard the EU has set out its expectations.*

The study examines that how can the institutions of the Hungarian supplementary pension system meet the expectations of the EU in the light of legal regulations.

Keywords: *state pension system, supplementary pension, occupational pension, pension insurance, pension funds*

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1. STRUCTURE OF THE HUNGARIAN PENSION SYSTEM

According to the Fundamental Law of Hungary, the livelihood of the elderly shall be provided by maintaining a single compulsory pension system based on social solidarity and by authorizing the operation of social institutions established on a voluntary basis.[1]

So, starting from the Fundamental Law, the Hungarian pension system is based *on two pillars*: on the compulsory, social security systems, or in another name on state pension system[2] and on the voluntarily created system of institutions, which facilitates an individual, facultative self-reliance. This system is confirmed by the Government Decree No. 1281/2010. (XII. 15.) on the conceptual directs of execution of pension reform and on the tasks relating to free choice of pension funds, which states in the 1. *a) point*, that in order to create long-term financing, the three-pillar system returns to the two-pillar system.

Some legal literature sources consider the Hungarian pension system as a three pillars system, in line with the widespread perception of the EU, in which the first pillar is the state pension, the second one is the occupational pension, and the third one is the other voluntary savings.[3] However we need to take into consideration that the occupational pension did not spread and did not strengthen in Hungary as much as in Denmark, in Netherlands, in France or in Germany,[4] etc., because the role of it is still slight, we don't consider it a separate pillar[5], and the laws mention two pillars.

We can find such a literary standpoint, which states, that there is a "supplementary pillar" because under the Subsection 1 of 32/B. Section of Act III of 1993 on the social administration and social benefits, the *allowance for elderly* can be

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[1] According to Subsection 4 of Article XIX of the Fundamental Law of Hungary, Hungary shall advocate the livelihood of the elderly by maintaining a single compulsory pension system based on social solidarity, and by authorizing the operation of social institutions established on a voluntary basis.

[2] According to Subsection 1 of Article 1 of Act LXXXI of 1997 on Social Security Pension Benefits, the operation and improvement of the compulsory social security pension scheme is the responsibility of the State. The social security pension system is designed to provide benefits to the insured persons in their elderly years, or to their relatives in the event of death.

[3] Anett Pandurics, Péter Szalai, „A második és harmadik nyugdíjpillér szerepe a magyar nyugdíjrendszerben", *Pénzügyi Szemle* 2/2017, 219-220.

[4] Európai Szemeszter – Tematikus tájékoztató, A nyugdíjak megfelelősége és fenntarthatósága, https://ec.europa.eu/info/sites/info/files/file_import/european-semester_thematic-factsheet_adequacy-sustainability-pensions_hu.pdf, 15 February 2019.

[5] The Hungarian economic journal describing the introduction of an occupational pension program in Poland stated that „this pillar of the pension system is missing in Hungary as well". See: Olyat lépnek nyugdíjügyben a lengyelek, ami Magyarországnak is példa lehet, https://www.portfolio.hu/befektetes/nyugdij/olyat-lepnek-nyugdijugyben-a-lengyelek-ami-magyarorszagnak-is-pelda-lehet.276735.html, 15 February 2019.

provided as a support for elderly people without a livelihood. The Act regards it as a supplementary pillar because it provides living benefits for the elderly people upon aid principle and not alongside the insurance logic.[6]

The second, supplementary private pension fund system started to develop after the change of regime. The first Act, which facilitates the institutional voluntary pension savings was born in 1993, which was the Act XCVI of 1993 on Voluntary Mutual Insurance Funds (VMIFA). Next came the Act LXXXII of 1997 on Private Pensions and Private Pension Funds (PPFA), which introduced the compulsory private pension fund system based on the principle of full funding.[7]

In 1997, the Hungarian Parliament adopted not only this one but a package of laws.[8] As a result of the changes, the pension system became a three-pillar system, with the inclusion of a mandatory two-pillar pension system consisting of a pay-as-you-go state pension system[9], and a pay-as-you-earn private pension system.[10] 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.[11]

The pension savings accounts were introduced by the Act CLVI of 2005, in order to be able to invest not only institutionally, but also with individual investments. From September 1997, the first mandatory private pension funds were

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[6] Árpád Olivér Homicskó, *A magyar társadalombiztosítási és szociális ellátások rendszere*, L' Harmattan Publisher, Budapest 2016, 239.

[7] The essence of the full-funding principle is that the monthly contributions of the members of the private pension fund are reserved and invested by the fund during the accumulation period or waiting period (its statutory duration is at least 15 years). This will create the capital coverage of the future pension service. The biometric risks (death, invalidity during the accumulation period) and investment risks are borne by the member.

