

# Rogue traders in Hungary

The EUR 1 bn scandal: history and lessons

# Young financial market

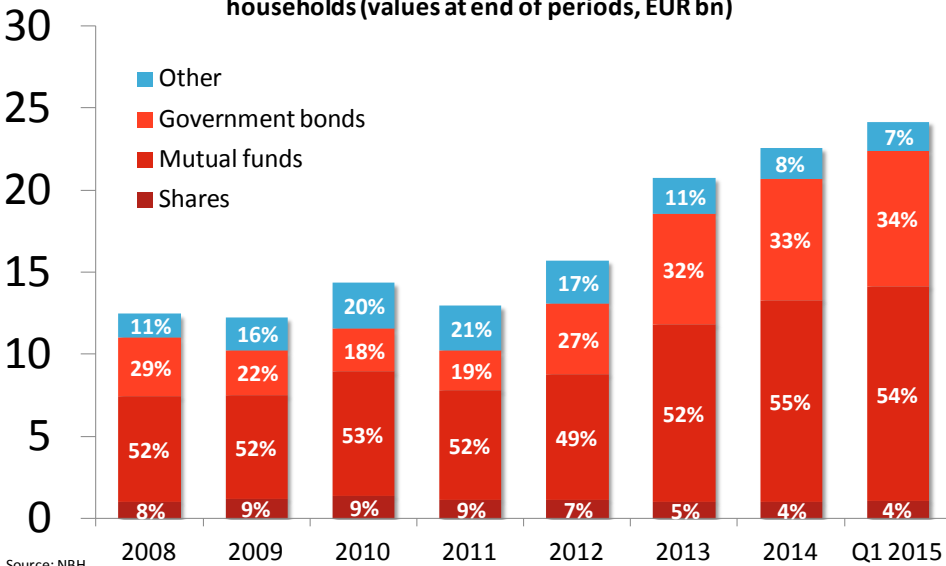
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- ▶ 150<sup>th</sup> anniversary of Hungarian stock exchange (2014)
- ▶ 25 years of modern capital markets (re-opening in 1990)
- ▶ Low general financial literacy (OECD, 2011/2012)
  - ▶ Higher theoretical financial knowledge  $\leftrightarrow$  lower skills in practice
  - ▶ No family budgeting
  - ▶ More than half of the 10 million population doesn't have any savings and only ~5% put their money in investment products
- ▶ Strong retail investor base at BSE:
  - ▶ 25-30% of the equities turnover
  - ▶ 40% of the retail flow is done through internet channels
  - ▶ They hold 6-8% of the Hungarian listed companies

