

A large, abstract graphic of a network or sphere made of interconnected blue nodes and lines, positioned in the upper right background of the page.

Hungary

Regulation

FUNDS AND FUND MANAGEMENT 2009

2.1 Types of funds

Collective investment schemes in Hungary are

- investment funds (securities funds, derivatives funds, and property funds, funds of funds, index funds, European funds); and
- venture capital funds.

Investment funds

The investment fund is a legal entity established by a company engaged in investment fund management activity (fund manager). It may be established either publicly (public fund) – by public offering of investment fund units, or by means of private placement (private fund). The fund manager invests the equity of the fund in securities and other instruments, real estate, and/or derivatives according to the investment policy of the fund. The fund manager manages the fund based on the general mandate of the investment unitholders. The investment fund is either an open-ended fund where the fund manager issues and distributes redeemable investment fund units or a closed-end fund where the fund manager issues non-redeemable investment units.

Venture capital funds

The main difference between investment funds and venture capital funds is that venture capital funds must primarily invest in equities of limited liability companies and companies limited by shares not listed on a securities exchange.

Under Hungarian law a venture fund is a separate legal entity established by a venture fund management company and registered by the State Supervision for Financial Services (PSZAF). A venture capital fund must be closed-ended and may be established by public offering or private placement of fund units. Venture fund units are non-redeemable securities in registered form.

2.2 Laws

The above schemes are regulated by Act CXX of 2001 on Capital Markets, Act CXII of 1996 on Financial Services, and Government Decree 215/2000 on Investment Funds.

The regulations concerning investment funds, investment management companies, venture capital funds, venture fund management companies, and the specific rules of public offering of investment fund units and venture fund units are laid down in the Capital Markets Act.

That Act also regulates the provision of investment advice, services of the custodian, the general rules of public offering, and the powers of PSZAF.

The Financial Services Act sets out the rules of establishing and supervising the custodian and the licensing procedure for the undertaking of mutual pension and health care fund management by investment fund management companies.

The Government Decree regulates the accounting and book-keeping requirements for the investment funds.

2.3 Managers, trustees, and custodians

Investment funds

A license is required to establish investment funds or investment fund management companies. A fund management company must be established in the form of a company limited by shares, all of which are registered shares. Fund management companies must be licensed by PSZAF.

The fund manager must satisfy the following requirements:

- It must be a company incorporated in Hungary.
- It must be a company limited by shares, all of which are registered shares, generally with a minimum share capital of HUF 100 million.
- Its exclusive activity shall be investment fund management, portfolio management, mutual pension and/or health care fund management, brokerage of units of funds managed by the fund manager, investment advice, and/or securities lending.
- It must possess a license from the PSZAF.
- A fund manager has to have a higher paid up share capital in order to be permitted to undertake the management of mutual pension funds with assets exceeding HUF 2 billion.

A fund manager may also be set up as a branch of a foreign fund manager provided that a co-operation agreement exists in this regard between the two national supervisory authorities. Branches of non-EU fund managers may not manage the European investment fund (UCITS III) and may not pursue portfolio management for private pension funds.

The activity of the fund manager is restricted to those mentioned above, and fund managers will not be permitted to carry on any other type of investment business.

A fund manager may establish and manage several investment funds, separately. The applicable laws, as well as the fund manager's by-laws, which have to be approved by PSZAF, regulate the fund manager's activity.

The management of a fund covers a wide area including preparation of the prospectus and financial reports issue and repurchase of investment units, appointment of and co-operation with the fund's auditor and the custodian.

The fund manager may charge a subscription (sales) and redemption commission, as well as an annual management fee for its activities. The management fee includes all costs incurred in connection with the management of the fund.

Venture capital funds

Under the Capital Market Act a venture capital fund management company must:

- be a company limited by shares incorporated in Hungary, all of the shares of which are registered shares, with a minimum share capital of HUF 20 million;
- have venture fund management as its sole activity; and
- be registered by PSZAF.

A fund manager may also be set up as a branch of a foreign fund manager provided that a co-operation agreement exists in this regard between the two national supervisory authorities.

The fund manager's competence includes the establishment of a venture fund, and the management and investment of the fund's assets on the basis of the general mandate of the unitholders. The venture fund manager must keep a register of unitholders. A venture fund manager may establish and manage several funds, separately. The fund manager may charge a management fee as determined in its management rules.

Custodian

The custodian of a fund must be a merchant bank or specialized financial institution incorporated in Hungary and licensed by PSZAF. The custodian keeps the securities owned by the fund in its custody based on the mandate of the fund manager as depositary and carries on related management. It manages the bank account of the fund including the deposit account where the fund's equities are kept, and takes care of the technical administration related to the sale of the fund units, their repurchase, the payment of returns, and the determination of the fund's net asset value. It also has a certain supervisory role in connection with the management of the fund. The custodian shall act in favor of the investors, independently from the fund manager. The custodian must notify the fund manager and PSZAF about any mismanagement that the custodian may notice in the course of its activity.

The approval of PSZAF is required for the appointment of a new custodian by the fund manager.

