IOPS GUIDELINES FOR THE SUPERVISORY ASSESSMENT OF PENSION FUNDS

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Introduction

1. The objectives of pension supervision include protecting the interests of pension fund members and beneficiaries, safeguarding the stability of the pension industry and contributing to the stability of the financial system as a whole. To achieve these objectives, supervisory authorities should establish supervision methods which include the ability to adequately assess pension funds, both via regular monitoring and analysis and via more in-depth investigations, which are often done on an 'on-site' basis.

2. Due to the crucial role of the private pension systems within the financial markets, and their increasing importance as a source of retirement income for individuals, the effective supervision of pension funds is becoming ever more important. Supervision is playing an increasing role due to the enhanced complexity of pension systems - which in turn puts increased pressure on supervisory costs and efficiency- and a trend towards a risk-based supervisory approach.

3. Regular assessment via monitoring and analysis is an important way to verify or capture reliable data and information in order to assess a pension fund's financial position and its ability to pay promised retirement income to current and future beneficiaries. Monitoring and analysis is also of great assistance in building a risk profile for pension funds, allowing supervisors to deal with pension funds' problems and to detect issues/ trends before they become entrenched, and may help to promote risk management within pension funds themselves. In addition, exposing funds to scrutiny via reporting requirements can have a deterrent effect in itself.

4. The in-depth evaluation of pension funds, whether by the supervisory authority or its formal representatives, is equally an important part of the supervisory process and is closely related to on-going monitoring, providing information that supplements the analysis of the financial and statistical information provided to the supervisory authority by pension funds. Such in-depth investigations may take place 'on-site' – i.e. at the pension fund's own premises. On-site inspection allows supervisory authorities to form more qualitative judgements regarding the operations of the pension fund. For example, are systems which look adequate on paper working in practice? Does the management display capability? Is the organisation of the fund efficient (allowing for files and data to be accessed quickly etc.)?

5. Pension supervisory authorities need to have a comprehensive supervisory approach and should consider using the full range of supervisory tools in order to operate in as efficient and effective a way as possible. The balance between on-going assessment and in-depth investigations will depend on the nature of the pension system and the supervisory approach. For example, supervisors will naturally have to rely more heavily on off-site supervision where they are operating in a context of supervising many thousands of pension entities which it would not be feasible to visit on a regular basis. However, under these circumstances, supervisors should apply a risk-based approach when deciding which entities to visit, and the frequency of such on-site inspections. Meanwhile more frequent on-site inspection is possible where there are few funds to oversee, and may be necessary where the supervisory authority has direct oversight of commercial institutions and where the system involves mandatory savings. Fewer in-depth investigations of funds may be necessary where trustees, fiduciaries or other third-parties play an active 'supervisory' role, acting as whistle-blowers – though these parties are themselves the subject of supervisory oversight.

6. Rather than being a choice between discrete alternatives, a range of supervisory tools exist which include elements of regular monitoring and analysis and more in-depth investigation. For

example, regular discussions with pension fund management may form an important part of the supervisory process. What is important is that the supervisory authority has a coherent, well thought-out policy for deciding on the mix of supervisory tools adopted. These will also changes over time – for example some supervisory authorities may move more towards off-site supervision as the size and sophistication of their pension system develops, whereas others will utilize more on-site inspections as their monitoring and early warning screenings and systems improve. Again it should be stressed that the mix of tools and the approach of the supervisory authority will depend on the context in which it is operating. The approach of the 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, and should represent the most efficient use of supervisory resources. Avoiding placing too heavy a burden on supervised entities should also be an important consideration.

Scope and Coverage

7. The purpose of these guidelines is to provide pension supervisors with general supervisory approaches for the conduct of the supervisory process. It should be noted that the focus of these guidelines is mainly prudential supervision. Some reference to conduct of business practices are made, but the IOPS may consider developing more detailed guidelines on this area in future (especially for contract type Defined Contribution pension funds). The guidelines are intended to cover all types of private pension arrangements[1], and although the term 'pension fund' is used in the document, some of the guidelines may also apply to the pension plan under which the fund itself is structured[2]. Implementation of these guidelines will vary from country to country depending on the nature of the pension system and supervisory structure. Pension Supervisory Authorities referred to in the document 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 guidelines are drawn from the IOPS 'Principles for Private Pension Supervision', the OECD's 'Core Principles of Occupational Pension Regulation' (in particular Core Principle 6 on Supervision) and other OECD pension related guidelines, the IAIS Core Principle 12 'Reporting to supervisors and off-site monitoring' and Core Principle 13 'On-site Inspection', as well as other IOPS projects (including the work on risk-based supervision and the use of information technology). The document is structured as follows:

[1] In EU countries, these Guidelines may not apply to those pension funds and plans which fall outside the scope of the directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the Activities and Supervision of Institutions for Occupational Retirement Provision (Article 2 of the Directive).

[2] According to the OECD's taxonomy, a pension fund is a legally separated pool of assets forming an independent legal entity that are 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.

- **Preamble** - outlining supervisory objectives
- **Supervisory Process** – divided into three parts:
  - ***Monitoring***: whereby checks of a routine nature undertaken are outlined
  - ***Analysis:*** outlining how to recognize potential problems
  - ***In-depth Investigations*****:** undertaken for selected entities are summarized
- **Organisation:** highlighting factors for ensuring an efficient use of supervisory resources

Preamble

Objective of Regular Monitoring of Pension Funds

The objective of regular collection and analysis of pension-fund specific information is to enable pension supervisory authorities to monitor and assess the risk profile of pension funds and to plan its supervisory approach

8. The main purpose of the regular assessment of pension funds is to determine the risk profile of a fund and plan a suitable supervisory response. Regular gathering and analysis of information will assist the supervisory authority in identifying risks in a timely manner (by comparing the risk profile of the fund with its risk-carrying capacity), to monitor regulatory compliance, and to detect any problem that may affect the fund's ability to meet its long-term obligations towards members and beneficiaries, or to decide whether further information should be sought.

9. Regular monitoring and analysis can serve some or all of the following broad functions, depending on the context in which the supervisory authority is operating:

a. assess the position of the pension fund in relation to the main categories of risk both in terms of financial strength and other risks posed to members and beneficiaries of the fund (such as investment risk, longevity risk, operational risk, agency risk and systemic risk);

b. verify information submitted by pension funds during a licensing or registration process and verify information provided on an ongoing basis (e.g. audit opinion);

c. check compliance of pension funds with legal and prudential requirements, such as funding regulation or investment limits, and with other social and labour laws where appropriate;

d. supplement, complement and enhance public information (such as audits etc.) available on pension funds;

e. check the valuation of assets and liabilities (which should be consistent, realistic and prudent);

f. check the risk management systems in place at the pension fund and therefore the fund's ability to handle the above risks;

g. ensure that sufficient information is being supplied to pension fund members and beneficiaries and that the fund is operating in a suitably transparent manner;

h. detect problems, particularly in the interval between in-depth reviews, thereby providing early exposure and prompting corrective action before problems become more serious. Regular assessments can also provide the basis for discussions with pension fund board / management, either at periodic intervals or when problems appear;

i. provide a key component of supervision planning so that maximum benefit is achieved from the limited time spent conducting an in-depth review;

j. generate statistics and monitor trends, consumer protection levels and competition in the pension system as a whole (which may also be used to coordinate with other financial sector supervisors).

k. gather information also required by other supervisory authorities, where more than one body has supervisory responsibility, avoiding duplication and ensuring compatibility and information sharing.

Objectives of In-depth Evaluations

The main objective of in-depth evaluations are to supplement on-going supervisory efforts, to detect problems that may not otherwise be evident, and to confirm or investigate findings from regular monitoring programs.

10. The purpose of more in-depth investigations, which may be carried out on-site at certain intervals or as required, is to enable the supervisory authority to gain deeper insights into a supervised entity's situation, obtain information and detect problems that may not be obtained or uncovered through on-going monitoring.

