

# **THE INTERNATIONAL ORGANISATION OF PENSION SUPERVISORS (IOPS)**

## **REVIEW OF IOPS PRINCIPLES OF PRIVATE PENSION SUPERVISION**

**DRAFT FOR PUBLIC CONSULTATION**



## REVISED IOPS PRINCIPLES OF PRIVATE PENSION SUPERVISION

### Preamble

1. The objectives of private pension supervision focus on protecting the interests of pension fund members and beneficiaries, by promoting the stability, security and good governance of pension funds. 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 (as investments made by pension funds have a major impact on the real economy in many countries ). Pension supervision should be mindful of financial innovation. .

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 fund 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;

- the rapid pace of financial innovation which creates new, untested financial products;
- the increased complexity and sophistication of financial crime.

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 consistent with international principles covering other financial service institutions. The IOPS will therefore 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/ or pension funds.<sup>1</sup> 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.<sup>2</sup> Supervisory activities vary depending on the regulatory

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<sup>1</sup> Principles may not apply to those pension plans and pension funds 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/358coreprinciplesmethodologyoct03revised.pdf>

Though these guidelines apply to private pension funds, it may also be considered good practice to apply similar standards to governmental funds.

According to the OECD's taxonomy, a pension fund is a legally separated pool of assets forming an independent legal entity that is bought with the contributions to a pension plan for the exclusive purpose of financing pension plan benefits. The plan/fund members have a legal or beneficial right or some other contractual claim against the assets of the pension fund. Pension funds take the form of either a special purpose entity with legal capacity (such as a trust, foundation, or corporate entity) or a legally separated fund without legal capacity managed by a dedicated provider (pension fund management company) or other financial institution on behalf of the plan/fund members.

A pension plan is a legally binding contract having an explicit retirement objective (or – in order to satisfy tax-related conditions or contract provisions – the benefits cannot be paid at all or without a significant penalty unless the beneficiary is older than a legally defined retirement age). This contract may be part of a broader employment contract, it may be set forth in the plan rules or documents, or it may be required by law. In addition to having an explicit retirement objective, pension plans may offer additional benefits, such as disability, sickness, and survivors' benefits.

<sup>2</sup> 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 form a core part of the OECD standard, recognized and applied by the OECD.

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<sup>3</sup>.

6. 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.

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<sup>3</sup> 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 should 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*

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.<sup>4</sup>

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 is usually appointed for a fixed term (normally between 3-6 years) with subsequent reappointment allowed (in order to retain skilled practitioners).

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, including the use of enforcement and sanction powers, should be over-ruled only by judicial decision, including tribunals with relevant powers, or by parliamentary process.

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<sup>4</sup> 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.<sup>5</sup>

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 or plans could be considered, provided independence is maintained. Where fees are charged, the fee structure should be transparent.

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, or to second staff with appropriate experience to work internally – 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.<sup>6</sup>

<sup>5</sup> For details see *IOPS Guidelines for Supervisory Intervention, Enforcement and Sanctions* <http://www.iopsweb.org/dataoecd/47/40/43972432.pdf>

and *IOPS Guidelines for the Supervisory Assessment of Pension Funds* <http://www.iopsweb.org/dataoecd/38/47/41042660.pdf?contentId=41042661>

<sup>6</sup> For details see IOPS Guidelines as above

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 supervision and on-site inspection.

4.3 Pension supervisory authorities should have comprehensive investigatory and enforcement powers. The legal framework that defines conditions and circumstances under which the pension fund supervisor must intervene should be flexible enough to enable the pension supervisor to undertake preventative, protective or punitive actions.

4.4 The pension supervisory authority should have the power to conduct a full investigation when a problem is suspected or observed, obliging funds and other relevant parties (such as asset managers, custodians, auditors) to submit documents and information. Necessary powers include the ability to impose corrective measures and remedial actions if the authority's orders are not carried out. The scope of the powers may extend to the power to impose administrative sanctions such as fines, to direct management, to revoke licences and to refer matters for criminal prosecution. In some cases, powers may include the ability to issue binding regulation.

4.5 The pension supervisory authority should have clear and well-defined strategic supervisory goals for the use of intervention, enforcement and sanction powers, clearly establishing whether the goal of their action is preventative, protective or punitive and use the appropriate tools and powers accordingly. The supervisory authority should have a coherent, well thought-out policy for deciding on the mix of supervisory tools adopted and the ability to adapt this approach to changing circumstances. .

