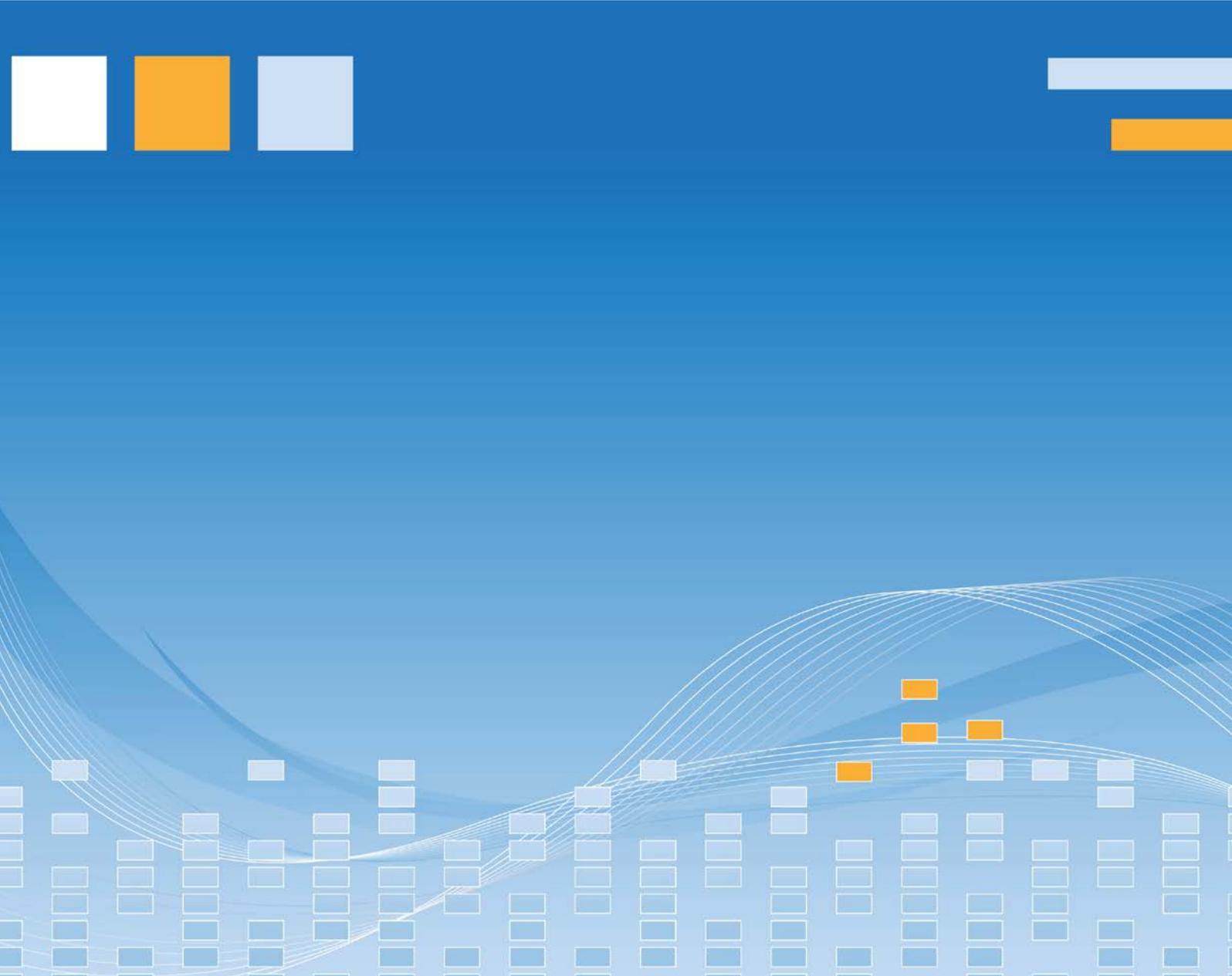
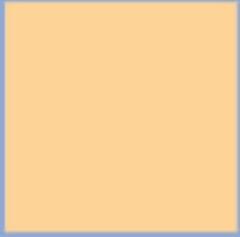




# OECD CORE PRINCIPLES OF **PRIVATE PENSION REGULATION**





# **OECD Core Principles of Private Pension Regulation**

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## *Foreword*

The OECD Core Principles of Private Pension Regulation serve to encourage more efficient regulation and management of private pension systems.