2.4 Investment restrictions

Investment funds

There are certain restrictions set out in the Capital Market Act concerning the investments, which an investment fund may make. As a general rule, only real estate funds may invest in realty. Further restrictions may be specified in the Investment Rules of the fund. The restrictions set forth by the Capital Market Act are as follows.

General restrictions

- The fund may not acquire more than 10 percent of the equity in any single issuer, whether directly or indirectly, and may not acquire more than 10 percent of voting rights in any single issuer.
- The fund may not acquire more than 20 percent of the debt securities and other financial instruments issued by any single issuer, with the exception of OECD government bonds;
- Upon the acquisition of any security the fund manager shall not have invested more than 20 percent of the fund's equity in securities and other financial instruments issued by the same issuer except for OECD government securities.
- Upon the acquisition of any OECD government bond the fund manager shall not have invested more than 35 percent of the fund's equity in the same series of government bonds issued by an OECD government.

- The fund manager may not place the assets of the fund in another fund that it also manages.
- The fund manager may not invest the equity of the fund in the fund's units.
- The fund manager may not purchase for any investment fund it manages:
 - securities issued by the fund manager; or
 - securities issued by any affiliated company of the fund manager, with the exception of listed securities.
- The fund manager may not sell financial instruments to or purchase financial instruments from any fund it manages.
- The fund manager may not place any financial instruments owned by any of its affiliated companies into any public fund it manages, with the exception of securities the price of which is listed publicly, government securities with a maturity of less than six months, and of securities listed on any regulated market.

As a general rule, investment funds may only invest in derivatives in order to achieve the investment objectives set forth in the management rules of the fund. Special rules apply to those investments.

Specific restrictions

Specific restrictions exist with regard to investment in derivatives. Also specific restrictions apply to investments by special types of funds. Such special fund types are:

- funds investing in publicly traded securities;
- funds of funds;
- derivatives funds;
- index following funds;
- real property funds; and
- European funds (UCITS Directives have been implemented into the Hungarian law).

The investment restrictions applicable for these funds may be significantly different to the generally applicable restrictions.

Venture capital funds

A venture capital fund may invest its equity in companies limited by shares (Rt.) or limited liability companies (Kft). The fund may not acquire real estate excluding the premises obtained by liquidation. The venture fund may invest in shares listed on a stock exchange only if the fund's share in the issuer would reach 10 percent within 12 months following the first issue.

The fund may not invest more than 20 percent of its equity (calculated at the price when the investment is made) in one company or group of companies.

The venture fund may keep its temporarily free liquid assets in government securities issued in Hungary and/or bank deposits.

Foreign exchange regulation

All foreign exchange restrictions concerning investment and venture capital funds have been abolished.

2.5 Borrowing

Investment funds

The fund manager may make borrowings up to 10 percent of the equity of an open-end fund, for the purpose of buying back the open-end fund's investments units. The term of such a loan must not exceed 30 days.

Subject to certain exceptions, the fund manager may not mortgage the fund's assets or encumber the same in any other way and shall not issue bonds or other debt securities on behalf of the investment fund.

Venture capital funds

A venture capital fund may only provide loans to companies in which the fund's holding exceeds 25 percent. The aggregate amount of loans provided by a fund to a company or a group of companies may not exceed twice of the amount of the capital invested by the fund in the same company or group of companies. The aggregate amount of all of the loans provided by a venture fund may not exceed the 25 percent of its equity.

2.6 Accounts and prospectus

Investment funds

An application for a license to establish a public investment fund must be submitted to PSZAF together with a draft of the prospectus, simplified

prospectus, and management rules of the investment fund. To establish a private investment fund, a custodian report also must be filed with PSZAF which states that all share capital has been provided. The Capital Markets Act regulates in detail what the prospectus, simplified prospectus, and the fund management rules must contain. The prospectus must, among others, contain information on the fund manager, the custodian, of the fund, and the investment advisor firm (if any) whose services are being used. It must also contain the fund management rules, which must set forth the detailed rules of the operation of the fund such as the investment policy, investment unit redemption, and return payments.

The prospectus and the fund management rules must be approved by PSZAF. Any changes to the prospectus, the fund management rules, or the publicity material must be submitted for approval to PSZAF. In certain cases, changing the terms of the management rules of a private fund requires the unanimous consent of the investors.

On issuing investment units and on the sale of investment units by the fund manager to the public, the prospectus of the investment fund shall be provided to the investor in all cases.

The fund manager shall, within 45 days – (or in the case of a foreign fund manager, within 60 days) - of the end of each half-year publish a half-yearly report. An annual report shall be published within 120 days of the closing of the financial year. Both reports must be submitted to PSZAF. The half-yearly and annual reports of public investment funds shall be made available to the investors. Different rules of disclosure may be determined by the management rules of private funds.

Regarding the open-ended funds the fund manager shall, based on the fund's net-asset value on the last trading day of each month, within 10 days of such date, publish a monthly portfolio report of the open-ended fund. The report shall contain the fund's portfolio by investment types, the fund's equity, and the net asset value per investment fund units,

Public funds are required to have their accounts audited by an auditor with expertise in the field of financial institutions. The auditor is, in certain circumstances, required to notify PSZAF on the findings of its audit.