4.6 A sufficient gradation of powers is required to enable the supervisory authority to tailor its response accordingly and sufficiently punitive powers are needed to enforce action.

4.7 Though not all powers may be used 'actively', the supervisory authority should still have certain powers either to use in exceptional circumstances – thereby avoiding what could be time consuming delays in dealing with other supervisory authorities – or, by acting as a deterrent, serving to modify the behaviour of supervised entities.

4.8 Pension supervisory authorities should have the power to take exceptional measures, if needed, in times of acute financial and economic difficulty and /or volatility (for example increasing reporting requirements, strengthening stress tests, or temporarily suspending certain regulatory or supervisory requirements which may have a pro-cyclical, adverse impact on financial markets in the short-term).

**Principle 5: Risk-based Supervision**

*Pension supervisory authorities should adopt a risk-based approach.*

5.1 In order to use their resources efficiently, pension supervisory authorities should adopt a risk-based approach, and a suitable risk-assessment methodology should be established.<sup>7</sup>

5.2 The move towards risk-based supervision should be carefully prepared for and undertaken gradually, combining this technique with more traditional rules-based supervision as the supervisory authority and pension industry develop the necessary expertise.

5.3 The move towards risk-based supervision should be seen as a movement along a continuum from one extreme of complete reliance on a rules or a compliance-based system to one where the emphasis of supervision is a function of risk. Rules-based supervision does not mean having no rules or compliance procedures.

5.3 A legal framework allowing suitable discretion in terms of interpretation and enforcement is required, which should also provide pension supervisory authorities with the necessary powers to adopt a risk-based approach.

5.4 Staff reorganization and training, in terms of the philosophy as well as the process of risk-based supervision, should be undertaken as the transition to the new approach takes place.

5.5 The Pension supervisory authority should communicate its risk-based approach to the pension industry, explaining what is expected of them – particularly in relation to risk-management – via guidance notes and possibly providing training.

5.6 Risk-based supervision will require different types of information, which the pension supervisory authority should obtain from existing sources where possible. Where specific supervisory returns are required they should be designed with care and focused on obtaining information regarding the main risks which the pension supervisory authority is concerned with.

5.7 Where quantitative risk assessment tools are used, the models involved should be carefully designed and their limitations fully understood

5.8 Risk-scoring models should reflect the risk-focus of the pension supervisory authority (which is driven by its objectives and resources), and the net risk of relevant individual entity and systemic risk factors. These factors should be suitably weighted according to the nature of the pension system, and a risk-score derived from the probability and impact of their occurrence.

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<sup>7</sup> For further details see IOPS Toolkit for Risk-based Supervision ([www.iopstoolkit.org](http://www.iopstoolkit.org)) and *IOPS Guidelines for Supervisory Intervention, Enforcement and Sanctions* <http://www.iopsweb.org/dataoecd/47/40/43972432.pdf>

**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 A logical connection should be made between the results of the risk assessment undertaken by the pension supervisory authority and its actions (for example through the use of a supervisory response matrix).<sup>8</sup> The remedial actions and if necessary sanctions imposed by the pension supervisory authority should be proportional to the amount of risk posed by the fund to its members and beneficiaries and the pension system as a whole - taking into account the nature, scale, complexity and seriousness of the potential compliance irregularities relating to the relevant party - and should represent the most efficient use of supervisory resources.<sup>9</sup>

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. During the decision making process, a balance should be struck between the potential benefits of the supervisory action and the costs and impact on pension fund members and beneficiaries.

6.3 Once a problem is identified, a clear and well-defined 'due process' should be followed. Due process describes the checks and balances that a supervisory authority should have in place to ensure that supervised entities are treated fairly, consistently and transparently.

6.4 To ensure proportionality, requirements should be set out in legislation, secondary regulation or detailed industry guidance (outlining various circumstances and risk as well as the associated intervention measures). Appropriate documentation, guidance and examples should be regulated or provided to staff.

6.5 Subject to the availability of regulatory and administrative powers and measures, the response should be escalated appropriately to achieve the desired regulatory objectives. Depending on the nature scale and complexity of the problem detected, a graduated response or exceptional measures should be adopted.

6.6 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.