Private pensions play a major and growing role in complementing retirement income from public sources in OECD countries and worldwide. Their importance in ensuring adequate pension provision is increasing as government revenues are less able to finance retirement promises.

The economic crisis led to a loss of public confidence in private pensions in many countries which needs to be reversed in order to encourage individuals to save for retirement. At the same time, the financial sustainability, solvency and adequacy of private pensions are challenged by population ageing and by an economic environment characterised by low growth, low returns and low interest rates.

Efficient regulation and management of private pension systems are essential to withstand these pressures and to rebuild trust in private pensions. The OECD, in coordination with pension regulators across OECD countries, has updated and expanded the OECD Core Principles of Occupational Pension Regulation, first adopted in 2009.

The 2016 OECD Core Principles of Private Pension Regulation provide governments, regulators and supervisors worldwide with a relevant common benchmark and high-level guidance on the design and operation of private pension systems. These revised Principles now include all funded pension arrangements, reflecting changes in the nature of private pension provision, especially the rise in defined contribution and personal pension plans; they aim to strengthen the regulatory framework of funded pension systems in order to promote the sound and reliable operation of private pension plans and thereby protect members' savings.

The OECD Core Principles of Private Pension Regulation can thus help countries to strengthen private pension systems and improve their complementary role in ensuring that retirement income is adequate.



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## Recommendation of the Council on Core Principles of Private Pension Regulation

27 September 2016

**HAVING REGARD** to Article 5 b) of the Convention on the Organisation for Economic Co-operation and Development of 14 December 1960;

**HAVING REGARD** to the Recommendation of the Council on Core Principles of Occupational Pension Regulation [C(2009)57], which this Recommendation replaces;

**HAVING REGARD** to the Recommendation of the Council on Good Practices for Financial Education Relating to Private Pensions [C(2008)23] and the Recommendation of the Council on High-Level Principles on Financial Consumer Protection [C(2012)102];

**RECOGNISING** the important role played by private pensions in retirement income systems worldwide in improving the adequacy of pension coverage and pension benefits;

**RECOGNISING** the growing importance of defined-contribution and personal pension plans in pension provision and the increased responsibility this places on pension plan members in securing their own retirement income;

**RECOGNISING** the important economic and social role played by occupational pensions, including the role of employers as plan sponsors;

**RECOGNISING** the need for appropriate regulation and supervision of private pensions;

**RECOGNISING** the desirability of an authoritative set of core principles and guidelines for private pension regulation and supervision;

**NOTING** that the OECD plays a leading role in supporting Members and Partners in encouraging the efficient regulation and management of private pension systems;

**On the proposal of the Insurance and Private Pensions Committee:**

- I. RECOMMENDS** that Members and non-Members adhering to this Recommendation (hereafter the “Adherents”) take due account of the Core Principles of Private Pension Regulation, which are set out in the Appendix to this Recommendation and which form an integral part thereof, when establishing, amending or reviewing their private pension regulations;
- II. ENCOURAGES** all institutions involved in the management of private pension systems as well as organisations that represent the interests of pension plan members and beneficiaries to follow this Recommendation;
- III. INVITES** the Secretary-General to disseminate this Recommendation;
- IV. INVITES** Adherents to disseminate this Recommendation at all levels of government;
- V. INVITES** non-Adherents to take due account of and adhere to this Recommendation;
- VI. INSTRUCTS** the Insurance and Private Pensions Committee, through its Working Party on Private Pensions, to:
- i) serve as a forum to exchange information on progress and experiences with respect to the implementation of this Recommendation;
  - ii) monitor the implementation of this Recommendation and report to the Council no later than five years following its adoption and as appropriate thereafter.