[8] Judit Barta, „The Role And Function of the PAY-AS-YOU-EARN pension system int the Hungarian pension system, *European Integration Studies* 1/2011, 5-15., Zoltán Varga, "Analysis of the changes in the Hungarian pension system", XXVI. microCAD International Scientific Conference, 29. March – 30. March. Conference Book, 2011.

[9] The pay-as-you-go financing means that the current pension expenditures are paide from the contributions that are currently paid. For the sustainability of the system it is essential that the side of the contributor and the side of the payer is balanced. The deficit is charged to the budget by the law in force.

[10] See more about the topic: Judit Barta, „Visszatérés az egypilléres kötelező nyugdíjrendszerhez (a 2010. december 13-án elfogadott törvénycsomag értékelése)", *Gazdaság és Jog* 3/2011, 9-15. (2011a)

[11] 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.

established 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 income 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. 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 provided grace period by the European Union, they criticised the serious budget deficit indirectly generated due to the introduction of the mandatory private pension fund system. Consequently, in the summer of 2010, not only in Hungary but also all of the Central Eastern European 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. 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, and they also wanted to achieve that the mandatory membership fees paid to the private pension funds could be recorded as budget revenue. In the event of the acceptance of this request, 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%.[12]

[12] The long-term sustainability of public finances remains a challenge, mainly due to ageing. The country is expected to face an increase in age-related costs of 3.3% of GDP until 2070, driven by public expenditure on pensions (1.9% of GDP) and on healthcare and long-term care expenditure (1.0% of GDP). In addition, pension adequacy is creating additional challenges to the long-term sustainability of public finances. There is a growing income gap between new and old pensioners and between pensioners and wage earners, which may lead to additional spending when the gap is corrected.

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 13, 2010. The members of mandatory private pension funds had to decide whether they wanted to remain in the private pension funds or return to the state pension system until January 31, 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 decide 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 31, 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. he 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.[13]

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

Communication from the Comission to the European Parlament, the European Council, the Council, the European Central Bank and the Eurogroup 2020 European Semester: Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011 (SWD/2020/516 final).

[13] 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.

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.[14]

2. THE MAIN FEATURES OF THE COMPULSORY SOCIAL SECURITY PENSION

In Hungary the comprehensive social security system, which concerns to everybody was established in 1975, by the adoption of the Act II of 1975 on Social Security Benefits. New rules were needed because of the changes of social and economic environment, which were resulted by the transition to market economy. In 1997, three Acts were adopted, which incorporates the new rules of social security. There is a comprehensive Act, which regulates the general provisions and there are separate acts in relation to the social security pension benefits and on the services of the compulsory health insurance system:

- Act LXXX of 1997 on the Eligibility for Social Security Benefits and Private Pensions and the Funding for These Services (Tbj.) (hereinafter referred to as “SPA”)
- Act LXXXI of 1997 on Social Security Pension Benefits (hereinafter referred to as “SPBA”) (Tny.)
- Act LXXXIII of 1997 on the Services of the Compulsory Health Insurance System (hereinafter referred to as “CHISA”) (Ebtv.)

According to the SPA, the social security means a societal pooling system covering – in accordance with the rules laid down in this Act – the citizens of Hungary and other natural persons working in Hungary subject to the special provisions set out in this Act. Participation in the social security system is mandatory in accordance with the law.

Insured parties shall pay contribution in the system of social security. For this they can obtain the right for themselves and for their relatives, described by law, to social security benefits. The insurance relationship is created on the strength of law simultaneously with the underlying relationship. In order to ensure sufficient financial cover for benefits provided under the social security system employers are required by law to pay contributions and other provisions of the like.

Everybody is an employer who employs insured parties or himself. Health insurance and pension insurance services are provided in the system of social security.

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[14] Judit Barta, (2011a), 9-15.

According to the provisions of the SPBA, the operation and improvement of the compulsory social security pension scheme is the responsibility of the State.[15]

The Act stipulates that the State shall guarantee the payment of social security pension benefits for the eventuality where the expenditures of the Pension Insurance Fund are in excess of its revenues. In this case, the central budget shall allocate the difference in an appropriation account.[16]

The social security pension system is designed to provide benefits to the insured persons in their elderly years, or to their relatives in the event of death.[17]

Therefore, pension insurance benefits can be:

- old-age benefits and
- dependents' benefits (widow's pension, orphans' pension, parent's benefits, accident-related dependent's benefits), and rehabilitation benefits.

