

Ideal Regulatory and Supervisory Powers for a Pension Authority*¹

Regulatory and supervisory powers establish how, and how effectively, a supervisory agency is expected to monitor and enforce regulatory requirements. In an ideal world an agency with responsibilities in the financial sector (including banks, insurance companies and pension funds) would have the following powers:

Registration and deregistration - the power to register/authorise/licence financial institutions under financial sector laws, and to administer registration requirements under those laws. This includes the power to impose relevant conditions on registrations, and the power to vary and revoke registrations in appropriate circumstances.

Making of legally binding regulations/directives and (less formal) guidance notes - the power to formulate and promulgate regulatory policy for registered financial institutions and the power to vary and revoke them. Policy is typically promulgated through a combination of regulations, prudential standards, and guidance notes. The first two of these usually have legal standing, while guidelines are not normally legally enforceable. While regulations are usually executed formally by the Minister, the regulatory agency should have primary responsibility for their development. Prudential standards (called directives in some countries) and guidance notes on the other hand are usually issued by the agency. In total these subordinate legislative instruments should cover at least the following:

- standards of corporate governance for registered entities, including codes of conduct, roles of boards and management, and methods for resolving conflicts;
- standards governing the ownership and control of financial institutions, including fit and proper conditions and minimum qualification requirements;
- standards of business conduct, including resolving conflicts between financial institutions and their clients, prohibition of certain abuses and insider trading;
- standards governing the prevention of financial crime;
- standards defining capital adequacy/solvency and the measurement of capital, including excluded assets and liabilities;
- standards defining valuation methods where relevant for both assets and liabilities, including choice of discount rates and levels of sufficiency in provisioning;
- standards concerning the management of risks by financial institutions; and

¹ This paper was prepared by Mr. Jeffrey Carmichael in relation to the IOPS risk-based supervision project and the case study on the experience of the Retirement Benefits Authority in Kenya

- standards of disclosure for securities and retail investment products, including insurance policies and pension products.

Reporting obligations and information gathering - the power to require financial institutions to provide whatever information the regulator requires in whatever form it judges to be appropriate. This should include both regular reporting and specific reporting in non-routine situations.

Monitoring and surveillance - clear monitoring and surveillance powers are an integral part of supervisory and market conduct functions. These include powers to:

- require the production of documents and the giving of information;
- inspect and copy documents; and
- test an institution's compliance with prudential regulations/standards including appointing, at the institution's expense, an appropriate expert (auditor, actuary, valuer, etc) to report on any aspect of the institution's business, or the business of a group of which it may be a part, for the purpose of establishing compliance with regulatory requirements.

These powers should be able to be exercised without having to demonstrate that there is any suspicion of wrongdoing; they are purely routine information gathering powers.

Directions – the power to direct any registered financial institution to do something specific, or to cease doing something specific, for the purposes of ensuring compliance with a financial sector law or regulation/standard. Directions powers are ideally parameterized in the law, both to provide legal certainty and to reduce the possibility of their being misused. A typical parameterization (subject in certain cases to conditions precedent) would include the power to issue directions:

- to comply with the whole or a specified part of a financial services law or standard;
- to appoint an auditor to audit the records of a registered entity;
- to appoint an actuary to prepare a report on the affairs of a registered entity;
- to prevent a specified director or employee of a registered entity from taking part in the management or conduct of the business of the entity;
- to appoint a specified person or persons to a specified office of a registered entity;
- to remove an actuary or auditor of a registered entity;
- not to incur further debt;
- not to pay a dividend;
- not to pay or transfer any amount to any person, or create an obligation (contingent or otherwise) to do so;

- not to undertake a financial obligation (contingent or otherwise) on behalf of another person or to transfer funds to another person;
- to take any other action that the regulator considers necessary or desirable in the interests of the registered entity, its members, or the financial system.

Investigating breaches - where the regulator has reason to suspect a breach of a financial sector law it should have comprehensive powers to investigate the suspected breach.

Responding to breaches – effective responses to breaches of financial sector laws require a combination of the powers to:

- revoke registration;
- suspend the operations of a registered institution;
- remove directors of a registered institution;
- require a registered institution to appoint new auditors and/or actuaries;
- levy administrative fines – the regulator should be able to penalise non-criminal breaches appropriately with administrative penalties. Ideally, the regulator should have the power and discretion to negotiate administrative penalties and remedial action without the need to rely on court proceedings. Where such remedies cannot be negotiated, prosecution should result.
- freeze assets of or under the control of a registered institution where the regulator suspects that the interests of the customers of the institution may be at risk;
- require a registered institution to publish corrective material;
- require a registered institution to terminate or unwind specific transactions; and
- accept enforceable undertakings from registered institutions and their officers who are in breach of financial sector laws or regulations/standards. These written undertakings can cover any aspect of an activity that is required to be registered under a financial sector law. An enforceable undertaking should be published and, in the event of a breach of the undertaking, the regulator should be able to apply to the court for an order directing compliance with the undertaking.

Prosecuting breaches - In many countries the prosecution of criminal breaches of financial sector laws are shared between the regulatory agency and the Department of Justice (or its equivalent). The case for the regulator to prosecute at least some breaches rests on both the support it adds to the agency's credibility as an effective regulator and to the particular expertise that it brings to the area. Prosecution can nevertheless be expensive and demanding on staff resources.

Imposing a statutory manager – Where the regulator is concerned that a registered pension fund may be insolvent, behaving imprudently in a manner that is putting members' interests at risk, or is violating a financial sector law, it should have the power to appoint a statutory

manager. The statutory manager should take directions from the regulator. A statutory manager should not be able to be appointed to a regulated financial institution without the regulator's consent.

Transfers of business – the power to approve mergers and acquisitions of registered institutions.

Winding up a registered institution – standing to apply to the Courts for the winding up of registered institutions. No application to the Court to wind up a registered regulated institution should be able to be made without the regulator's prior approval.

Authorising self-regulatory organisations - the power to authorise and make appropriate arrangements with industry self-regulatory organisations and other agencies with regulatory roles as the regulator sees fit.

Information sharing powers - the power to share information with other regulatory agencies (some of which may not yet be established), including the Central Bank, the Insurance Commission, other relevant domestic agencies, and overseas financial regulators, as well as the Police. In all cases, the nature and extent of the information sharing arrangements should be detailed in a Memorandum of Understanding between the agencies.