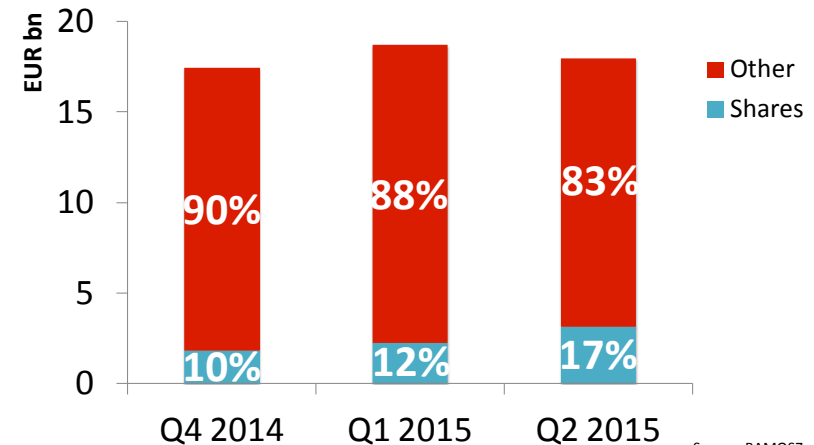


# Young financial market in a few number

**Breakdown of domestic investment products held by Hungarian households (values at end of periods, EUR bn)**



**Risk appetite of investors (retail and others): proportion of shares in the mutual funds of domestic fund managers**



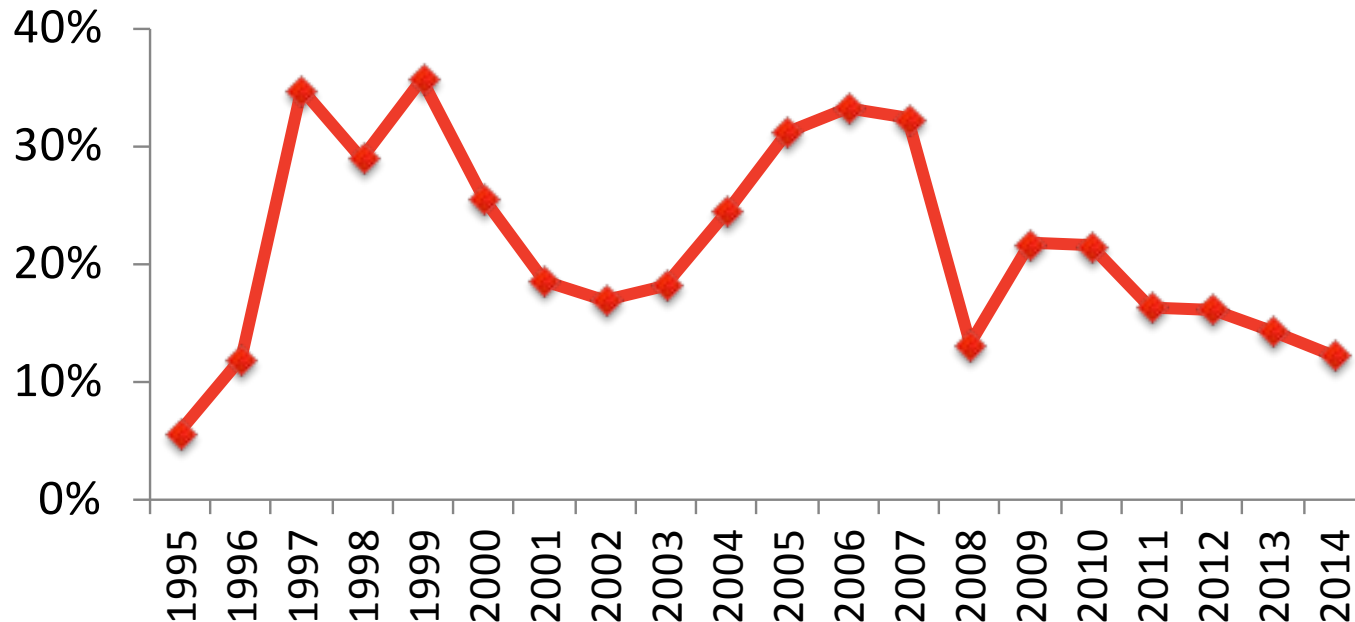
## BSE's equity market in numbers:

Average daily turnover: EUR 31 m  
 Market capitalization: EUR 15 bn  
 Yearly turnover velocity: ~55%