Social security pension benefits are adjusted to the income or earnings on which pension contributions are paid consistent with the length of service time acknowledged.[18]

Full old-age pension benefits shall be given:

- to persons of the age categories specified in the Act[19],
- who has at least twenty years of service time.[20]

Full old-age pension benefits shall be due to any woman, irrespective of age, who has at least forty years of service time.[21]

The amount of old-age pension benefits depends upon the recognized service time and the average monthly income on which the old-age pension is based. The amount of old-age pension benefits shall be a percentage of the average monthly income on which the old-age pension is based. The Act contains a Schedule No. 2 which defines the concrete percentage, e.g. in case of a service time of 40 years, the old-age pension is the 80% of the average monthly income, while in case of a service time of 50 years or more, the old-age pension is the 100% of the average

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[15] Subsection 1 of Section 1 of the SPBA.

[16] Subsection 2 of Section 2 of the SPBA.

[17] Subsection 1 of Section 1 of the SPBA.

[18] Subsection 3 of Section 2 of the SPBA.

[19] According to Subsection 1 of Section 18 of the SPBA the retirement age for old-age pension benefits under the social security system shall be:

a) the 62nd birthday for persons born before 1 January 1952;

b) the 62nd birthday for persons born before 1 January 1952, plus 183 days;

c) the 63rd birthday for persons born in 1953;

d) the 63rd birthday for persons born in 1954, plus 183 days;

e) the 64th birthday for persons born in 1955;

f) the 64th birthday for persons born in 1956, plus 183 days;

g) the 65th birthday for persons born in 1957 or thereafter.

[20] Subsection 2 of Section 18 of the SPBA.

[21] Subsection 2a of Section 18 of the SPBA.

monthly income.[22] In order to ensure the minimum subsistence level, the Act stipulates that the amount of full old-age pension benefits may not be less than the mandatory minimum defined in specific other legislation.[23] If the average monthly income on which the amount of full old-age pension benefits is based is below the minimum amount of old-age benefits described in specific other legislation, the amount of full old-age pension benefits shall correspond to the average monthly income on which the pension is based.[24]

3. THE PRESENT AND FUTURE ROLE OF THE SECOND, SUPPLEMENTARY PILLAR FROM THE POINT OF VIEW OF THE EU[25]

In Hungary, the second pillar has a supplementary function in the area of pension insurance. The role of the second pillar is currently to complement the state pension and to provide a higher standard of living for pensioners.[26]

[22] Subsections 1-2 of Section 20 of the SPBA.

[23] According to Section 11 of the Government Decree 168/1997 (X. 6.) on the implementation of Act LXXXI of 1997 on Social Security Pension Benefits the mandatory minimum amount of full old-age benefits assessed for periods commencing between the 31th December 2007 and 1st January 2019 shall be 28,500 forints monthly.

[24] Subsection 3 of Section 20 of the SPBA.

[25] See further: Judit Barta, Tivadar Dezse, „The hungarian pension system: the present and a possible future", *European Integration Studies* 1/2017.

[26] It compares the pensions of pensioners between the age of 65 and 74 to the income of persons between the age of 50 and 59. It can be concluded that this rate was 67% in 2016, which is the fourth highest in the EU.

Hungarian Central Statistical Office: Hungary 2017, p. 66., http://www.ksh.hu/docs/hun/xftp/idoszaki/mo/mo2017.pdf, 15. February 2018.

In the OECD countries, the average wage rate is 63%, the lowest rate is in the UK while the highest in the Netherlands. see: http://www.oecd.org/australia/PAG2017-AUS.pdf (Table 4.8), 15. February 2019, and http://www.oecd.org/publications/oecd-pensions-at-a-glance-19991363.htm, 15 February 2019.

The problem in Hungary is that the average wage is below the EU level, therefore the purchasing power of old-age pensions falls into the third third of the ranking of the Member States. This does not mean that pensions generally do not provide old-age livelihood. see: Hungarian Central Statistical Office: Hungary 2017, 66, http://www.ksh.hu/docs/hun/xftp/idoszaki/mo/mo2017.pdf, 15 February 2019.

As an evidence, the proportion of people over 65 years with the risk of poverty in old age was 6.8% in 2016, which is a good value compared to the EU average (14.6%). However, compared to the EU minimum Slovakia (5.4%), there is still room for improvement. see: Hungarian Central Statistical Office: Hungary 2017, 67. http://www.ksh.hu/docs/hun/xftp/idoszaki/mo/mo2017.pdf, 15 February 2019.

Since 2016, wages have increased much faster than pensions. According to the law, pensions are rising in line with inflation. In addition, in years when GDP grows faster than 3.5%, pensioners receive a premium linked to economic growth. The premiums amounted to 0.9%, 1.2% and 1.4% of total pension benefits in 2017, 2018 and 2019, respectively. On top of that, the government provided

However, this role may change in the future as a result of the aging of the population. Europe faces a major demographic crisis, the life expectancy is increasing and birth rates are decreasing, which will lead to dramatic changes in the age composition of the population.

