OECD Core Principles and Guidelines of Occupational Pension Regulation

OECD-IOPS MENA WORKSHOP ON PENSION REGULATION AND SUPERVISION

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The Framework

- Population ageing
- longer longevity, better health…Good news which can become a nightmare
- 1998 OECD Ministerial meeting
- Importance of the challenges and need for, comprehensive reform- urgency of the reform

The Framework

- Calling for policy action
- Reforming public pension systems
- Various measures
- Most efficient ones are the painful ones:

  $\Rightarrow$ Increase of retirement ages; and,

  $\Rightarrow$ Reduction of public pension generosity when relevant

The Framework

- Another axis is related to private pensions
- Retirement income should be provided by a mix of tax and transfer systems, funded systems and private savings.
- Objective is risk diversification, a better balance of burden-sharing between generations and to give individuals more flexibility over their retirement decision
- Promotion of private funded schemes

The Framework

- If the OECD is promoting the diversification of the sources of retirement income and the development of private pensions, as a complement and not (necessarily) as a substitute of public schemes
- But whatever the role of private pensions, they also address a societal objective and need to be considered as such

The Framework

- OECD is not either recommending specific types of private schemes:
  - Respect of country sovereignty and
  - Need to reflect national social, cultural and economic features
- But private pensions must be well –but not over-regulated
- Must go hand in hand with strengthening of financial markets
- In 1998: 15 principles endorsed by the Ministers…the predecessors of the current OECD Principles

The crisis

- The recent crisis has strengthened the need for
- --better regulation and supervision of pension funds
- --better governance
- --better protection of the beneficiaries
- --better financial education and awareness

The OECD's Working Party on Private Pensions

- Created shortly after the 1998 Ministerial meeting
- Work covered regulatory, policy and supervisory issues
- Refocused in 2004 on regulation and policy while IOPS took the lead on supervision
- Since its creation in 1999, the WPPP has focused on four activities:
  - International comparative information (regulations and statistics)
  - Development of regulatory principles and guidelines
  - Policy analysis
  - Cooperation with non-OECD countries

The OECD's Core Principles of Occupational Pension Regulation

- **First approved as an OECD recommendation in 2004**
- **Supported by separate guidelines**
- **Reviewed in 2007/8**
- **Methodology for implementation completed in 2008**
- **First used formally on OECD accession**

The OECD's Guidelines for the regulation of private pension systems

I. **Regulatory guidelines supporting Core Principles**

- **Guidelines on pension fund governance**
- **Guidelines for the protection of the rights of members and beneficiaries**
- **Guidelines on pension fund asset management**
- **Guidelines on funding and benefit security**
- **Guidelines on licensing and registration (jointly with IOPS)**

II. **Other Guidelines**

- **Good practices for financial education relating to private pensions**

	Core Principle	Corresponding Guideline
1	Conditions for effective regulation and supervision	
2	Establishment of pension plans, pension funds and pension fund managing companies	OECD-IOPS Guidelines on the Licensing of Pension Entities
3	Pension plan liabilities, funding rules, winding up, and insurance	OECD Guidelines on Funding and Benefit Security
4	Asset Management	OECD Guidelines on Pension Fund Asset Management
5	Rights of member and beneficiaries and adequacy of benefits	OECD Guidelines for the Protection of Rights of Members and Beneficiaries in Occupational Pension Plans
6	Governance	OECD Guidelines for Pension Fund Governance
7	Supervision	IOPS Principles of Private Pension Supervision

Core Principle 1: Conditions for effective regulation and supervision

An adequate regulatory framework for private pensions should be enforced in a comprehensive, dynamic and flexible way (taking into account the complexity of the schemes) in order to ensure the protection of pensions plan members and beneficiaries, the soundness of pensions plans and funds and the stability of the economy as a whole. This framework should however not provide excessive burden on pensions markets, institutions, or employers.

Core Principle 1: Conditions for effective regulation and supervision

A productive, diversified investment of retirement savings which spreads risk requires well-functioning capital markets and financial institutions. The development of advance-funded pension systems should go hand-in-hand with a strengthening of the financial market infrastructure and regulatory framework (including the development of new financial instruments and new markets such as inflation-indexed markets and the improved functioning of retirement annuity markets).

Regulation should promote a level playing field between the different operators and take account of the usefulness of a functional approach. The fair competition should benefit to the consumers and allow for the development of adequate private pensions markets.

Core principle 1: Implementing guidelines

Example :The legal system allows the enforcement of financial contracts pertaining to occupational pensions. In particular, there is a body of ethical, professional and trained lawyers and judges, and a court system, whose decisions are enforceable. Comparable standards apply in cases where alternative dispute mechanisms exist.