11. Again depending on the context, an in-depth investigation may give supervisors the opportunity to carry out some of the following goals:

a. it gives the supervisory authority the opportunity to identify any problem that the fund could be unaware of, or tempted to ignore, or perhaps even to hide (including to detect problems that may arise from the pension fund's organisation). If problems have been identified it enables the supervisor to obtain more data to confirm the existence and/or extent of this problem;

b. rather than being limited to detecting the fund's problems, in-depth investigations allow the supervisor to delve into the reasons behind them, require the pension fund identify solutions to overcome them and encourage best practice in the face of emerging risks;

c. it offers supervisors the opportunity to have a closer relationship with the managers of the pension fund, which may be important for assessing their fitness and propriety;

d. it enables supervisors to assess the management's decision-making processes and internal controls (including risk management and IT systems, accounting and reporting systems etc.), and to form an opinion on the governance of the fund in practice rather than on paper;

e. it makes it possible to persuade pension funds' management to take action to avoid current or future problems through dialogue during the in-depth investigation process (which may be more efficient than through formal action such as regulations or directions), or even dissuade them from pursuing activities which are either illegal or imprudent;

f. it provides supervisors the opportunity to explain specific regulations or guidelines (to avoid misinterpretation or promote good practice), to analyse the impact of such regulations and, more generally, to gather information for benchmarking.

The Supervisory Process

I. Monitoring

Guideline 1 : Information Gathering and Sharing

The pension supervisory authority should receive the necessary information to conduct effective assessment and to evaluate the risks in individual pension funds as well as the market as a whole, though a policy for protecting confidential information should be maintained.

Where the information is of material importance internationally it should be shared with other pension supervisory authorities, subject to secrecy or confidentiality requirements and in principle based on formal agreements.

1.1 The main procedure in the regular assessment of pension funds is the gathering of sufficient information to build a risk-profile of the funds being supervised, to assess the potential risk exposure, and to collect data and statistics about the whole sector. Information can be gathered on a regular or irregular basis (publicly available and supplementary information) on pension fund procedures, governance mechanisms, transactions, financial position etc. The information collected should be used to direct the actions of the supervisor and may also enhance pension funds' transparency.

1.2 Where the information requested is of a confidential nature, information on how it will be used and to what other parties (if any) it will be disclosed should be made available. If legislation does not adequately cover this, then the supervisory authority should publish a policy.

1.3 Where information could have a bearing on operations in/ or the stability of international pensions markets, information sharing between national supervisors should be undertaken, in principle based on formal agreements. Such information sharing will be subject to secrecy or other confidentiality requirements.

Guideline 2: Reporting Requirements

Basic reporting requirement should apply to all pension funds.

Though specific requirements will be determined by supervisory needs and the structure of the pension system, basic fund information, financial information, governance information (including market conduct, transparency and disclosure policies) and investment information should be considered.

Information should be collected with adequate frequency, detail and amount, but should not overburden the pension funds themselves, and reporting requirements should be reviewed periodically.

2.1 Basic reporting requirements should apply to all pension funds licensed or registered in a jurisdiction and form the basis for regular monitoring and analysis. However, a supervisory authority may wish to collect some information only from a sub-set of entities (e.g. large pension funds) in order to obtain more detailed information on the prevalence of risk than can be collected from all funds (surveys, for example, may be a tool for doing so).

2.2 The supervisory authority decides, within the national legal framework and market conditions, what information it requires, in what form and detail, from whom with what frequency The reporting requirements are mainly a reflection of the supervisory needs taking into account the principle of proportionality and the risk the pension fund faces, and will thus vary according to the overall situation in the pension sector. They may also reflect the situation at individual pension funds and the effectiveness of their risk management.

2.3 According to the nature of the pension system, the structure of the supervisory authority and its procedures, this information should be requested with an appropriate frequency (such as daily, weekly, monthly, quarterly, annually, triannually, as well as ad hoc requests).

2.4 The information required can be retrospective, current and prospective (e.g. involving ‘stress testing’).

2.5 In setting reporting requirements the supervisory authority should aim for an adequate balance between the need for information for supervisory purposes and the administrative burden it puts on pension funds. The costs associated with the information gathering process should be optimized. For example, information should, as far as possible, be already available to the fund and in a convenient format for the fund.

2.6 The deadline for regular reporting should be as soon as practicable after the end of the period to which the report relates. Penalties for false, incomplete or late reporting may also be useful tools.

2.7 From time to time, the supervisory authority should review its regular and systematic reporting requirements to ensure they still serve their intended aims and are carried out in an efficient and effective manner. Where it is decided to introduce new or changed reporting requirements, an adequate lead up time should be provided to pension funds to ensure they are in a position to provide the information accurately and in a timely manner.