Currently, more than 17% of people in the European Union are currently aged 65 or older, and that, according to Eurostat's forecasts, this figure will rise to 30% by 2060.[27][28]

In 2019, there were on average 2.9 persons of working-age for every person above 65. In 2070, this ratio is projected to fall to 1.7.[29] According to a recent analysis of the OECD (2017), the situation is even worse, and there will be 53 elderly people for 100 active persons by the year 2050.[30]

Between 2023 and 2060, the European labour force (aged 20–64) is projected to decline by 8,2 % (approximately 19 million people). This shrinking working-age population is expected to provide the means for pensions and healthcare services for the rapidly growing cohort of pensioners, challenging the sustainability and adequacy of pension systems.[31]

The fewer contributors and the more pensioners unravel the state pension systems operating on the principle of the pay-as-you-go financing, which may result in a significant deficiency, because of which there will be a need for budget support. However, this should not be oversized and should not hinder the growth. As a last resort, this could lead to the reduction of the level of state pensions, which

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ad hoc compensation to pensioners (food and utility vouchers), amounting to an annual increase of 0.7%, in 2018 and 2019. The premium and the ad hoc compensation are one-off items and are disregarded when setting the next year's pension. Overall, pensions increased by 2.8%, while wages grew on average by 9.2% annually in the last five years. As a result, the benefit ratio, which is the ratio of average pension over average net wage, declined from 67% in 2015 to 53% in 2019.

Comission Staff Working Document Country Report Hungary 2020 Accompanying the document Communication from the Comission to the European Parlament, the European Council, the Council, the European Central Bank and the Eurogroup 2020 European Semester: Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011 (SWD/2020/516 final)

[27] Adequate, safe and sustainable pensions, European Parliament resolution of 21 May 2013 on an Agenda for Adequate, Safe and Sustainable Pensions (2012/2234(INI)), https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52013IP0204&from=HU, 25 February 2019.

[28] See further Péter Novoszáth, "The Main Challenges and Risks for Social Security Systems in the European Union. The Essence of Reforms in Hungary After 2010", *Polgári Szemle*, http://eng.polgariszemle.hu/current-publication/139-economic-and-public-finances/887-the-main-challenges-and-risks-for-social-security-systems-in-the-european-union-the-essence-of-reforms-in-hungary-after-2010, 15 February 2019.

[29] Report from the Commission to the European Parlament, the Council, the European Economic and Social Commitee and the Committee of the Regions on the impact of demographic change (COM/2020/241 final).

[30] http://www.oecd.org/australia/PAG2017-AUS.pdf (Figure 1.1.)

[31] Council Conclusions on 'Demographic Challenges – the Way Ahead' 2020/C 205/03

will worsen the previous rate of wage supplements. According to forecasts, an additional pension will be required to provide old-age living in most of the Member States.[32]

Both the EU and the OECD focus on the issue of the future sustainability of pension systems and the provision of subsistence for the elderly. In July 2010, the European Commission published a Green Paper on the road to the adequate, sustainable and safe European pension systems. It launched a debate at European level on the key challenges of the pension systems and the search for appropriate solutions. The results of this are discussed in the Commission Communication of 16 February 2012 with the title "White Paper – An Agenda for adequate, safe and sustainable pensions (COM (2012)0055).[33]

According to the ascertainments of the White Book, the sustainability and adequacy of pension systems depends on the degree to which they are underpinned by contributions, taxes and savings from people in employment. Financing arrangements, eligibility conditions and labour market conditions must be calibrated such that a balanced relation between contributions and entitlements, and between the number of actively employed contributors and the number of retired beneficiaries, can be achieved.

The resolution of the European Parliament of 21 May 2013 on an Agenda for Adequate, Safe and Sustainable Pensions (2012/2234(INI)) also deals with this question.[34] In its resolution, the European Parliament stresses that first-pillar, public pension schemes remain the most important source of income for pensioners.

It observes that there will be a greater need for supplementary pensions in the future. It recommends a multi-pillar pension approach, consisting of combinations of:

i. a universal, pay-as-you-go, public pension;

ii. a funded, occupational, supplementary pension, resulting from collective agreements at the national, sector or company level or resulting from national legislation, accessible to all workers concerned;

It stresses that the first pillar alone, or in combination with the second-pillar pension (depending on national institutional arrangements or legislation) should establish a decent replacement income based on a worker's prior wages, to be complemented, if possible, with:

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[32] https://ec.europa.eu/info/sites/info/files/file_import/european-semester_thematic-factsheet_adequacy-sustainability-pensions_hu.pdf

[33] WHITE PAPER, An Agenda for Adequate, Safe and Sustainable Pensions, https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0055:FIN:EN:PDF, 25 February 2019.