# The importance of the stock exchange

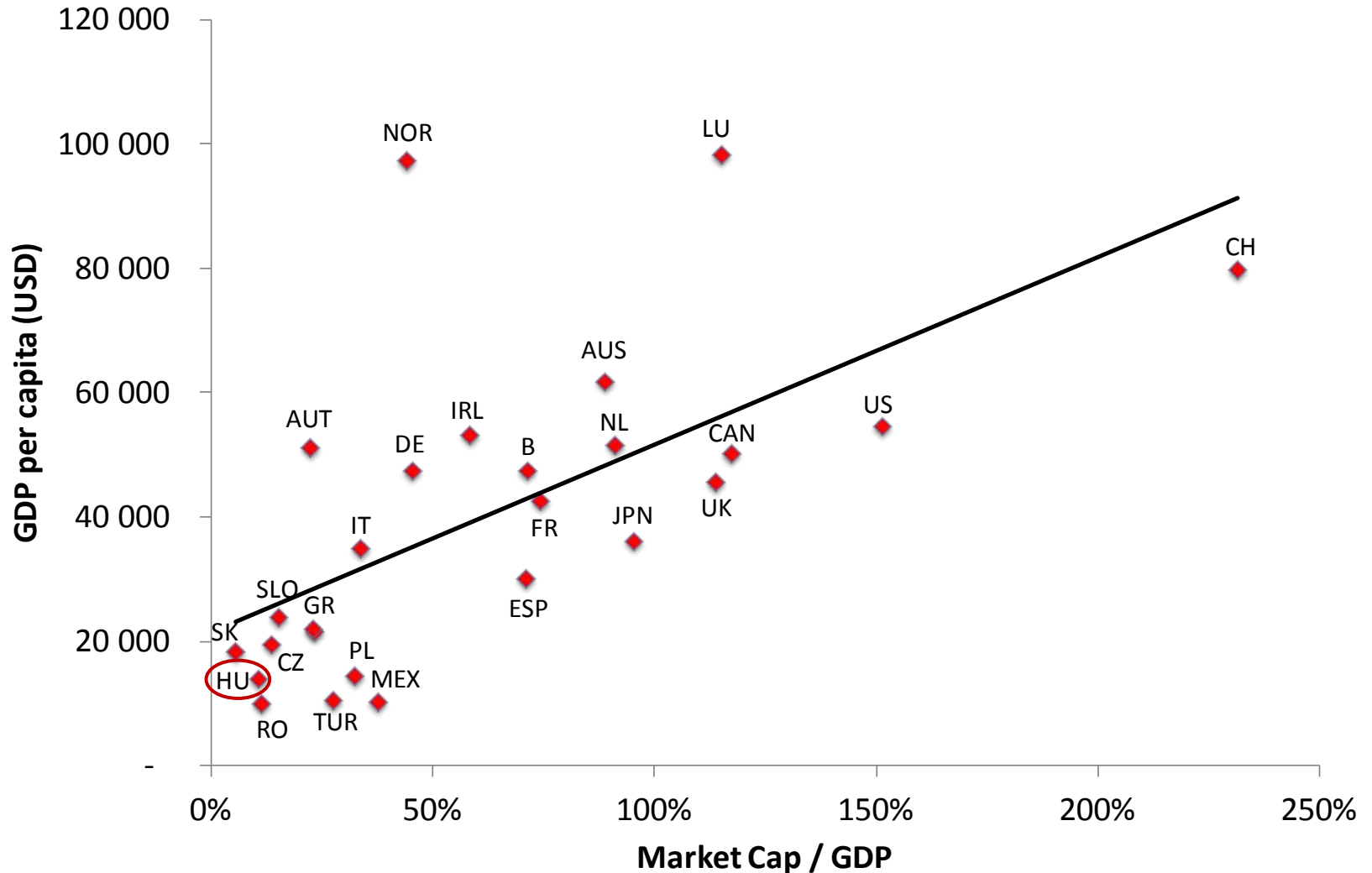
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**Equities' market capitalisation in proportion  
of the yearly Hungarian GDP**