## *OECD Core Principles of Private Pension Regulation*

The OECD Core Principles of Private Pension Regulation contain general principles that are applicable to all funded private pension plans, as well as specific principles for occupational and personal pensions as defined in the glossary. While the Core Principles apply to all funded private pension plans, Members and non-Members having adhered to the Recommendation (the Adherents) may decide to apply it only to occupational pension plans.<sup>1</sup>

The Core Principles are separated into three main sections:

- Six Core Principles in Part I form the general principles applicable to all types of private pension plans.
- Part II encompasses two Core Principles specific to occupational pension plans.
- Part III specifies two Core Principles relating to personal private pension plans.

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<sup>1</sup> EU countries may choose not to apply the Core Principles to those occupational private pension plans, pension funds and pension entities that 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. These include institutions that operate on a pay-as-you-go basis, institutions where employees of the sponsoring undertakings have no legal rights to benefits and companies using book-reserve schemes with a view to paying out retirement benefits to their employees.



*Part I*

**General Principles**

## Core Principle 1. Conditions for effective regulation

Private pension systems should have clear and well-defined objectives regarding coverage, adequacy, security, efficiency and sustainability. The achievement of these objectives should be regularly monitored. An effective legal framework, a robust institutional and financial market infrastructure, and a sound regulatory and supervisory system for pensions should be in place to support these objectives.

Well-functioning capital markets and financial institutions should be in place to ensure productive and diversified investment of retirement savings and the efficient management of risks. The development of funded pension systems should go hand-in-hand with the strengthening of the financial markets, based on a sound and integrated regulatory framework for the financial sector and a stable macroeconomic environment conducive to longer-term investment.

Regulation should encourage the development of efficient private pensions. It should ensure appropriate and transparent treatment of different types of operators, and support the provision of cost-efficient pension arrangements.

Regulatory provisions for private pensions should be applied in a comprehensive and dynamic manner. They should take into account the complexity of pension plans, the environment in which the pension system operates and the stability of the economy as a whole in order to ensure that the rights of pension plan members and beneficiaries are protected and that pension plans and pension funds are sound. This framework should not, however, impose excessive burden on pensions markets, institutions, or employers. Reliable data should be available to facilitate the design and implementation of private pension systems.

### Introduction to Core Principle 1

The successful establishment of private pension systems requires clear objectives regarding their role in the provision of retirement income. These objectives should reflect developments in the broader environment, such as economic, financial, market and demographic developments and the functioning of the financial sector, as well as factors specific to pensions, such as the role of public pension plans in retirement income provision, tax treatment and labour market regulations. In this way, a complete view of the pension system is achieved, putting private pensions in a clear context.

Effective implementation and delivery of private pensions is contingent on a legal and institutional framework that ensures sound, effective and well run pension plans. The macro and microeconomic environment also need to

be conducive to efficient private pension delivery, including a well-functioning financial sector. This includes encouraging the establishment of financial institutions and other service providers and appropriate and transparent treatment of these in the regulatory framework.

The ultimate goal of pension regulation and supervision should be to protect the rights and interests of plan members and beneficiaries. The regulatory framework should not, however, place an excessive administrative burden on pension plan operators and sponsors nor require them to bear undue costs and risks. It should allow scope for operators within the private pension market to adapt to evolution in the environment in which they operate.

### Implementing Guidelines for Core Principle 1

**1.1** Clear and well-defined policy objectives should be established regarding coverage, adequacy, security, efficiency and sustainability of private pension systems, and their role in overall retirement income provision. These objectives should be reflected in legal provisions and their achievement should be regularly monitored as part of the policy and regulatory process.

**1.2** The regulatory and supervisory system, institutional and financial market structure, and conduct of the different actors should be coherent, so that each plays a supportive and complementary role in achieving the overall objectives for the system. The regulatory framework should take into account the extent of integration of private pension plans with other systems of retirement income provision, especially public systems.

**1.3** The legal provisions should promote the protection of pension plan members and beneficiaries and the soundness of pension plans and funds.

**1.4** The legal provisions should facilitate the efficient operation and development of private pension plans by promoting good governance and prudent management, ensuring appropriate and transparent regulatory treatment of different types of operators, and favouring the provision of cost-efficient pension arrangements.