2.8 As stated, the amount of information requested in regular reports to the supervisory authority will depend on the nature and risk of the pension fund and supervisory system. Reports should contain information about the financial position, financial performance, risk exposures, the way these risk exposures are managed and the basis, methods and assumptions on which information is prepared including accounting policies and information on outsourced functions. Information to assess the investment performance of the fund should be provided. In addition to transaction records and historic performance, stress testing to assess the potential impact of asset movements on the pension fund could be requested. Information on the level of contributions should be sought. In the case of defined benefit funds, where applicable, information on the financial position of the plan sponsor and how this may impact the pension fund should be gathered (although this may be from sources other than the fund itself). In addition to financial data, information relevant to the governance mechanisms of the pension fund should be sought, which may include market conduct, transparency and disclosure policies.

2.9 The type of information which may be requested may be broken down into the following categories (though this list does not claim to be exhaustive) – with actual collection again depending on the pension system and supervisory approach:

a. *Basic Fund Information:* type of fund; status of fund; number of active, deferred members and pensioners; movements in numbers over the period; benefit eligibility and plan access; vested rights; merger and liquidation process; disclosure procedures; redress mechanisms.

b. *Financial Information:* value of fund; value of liabilities; value of contributions received; transfer values; value of investment income; value of benefits paid, portfolio 'stress tests'.

c. *Governance Information:* structure and mandate of governing board; appointment procedure and qualifications of members; decision making procedures; risk management procedures (such as internal compliance programmes); details of service providers and outsourced functions (actuaries, auditor, custodian, investment manager etc.), including how appointed, monitored and dismissed; plan sponsor details.

d. *Conduct of Business Information:* transparency and disclosure policies, including what information is transmitted to members and beneficiaries of the pension fund and in what form;

e. *Investment Information:* investment strategy; asset allocation; transaction details; investment performance; costs and fees charged.

2.10 The required information may be gathered from multiple sources, including the following:

a. pension fund contracts or articles and funding agreement with plan sponsor;

b. financial statements (including actuarial or auditor reports);

c. annual returns or reports specifically required by the supervisor:

d. transactions (such as quarterly investment reports);

e. reports from service providers providing outsourced services to pension fund;

f. reports from other supervisory authorities;

g. periodic consultation between supervisory authority and members of the pension fund's managing board ;

h. whistle blowing reports from service providers, fund members and beneficiaries or fund administrators.

Guideline 3: Other Information

Pension supervisory authorities should have the authority also to request information on an ad hoc basis, including when problems or inaccuracies are detected, and have the power to impose measures for misreporting

Pension funds should be required to update the pension supervisory authority promptly of changes which may have a sufficiently material impact on the assessment of their condition and risk level

The supervisory authority should gather information and produce analysis on the pensions landscape

3.1 Information may be requested from specific pension funds on a case-by-case basis. New developments may require the supervisory authority to carry out sector-wide off-site analyses, which will require having pension funds to submit information on an ad-hoc basis.

3.2 The supervisory authority should require pension funds to report promptly any changes that might affect the evaluation that the supervisor has undertaken of their condition and is sufficiently material to substantially change the risk assessment (which may include changes in respect to the fund or to the employer in relation to the fund). Proportionate follow up action should be undertaken where the reported changes are deemed to impact the risk levels of the fund.

3.3 Where problems are suspected or detected, the supervisory authority may request additional information from a pension fund (for example minutes from the Board of Directors, managing board or trustees meetings, contracts with assets mangers or other service providers etc.).

3.4 The supervisory authority should require that inaccurate information is corrected and have the authority to impose sanctions for misreporting.

3.5 As well as gathering and analysing information on individual pension funds, the supervisory authority should also seek to acquire, and then publish, information on the pensions landscape. Making use of key available sources, the supervisory authority should monitor and analyse relevant factors that may have an impact on pension funds and the pension fund market. It can then draw conclusions and take action as appropriate. Such market analysis may help identify risks and vulnerabilities, supports supervisory intervention and strengthens the supervisory framework with a view to reducing the likelihood of severity of future problems. Depending on the nature of the pension system, the supervisory authority may also seek to assess the level of consumer protection and the level of competition in the pension fund market. It is recognised that in-depth market analysis requires skilled resources.