Core Principle 2: Establishment of pension plans, pension funds, and pension fund managing companies

An institutional and functional system of adequate legal, accounting, technical, financial, and managerial criteria should apply to pension funds and plans, jointly or separately, but without excessive administrative burden. The pension fund must be legally separated from the sponsor (or at least such separation must be irrevocably guaranteed through appropriate mechanisms).

Core Principle 2: implementing guidelines

- Legal provisions on licensing (essential for control, trust, fair competition)
- Governing documents
- Risk control, reporting and auditing mechanisms
- Funding policy
- Investment policy
- Capital requirements
- Governance

Core Principle 2: Implementing guidelines

– **Business plan :**

Pension entities should create a business plan which should at least include (i) a list of the plans/funds that the pension entity will manage; (ii) the types of obligations that the pension entity proposes to incur (*e.g.* return or benefit guarantees), if any; (iii) the estimated setting-up costs and the financial means to be used for this purpose; (iv) the projected development of the fund/plan; (v) where relevant, the means for fulfilling any capital requirements; and (vi) details regarding the adequate risk control reporting and auditing mechanisms, and a sound investment policy that are in place or to be established at start-up)

Core Principle 2: Implementing guidelines

- **License withdrawal**
- **Role of the licensing authority in supervisory matters**
- **Clarity of licensing application procedure**
- **Submission of documents**
- **Assessment of the licence application**
- **Guidance materials**
- **Power to reject, modify or with draw a licence**

Core Principle 3: Pension plan liabilities, funding rules, winding up, and insurance

Private occupational plans should be funded. While full-funding exists in principle for defined contribution plans, other types of plans should be subject to minimum funding rules or other mechanisms to ensure adequate funding of pension liabilities. Rules based on winding-up approach may be promoted as a minimum level to complement the ongoing approach. Flexibility can be allowed for temporary limited under-funding under restricted circumstances. Consideration should be given to the development of adequate but flexible requirements for minimum capital/guarantee in pension funds, taking account of the long term nature of their liabilities. Tax and prudential regulations should encourage a prudent level of funding. Private unfunded pay-as-you-go plans at individual company level should generally be prohibited.

Core Principle 3: Pension plan liabilities, funding rules, winding up, and insurance

Appropriate calculation methods for asset valuation and liabilities funding, including actuarial techniques and amortisation rules must be set up and based on transparent and comparable standards.

Proper winding-up mechanisms should be put in place. Arrangements (including, where necessary, priority creditors' rights for pension funds) should be put in place to ensure that contributions owed to the fund by the employer are paid in the event of his insolvency, in accordance with national laws.

The need for insolvency insurance and/or other guarantee schemes has to be properly evaluated. These mechanisms may be recommended in some cases but in an adequate framework. Recourse to insurance mechanisms (group and reinsurance) may be promoted.

Core Principle 3:
Implementing guidelines

Funding of occupational pension plans

Example: Occupational defined benefit plans should in general be funded through the establishment of a pension fund or through an insurance arrangement (or a combination of these mechanisms). Additional protection may be provided through the recognition of creditor rights to the pension fund or the plan members and beneficiaries and, in some cases, through insolvency guaranty schemes that protect pension benefits in the case of insolvency of the plan sponsor or the pension fund.

Core Principle 3: Implementing guidelines

Measurement of occupational pension plan liabilities

Example: The legal provisions (referencing generally recognised actuarial standards and methods) should require the use of prudent actuarial assumptions which are considered appropriate for the calculation of the pension plan's liabilities. These assumptions would include, among others, the mortality table (representing the assumed level of mortality of plan members and beneficiaries as at the date at which the plan's liabilities are calculated), future trend in mortality (representing permanent changes in mortality that are assumed to occur after the date at which the liabilities are calculated) and retirement and early leaver patterns at different ages (taking into account the actual retirement and early leaver behaviour of those covered by the plan).

The legal provisions (referencing generally recognised actuarial standards and methods) should require the use of prudent discount rates for determining liabilities that are consistent with the methodologies used in the valuation of assets and other economic assumptions. These legal provisions (or the actuarial profession) should provide guidance as to the factors that may be considered in determining the discount rate for ongoing and termination liabilities

Core Principle 3: Implementing guidelines

Funding rules for occupational defined benefit plans

The legal provisions require the identification and maintenance of a level of assets that would be at least sufficient to meet accrued benefit payments. The targeted funding level may be based on the termination or the ongoing liability. It should also take account of the plan sponsor's ability and commitment to increase contributions to the pension plan in situations of under funding, the possibility of benefit adjustments or changes in retirement ages, as well as the link between the pension fund's assets and its liabilities.