- 1.5** The development of well-functioning and transparent capital markets and financial institutions should be promoted to enable the development of new financial instruments and markets to support pension provision (e.g., inflation-indexed instruments and retirement annuity markets).
- 1.6** The legal system should enable the enforcement of contracts pertaining to private pensions. In particular, there should be a body of ethical, professional and trained lawyers and judges, and a court system whose decisions are enforceable. Comparable standards should apply in cases where alternative dispute mechanisms exist.
- 1.7** Accounting, auditing and, where applicable, actuarial standards for pension funds and pension entities should be comprehensive, documented, transparent and consistent with international standards.
- 1.8** The legal provisions should promote the availability of data through appropriate reporting and disclosure mechanisms. The availability of this information, including economic and demographic data, will enable regulators and stakeholders to evaluate the design and operation of the pension system relative to its goals and so help ensure that private pension plans are coherent with the objectives set for them and their role in overall retirement provision. Data should be maintained and delivered in a manner that takes full account of their potentially confidential nature.

## **Core Principle 2. Establishment of pension plans, pension funds, and pension entities**

Pension plans, pension funds, and pension entities, jointly or separately, should be subject to an adequate, transparent and coherent set of legal, accounting, technical, financial, managerial and governance requirements, without imposing an excessive administrative burden. Pension fund assets should be legally separate from the assets of any other legal entity, including those involved in managing the pension plan assets. In the case of occupational pension plans, the pension fund or pension entity should be legally separate from the sponsor (or at least such separation should be irrevocably guaranteed through appropriate mechanisms). The ownership of any financial institution or other entity managing pension plans or plan assets should be clear and transparent.

### **Introduction to Core Principle 2**

The regulation should set up clear processes for establishing pension plans, pension funds and pension entities. Regulation should appropriately stipulate the different types of funding vehicles permitted for private pension plans. It should clearly set out the permitted legal form of pension plans, funds and entities and the rules that apply for their establishment and operation. For example, the legal provisions where applicable should clearly state the requirements for registration and licensing (e.g. application, modification and withdrawals), governing documents, risk control, reporting and auditing mechanisms, funding policy, investment policy, capital requirements, governance and business plan.

The function and responsibilities of pension plans, funds and entities involved in the provision of private pensions need to be defined, as do those of the plan sponsor in occupational pension plans. The pension entity is an independent entity with legal capacity that has ultimate legal responsibility for a pension fund but which may have a broader range of activities. For example, it might be responsible for investing the assets of more than one fund, or it may carry out other activities related to the management of a single fund, such as custody or administration. An autonomous pension fund can be set up as an independent pension entity. Alternatively, the pension assets may constitute a legally separate account or pool of assets managed by a financial institution or a dedicated provider, which would be considered the pension entity.

Regulations should encourage clear disclosure of the ownership of the pension plan, fund or entity and of the pension plan assets. This facilitates an assessment of conflicts of interest, the sources of initial capital, and the financial and legal suitability of eventual major shareholders or ultimate beneficial owners for licensing, registration and supervisory purposes. Plan members may have either a legal or a beneficial ownership right over the pension assets, or a contractual claim against the pension entity with respect to their rights to the pension assets. The pension assets should generally be segregated from those of the pension entity and the plan sponsor so that they can be invested with the sole objective of funding the retirement benefits of the plan members and beneficiaries.

The licensing and registration processes of pension funds, entities and, where relevant, pension plans, should promote the development of a robust private pensions industry. This can have a significant effect on maintaining public confidence in private pension plans. Licensing and registration processes should reinforce legal provisions in encouraging pension funds, entities and, where relevant, plans to establish appropriate governance and control structures, investment and risk management policies and accounting and control mechanisms, and support prudent investment of the pension assets. The licensing and registration processes should ensure that applicants have policies and procedures that will allow benefits to be delivered to plan members in accordance with the terms of the plan and the pension laws of the jurisdiction.

Licensing and registration procedures should avoid the creation of inappropriate barriers to market access. For example, the licensing authority can be given some degree of discretion in assessing applicants as licensing requirements may vary depending on the type, scale and complexity of the applicant. At the same time, the application process must be transparent, efficient, fair and subject to appropriate redress mechanisms. Applicants should be provided with sufficient guidance to facilitate their fulfilment of the procedural requirements.

