INPRS

INTERNATIONAL NETWORK OF PENSIONS REGULATORS AND SUPERVISORS

In cooperation with

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A PROPOSAL FOR DEVELOPING A TAXONOMY FOR PRIVATE PENSION SYSTEMS

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PROPOSED TAXONOMY FOR PENSION PLANS AND PENSION FUNDS*

1. The development of a taxonomy for private pension systems is one of the key activities of the Secretariat of the International Network of Pensions Regulators and Supervisors (INPRS) and of the OECD Working Party on Private Pensions. It is necessary both for future data collection projects and policy discussions. After sufficient opportunity to comment, the final version of this taxonomy will be submitted for INPRS approval.

I. Background

2. In order to be useful, a classification of pension systems (both pension plans and pension funds) must fulfil two basic critical conditions: (1) it must be consistent across the largest possible number of countries, covering as many specific cases as possible; (2) it must be based on descriptive criteria, and not on some prescriptive model of pension systems. Some of the current classifications, such as the three pillar, present some weaknesses in this respect, not least of which is the fact that different uses are made of the same terms.

3. The approach followed in the development of the proposed taxonomy has been composed of two steps. First, the various criteria that can be used to classify pension systems were identified. This exercise necessitated the collection of information on the structure of the pension systems of individual countries. The second step was to group those criteria in order to create a classification for pension systems that as far as possible met the two conditions mentioned above. Section 1 of this note describes the criteria and the classifications for pension plans, while Section 2 does the same for pension funds.

II. Pension plan taxonomy

Pension plan

4. *Pension plan or scheme*: A legally binding contract, that may be part of a broader employment contract set forth in the plan rules or required by law, or a tax qualified savings or retirement programme designed to provide the plan's members and beneficiaries with an income after retirement. The plan must therefore have an explicit retirement objective, or - in order to satisfy tax related conditions or contract provisions - the benefits can not be paid at all or without a significant penalty unless the beneficiary is older than a legally defined retirement age. Pension plans may offer additional benefits, such as disability, sickness, and survivors' benefits.

Public vs. private pension plans

5. *Public pension plan*: a pension plan supported by financing instruments (e.g. PAYG financing) and administered by institutions (e.g. social security administration, public sector companies) that are not subject to private sector law.

6. *Private pension plan*: a pension plan supported by financing instruments (e.g. pension fund, insurance policy, collective investment schemes, bank trusts, brokerage accounts) or administered by institutions (e.g. pension funds, insurance companies, collective investment scheme managers, banks) that are subject to private sector law.

Mandatory vs. voluntary pension plans

7. *Mandatory pension plans*: pension plans into which mandatory pension contributions may/must be paid or plans that may/must be used to pay out mandatory pension benefits. The mandate may fall on employers (who must set up occupational pension plans which employees will normally be required to join, or they may be required to make contributions to personal pension plans chosen by their employees) or/and on employees (who may be required to make pension contributions to a pension plan of their choice

* This document is not to be quoted.

-normally within a certain range of choices- or to a specific pension plan). The mandate may be set by law, or by nation-wide or industry-wide collective bargaining agreements. Pension plans in which both mandatory and voluntary contributions are deposited are considered mandatory.

8. *Voluntary pension plans*: these include plans that are sponsored or provided on a voluntary basis by employers (including those in which there is automatic enrolment as part of employment contract or where the law requires employees to join plans set up on a voluntary basis by their employers) as well as all plans where membership by employees is voluntary.

Occupational vs personal pension plans

9. *Occupational plans*: access to such plans is linked to an employment relationship. The plans are organised and possibly administered by employers, industry associations, and the employment or professional association representing a group of individuals for the employees or members of that relevant entity that sponsors the plan. In these plans, the plan sponsor has other responsibilities in addition to paying contributions to the pension plan. Its involvement may include negotiating the design of the plan with the plan provider/administrator (e.g. an insurance company). In the case of book reserve, the plan sponsor is responsible for all aspects of the management of the plan.

10. *Personal pension plans*: access to these plans is not linked to an employment relationship. That is, except for possible contributions from the employer, individuals independently purchase and determine material aspects of the arrangements without regard to their particular employers or their membership in particular employment-based associations.