[34] Adequate, safe and sustainable pensions, European Parliament resolution of 21 May 2013 on an Agenda for Adequate, Safe and Sustainable Pensions (2012/2234(INI)), https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52013IP0204&from=HU, 25 February 2019.

iii. an individual third-pillar pension based on private savings with equitable incentives geared to low income workers, self-employed people and to people with incomplete contributory years as regards their employment-related pension scheme.[35]

The Parliament supports the development of additional occupational and private pension savings, suggests the strengthening of the pension supervision instruments, and also emphasizes the importance of improving pension awareness.

In the following we present some elements of the Hungarian supplementary pillar and their main features, and examine to which extent they are able to meet the expectations of the EU, whether they are generally suitable for providing adequate supplementary pension income, and we review the role of employers in the supplementary pillar as well.

Long-term accumulation of at least 20 years, sufficient monthly or other regular payments is essential to achieve an appropriate supplementary pension income. The actual income supplement can be provided with a lifetime annuity[36], the lump sum payments do not ensure the preferred goal of the EU about complementing long-term pensions with a decent subsistence in the long term.

4. THE VOLUNTARY MUTUAL INSURANCE FUNDS AND THE PRIVATE PENSION FUNDS

By eliminating the element of compulsory self-care and by abolishing the statutory guarantees, the private funded pension system has completely lost its leading role and importance for today.[37] The majority of private pension funds and voluntary mutual pension funds were not organized with the help of employers, but their establishment were supported by insurers and banks. In the case of voluntary mutual pension funds, the employer may support the members by supplementing the membership fee or by paying the membership fee in full or in part (employer‘s contribution) or by supporting the fund with donations.[38] The reduction

[35] Adequate, safe and sustainable pensions, European Parliament resolution of 21 May 2013 on an Agenda for Adequate, Safe and Sustainable Pensions (2012/2234(INI)), https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52013IP0204&from=HU, 25 February 2019.

[36] Anett Pandurics, Péter Szalai, (2017), 220.

[37] Judit Barta, „A kiegészítő nyugdíjpillér ezen belül a magánnyugdíjpénztári rendszer aktuális helyzete és értékelése.“ *The Publications of the MultiScience – XXIX. microCAD International Multidisciplinary Scientific Conference University of Miskolc, 9-10 April, 2015.*, see: http://www.uni-miskolc.hu/~microcad/publikaciok/2015/E2_Barta_Judit.pdf.

[38] According to Subsection 1 of Section 12 of VMIFA, an employer member is a natural or legal person that, under contract concluded with the fund, undertakes to pay part or all of its employee‘s membership contributions (employer‘s contribution). According to Subsection 1 of Section 17 of the VMIFA, natural persons or legal entities – not including the tax authority as regards the transfer of fund payment allowances – who (that) perform services in cash or in kind occasionally

and elimination of the tax allowance of contribution and donation of the employers, led to the withdrawal of these contributions by employers, which resulted in the disappearance of several funds in 2017.[39] In case of private pension funds, the law abolished the employer's contribution from 2012.

Voluntary mutual pension funds and private pension funds operate on a pay-as-you-earn principle.[40] 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 (the waiting period) is stipulated by the relevant laws (it is 10 years in the case of voluntary mutual pension funds and 15 years in the case of private pension funds).

During this period, the members perform payments (membership payment)[41] to their so-called *individual account*, 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[42] which is calculated based on the amounts accumulated in their individual accounts, mostly in the form of annuity.

The private pension fund provides the fund member with pension plan benefits in the form of a fund benefit of the type chosen by the fund member, or in the form of an *annuity* purchased from an insurance company or an institution for occupational retirement provision.[43]

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or on a regular basis for the benefit of the fund (hereinafter referred to as 'donations'), without stipulating a consideration, shall qualify as sponsors of the fund.

[39] Since 2015, the National Bank of Hungary has published the risk report on the non-banking financial markets once a year, under the name of 'Risk outlook for non-bank financial sectors'. From 2017 its title is 'Insurance, funds and capital market risk report'. The Report presents the risks facing insurance companies, funds, financial enterprises and intermediaries as well as the capital market. See: Insurance, funds and capital market risk report 2018, https://www.mnb.hu/letoltes/kockazati-jelentes-2018-0613-vegleges.PDF, 25 February 2019.

[40] In 2017, 4 private pension funds operated on the market, with a membership of over 57,000 persons. The number of voluntary pension funds was 38 at the end of 2017, and the number of members in 2017 was 1,138,000 persons. See: Insurance, funds and capital market risk report 2018, https://www.mnb.hu/letoltes/kockazati-jelentes-2018-0613-vegleges.PDF, 25 February 2019.

[41] According to Section 26 of the PPFA, membership payment means regular financial contributions made by fund members voluntarily, collected to cover the fund's services, as well as the fund's operating expenses. Membership payments must be made by all members, the minimum amount of which (hereinafter referred to as "standard contribution") shall be determined by the fund's bylaws.

