

Heralding GIPS® Standards in Hungary

BY CHRISTINE MARTIN

The investment industry in Hungary has taken off. Essentially valueless in the early 1990s, the Eastern European market has grown to reach roughly US\$10 billion in its first decade. A corps of ambitious and forward-thinking Hungarian investment professionals is attempting to inculcate ethical standards and self-regulation into the rapidly developing Hungarian market through the promotion of AIMR's Global Investment Performance Standards (GIPS®).

Krisztina Kozma, Ph.D., chairs the GIPS subcommittee of the Hungarian Society of Investment Professionals (HSIP), which also serves as the GIPS country sponsor in Hungary. "Several

years ago, a few Hungarians who were involved with the European Investment Performance Committee realized that other European countries were moving toward adopting global standards, and that in order for the Hungarian investment industry to be competitive in the future, local market participants would need to embrace these standards as well," explains Kozma.

To facilitate the promotion and implementation of the GIPS standards in Hungary, HSIP sought to translate the standards into Hungarian. The translation was a big effort. "Some of the concepts were very difficult to convey in Hungarian," says Kozma. Ultimately, the Investment Performance Council (IPC) endorsed the translation in October 2001.

Despite enthusiasm for the GIPS standards by HSIP members and small pockets within Hungary's investment community, Kozma notes that the Hungarian investment industry is still several years away from truly embracing the GIPS standards or any standards that the law does not require. Few have considered the long-term benefit of voluntarily implementing investment performance standards at the firm level.

Kozma described Hungary's emerging market and explained why local investment management firms are not yet motivated to comply with the GIPS standards.

"Before the early 1990s, it was simply impossible to invest in capital market instruments in Hungary. There was not even a bond market in Hungary before that time. Insurance companies

JOINING THE GIPS BANDWAGON

Enthusiasm for AIMR's Global Investment Performance Standards (GIPS®) continues to build worldwide. Twenty countries have adopted the GIPS standards since its introduction in 1999, and more are sure to follow. AIMR Vice President Alecia Licata attributes this success in part to country sponsors and their efforts to promote the global standards at a local level. "The fact that the demand for GIPS standards is driven by local investment communities is key to its global acceptance," says Licata.

Although its success currently is gauged by its advancement within individual markets, Licata notes that the Investment Performance Council (IPC) created the GIPS standards with the increasingly global investment industry in mind. "Because compliance with GIPS standards is equivalent to compliance with local standards, investment management firms that are in compliance have a 'passport' to compete for business in other countries," explains Licata.

Creating cross-border opportunities and increasing market transparency for investors worldwide are what the GIPS standards are all about. Yet says Licata, although AIMR's presence is global, it doesn't necessarily reach all markets and all players, especially with regard to investment performance standards. Also, for the GIPS standards to gain global acceptance, investment communities must embrace and promote them at the local level.

Consequently, the presence of a local sponsoring organization is vital to the realization of the GIPS standards within

a country. "The country sponsor isn't necessarily an AIMR society," says Licata. "Sometimes other professional groups are better positioned to implement the GIPS standards."

Ultimately, however, all country sponsors seeking IPC endorsement agree to the same fundamental conditions: to promote and support the standards locally; to yield to a centralized interpretation process — that of the IPC; to ensure the ongoing operation of the GIPS standards within the country by agreeing to incorporate all future additions or improvements to the GIPS standards, as well as new interpretations of existing provisions; and to serve as a link between the IPC and the local investment communities.

"Also, country sponsors seeking IPC endorsement must decide whether to adopt the GIPS standards in their English form or whether a translation would be beneficial or more appropriate for their market," explains Licata. A few countries seek IPC endorsement of a "country version" of the GIPS standards, which accommodates a few additional local standards and regulations without diluting the GIPS standards.

In most countries, however, local investment performance reporting standards do not exist, and Licata sees an opportunity for investment professionals to straightforwardly introduce the GIPS standards to their local markets. Says Licata: "Sharing the GIPS perspective will raise awareness of the need for ethics and standards in the investment industry and, over time, will lead to higher expectations by investors worldwide." //

existed prior to the investment markets, but they were state-run organizations. Not until the early '90s were laws enacted to modify insurance business and to allow for the creation of mutual funds. The first pension funds were developed in 1995," she says.

Today, Hungary's institutional investment market is equally portioned between pension funds, mutual funds, and insurance. But direct investment by individual investors is very rare. "Hungarians received so-called compensation coupons for property seized by the government in the mid 1990s. But few Hungarians have used these coupons to buy equity," explains Kozma.

Most investing, including retirement saving through pensions, is institutional, and insurance companies, retail banks, and asset management firms are the main managers.

According to Kozma, in Hungary, conservatism dominates all investment strategies — even those with long time horizons. Insurance companies hold no more than 5 percent equities. And investors put 90 to 95 percent of all mutual fund assets in money-market or fixed-income instruments. "Even pension funds never hold more than 12 or 13 percent equity," says Kozma, who noted that pension funds are the most stringently regulated segment within Hungary's investment industry and the only segment for which performance measurement is regulated.