The powers of the licensing or registration authority should be clearly specified, as should the criteria for granting, denying, modifying or withdrawing an operating licence or registration. The registration and licensing of financial institutions to perform the functions of pension fund administration and management should be coordinated with the processes of other supervisors or authorities involved in their establishment.

## Implementing Guidelines for Core Principle 2

### *Legal provisions for the establishment of pension plans, pension funds and pension entities*

- 2.1** Pension funds and pension entities should be established as independent legal entities. Pension funds that themselves constitute a pension entity should have legal capacity. If a pension fund is managed by a legally separate entity (such as a pension fund management company, an insurer, or other financial institution), this entity should have legal capacity. The ownership structure of the pension funds and/or pension entity should be clearly and transparently disclosed.
- 2.2** Pension fund assets should be legally separate from the assets of any other legal entity, including those involved in managing, administering or acting as custodians of the assets. In the case of occupational pension plans, pension funds or pension entities should be legally separate from the plan sponsor.
- 2.3** Legal provisions should be in place regarding the type of pension plans and/or pension funds that can be established and the permissible legal forms of pension entities.
- 2.4** Legal provisions should be in place requiring the registration and/or licensing of pension funds and pension entities (and, where relevant, pension plans) by the relevant authorities. Licensing and/or registration requirements should be public, objective, fair and promote a competitive market. The registration and/or licensing procedures should be an integral part of private pension regulation. These procedures should be efficient, promote market access and contribute to ensuring that pension plans, funds and entities have appropriate governance structures and mechanisms in place.

### *Governing documents*

- 2.5** Pension plans, pension funds and pension entities should have (jointly or separately) formal, written charters or documents describing their objectives. These documents should set out the plan's parameters (such as types of contributions and benefits), governance structure, the rights of members and other beneficiaries and any incumbent outsourcing or third party service

provisions. They should also clearly identify all parties with authority and responsibilities for the management of the pension plans, pension funds and pension entities.

### ***Risk control, reporting and auditing mechanisms***

**2.6** Pension funds and entities should have adequate risk control mechanisms in place to address investment, operational and governance risks, as well as internal reporting and auditing mechanisms.

**2.7** If they manage more than one pension fund, pension entities should be required to maintain separate accounts and records for each.

### ***Funding policy***

**2.8** Pension funds and entities that offer defined benefit plans (traditional, hybrid or mixed) or protected defined contribution plans should have a funding policy that specifies the sources of funding, the actuarial method to be used (if relevant), and the mechanisms for fulfilling legal funding requirements.

**2.9** The funding policy should specify the funding objective, the level of target funding on an ongoing and termination liability basis, the sources and mechanisms for fulfilling target funding, including potential risks to employer contribution levels, legal funding requirements, and how quickly target funding is projected to be achieved. The policy should be communicated to plan members and other concerned parties.

**2.10** Where a pension entity manages assets for different pension funds or plans, separate funding policies and methods should be prepared for each.

### ***Investment policy***

**2.11** Pension funds and entities should prepare a statement of investment policy.

**2.12** Where a pension entity manages different pension funds or plans, separate statements of investment policy should be prepared for each.

### *Capital requirements*

**2.13** Pension funds and entities should be required to hold a minimum amount of free, uncommitted starting capital or other equivalent form of financial security. The amount should be dependent on the risks to be covered. The required minimum capital should not be used to cover set-up costs. In order to ensure the guarantee function of the minimum capital, legislation could require that appropriate assets be set aside. Capital requirements may also be satisfied by the purchase of insurance providing the same level of protection to the plan members and plan beneficiaries.

### *Governance*

**2.14** Pension funds and entities and, where relevant, plans, should have a governing body that is ultimately responsible for the entity and a code of conduct for the members of its governing bodies and staff. The code of conduct may be laid out in specific legislation applying to pension entities.

**2.15** Membership in the governing body of a pension fund, entity or, where applicable, plan, should be subject to minimum suitability requirements.

**2.16** Pension funds and entities should be required to keep a functional separation between those staff responsible for investments and those responsible for settlement and bookkeeping.

### *Business plan*

**2.17** Pension entities should have a business plan which should include at a minimum (i) a list of the 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; (v) the means for fulfilling eventual 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.