3.6 Pension supervisory authorities should play a role in providing this information on the operation of pension funds to the public. Disclosure will generally be on an aggregate basis, but could also be on individual pension funds, in which case the rules of confidentiality are particularly relevant.

3.7 A quantitative analysis of the market could include, for example, developments in the financial markets generally; the number of pension funds entering and/ or exiting the market; market indications such as consolidation; funding levels; investment structure; new product development and market share; distribution channels etc.

3.8 A qualitative analysis of the market could include, for example, reporting on general developments which may impact pension funds; new or forthcoming financial sector and other relevant legislation; emerging risks and controls; developments in supervisory practice and approaches etc.

II. Analysis

Guideline 4 : Analysis

Once the pension supervisory authority has gathered sufficient information to assess a pension fund, a range of analysis and checks may be carried out, which may cover issues of legal compliance, financial strength, risk management, market conduct, governance, disclosure, operations and performance, according to the supervisor's risk approach

4.1 Once the supervisory authority has gathered the information necessary to make an assessment of a pension fund's position, various forms of analysis may be carried out. Again depending on the context in which the supervisory authority is acting, and the potential risk exposure of the pension fund, these could include the following:

a. *Compliance checks*: to ensure the fund is in compliance with legal obligations and international guidelines; funding regulations; technical provisions and asset valuation regulation; investment regulation; governance requirements; internal funding rules.

b. *Financial checks*: to ensure broad solvency and more specific 'stress tests' are met.

c. *Governance checks*: to check whether the governing board is suitably qualified and is operating according via transparent mechanisms; to check that appropriate risk-management systems are in place; to ensure that appropriate systems for appointment, monitoring and dismissing external service providers are in place; to ensure that appropriate disclosure is being made to fund members and beneficiaries.

d. *Operational checks:* to ensure that contributions are being received; payments are being made on time, complaints are being followed up etc.

e. *Disclosure checks:* to ensure that the pension fund is acting in a suitably transparent manner and is disclosing adequate information to members and beneficiaries in an understandable and accessible manner;

f. *Performance checks:* to ensure that investments are being made in line with stated policy and risk tolerance; that investment returns are in line with benchmarks or peers and material divergence can be explained; and that costs and fees are at a reasonable level.

4.2 Having collected the required information, the pension supervisory authorities should establish processes to analysis this data efficiently and effectively.

4.3 The manner and extent to which pension supervisory authorities analyse and evaluate the information they receive from pension funds will depend on the pension system and regulatory framework. Some regulatory environments are based on quantitative standards which will require the supervisory authority to undertake measurements with defined periodicity, comparing pension funds financial status and activities to normative standards. Other regulatory structures are orientated towards more comparative analysis and evaluate funds over a longer period against behavioural benchmarks for the pension industry as a whole.

Guideline 5 : Risk Assessment Process

In addition to checking compliance, the pension supervisory authority should assess pension funds for the level of risk posed to their members and beneficiaries and the pension system as appropriate

Risk-scoring systems, using consistently applied quantitative and qualitative factors, may be used, assessing risk in the context of both potential impact and probability of occurrence

5.1 The process of pension supervision should not simply consist of acquiring data and checking compliance with rules. Once information has been collected, checked, and potential problems detected, supervisors should assess a fund in terms of the level of risk posed to members and beneficiaries, and the pension system as appropriate. The pension fund's risk-management ability should also be assessed.

5.2 Risk-scoring systems- using consistently applied quantitative and qualitative factors - may be used, assessing risk in the context of both potential impact and probability of occurrence. An overall risk score for the fund may result. This allows off-site supervision to be proactive and part of a risk-based approach to pension supervision, with the risk assessment of pension funds directing further supervisory action. Risk-scoring may involve quantitative, automatic triggers - for example if certain documents are not provided or if certain limits are breached (e.g. investment limits). Qualitative triggers involving supervisors' judgement will also be required - for example if an investment strategy is judged to be abnormal or the composition of the supervisory board unusual. As well as triggers from historic data, problems may be detected by using 'early warning systems.' For example, stress tests may be used to analyse how portfolios would react to future market conditions.