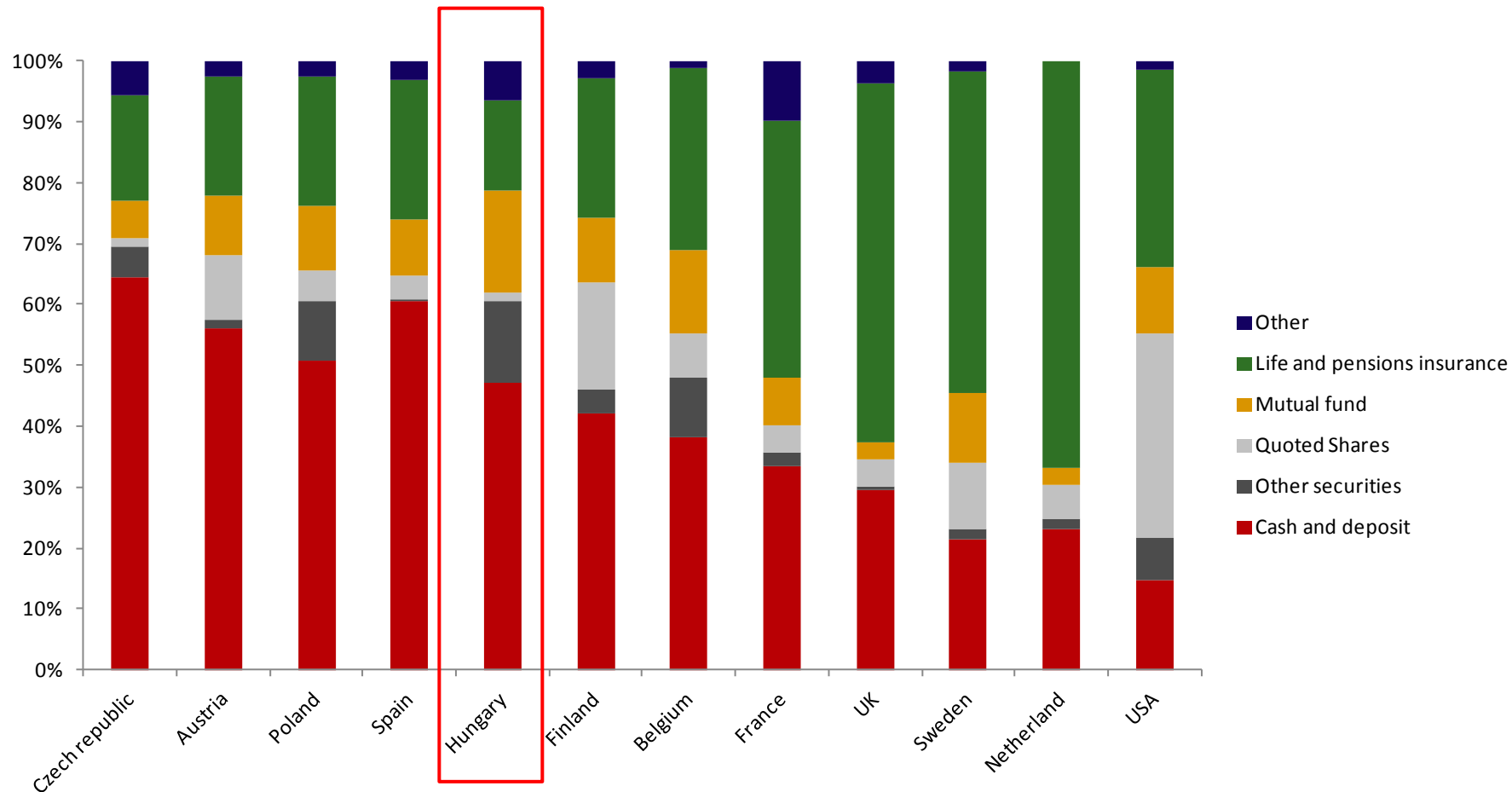


Source: KSH, BSE

# Hungary's place in the world (2014)



# Saving structures (Q1 2014)



Source: ECB

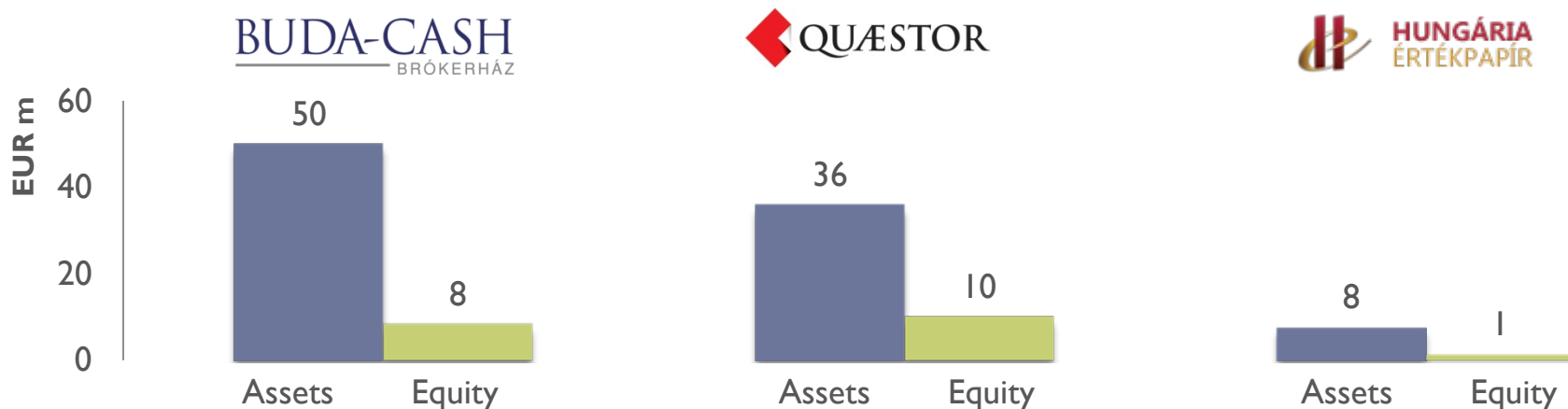
# Scandal chronology

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- ▶ 24 February – suspension of the license of **Buda-Cash** and its management is taken over by National Bank of Hungary (NBH, the market regulator)
- ▶ 4 March – NBH revokes the license of Buda-Cash and initiates its liquidation
- ▶ 6 March – BSE terminates the exchange membership of Buda-Cash and NBH partially suspends the license of **Hungária Értékpapír**
- ▶ 10 March – NBH partially suspends the license of **Quaestor Értékpapír**
- ▶ 16 April – New proposals (draft bill) to enhance Investor Protection Fund (e.g. increased amount of compensation to EUR 100,000)
- ▶ 17 April – NBH revokes the license and BSE terminates the membership of Quaestor Értékpapír
- ▶ 20 April – NBH revokes the license and BSE terminates the exchange membership of Hungária Értékpapír
- ▶ 1 June – deadline of extraordinary contribution (EUR 4 m) to BEVA (Investor Protection Fund) by members
- ▶ 5 June – deadline for victims of Quaestor to submit application for extraordinary compensation (QKKA special fund)
- ▶ 23 June – amended version of Investor Protection Fund approved by the Parliament



# Summary of the 3 brokerage houses



## Ranks by turnover at BSE's markets

|                |   |    |    |