[42] Subsection 1 of Section 30 of the PPFA, Subsection 1 of Section 47 of the VMIFA.

[43] Section 27 of the PPFA.

The private pension fund only provides the pension service as a lump sum payment in exceptional cases, if the amount of monthly benefits does not reach 25 per cent of the minimum old-age pension, the balance available in the fund member's individual account shall be paid to the fund member in full, upon request, upon providing proof of entitlement to receive such benefits.[44]

Following the waiting period and within the accumulation period, the fund member shall have the option to close his account and terminate membership and take out his savings as a whole.[45] In this case, however, the yield of the savings is not tax exempt because it was not paid as a pension. In Hungary, the amounts paid out as pension services are exempt from personal income tax.[46]

In case of voluntary mutual pension fund, the fund member shall declare in writing whether he will request pension payments in one lump sum or in the form of annuity.[47] Therefore, the annuity is not compulsory, the fund member can requiest the payments in one limp sum.

The voluntary mutual pension fund is not obliged to provide life annuity, if it provides his own annuity. Own annuity shall be provided for a minimum term of five years.[48] The fund can purchase life annuity from an insurance company as well, however, in this case premium is paid upon the annuitant reaching retirement age in return for a stream of payments for the rest of the annuitant's life.[49]

Maintaining a membership relationship and paying the membership fee is essential to ensure adequate pension provision.[50] Private pension funds are not legally entitled to prescribe sanctions for members if they do not pay the membership fee. The membership relationship does not cease when the membership fee is not paid.[51] However, the law forces the funds to encourage their members with different means – mostly with active information – to pay the membership fee, because the funds are dissolved without succession if the number of members effectively paying membership contributions drops below seventy per cent of the total number of members based on previous six months' average, over a period of two months.[52]

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[44] Subsection 3 of Section 30/A of the PPFA.

[45] Subsection 4 of Section 47 of the VMIFA.

[46] According to Point 6.5 of Annex 1 of the Act CXVII of 1995 on Personal Income Tax, the amount paid as pension services are tax-exempt revenues.

[47] Subsection 5 of Section 47 of the VMIFA.

[48] Subsection 6c of Section 47 of the VMIFA.

[49] Subsection 6d of Section 47 of the VMIFA.

[50] A member of a private pension fund may not terminate his membership relationship at his own discretion. However, according to Subsection 2 of Section 47 of the VMIFA, a member of a voluntary mutual pension fund has the possibility to terminate membership of the fund after the waiting period has expired.

[51] According to Subsection 2 of Section 23 of VMIFA, the failure to pay membership contributions shall not result in termination of membership.

[52] Subsection 1a of Section 83 of the PPFA.

In the case of voluntary mutual pension funds, the possible consequences (limitation of the exercise of membership rights) of the failure of the payment of the membership fee are laid down in their bylaws. If a member fails to pay the membership contribution inside the waiting period but beyond the duration specified in the bylaws, the membership may be terminated as of the last day of the waiting period.[53] This also eliminates the savings.

The voluntary mutual pension funds shall not permit any suspension of the payment of membership dues in its bylaws.[54] The membership of the voluntary mutual funds is continually decreasing, mainly due to the non-fulfillment of the obligation to pay membership fees and due to the fact that many people take out their savings after the waiting period expires.[55] The possibility of terminating membership before retirement and the possibility of withdrawing savings do not serve the purpose of retirement savings.

In both institutions the member pays the contribution from their taxed income. The state encourages the members of voluntary mutual pension funds with tax support.

A member may convey an instruction in their statements made in their tax returns regarding the transfer of sums from the part of the tax payable on the consolidated tax base that remains following the deductions of tax allowances as: 20 per cent of the combined total of the sums the private individual has paid into the voluntary mutual fund(s) of membership during the tax year, not exceeding 150,000 forints for the tax year.[56]

The members of the private pension funds are not entitled for such tax allowance. 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 an heir but anyone else. More than one beneficiary can be designated

[53] Subsection 1 of Section 47/A of VMIFA.

[54] Subsection 1 of Section 14 of VMIFA.

[55] 48% of the members do not pay membership fee. See: Insurance, funds and capital market risk report 2018, https://www.mnb.hu/letoltes/kockazati-jelentes-2018-0613-vegleges.PDF, 25 February 2019.

[56] Section 44/A of the Act CXVII of 1995 on Personal Income Tax.

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.[57] 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.[58]

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 can provide the "care".

5. OCCUPATIONAL PENSION SCHEME PROVIDERS[59]

The occupational pension scheme provider can be established and operated in the form of a private limited company. The pension provider can be established by one or more employers, or by a bank, insurance company, or investment firm. In Hungary, the first and still sole occupational pension scheme provider was established by an investment firm.

