IOPS PRINCIPLES OF PRIVATE PENSION SUPERVISION

IOPS Principles of private pension supervision, November 2006

IOPS PRINCIPLES OF PRIVATE PENSION SUPERVISION

Preamble

1. The main objective of private pension supervision is to promote, the stability, security and good governance of pension funds and plans, and to protect the interests of pension fund members and beneficiaries. Pension supervision involves the oversight of pension institutions and the enforcement of and promotion of adherence to compliance with regulation relating to the structure and operation of pension funds and plans, with the goal of promoting a well functioning pensions sector. In addition, achieving stability within the pension sector is an important part of securing the stability of the financial system as whole. Pension supervision should be mindful of financial innovation. Pension supervision should also pay attention to financial crime.

2. The provision of pensions is of fundamental economic and social importance, ensuring the successful delivery of adequate retirement income. The effective supervision of pensions, and of the institutions that provide pension products and services, is required to ensure the protection of consumers – a necessary task with any financial product being sold to non-professionals. Pension supervision is required to achieve the degree of protection needed to support privately managed savings and is a means to help pensions adapt to market risks. Such risks can be particularly problematic with regard to pensions due to the unique characteristics of these financial products, such as:

- the long-term nature of the contract involved, and the subsequent requirement for incentives or even compulsion to overcome individual's 'myopia' towards long-term savings;

- their coverage of a wide social and economic range of the population (particularly where incentives or compulsion are applied);

- the low risk tolerance of pension members and beneficiaries, as subsistence rather than discretionary savings is often involved;

- the complexity of the products, involving tax issues, assumptions over future salaries, longevity, difficulty in the valuation of assets and liabilities etc. – a complexity which is beyond the financial literacy of most investors and which gives rise to asymmetrical information between pension providers or financial intermediaries and consumers;

- limited competition and choice, with decisions often made collectively by employers or unions;

- their potential impact on financial market and economic stability given their large and increasing size relative to financial markets and countries' GDP;

- their 'social' as well as financial role, which is becoming more important as reforms in many countries have given an increasing role to private pensions (through tax incentives and other public policy), as aging populations are in some cases making social security an ever increasing burden on government resources, forcing public pensions to be reduced.

3. Consequently pension supervision faces unique challenges: in terms of ***breadth,*** including the number of pension funds or plans being supervised, the number of members and beneficiaries, the different types of pension products involved, and the fact that supervision may need to be coordinated across sectors

due to the diverse nature of providers; as well as in the ***depth*** of supervision which is required, due to the vulnerability of members and beneficiaries and, in many cases, the mandatory nature of the system.

4. Though pension supervision has many unique aspects, the IOPS recognizes that many pension supervisors work in integrated financial supervisory structures and it is therefore important that these principles are not inconsistent with international principles covering other financial service institutions. The IOPS will therefore strive to consult with other international organisations.

Scope and Coverage

5. The IOPS Principles for Pension Supervision are designed to cover occupational and personal pension plans and pension funds[1]. Pension supervision includes the monitoring of the activities of pension plans and funds to ensure that they remain within the requirements of the regulatory framework, essentially enforcing compliance with the rules[2]. Supervisory activities vary depending on the regulatory and legal environment, policy choices and a variety of other factors. In general they may be defined as influencing changes in pensions provision that contribute to the achievement of pension supervisory objectives, either through direct intervention or guidance. The scope of supervision can encompass any supervisory activity that is primarily concerned with ensuring the requirements and limitations imposed on pension funds or plans are adhered to[3]. Pension Supervisory Authorities referred to in the Principles are defined as any entity, responsible in whole or in part for the supervision of pension funds, plans, schemes or arrangements in a country or in the subdivision of a country, whether invested with its own personality or not. The Principles are designed to cover the different types of supervisory structure (specialized, partially integrated and integrated). Pension products also come in many different forms (defined contribution vs. defined benefit, mandatory vs. voluntary etc.) and the pension systems of countries also differ greatly, having been shaped by many factors (from the nature of the state, to the level of economic development, and the pension market structure). The IOPS has taken account of such diversity, and intends that these Principles identify good practice which can be applied universally.

---

1 Principles may not apply to those pension plans and pension fund in European Union countries which fall outside the scope of the Directive 2003/41/EC of the European Parliament and the Council of the 3 June 2003 on the activities and supervision of institutions for occupational retirement provision (for example pensions funded via book reserves).

The Principles do not cover insurance contracts as such (although they may be used in both occupational and personal pension plans). Principles for the supervision of insurance is are provided by the International Association of Insurance Supervisors*: 'Insurance Core Principles and Methodology' – see http://www.iaisweb.org/358coreprinicplesmethodologyoct03revised.pdf*

2 Pension regulation encompasses all actions having the common objective of delineating the form, rules and standards that will define permissible organisations and activities, essentially establishing the parameters within which institutions will be required to function. Principles of pension regulation are provided by the OECD: *'Core Principles of Occupational Pension Regulation' – see* *http://www.oecd.org/dataoecd/14/46/33619987.pdf* The IOPS Principles are drawn from and are compatible with OECD Core Principle 6 on Supervision.