|----------------|---|----|----|
| Equity         | 8 | 16 | -  |
| Equity futures | 1 | 8  | 14 |
| Index futures  | 9 | 4  | 4  |
| FX futures     | - | 8  | -  |

Value of assets  
"stolen"



EUR 300 m



EUR 700 m



EUR 10 m

Number of  
victims



15,000



32,000



5,000



# How could it happen? Why now?

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- ▶ NBH overtook duties of Hungarian Financial Supervisory Authority in 2013
  - ▶ New methodology introduced by NBH: banking supervisory practice implemented
- ▶ Spillover effects of Swiss National Bank's decision (January)
  - ▶ Immediate cause
  - ▶ Domino effect
- ▶ Wrong business policies and illegal activities



# 3 different cases revealed

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## Buda-Cash

- EUR 200 bn of collateral disappeared
- False trade confirmations to the clients for 10-15 years
- Buda-Cash cleverly moved all money and other assets to show match with the theoretically correct numbers
- In practice no one knows exactly what happened and where the missing money is

## Quaestor

- Promise of high returns on its corporate bonds
- Illegal bond issuances (EUR 500 m)
- Quaestor group had a diversified business portfolio → the management financed long term investments from short term sources
- In addition: corporate bonds were refund guaranteed
- No one knows where the money is (similar to BC)