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[57] Subsection 2 of Section 30/A of the PPFA, Subsection 6h of Section 47 of the VMIFA.

[58] Judit Barta, „Örökölhetőség, és hozzátartozói ellátás kérdése a magyar kiegészítő nyugdíjpillér egyes intézményeiben." *A szociális jog aktuális kérdései Magyarországon és az Európai Unióban. Conference volume* (ed. Gabor Mélypataki), University of Miskolc, Faculty of law 2016, 22-29.

http://jogikar.uni-miskolc.hu/projectSetup/files/kiadvanyok/a-szocialis-jog-aktualis-kerdesei--magyarorszagon-es-az-europai-unioban.pdf, or Friedrich Ebert Stiftung http://fesbp.hu/common/pdf/A_szocialis_jog_aktualis_kerdesei_2017.pdf

[59] See in details: Judit Barta, „A foglalkoztatói kiegészítő nyugdíj" *Magyar Jog* 7/2013, 426-435., Judit Barta, Tamas Prugberger „A foglalkoztatói kiegészítő nyugdíj megszervezésének és finanszírozásának útjai az Európai Gazdasági Térség államaiban és Magyarországon" *Adózási pénzügytan és államháztartási gazdálkodás.* (ed. Csaba Lentner) Nemzeti Közszolgálati Egyetem, Budapest, 2015, 553-566.

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 savers. The employer decides 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 employer may allow the employee to choose between the possible pension services, which may be lump sum, fixed-term annuity or life annuity.

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.

The sole occupational pension scheme provider in Hungary mostly prefer fully funded pension schemes, that is, retirement services determined by paid contributions.

Retirement's 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 if the person is entitled to a pension. 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*[60] 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. If the membership of employee ceases during the period of conditional acquisition, he

[60] 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.

will not receive any payment or pension. After the end of the conditional acquisition period, the member may not withdraw his accumulation if his employment relationship, and hence his membership status is terminated. In this case his accumulation either remains in the pension provider or is transferred to another pension provider.

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.

6. INDIVIDUAL RETIREMENT ACCOUNT

Individual retirement account (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 two 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, which is a lump sum payment, there is no annuity. 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.

The purpose of the construction is to make individual savings, to raise individual capital for the retirement years, to make independent investment decisions beside tax support.

7. PENSION INSURANCE CONTRACTS CONCLUDED WITH INSURERS[61]

Pension insurance belongs to the life insurance branch, it is one of the branches of it and it is provided by life insurance companies only. According to the main rule, the insurance event is the reaching of the retirement age, but it can be combined with risk elements too, such as disability or death before the reaching of the retirement age. Only the pension insurance shall enjoy tax benefits, which complies with the regulations of the Act on Personal Income Tax.

Pension insurance means a type of life insurance where the insured person on whose behalf the insurance contract was concluded is the sole beneficiary of the benefits – other than death benefits – for the entire term of the pension insurance contract, and where the payment of benefits is triggered:

a) by the insured person's death,
b) upon the insured person acquiring eligibility for pension benefits in his own right according to the legislation on social security pension benefits (meaning the state of being retired),
c) upon health impairment of a degree of at least 40 per cent, provided that the degree of health impairment of the insured person did not reach 40 per cent at the time of conclusion of the pension insurance contract (irrespective of whether the insured person is entitled to invalidity or rehabilitation allowance), or
d) upon the insured person reaching the retirement age in effect at the time of conclusion of the contract,

provided that at least ten-year lapses from the date of conclusion of the pension insurance contract (from the date of signature by the client of the offer or contract amendment) until benefits are in fact paid in connection with a specific insured event (excluding the insured person's death, health impairment of a degree of at least 40 per cent.

The pension service may be a lump sum payment or annuity, depending on the choice of the insured person.

In the event of pension insurance, if the insured party dies in the service (annuity) period, the amount, which was not paid as annuity, cannot be inherited,

[61] See in details Judit Barta, „A nyugdíjbiztosítások szerepe és jellemzői a kiegészítő nyugdíjpillérben" *Biztosítási Szemle* 1/2019.

https://mabisz.hu/wp-content/uploads/2018/08/biztositas-es-kockazat-5-evf-1-szam-5-cikk.pdf, 18 January 2019.

Judit Barta, Edit Ujváriné dr. Antal, *Insurance Law Hungary,* Alphen aan den Rijn, NL: Kluwer Law International, 2018.

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and there is no possibility to nominate a beneficiary. Its reason is that, the insured parties create a risk community and the savings of dead insured shall be transferred for those, who live up to the age calculated by the insurance company.