Funded vs unfunded pension plans

11. *Funded plans*: Funded plans are financed from the accumulated assets which result from the contributions made to the plan and the earnings on those assets. These assets may be legally separated from any entity that sponsors, provides, or administers the plan and from any other assets that do not originate from contributions to a pension plan (constituting a pension fund, as defined below); they may be part of the sponsoring company's balance sheet (book reserves); or they may form part of the balance sheet of the company that provides or administers the plan (through e.g. an insurance policy, collective investment scheme, or bank deposit).

12. *Unfunded plans*: are those that are financed directly from contributions from the plan sponsor or provider or/and the plan participant. Unfunded plans are said to be financed on a current disbursement method (also known as the pay-as-you-go method).

Defined benefit vs defined contribution

13. *Defined benefit (DB) plan:* A plan where benefits are predetermined as part of the plan rules, and are based on some measure of the plan member's earnings, and employment record. These plans provide insurance against both financial and longevity risks (and often other biometric risks). The plan member's contribution to a defined benefit plan may be fixed in the plan rules/contract, but the plan sponsor's (in the case of occupational DB plans) will vary depending on the extent of funding. Defined benefit plans is a type of pension plan with promises.

14. *Defined contribution (DC) plan*: a plan where the minimum contributions by both the plan sponsor (in occupational DC plans) and the plan member are fixed as part of the plan rules/contract. Other biometric risks (such as disability, sickness or survivor's) may be insured through related benefit plans. Two types of DC plans exist:

- DC plans with promises: DC plans where the plan sponsor, provider or administrator offers some form of insurance against financial or/and longevity risk) Defined contribution plans with guaranteed returns is the main type of defined contribution plan with promises. There are also defined contribution plans that offer at retirement the higher of a benefit based on a DB formula and one based on a DC formula.

- DC plans without promises: DC plans where the plan sponsor, provider or administrator offers no insurance against financial or longevity risks. Such plans may nonetheless envisage the purchase financial products from the same or other providers/administrators that do offer such insurance. For example, a DC plan provider may offer the option of purchasing an annuity at retirement.

Type of plan	**Sub-classification**	**Insurance against financial and biometric risks**	**Examples**
Defined benefit	Plan with promises	Full insurance	Benefit formula based on member's salary and employment/contribution record
Defined contribution	DC plan with promises	Partial insurance or full insurance with upside potential	DC plan with guaranteed returns
	DC plan without promises	No insurance	DC plan without any guarantees

III. Basic pension plan taxonomy

15. These classifications by criteria can be grouped into various general classifications. The following two basic classifications of <u>private</u> pension plans are proposed:

Option A	
1.	**First System:** Public Plans
2.	**Second System**: Mandatory Pension Plans:
	2.1 Mandatory, occupational pension plans
	2.2 Mandatory, personal pension plans
3.	**Third System**: Voluntary Pension Plans
	3.1 Voluntary, occupational pension plans
	3.2 Voluntary, personal pension plans
Option B	
1	**First System**: Public Plans
2	**Second System**: Occupational pension Plans
	2.1 Mandatory, occupational pension plans
	2.2 Voluntary, occupational pension plans
3	**Third System**: Personal pension plans
	3.1 Mandatory, personal pension plans
	3.2 Voluntary, personal pension plans

16. Private pension plans would encompass "Pillars 2 and 3" under the previous definition used by the Group. An additional subdivision that could be considered would be to split each category into DB and DC plans, and DC plans in turn, into DC plans with promises and DC plans without promises.

IV. Examples of pension plans

17. In order to clarify the definitions developed above and to determine its suitability for a world-wide taxonomy, the classifications are applied to pension plans from OECD countries. All private pension plans described, except occupational plans in France are funded.

2.1 Mandatory, occupational pension plans: the industry and occupational funds of the superannuation guarantee in Australia, the funded component of the statutory schemes in Finland, occupational schemes in Iceland, the Employee Pensions Fund in Japan, contracted-out plans in the United Kingdom, plans under collective bargaining agreements in Denmark, the Netherlands (by statute in some cases), and Sweden, ARRCO and AGIRC plans in France, occupational plans in Iceland, *Prevoyance professionelle* in Switzerland.