3 As reflected in the IOPS by-laws, supervision mainly involves issues related to the organisation, structure and functions of the supervisory body, the development of proper supervisory techniques and the implementation of enforceable regulations by supervisory bodies.

Principle 1 : Objectives

National laws should assign clear and explicit objectives to pension supervisory authorities

1.1 The principal strategic objectives of the pension supervisory authority should be clearly and publicly specified. They should include a focus on the protection of pension members and beneficiaries' interests. Objectives can also be directed towards the stability and security of pension funds and plans, the sustainability of the pension sector as a whole, the promotion of good governance and the encouragement of pension provision.

1.2 The responsibilities of the pension supervisor should be clearly and objectively stated, giving a clear mandate and assigning specific duties.

Principle 2 : Independence

Pension supervisory authorities should have operational independence[4]

2.1 The pension supervisory authority should have operational independence from both political authorities and commercial interference in the exercise of its functions and powers.

2.2 To ensure independence, stability and autonomy are particularly required at the senior director level of the pension supervisory authority. The nomination, appointment and removal of the head of the pension supervisory authority should be done via explicit procedures and transparent mechanisms. The head of the authority may be appointed for a fixed term.

2.3 The pension supervisory authority should also be funded in such a way as to ensure independence and there should be a transparent budgetary process.

2.4 Supervisory acts should be over-ruled only by judicial decision, including tribunals with relevant powers, or by parliamentary process.

[4] Operational independence is taken to mean that at the day to day operational and decision making level the supervisory authority has autonomous management of its activities. At a higher, more policy orientated level, supervisory agencies may be subject to national governmental and political influences which are out of their control. There may be an intermediate stage where Ministerial approval is required for enforcement actions that involve removal or deregistration of an industry participant.

Principle 3: Adequate Resources

Pension supervisory authorities require adequate financial, human and other resources

3.1. Pension supervisory authorities should be granted adequate staff and access to resources.

3.2 The pension supervisory authority should have its own budget sufficient to enable it to conduct proportionate, effective and independent supervision. Funding, in part or in full, of the pension supervisory authority by supervised pension funds and plans could be considered, provided independence is maintained.

3.3 The pension supervisory authority should hire, train and maintain sufficient staff with high professional standards, including appropriate standards of confidentiality and disclosure (e.g. of interests in regulated entities).

3.4 The directors and head of the authority should be suitably qualified, with sufficient education, experience, capacity and reputation.

3.5 If its own capacities are insufficient, or for other reasons deemed necessary, the pension supervisory authority should have the authority to outsource to third parties (e.g. auditors, actuaries) supervisory tasks – though the supervisory authority remains responsible for the supervisory process and decisions. Where pension supervisory functions are outsourced to third parties, the pension supervisory authority should be able to assess their competence, monitor their performance and ensure their independence from the pension fund or any other related parties. If required, the pension supervisory authority must have the ability to take actions against these third parties either directly or through the appropriate professional body. Decision making and the application of sanctions, within the scope of the pension supervisor, should not be outsourced.

Principle 4: Adequate Powers

Pension supervisory authorities should be endowed with the necessary investigatory and enforcement powers to fulfill their functions and achieve their objectives

4.1. Pension supervisory authorities should be legally charged to undertake supervision and should be granted adequate powers and the capacity to exercise these powers.

4.2 The pension supervisory authority should have the power to conduct necessary supervisory functions, according to the nature of the pension system being supervised. Effective supervision of pension funds or plans should focus on legal compliance, financial control, minimum capital requirements, investment activity, good governance and integrity, actuarial examination, the supervision of pension plan or fund managers, and the provision of adequate disclosure and information to members. Powers should allow for relevant off-site and on-site inspection.

4.3 Pension supervisory authorities should have comprehensive investigatory and enforcement powers. On the suspicion of problems, they should have the power to conduct a full investigation, to oblige funds to submit documents and information, and to impose corrective measures and remedial actions if their orders are not obeyed –up to and including the power to impose administrative sanctions such as fines, the power to direct management, the power to revoke licences and the power to refer matters for criminal prosecution. In some cases, powers may include the ability to issue binding regulation.

Principle 5: Risk Orientation

Pension supervision should seek to mitigate the greatest potential risks to the pension system

5.1 The objectives of private pension supervision should be risk-based. Pension supervisory authorities should have a strategy for allocating their finite resources which targets mitigating actions on pension funds or plans which represent the highest risks to achieving the supervisor's objectives. This assumes that they understand the probability and impact of potential risks.

5.2 Pension supervisory authorities should be pro-active, seeking to avoid significant problems before they occur and intervening, in a proportionate way, at as early a stage as possible and searching for those supervisory instruments which add most value to the desired supervisory result.