The number of life insurance for retirement provided by insurance companies has increased, because the state urges the conclusion of these contracts with tax benefits from 2014.[62] 20% of the fee paid in the year will be credited by the state from the paid tax up to a maximum of HUF 130.000 per year for the benefit of the insurance contract.[63] Insurers offer more and more types of pension insurance products, currently there are about 80 different pension insurance schemes in the market, all insurance companies, which deals with life insurance have at least 2-3 kinds of pension products.[64]

Insurance contracts can be terminated before expiration, but in this case the tax credit has to be refunded. Therefore, the pre-saver can change his mind and withdraw the entire savings from insurance for other purposes.

8. SUMMARY

In Hungary, the supervision of the supplementary pillar's institutions, the protection of the members (limitation of the deductible costs, information obligation, investment protection), the regularly reference for the members about developments in payments and yields is in line with the European standards. The existing institutions are potentially capable of providing such a supplementary pension that can support the livelihood of the elderly.

But, in Hungary, the occupational pension was not strengthened and widened, it is not able to perform the role of the second pillar. The employers' background institution is also insignificant in the voluntary, supplementary pillar, the additional employer contributions depend on tax benefits. In Hungary, the role of employers in the supplementary pillar is not significant.

[62] In the light of the insurers' data from 2016, the pension insurance is the most dynamically development area among the pension targeted self care services thanks to the tax allowance. See: Csak minden ötödik Magyar takarékoskodik a nyugdíjas éveire, http://www.biztositasiszemle.hu/cikk/hazaihirek/eletbiztositas/csak_minden_otodik_magyar_takarekoskodik_a_nyugdijas_eveire.5629.html, 28 February 2019.

[63] For the HUF 130,000 tax credit, an average of HUF 54,000 per month shall be paid, which means HUF 650 thousand per year. For this, only a small percentage of the contractors are able to pay. They pay an average of 200 thousand forints annually to their pension insurance account; wich will entitle them to a tax credit of 40,000 HUF in the next year. See: Év végére elérheti a 200 ezret a nyugdíjbiztosítások száma, http://www.biztositasiszemle.hu/cikk/hazaihirek/gazdasag/ev_vegere_elerheti_a_200_ezret_a_nyugdijbiztositasok_szama.6178.html, 28 February 2019.

[64] Év végére elérheti a 200 ezret a nyugdíjbiztosítások száma, http://www.biztositasiszemle.hu/cikk/hazaihirek/gazdasag/ev_vegere_elerheti_a_200_ezret_a_nyugdijbiztositasok_szama.6178.html, 28 February 2019.

Most of the additional institutions: voluntary mutual pension fund, NYESZ, life insurances, occupational pension do not offer life annuity, or they offer it just as an alternative. There are no appropriate incentives for choosing an annuity or life annuity as a service (legal regulation, or specifically related tax relief). The legal regulation, that allows, that 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 is a significant allowance.

The statutory accumulation period for voluntary pension savings forms varies between 5 and 15 years and in most of the cases, it can be paused without significant sanctions, or the payment van be terminated. So, legislation does not encourage for long-term and regular savings.

The state is trying to encourage population for pre-savings of retirement years with tax allowance,[65] which has a particularly positive effect, but based on the total number of potential savers (there is no comprehensive statistics, only different partial data), it can be said, that the Hungarian population does not use these opportunities in the desired extent.

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[65] (1) If a private individual has provided for the transfer of a specific portion of his tax in a voluntary mutual fund statement, an individual retirement account statement and in a pension insurance statement alike, the sum transferred by the state tax and customs authority may not exceed (on the aggregate) 280,000 forints. (Subsection 1 of Section 44/D. § of PIT).

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Структура мађарског пензијског система, анализа института допунског стуба пензијског осигурања из аспекта очекивања Европске уније

Сажетак: *Европа се суочава за значајном демографском кризом: очекивана животна доб постаје све виша, смањује се број рођења, док становништво постаје све старије. Ово дотиче и систем државних пензија заснован на принципу дистрибуције и редистрибуције: све више младих треба да издржава све више старијих, и то све дуже време. Смањење уплата и повећања исплата из пензијског фонда чини нужним додатно финансирање из буџета. То међутим има своја ограничења у комунитарном праву. Све то у крајњем исходу може да доведе до смањења износа државних пензија, што би додатно погоршало стопу компензације износа зарада износом пензије осигураника.*

Према прогнозама у већини држава чланица биће потребно увођење допунских пензија ради обезбеђења животног стандарда у старијим годинама. У овом погледу је Европска уније формулисала своја очекивања.

У раду се у светлу правне регулативе разматра да ли институти допунског пензијског осигурања у Мађарској одговарају захтевима Европске уније, тј. да ли су у принципу подобни да обезбеде адекватну допунску пензију.

Кључне речи: *државни пензијски систем, допунска пензија, професионална пензија, пензијско осигурање, пензиони фондови.*

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