5.3 Such risk assessment and scoring generally involves looking at the magnitude of the potential impact as well as the probability of occurrence. The supervisory authority needs to apply a consistent, logical approach to selecting, rating and weighting risk factors in order to come up with a robust risk-scoring approach. An internal 'peer review' process may be designed to ensure such consistency.

5.4 The results of such risk assessment and potentially scoring should be used to direct the supervisory authority's own supervisory stance and approach towards pension funds. For example, a high risk score may potentially trigger a further, more in-depth investigation.

III. In-depth Evaluations

Guideline 6 : In-depth Evaluations – Planning and Preparation

Pension supervisory authorities should carefully coordinate on-going monitoring and in-depth inspection procedures to ensure maximum efficiency and avoid duplication

6.1 In-depth evaluations can take several forms. These may be routine, on-site visits which take place at a scheduled period (e.g. once every few years) or on a random basis (when a fund is chosen without warning). Alternatively, 'emergency' on-site visits may be required to investigate funds where problems have been detected. Some authorities undertake a regular cycle of inspections that covers the bulk of the assets under supervision.

6.2 In-depth evaluations may be full - looking at all aspects of the fund - or can be focused on the high risk areas or certain aspects of the fund where the supervisor requires more information or problems have been detected (e.g. a further investigation of the governance procedures to check that the board is fully capable or independent).

6.3 Given in-depth evaluations can be time consuming and expensive for the supervisor and the pension fund involved, supervisory authorities should carefully coordinate their on-going monitoring and on-site inspection procedures to ensure maximum efficiency and avoid duplication. Following the analysis of the financial and statistical information including returns provided by the pension funds, which forms part of the regular monitoring process, the supervisor should develop an approach for determining when and how in-depth evaluation is needed and which funds should be evaluated.

6.4 This approach will determine the number and timing of in-depth evaluations and how this is driven by the pension fund's risk profile. Some evaluations take place periodically and others due to indicators arising from 'early warning systems' built into the off-site inspection process. Reasons for undertaking or for having a higher frequency of evaluations may include concern about funds that are in a difficult economic or financial position. However, a major change in the top management or in the objectives and investment policy of the fund might be a sufficient reason for a new in-depth inspection.

6.5 In-depth evaluations may be triggered by concerns raised by parties internal to the pension fund itself, or by professional third parties who become aware, while carrying out their tasks, of certain facts which may have a significant effect on the financial situation or the administrative and accounting organisation of a pension fund. Actuaries and auditors, (in compliance with OECD *'Guidelines for the governance of pension funds'*[3]), should report promptly to the governing body of the fund if such concerns arise, and if the governing body does not take any appropriate remedial action they should report to the competent authorities without delay. Such a concern should trigger a suitable response, which may include an on-site investigation by the supervisory authority. In summary, such reports by third party professionals should be reflected in the risk-profile of the fund and the supervisory response consequently required.

[3] http://www.oecd.org/dataoecd/18/52/34799965.pdf

6.6 In-depth evaluations may also be triggered by complaints from pension participants or the need to examine compliance with newly issued legislation and regulatory requirements.

6.7 The in-depth evaluation plan should remain flexible since new priorities might arise during the year. Besides, the length of the inspections is not predictable – the actual on-site inspection, for example, may take anything from a day to several months depending on the types of risk being evaluated.

6.8 Where in-depth evaluations take place on-site, the inspection should begin with an overview of the fund in order to properly plan and focus the fieldwork. This review should result in an agenda of the fieldwork being finalised. Some detailed information may be requested in advance of the inspection to assist the on-site analysis.

Guideline 7: In-depth Evaluations – Field Work

In-depth evaluations should be customized to the pension fund's particulars and problems and should consist, where appropriate, of an evaluation of the management and internal controls of the pension fund, , the protection provided to members and beneficiaries, relations with external entities and the pension fund's financial position

7.1 While on-going monitoring can be systematic and to a certain extent standardised (analysis of the consistency of financial statements etc.), in-depth evaluations are customised and suited to the pension fund's particulars, and to the problems detected as the investigation unfolds. Thus, it is difficult to determine in advance the length and exact outlines for such inspections. Besides, in-depth evaluations can either be a full-scale inspection or a focused one. In the case of the latter, regular monitoring and assessment should be used to highlight particular areas of weakness upon which the in-depth evaluation should concentrate (i.e. a risk-based approach should be applied to all parts of the supervisory process).