Principle 6: Proportionality and Consistency

Pension supervisory authorities should ensure that investigatory and enforcement requirements are proportional to the risks being mitigated and that their actions are consistent

6.1 The remedial actions and if necessary sanctions imposed by the pension supervisory authority should be proportional to the problem which is being addressed. In taking or promoting mitigating actions, pension supervisory authorities should choose between the powers available to them according to the assessed seriousness of the risk or compliance failure being addressed.

6.2 The extent of supervisory demands placed on pension funds or plans and associated parties being supervised should be in accordance with the value expected to be derived.

6.3 In fulfilling its supervisory powers, the pension supervisory authority should give pension funds and plans flexibility, where appropriate, in the way they achieve compliance with regulatory requirements.

6.4 Supervisory decisions and intervention should be consistent, taking appropriately into account circumstances of each individual case. Supervisors should have procedures (for example, documentation, training and review) for ensuring that similar decisions are taken in similar circumstances and that these decisions are taken on objective and unbiased grounds.

Principle 7: Consultation and Cooperation

Pension supervisory authorities should consult with the bodies they are overseeing and cooperate with other supervisory authorities

7.1 The pension supervisory authority should consult, as appropriate, with the pensions sector when determining its approach to supervision.

7.2 The pension supervisory authority is empowered to exchange information with other relevant supervisory authorities, subject to legal and confidentiality requirements. This includes cooperation with other authorities or departments involved in pension supervision both nationally and internationally (particularly where cross-border pensions are involved), as well as with authorities supervising other relevant financial institutions or markets and law enforcement agencies. Cooperation should be for both efficiency purposes (avoiding overlaps and promoting economies of scale and scope) as well as promoting pro-active preventative measures (e.g. tackling financial crime).

Principle 8: Confidentiality

Pension supervisory authorities should treat confidential information appropriately

8.1 The pension supervisor should only release confidential information if permitted by law.

8.2 The pension supervisor in regard to non-public information should when requested by the providing authority keep information confidential and maintain appropriate safeguards for the protection of confidential information within its possession.

8.3 Where unsure of the status of the information, the supervisory authority should treat it as confidential if not publicly available or should check the status with the provider.

8.4 If agreed by the providing authority, the receiving supervisory authority may pass on information to other supervisory bodies or law enforcement agencies with legitimate supervisory interests and equivalent confidentiality standards.

8.5 Where staff transfer between the supervisory authority and the private sector, mechanisms should exist to ensure against the disclosure of confidential information.

8.6 Third parties to whom the pension supervisory authority has outsourced supervisory tasks should be subject to the same confidentiality requirements as the staff of the pension supervisory authority itself.

Principle 9: Transparency

Pension supervisory authorities should conduct their operations in a transparent manner

9.1 Pension supervisory authorities should adopt clear, transparent and consistent supervisory processes. The rules and procedures of the pension supervisory authority, and updates thereof, should be published. The pensions supervisory authority should generally operate in a transparent environment and should provide and publish a regular report – at least annually and in a timely manner – on the conduct of its policy, explaining its objectives and describing its performance in pursuing those objectives. The pension supervisory authority should be subject to regular audit and reporting requirements which allow for the assessment of how well the authority is fulfilling its responsibilities and ensuring the mandate and functions of the pension supervisory authority cannot be changed on an ad hoc basis.

9.2 When directing the management of pension funds or plans pension supervisory authorities should explain to those affected why they are acting.

9.3 Pension supervisory authorities should provide and publish clear and accurate information for the pension industry and the general public on a regular basis – such as the financial situation of the pension fund industry and observations on major developments in the pension sector. Disclosure will generally be on an aggregate basis, but could also be on individual pension funds, in which case the rules of confidentiality may be particularly relevant.

Principle 10: Governance

The supervisory authority should adhere to its own governance code and should be accountable

10.1 The pension supervisory authority should establish and adhere to a governance code, outlining suitable internal controls, checks and balances, and effective processes for risk and performance management. A code of conduct should be established and enforced in relation to all staff members.

10.2 There should be clearly documented procedures for decision-making, with processes for referring decisions up to the appropriate level of seniority, reviewing and documenting decisions.

10.3 For interventions with serious impact there should be some separation between those within the authority proposing interventions and those taking the final decision, so the scope for emergency action is balanced by a review process.

10.4 Pension supervisory authorities should be clearly accountable for their general conduct and activity. Pension supervisory authorities should have accountability arrangements, which may vary according to specific country circumstances and which may include accountability to a range of bodies, from parliament to the members and beneficiaries of pension funds or plans.

10.5 Procedures should be in place for the governing body of a pension plan or fund to appeal to the pension supervisory authority or relevant tribunal for decisions taken by the pension supervisory authority that affect them and which they consider inconsistent with legal provisions.