### ***Registration and license withdrawal***

**2.18** Legal provisions should clearly set out under which circumstances registration or a licence can be withdrawn.

**2.19** Legal provisions should grant a pension fund, entity or, where applicable, plan, whose registration and/or licence has been withdrawn the possibility to appeal the decision and have it reviewed.

### ***Role of the registration and/or licensing authority in supervisory matters***

**2.20** Legal provisions should establish the role of the registration and/or licensing authority in the wider supervisory and regulatory system. Where registration, licensing and supervisory authorities are separate, the legal provisions should require the supervisor to be consulted on each specific licence application.

## **Clarity of the registration and/or licensing application procedure**

**2.21** Registration and licensing procedures should be clear, objective, efficient and transparent. They should set out the application process, including:

- information about the obligations on the registration and/or licensing authority and the timeframe for the submission of applications and the decision process;
- procedures for the registration and/or licensing authority to seek further information from the applicant;
- the actions that the registration and/or licensing authority will take to confirm the information received as part of the licence application;
- requirements that the staff of the registration and/or licensing authority observe the appropriate standards of confidentiality with regard to the information gathered as part of the licensing application process (with the exception of information which may have to be provided to other public authorities).

**2.22** The licensing authority should ensure that a licence clearly states the terms of the licence regarding operations, rights and obligations of the licensee. It should publish this information about any pension plans, funds and entities that are licensed.

### *Submission of documents*

- 2.23** The registration and/or licensing authority should have the power to require the submission of the governing documents and other documents necessary for assessing a licensee's compliance with the registration or licensing requirements.

### *Assessment of the licence application*

- 2.24** The licensing authority should have the power to:
- examine the proposed legal, managerial and ownership structures (including beneficial owners) of the applicant and its wider group (if any);
  - evaluate proposed directors and other members of the governing bodies as to their expertise and integrity, their skills and experience, including their ability to nominate and monitor external advisors where relevant, and their judicial records;
  - review the proposed strategic and operating plans of the applicant, including:
    1. determining that an appropriate system of corporate governance, risk management and internal controls and a code of conduct will be in place
    2. considering whether the operational structure of the applicant reflects the scope and degree of sophistication of the proposed activities of the applicant;
  - review the policies and procedures that the applicant has/intends to put in place to ensure ongoing compliance with its obligations under relevant legislation and the conditions of the licence and the risk management control framework established by the applicant.
  - review financial projections for the applicant and assess its financial strength and other resources;
  - identify and determine the suitability of eventual major shareholders, ultimate beneficial owners, and other significant parties that may exert influence on the applicant, as well as assess the transparency of the ownership structure and the sources of required initial capital.

**2.25** Regulation should give the licensing authority flexibility in the licencing procedure, in specific circumstances, so that the nature, scale and complexity of an applicant’s activities may be taken into account in the assessment as to whether and how licensing criteria are met. The circumstances in which the licensing authority may apply such flexibility should be clearly stated in legislation and protection against arbitrary action on the part of the licensing authority should be guaranteed.

**2.26** The licensing authority may have the power to impose conditions on the licence of the applicant, and to subsequently vary or withdraw those conditions. The circumstances in which conditions can be imposed, withdrawn or modified should be clearly stated in legislation.

**2.27** Where a pension entity is seeking to establish a physical presence such as a branch or subsidiary in a foreign jurisdiction, the licensing authority in the host country should consult the appropriate authorities in the home jurisdiction before permitting such activities and issuing a licence.

**2.28** Where a pension entity is seeking to conduct cross border activities without a physical presence in a foreign jurisdiction, the appropriate authorities in the host country should consult with the appropriate authorities in the home jurisdiction of the pension entity before allowing such activities.

### ***Guidance materials***

**2.29** The registration, licensing and/or supervisory authority/ies should provide guidance to applicants regarding their expectations as to how licensing and/or registration criteria can be met in order to facilitate the application process.

**2.30** The registration and/or licensing authority should provide appropriate guidance to officers carrying out the registration or licensing assessment.