7.2 The following are the types of evaluations which may be undertaken as part of an in-depth investigation, again depending on whether this is full-scale or partial, and upon the context of the pension and supervisory system in which the supervisor is operating:

a. Evaluation of the management and internal control system

- review of the minutes of the meeting of the governing body of the pension fund, and detailed examination of the auditor's and actuary's reports;
- evaluation of the management's capacity to run the fund, their efficiency, and their ability to acknowledge and correct their management mistakes (especially after management changes);
- audit of selected internal procedures and risk control systems, (including internal audit, reporting, monitoring and IT systems), in order to assess the relevance and robustness of these internal controls and the fund's approach to risk management;
- examination of the accounting procedures in order to know whether the financial and statistical information periodically sent to the supervisory authority is reliable or not, and in compliance with the regulations;

- examination of the governance structure and governance mechanisms of the pension fund (including the segregation between operational and oversight responsibilities).

b. Evaluation of the technical conduct of the pension fund

- detailed evaluation of the plan's investment policy and any relevant plan rules;
- evaluation of compliance with the contribution and benefit schedules as stated in the legal provisions and the pension plan's governing rules;

c. Evaluation of member and beneficiaries' protection

- analysis of the disclosure policy (including content, timeliness of information provided, the ease with which it can be understood);
- evaluation of the fund's general policy towards educating members and beneficiaries as to the risks and responsibilities to which they are exposed and, as appropriate, an analysis of the of investor choice options;
- a broad assessment of applicable other laws such as privacy, non-discrimination processes of the fund, particularly of access etc.;
- analysis of the accrual, vesting and portability processes;
- examination of the fees charged by the pension fund against those disclosed.

d. Analysis of the relationships with external entities

- analysis of the pension fund operations and relationships with external service providers and other parties (e.g. pension consultants, asset managers, and custodians), with a special focus on related parties;
- analysis of agreements with these external service providers, including their structure and implementation;
- analysis of relationship with auditors and qualified actuaries;
- analysis of the relationship with the plan sponsor, where appropriate (including contribution schedule);
- evaluation of the fees paid to third parties.

e. Evaluation of the pension fund's financial strength[4]

- analysis of funding levels;
- verification of calculation of liabilities (i.e. whether conform with appropriate actuarial standards) / credit ratings / unit pricing policies;

[4] *NB more appropriate for defined benefit plans.*

- follow up with auditors and qualified actuaries;

– analysis of the investment policy (including derivatives policy), the existence and title of assets held to back liabilities;

– verification of the property and valuation of the pension fund's investments.

Guideline 8 : In-depth Evaluation – Assessment and Reporting

The results of in-depth evaluations should be fed into the supervisory authority's risk assessment mechanisms

Where appropriate, pension supervisory authorities should provide clear findings and recommendations for action following in-depth inspections, provide the opportunity for the pension fund to respond and follow up to ensure that they have been acted upon

8.1 Information, analysis and results from in-depth evaluation should be fed into the pension supervisory authority's risk assessment process. More qualitative judgments formed during such investigations, for example on the quality of the pension fund's own risk-management ability, will impact the supervisory authority's overall assessment of the risk levels of the fund, and consequently its own supervisory response.

8.2 During, or at least at the end of this inspection, the supervisor should discuss findings with the pension fund and should pay adequate regard to its reaction. A written report including findings and recommendations from the in-depth evaluation should be produced where appropriate, including actions which will result if the recommendations are not followed. The board of the pension fund should be provided with the opportunity to respond to the written report of the finding of the supervisory authoirity.

8.3 The pension supervisory authority should follow up to ensure corrective action, when identified, has been acted upon.

Organisation of Pension Supervisory Resources

Guideline 9: Organisation of Supervisory Process

Pension supervisory authorities should be provided with sufficient powers to carry out in-depth investigations themselves, including provisions for investigating activities outsourced by pension funds

The internal organisation of the supervisory authority should be carefully structured to allow for maximum efficiency and effectiveness, including procedures allowing pension funds to appeal against supervisory decisions.