2.2 Mandatory, personal pension plans: the retail funds of the superannuation guarantee in Australia, personal, DC plans of Hungary, Mexico, Poland, and Sweden, appropriate personal pension plans in the United Kingdom.

2.1 Voluntary, occupational pension plans: occupational plans in most other OECD countries, including some civil servant plans, such as the civil servants scheme (ABP) in the Netherlands, that are subject to private sector regulation.

2.2 Voluntary, personal pension plans: personal plans in other OECD countries, including for example, the IRAs in the United States, and the RRSPs in Canada.

V. Pension fund taxonomy

Pension fund

18. *Pension fund*: pool of assets consisting exclusively of the contributions to a pension plan and the income earned on them.

Autonomous vs. non-autonomous pension funds

19. *Autonomous pension funds*: pension funds that constitute either (i) independent and self-administered legal entities (with legal capacity and personality, and therefore able to engage in financial transactions in the market on their own account), different from other institutions providing pension funding services such as banks, collective investment scheme managers, and insurance companies, that are dedicated primarily to the provision of retirement and related benefits of a funded pension plan or (ii) pools of pension assets that are legally separate from the assets of the plan sponsor, provider, and administrator (such funds have no legal capacity and personality are administered by separate persons or institutions - specialised pension fund managing companies or other financial institutions -, whose assets are legally separated from those of the pension fund) and which are either the legal property of pension plan members or must be used only to fund the pension plan benefits and distributions.

20. *Non-autonomous pension funds*: pension funds whose assets are not legally separated from those of the plan sponsor. An example of such funds is the book reserve system used in some occupational pension plans.

Collective/group vs individual pension funds

21. Collective or group pension funds: a pension fund that comprises the assets of various pension plan members.

22. *Individual pension funds*: a pension fund that comprises the assets of a single member and his/her beneficiaries.

Closed vs open pension funds

23. *Closed pension funds*: funds that support only pension plans that are limited to certain employees (e.g. those of an employer or group of employers). Individual pension funds are by definition closed.

24. *Open pension funds*: funds that support at least one plan with no restriction on membership (collective membership may be possible, however).

VI. Glossary of related terms

25. *Asset manager of a pension fund (or pension fund manager):* is the individual(s) or entity(ies) endowed with the responsibility to physically invest the pension fund assets. Asset managers may also set out the investment strategy for a pension fund.

26. *Actuary:* is the person or entity whose responsibility, as a minimum, is to evaluate present and future pension liabilities in order to determine the financial solvency of the pension plan, following recognised actuarial and accounting methods.

27. *Custodian:* is the entity responsible, as a minimum, for holding the pension fund assets and for ensuring their safekeeping.

28. *Governing body or administrator of a pension fund*: is(are) the individual(s) or entity(ies) ultimately responsible for the operation and oversight of the pension fund. Depending on the legal form of the pension fund, the governing body or administrator may be internal or external to the pension fund.

29. *Pension fund governance or administration:* is the operation and oversight of a pension fund. The governing body is responsible for administration, but may employ other specialist entities, such as actuaries, consultants, and asset managers to carry out specific operational tasks.

30. *Pension fund managing company:* is a type of pension fund governing body or administrator in the form of a company whose exclusive activity is the administration of pension funds. The pension fund's assets are legally separated from the managing company. By definition, the pension fund managing company is also the asset manager of the pension fund.

31. Pension plan governance or administration: is the operation and oversight of a pension plan.

32. *Pension plan administrator/provider*: the institution responsible for the operation and oversight of a pension plan.

33. *Pension plan beneficiary:* is an individual, other than a plan member, entitled to a benefit (e.g. survivors' benefit).

34. *Pension plan member***:** is an individual that is an active (working or contributing) or passive (retired) participant in a pension plan.

35. *Pension plan sponsor*: an institution (e.g. company, industry/employment association) that designs, negotiates, and normally helps to administer an occupational pension plan for its employees or members.

36. *Supervisory body of a pension fund*: is(are) the individual(s) or entity(ies) responsible for monitoring the governing body of a pension fund. The supervisory body may be, for example, a board of supervisors or a control commission.