Private funds' fund managers are not obliged to appoint auditor for auditing the fund's annual report; however in this case the fund manager has to bring the investor's attention to this fact in the management rules of the fund.

Venture capital funds

The preparation and approval by PSZAF of the fund management rules (rules) is a condition to the public offering or private placement of the units. Any changes to the Rules become effective upon the approval of PSZAF. The fund manager

of a public venture capital fund shall, after the year-end, prepare an annual report for the information of unitholders, and submit it to PSZAF.

2.7 Supervision

The supervising authority of investment funds, venture capital funds, and fund managers in Hungary is the State Supervision for Financial Institutions (1013 Budapest, Krisztina krt. 39., Hungary). PSZAF's competence includes the supervision of the establishment, management, and operation of investment and venture capital funds and of their managers. PSZAF keeps a register of fund managers. Once approved PSZAF will continue to supervise the activities of the funds.

The PSZAF has to make a decision (approval or rejection) within 20 days after the fund manager submits the prospectus of a new fund. If PSZAF approves it the fund manager can start public offering. After successful offering the supervising authority has two to three days to register the new fund.

2.8 Fund ownership

There are no specific restrictions on the percentage of units which may be held by any one person or group of persons other than a restriction regarding the acquisition of fund units by the fund manager or, in certain cases, another fund. However in the case of public funds, the Capital Markets Act refers to the fund's equity as raised from the public by means of public offering. The definition of public offering can be deduced from the definition of private placement. Private placement is defined as offering the securities to certain designated persons on the basis of the prior declaration of their intent to subscribe. However, the definition also includes offerings made exclusively to institutional investors. During 2008 in case of real estate investment funds a minor change has been introduced due to the financial crisis: investment fund coupons may not be redeemed within 90 days.

2.9 Fund structure

Funds of funds are permitted under Hungarian law. Umbrella funds are not definitely permitted under Hungarian law. However, the fund manager may publish the management rules of similar type of funds in one single sales prospectus.

Hedge funds may be created as derivatives funds, although they are subject to several restrictions, such as with regard to lending and borrowing money and securities.

Units of investment funds may not be issued in bearer form.

2.10 Stock exchange

In the case of a closed-end investment fund established in public form – or closed-end investment fund established as a private fund but which is later transformed into a public fund – the issuer must initiate the listing of the investment units on the Budapest Stock Exchange (BSE) within one month of the establishment or transformation.

2.11 Bank secrecy

There is money laundering laws in Hungary, which can be applied for obtaining information from banks in the case of alleged money laundering.

2.12 Fund set-up

Investment fund

The set-up of investment funds must be approved by PSZAF. A fee (HUF 500,000) is payable for the approval as well.

Another significant cost element is the legal fees for drafting the prospectus (or in the case of private funds the fund management rules). Internal costs of the fund must be listed in the fund management rules.

Venture capital fund

The set-up of venture capital funds must be approved by PSZAF. A fee is payable for the approval as well.

2.13 Foreign funds

With the entry into force of the Capital Markets Act on 1 January 2002, basically all obstacles to selling units of foreign funds in Hungary have been abolished.

In order for a foreign fund's units to be offered to the public or listed on a securities exchange in Hungary, the approval of PSZAF is required. The prospectus must be prepared in Hungarian and is pre-vetted by PSZAF. The prospectus approved by the relevant authority in the fund's home jurisdiction may be accepted by PSZAF. The use of the existing and licensed prospectus of the fund for the Hungarian distribution is subject to the translation of the prospectus into Hungarian and its supplementation with the particulars of the Hungarian distribution. The supplement to be attached to the translation of the prospectus shall also include information to the investors on the tax treatment of the fund units. The investors have to be separately notified regarding the diverse rules of both prospects in the supplement. Also, it has to be shown that

the fund satisfies all requirements prescribed by law in its home jurisdiction, its units qualify as securities in its home jurisdiction, and that Hungarian investors are enabled to effectively exercise their rights with respect to the fund (this latter requirement is satisfied if the prospectus contains an arbitration clause referring disputes between the fund and Hungarian unitholders to the jurisdiction of a Hungarian court or arbitration tribunal). Public funds also have to comply with the continuous disclosure requirements of the Capital Markets Act.

The license for the issue is granted by the foreign financial supervisory authority, should the fund's registered office be in the EU and the fund:

- simultaneously issues investment fund units; and
- at least in two Member States.

In this case and if the fund wishes to issue the investment fund units in Hungary, the prospectus with its translation prepared by the Hungarian Office for Translation and Attestation Company and the supplement to the prospectus has to be submitted to the PSZÁF.

Foreign fund's units can be distributed by such financial institution that has its registered seat in the EU.

2.14 Bearer shares

Investment funds, venture capital funds, and fund management companies may only issue registered securities (units).

2.15 Use of the internet

The internet is used by most fund managers for marketing purposes. However, only some fund managers provide on-line trading facilities.

Specific regulations are in force concerning the use of the internet including the Electronic Signatures Act.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.