9.1 In-depth investigations, including on-site inspections, should have a legal basis in order to sustain the right of the supervisor to obtain any information. Legislation should give the Supervisory Authority wide-ranging power to investigate pension funds (including the right to enter premises etc.), and to gather any kind of information regarding their business.

9.2 Furthermore, the supervisor should have the power, where appropriate, to extend in-depth evaluations to companies that have accepted functions outsourced by the supervised fund (such as custodian banks or plan fiduciaries). Where such powers are not available to the pension supervisor, they should consider coordinating with other supervisory authorities.

9.3 Some supervisory organisations may be organized along sectoral lines, with staff having responsibility for both on-going monitoring and in-depth investigations for a group of companies. This type of organisation provides close relation between the monitoring and in-depth investigations. It also appears to be an efficient way to follow through companies during a long period of time. However, it needs officers dealing with all the aspects of pension supervision (e.g. accounting, actuarial methods, finance etc.).

9.4 Some supervisory authorities may be organised on a functional basis, with specialists in some tasks and taking part in the in-depth evaluation of a great number of pension funds. This type of organisation appears to be flexible and efficient to deal with market problems. However, a good cooperation and exchange of information is needed between officers in charge of the monitoring and those in charge of in-depth investigations. Accordingly, results of analyses must be documented and accessible to both groups.

9.5 In exercising its supervisory powers, the pension supervisory authority should give pension funds flexibility, where appropriate, in the way they achieve compliance with regulatory requirements. Guidance may be provided by the supervisor as to how pension funds can remain in compliance with regulatory and supervisory requirements and expectations.

9.6 Procedures should be in place for pension funds to challenge, on reasonable grounds, the modalities of an in-depth inspection and to appeal against any resulting enforcement action.

Guideline 10: Appropriate Resourcing for Supervisory Activities

Where pension supervisory authorities lack relevant expertise internally, is should be possible for them to outsource activities to other supervisory authorities or external professionals, though exercising suitable monitoring and controls and always remaining accountable. The option to secondee staff with appropriate experience should also be available.

10.1 Supervisory Authorities should organise the supervisory process in order to balance effectiveness and efficiency, and in order to minimize supervisory interference with supervised entities. By doing so, they should consider, among other matters, the allocation of supervisory tasks between supervisors and whether they wish to receive support for certain parts of the inspection from other external parties. Coordination with other supervisory authorities (for example responsible for conduct of business activities) may be required.

10.2 Whatever the internal organisation of the supervisory services, supervisors may get assistance, particularly for in-depth investigations, from independent, external experts or secondee staff with the appropriate skills to work internally (these staff being subject to the same level of accountability as internal staff and bound by suitable confidential clauses where required). Using these professionals may provide the supervisory authorities with flexibility and augment their skill.

10.3 However, since supervisors remain responsible for the supervision, before using external professionals, they should consider:

a. whether adequate controls over their competence exist and the need to monitor their performance (for instance, through reviewing their working papers);

b. their independence towards the pension funds (in particular when they are paid by the governing body of the pension fund) and the consideration they give to the protection of member and beneficiaries' interests.

10.4 In addition, should such a delegation be set up, the supervisor should have the ability to rely on and if necessary take legal action against these external parties

Guideline 11: Use of IT

The use of Information Technology should be encouraged as a key part of the on-going monitoring process

11.1 As part of the information gathering procedures which form a key component of on-going monitoring, the use of Information Technology systems should be encouraged. In addition to not easily quantified cost savings, the use of IT systems leads to increased data quality and reliability, time savings, prompt actions, and generally increased efficiency and effectiveness. However, care should be taken not to overburden pension funds with costly technological requirements and pension funds should be given sufficient time to implement any new IT systems.

11.2 As much comparative data as possible should be extracted from the monitoring system and disseminated widely. To improve the quality of the data collected, variables should be clearly defined and the importance and usefulness of the data collection process should be communicated effectively among parties such as pension funds, members and beneficiaries.

11.3 System rules and checks should be in place to enable questioning or ensuring the accuracy of information received. Data should be kept as far as possible and preferably indefinitely and effective disaster recovery systems should be in place.

11.4 Care should be taken to ensure confidentiality during the information gathering process and for the security of the supervisory authority's database.