Funding rules should aim to be countercyclical, providing incentives to build reserves against market downturns. They should also take market volatility into account when limiting contributions (or their tax deductibility) as a certain funding level is reached. Tax regulations should not discourage the build-up of sufficient reserves to withstand adverse market conditions and should avoid restricting the full funding of the ongoing or termination liability. Temporary suspension of contribution obligations may be appropriate in circumstances of significant over funding (calculated on an on-going basis).

Core Principle 3: Implementing guidelines

Winding up

Whenever plan benefits are guaranteed by sponsoring employers, the creditor rights of pension plan members and beneficiaries (either directly, via the pension fund, or, where relevant, via insolvency guarantee schemes) should be recognised in the case of bankruptcy of the plan sponsor. Priority rights relative to other creditors should be required for at least due and unpaid contributions.

Core Principle 4:
Asset Management

Investment by pension funds should be adequately regulated. This includes the need for an integrated assets/liabilities approach, for both institutional and functional approaches, and the consideration of principles related to diversification, dispersion, and maturity and currency matching. Quantitative regulations and prudent-person principles should be carefully assessed, having regard to both the security and profitability objectives of pension funds. Self-investment should be limited, unless appropriate safeguards exist. Investment abroad by pension funds should be permitted, subject to prudent management

Core Principle 4:
Asset Management

Increased reliance on modern and effective risk management, industry-wide risk management standards for pension funds and other institutions involved in the provision of retirement income should be promoted. The development of asset liability management techniques should be given proper consideration.

Core Principle 4: Implementing guidelines

- **Retirement income objective and prudential principles**
- **Investment policy**

•The investment policy should establish clear investment objectives for the pension fund that are consistent with the retirement income objective of the pension fund and, therefore, with the characteristics of the liabilities of the pension fund and with the acceptable degree of risk for the pension fund, the plan sponsor and the plan members and beneficiaries. The approach for achieving those objectives should satisfy the prudent person standard taking into account the need for proper diversification and risk management, the maturity of the obligations and the liquidity needs of the pension fund, and any specific legal limitations on portfolio allocation

•Portfolio limits

•Valuation of pension assets

Core Principle 4: Implementing guidelines

Portfolio limits

- The legal provisions may include maximum levels of investment by category (ceilings) to the extent that they are consistent with and promote the prudential principles of security, profitability, and liquidity pursuant to which assets should be invested. Legal provisions could also similarly include a list of admitted or recommended assets. Within this framework, certain categories of investments may be strictly limited. The legal provisions should not prescribe a minimum level of investment (floors) for any given category of investment, except on an exceptional and temporary basis and for compelling prudential reasons

- Self-investment by those undertaking investment management of pension funds should be prohibited or limited, unless appropriate safeguards exist. Investment in assets of the plan sponsor, in parties related or affiliated with any pension entity or pension fund managing company is prohibited or strictly limited to a prudent level (e.g. 5 percent of the pension fund assets). When the plan sponsor, the pension entity or the pension fund managing company belong to a group, investment in undertakings belonging to these same groups should also be limited to a prudent level, which may be a slightly higher percentage (e.g. 10 percent of the pension fund assets).

Core Principle 4: Implementing guidelines

Prudent person standard

- The governing body of the pension plan or fund and other appropriate parties should be subject to a "prudent person standard" such that the investment of pension assets is undertaken with care, the skill of an expert, prudence and due diligence. Where they lack sufficient expertise to make fully informed decisions and fulfil their responsibilities the governing body and other appropriate parties should be required to seek the external assistance of an expert.

- The governing body of the pension plan or fund and other appropriate parties should be subject to a fiduciary duty to the pension plan or fund and its members and beneficiaries. This duty requires the governing body and other appropriate parties to act in the best interest of plan members and beneficiaries in matters regarding the investment of pension plan assets and to exercise "due diligence" in the investment process

Core Principle 5: Rights of members and beneficiaries and adequacy of benefits

Non-discriminatory access should be granted to private pensions schemes. Regulation should aim at avoiding exclusions based on age, salary, gender, period of service, terms of employment, part-time employment, and civil status. It should also promote the protection of vested rights and proper entitlement process, as regard to contributions from both employees and employers. Policies for indexation should be encouraged. Portability of pensions rights is essential when professional mobility is promoted. Mechanisms for the protection of beneficiaries in case of early departure, especially when membership is not voluntary, should be encouraged

Core Principle 5: Rights of members and beneficiaries and adequacy of benefits

Proper assessment of adequacy of private schemes (risks, benefits, coverage) should be promoted, especially when these schemes play a public role, through substitution or substantial complementary function to public schemes and when they are mandatory. Adequacy should be evaluated taking into account the various sources of retirement income (tax-and-transfer systems, advance-funded systems, private savings and earnings).