Pension fund regulation is, in fact, a big problem in Hungary, and a large reason for the local investment community's general disinclination toward embracing higher investment performance standards. "From 1995 to 2000, investment restrictions of pension funds were based on book costs, not on the market value of the investments, and pension funds were valued on prices determined by the law and not by the market. Current regulations stipulate that pension fund value be derived from the market value and that performance be measured quarterly using a money-weighted return calculation



The city of Budapest stands witness to Hungary's transformation from a former Eastern-bloc country to a place of prosperity today, as evidenced by the country's thriving investment industry.

method. Consequently, actual performance is completely distorted by cash flows, making it difficult to compare the true performance of fund managers," explains Kozma.

The fact that all local asset management firms apply the "pension fund" performance calculation method to all other portfolios compounds the problem. "Local asset managers simply will not make the effort to change their methods of calculation and presentation to comply with the GIPS standards because it takes money, time, and education of their employees — and most significantly, there is no demand from the client," says Kozma.

According to Kozma, HSIP believes that local acceptance of the GIPS standards will come only through new legislation or pressure from clients. Hence, the organization has focused its promotional strategy on educating these groups.

Once or twice a year, HSIP hosts Hungarian investors at a GIPS confer-

ence. Explains Kozma: "We show attendees how different calculation methods can result in return percentage differences. Clients quickly realize that the numbers they are being shown are completely useless without established standards because investment managers in Hungary can calculate and present their performance as they wish."

Kozma notes an encouraging sign that their efforts to educate Hungarian investors is beginning to pay off. "One client that now understands how cash flows distort asset management performance using the money-weighted method intends to request that their asset managers make daily valuations and use a time-weighted valuation method. So although the client is not requiring the asset management firms to be compliant with the GIPS standards, it's a good first step toward demanding higher standards."

She also adds that, as more and more Hungarian investment profes-

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sionals become Chartered Financial Analyst® (CFA®) candidates and charterholders, opportunities to share the GIPS perspective with investors will continue to present themselves.

HSIP also meets periodically with regulators, who are open to the GIPS perspective. “Hungary will join the European Union next year, and regulators realize that local companies will be at a competitive disadvantage if local standards are not comparable to EU standards,” says Kozma.

HSIP members have been working with regulators since 2000 to ensure that the new legislation at least incorporates the principles of the GIPS standards. Kozma notes, however, that Hungary heavily regulates its pension funds compared to other markets, and some existing regulations conflict with

the methods set out by the GIPS standards. For example, the new legislation would require those companies managing pension funds to use two separate performance measurement calculation and presentation methods in order to comply both with the GIPS standards and the law. Doing so is unappealing to investment management firms.

Kozma estimates that local investors will begin to demand that Hungarian investment management firms comply with the GIPS standards three or four years from now — maybe sooner with Hungary’s entrance into the European Union.

For now, however, the Hungarian Society of Investment Professionals plays the key role in promulgating the GIPS standards within the local marketplace. And through its involvement with the IPC — AIMR’s governing body of GIPS — HSIP ensures that Hungary’s perspective is considered as the GIPS

standards continue to evolve.

Notes Kozma: “Members of HSIP feel that we are the only professional body in Hungary with a clear commitment to standard setting. It is our responsibility, and the obligation of individual investment professionals in Hungary, to educate the industry and to develop the market into one that embraces standards and self-regulation.” **///**

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STANDARDS E-MAIL ALERT

To receive a bi-monthly e-mail alert detailing current events relating to the Investment Performance Standards (AIMR-PPS and GIPS), write to standards@aimr.org and enter “Standards E-mail Alert” in the subject heading, with your name, postal address, and e-mail address in the body of your message.

INVESTMENT PERFORMANCE COUNCIL

MEETING DATE

25 September 2003
Sydney, Australia

All meetings are open to the public. To observe a meeting, e-mail standardsetting@aimr.org at least two weeks prior to the scheduled meeting date.

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IPC-ENDORSED STANDARDS

as of 6 March 2003

Country Version of GIPS (CVG)

AIPS (Australia)
E-IPS (Egypt)*
IPS (Ireland)
IPPS (Italy)
SAAJ-IPS (Japan)
SPPS (Switzerland)
UKIPS (UK)
AIMR-PPS (US & Canada)

Translation of GIPS (TG)

GIPS (Austria)
GIPS (Denmark)
GIPS (France)
DVFA-PPS (Germany)*
GIPS (Hungary)
GIPS (Luxembourg)**
VBA-PPS (Netherlands)
GIPS (Norway)
GIPS (Poland)*

GIPS (In English)

Belgium*
Luxembourg**
Portugal
New Zealand

* Indicates submission has been received, but not yet endorsed by the IPC.

** Luxembourg has adopted three standards: GIPS in English, France TG, & Austria TG

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