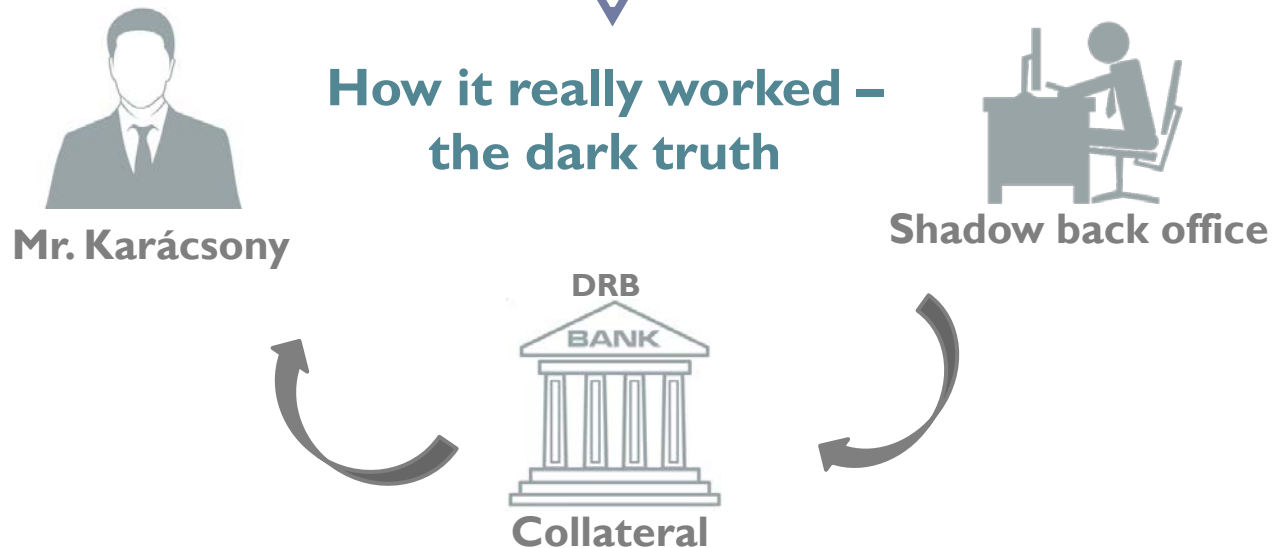
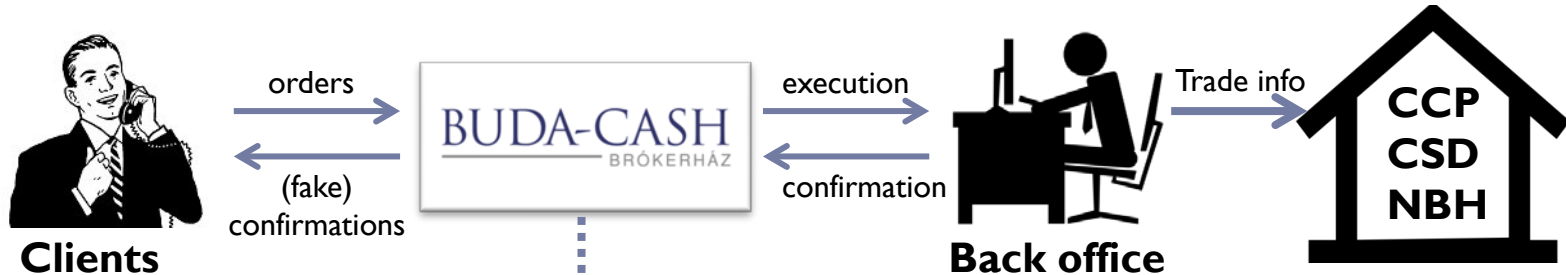
## Hungária

- Mysterious fraud with a lot of open question
- It was a little, independent brokerage house with smaller damage (max EUR 10 m)
- The firm has signed short term loan contracts (max 1 year maturity) with the clients for the last 20 years: 15-20% (or more) returns promised → Hungária paid its clients from the payments of the others



# Case of Buda-Cash

## What it looked like on the surface...



# Case of Quaestor



Mandate to organize bond issuance  
(no guarantee from Quaestor!)

**Quaestor Hrurira Ltd.**  
(own equity only **EUR 33k**)

Nobody cares if it's under a  
Quaestor named firm



PERMISSION

Authorised  
Bonds

EUR 200m

Unauthorised  
Bonds

EUR 500m



OFFICIALLY REGISTERED



Clients

Indemnification  
for both types



Moral hazard?

# What's happening now?

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- ▶ Amended version of Investor Protection Fund (23<sup>rd</sup> June) to enhance investor protection and facilitate the ongoing compensation processes
  - ▶ The amount of compensation is raised to EUR 100,000 (5x raise)
  - ▶ The operational management will be supported by the National Deposit Insurance Fund of Hungary
  - ▶ Members pay initial contribution + annual contributions + penalties
  - ▶ Members may finance these contributions by loan
- ▶ NBH to launch a new online web service: securities account holders can check their current balances (cash & securities)
- ▶ Continuous liquidation and assessment of properties/damages
- ▶ Indemnification of victims



# Impacts expected

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- ▶ Decreased levels of investors' confidence
- ▶ However, BSE experienced an increased activity of retail investors (increasing turnover during the 1<sup>st</sup> trimester, while market share of retail investors went up to 30% from 23%)
  - ▶ Fear of independent brokerage houses: retail investors may shift to bank backed brokerage services (no sign of this at the moment)
- ▶ Tightened investor protection rules may enhance investors' confidence
  - ▶ The way of indemnification process and the raised level of Investor Protection Fund may trigger moral hazard problems
- ▶ More frequent on-site supervisions will be led by the NBH
- ▶ Consolidation of the brokerage industry
- ▶ Or worse: domestic brokerage houses may relocate their headquarters to foreign countries because of
  - ▶ the overregulated Hungarian market
  - ▶ the excessive need of bigger compliance staff
  - ▶ additional payment obligations to the Investor Protection Fund