Appropriate disclosure and education should be promoted as regards respective costs and benefits characteristics of pension plans, especially where individual choice is offered. Beneficiaries should be educated on misuse of retirement benefits (in particular in case of lump sum) and adequate preservation of their rights. Disclosure of fees structure, plans performance and benefits modalities should be especially promoted in the case of individual pension plans

Core Principle 5:
Implementing guidelines

Access to plan participation, equal treatment and entitlements under the pension plan

•Employees should have non-discriminatory access to the private pension plan established by their employer. Specifically, regulation should aim at avoiding exclusions from plan participation that are based on non-economic criteria, such as age, gender, marital status or nationality. In the case of mandatory pension plans, those plans that serve as the primary means of providing retirement income, and those that are significantly subsidised by the state, regulation should also aim at avoiding other unreasonable exclusions from plan participation, including exclusions based on salary, periods of service and terms of employment, (e.g., by distinguishing between part-time and full-time employees or those employed on an at-will and fixed-term basis). Regulation of voluntary and supplementary pension plans also should aim towards similarly broad access, although the extent of such access may take into account factors including the voluntary nature of the arrangement, the unique needs of the employer establishing the pension plan, and the adequacy of other pension benefits

•Accrued benefits should vest immediately or after a period of employment with the employer sponsoring the plan that is reasonable in light of average employee tenure. Benefits derived from member contributions to the pension plan should be immediately vested.

Core Principle 5: Implementing guidelines

- **Benefit Accrual and Vesting Rights**
- **Pension portability and rights of early leavers**
- **Disclosure and availability of information**

And financial education and awareness (see presentation by Flore-Anne Messy)

- **Additional rights in the case of member-directed, occupational plans**
- **Entitlement process and rights of redress**

Core Principle 6: Governance

Regulations on pension governance need to be guided under the overriding objective that pension funds are set up to serve as a secure source of retirement incomes. The governance structure should ensure an appropriate division of operational and oversight responsibilities, and the accountability and suitability of those with such responsibilities. Pension funds should have appropriate control, communication, and incentive mechanisms that encourage good decision making, proper and timely execution, transparency, and regular review.

Core Principle 6: Implementing guidelines

(see presentation by Fiona Stewart)

- **Identification of responsibilities**

- **Governing body**

Every pension fund should have a governing body vested with the power to administer the pension fund and who is ultimately responsible for ensuring the adherence to the terms of the arrangement and the protection of the best interest of plan members and beneficiaries. The responsibilities of the governing body should be consistent with the overriding objective of a pension fund which is to serve as a secure source of retirement income. The governing body should retain ultimate responsibility for the pension fund, even when delegating certain functions to external service providers. For instance, the governing body should retain the responsibility for monitoring and oversight of such external service providers. Appropriate oversight mechanisms should also be established where the governing body is a commercial institution.

Core Principle 6: Implementing guidelines

- **Delegation and expert advice**
- **Auditor and Actuary**

Example: As soon as the actuary realises, on performing his or her professional or legal duties, that the fund does not or is unlikely to comply with the appropriate statutory requirements and depending on the general supervisory framework, he or she shall inform the governing body and - if the governing body does not take any appropriate remedial action - the supervisory authority and other appropriate persons without delay.

- **Custodian**
- **Accountability**

The governing body should be accountable to the pension plan members and beneficiaries, its supervisory board (where relevant), and the competent authorities. Accountability to plan members and beneficiaries can be promoted via the appointment of members of the governing body by pension plan members and beneficiaries or their representative organisations. The governing body may also be accountable to the plan sponsor to an extent commensurate with its responsibility as benefit provider. In order to guarantee the accountability of the governing body, it should be legally liable for its actions which fail to be consistent with the obligations imposed on it, including prudence. In defined contribution plans, accountability calls for safe harbour rules that clarify the responsibilities and liabilities of the governing body.

Core Principle 6: Implementing guidelines

- **Suitability**
- **Risk-based internal controls**
- **Reporting**
- **Disclosure**

Core Principle 7 Supervision

This principle has been replaced by IOPS Principles

Effective supervision of pension funds and plans must be set-up and focus on legal compliance, financial control, actuarial examination and supervision of managers. Appropriate supervisory bodies, properly staffed and funded, should be established in order to conduct when relevant off and on site supervision, at least for some categories of funds and in particular when problems are reported. Supervisory bodies should be endowed with appropriate regulatory and supervisory powers over individual plans, in order to prevent miss-selling cases arising from irregularities in the distribution and expenses methods.

Thank you!
For further information on
OECD work on private pensions

www.oecd.org/daf/pension