6.7 Supervisory decisions and intervention should be consistent (both horizontally between pension funds and vertically over time), taking appropriately into account circumstances of each individual case. Supervisors should have well-documented procedures (for example, documentation, training, peer review, specialist team reviews and/or senior oversight) for ensuring that similar decisions are taken in similar circumstances and that these decisions are taken on objective and unbiased grounds.

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<sup>8</sup> For further details see the IOPS Toolkit for Risk-based Supervision.

<sup>9</sup> *IOPS Guidelines for the Supervisory Assessment of Pension Funds*  
<http://www.iopsweb.org/dataoecd/38/47/41042660.pdf?contentId=41042661>

### **Principle 7: Consultation and Cooperation**

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

7.1 The pension supervisory authority should consult, as appropriate, with the pensions sector when determining its approach to supervision.<sup>10</sup>

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 (for example conduct of business supervisors) 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).

7.3 Pension supervisory authorities should ensure that intensified, extraordinary coordination between financial sectors and internationally takes place during periods of economic difficulty and financial system volatility.

### **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 (with fines or even prison sentences imposed for breaches). Staff should be bound by internal codes of confidentiality -also after leaving the authority.

8.2 IT systems used by supervisors should include limited access restrictions to improve confidentiality and care should be taken regarding the security of the supervisory authority's database.

8.3 The supervisory authority should publish its policy on how confidential information will be treated. A suitable balance should be struck between conduct of business supervision (where disclosure can be used to influence the behavior of the supervised community), prudential supervision (where confidentiality is important to protect the interests of particular supervised entities), and system integrity, according to the nature of the pension system.

8.4 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.

8.5 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.

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<sup>10</sup> For further details see *IOPS Guidelines for Supervisory Intervention, Enforcement and Sanctions* <http://www.iopsweb.org/dataoecd/47/40/43972432.pdf>

8.6 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.

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

8.8 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.

9.2 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.

9.3 Where appropriate, the broad outlines of any supervisory response framework (such as an enforcement pyramid) should be made public by the supervisory authority, so that its actions will be understood by supervised entities and are not unexpected.

9.4 When directing the management of pension funds or plans pension supervisory authorities should explain to those affected why they are acting.<sup>11</sup>

9.5 A transparent information disclosure mechanism and timely publication of intervention and sanction decisions, where appropriate, should be in place, subject to relevant confidentiality requirements.

9.6 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.

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<sup>11</sup> For further details see *IOPS Guidelines for Supervisory Intervention, Enforcement and Sanctions* <http://www.iopsweb.org/dataoecd/47/40/43972432.pdf>

### **Principle 10: Governance**

*The supervisory authority should adhere to its own good governance practices – including governance codes, internal risk-management systems and performance measurement - and should be accountable*

10.1 Supervisory authorities themselves should establish and operate sound governance practices in order to maintain credibility and moral authority to promulgate good practices in the entities under their oversight.<sup>12</sup>

10.2 Pension supervisory authorities should be overseen by a governing board of a manageable size. The remuneration of the senior executives of the authority may be published for transparency.

10.3 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.

10.4 An internal audit should be considered good practice for pension supervisory authorities, which reviews the consistency and transparency of the decision making process, the effectiveness of risk management practices and the efficiency and propriety in the use of resource. These internal audits should be carried out as part of the legal and functional oversight of the supervisory authorities and their findings should be presented to the overseeing (parent) ministry or other statutory authority.

10.5 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.

10.6 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.

10.7 As part of good governance practices, pension supervisory authorities should monitor their own performance using a range of measures.

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

10.9 Pension supervisory authorities should be subject to an external audit by a state or independent audit institution.

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<sup>12</sup> Good governance of pension supervisory authorities can be summarized in four categories: **independence:** requiring clarification of the authority's responsibilities and powers, processes for appointing its governing board and the ability to secure resources and operate without undue influence; **accountability:** involving external audits, suitable internal organisation and measuring performance; **transparency:** ensuring that the authority's objectives and achievements are understood, and that a consultative relationship with industry is established; **integrity:** requiring codes of conduct, discretion to apply powers, internal controls and competent staff.

10.10 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 unreasonable or inconsistent with legal provisions. Individual members of staff at the supervisory authority should have indemnity from civil prosecution.<sup>13</sup>

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<sup>13</sup> For further details see *IOPS Guidelines for Supervisory Intervention, Enforcement and Sanctions*  
<http://www.iopsweb.org/dataoecd/47/40/43972432.pdf>