***Power to reject, modify or withdraw a registration and/or licence***

- 2.31** The registration and/or licensing authority should have the power to reject an application if the criteria are not fulfilled or if the information provided is inadequate. Any rejection should specify the criteria on which the rejection is based.
- 2.32** The licensing authority should have the power to make adjustments to a licence already granted and to withdraw a licence when the conditions for the licence are no longer fulfilled. These powers should be clearly stated in legislation.
- 2.33** The registration and/or licensing authority should have a review mechanism in place to examine the claims of an entity whose registration and/or licence has been modified or withdrawn.
- 2.34** Decisions of the registration and/or licensing authority should be open to administrative and legal appeal. Adequate protection to preclude arbitrary action on the part of the licensing authority should be in place. The appeal process should be transparent and efficient.

### Core Principle 3. Governance

Regulations on private pension governance should be guided by the overriding purpose of serving the best interests of plan members and beneficiaries and ensuring the soundness of pension plans, pension funds and pension entities. The governance structure of pension funds and pension entities should ensure an appropriate division of operational and oversight responsibilities, and the accountability and suitability of those with such responsibilities. Pension funds and pension entities should have appropriate control, communication and structures that encourage good decision-making, proper and timely execution, transparency, and regular review and assessment. The governing body of a pension fund or pension entity should ensure that the investment strategy follows a prudent approach and, where applicable, takes into account the profile and duration of its liabilities.

#### Introduction to Core Principle 3

Private pensions governance should ensure that the industry operates with integrity and effectiveness in the interest of pension plan members. Regulation can provide guidelines and recommendations to steer the governance process; however pension funds, entities and sponsors often need to develop internal rules and practices in order to reach these goals. In this way, overregulation can be avoided and supervision of the industry facilitated.

The governance of private pension plans entails responsibility for all aspects of pension plan management, including the operations of related pension funds and entities. The governing body should manage, monitor and have oversight of the duties of operational and executive managers, and/or external service providers.

Good governance goes beyond this and aims at delivering high risk-adjusted pension fund performance while keeping costs low for all stakeholders. Good governance can instil trust amongst all stakeholders, reducing the need for prescriptive regulation, and facilitating supervision. Good pension fund governance can also be conducive to more effective corporate governance of the companies that they invest in. This is because well-managed pension funds are more likely to seek value for their investments via more active shareholder engagement.

The governing body of a pension fund, a pension entity or, where relevant, a pension plan, should be accountable to members, beneficiaries and eventual plan sponsors. They should be subject to oversight and control

of their activities and decisions. Appropriate supervision and oversight of the governance of pension plans should be encouraged. Independent internal and external controls should be urged, as should more balanced representation of stakeholders in the governing body and in oversight committees. Applying risk-based oversight can help to focus the controls. For example, a stricter governance oversight may be required if a pension fund adopts a more sophisticated investment strategy or increases the complexity of the administrative arrangements of the plan.

Some of the worst governance failures could be avoided through higher levels of expertise amongst members of the governing body. In having the ultimate fiduciary responsibility for a pension plan, members of the governing body should be able to understand and challenge advice they receive from external advisors. This can be especially challenging in smaller pension funds. For example, plans sponsored by small employers may lack a suitable pool of workers with relevant skills and experience from which to recruit members of the governing body. Expertise can be gained through appropriate training and greater use of independent professional trustees.

Members' lack of knowledge can instigate moral hazard and agency problems. The fiduciary responsibilities of the governing body and, where relevant, the sponsoring employer in an occupational plan, should be clearly set out to ensure that plans are managed with appropriate care and with the best interest of the members in mind. The design and implementation of a code of conduct and regulations to establish fit and proper criteria for members of the governing body can effectively tackle conflicts of interest. Self-assessments and independent reviews of the governing board should include issues related to conflicts of interest. Clear and ample information should be provided to members to improve their understanding of their rights and responsibilities. There should also be cost-efficient procedures for complaints handling and redress.

## Implementing Guidelines for Core Principle 3

### *Identification of responsibilities*

- 3.1** There should be a clear identification and separation of operational and oversight responsibilities in the governance of pension funds, entities and, where relevant, plans. The ownership and management structure of a pension plan, the legal form of the operating entities, the internal governance structure of these entities and the main objectives should be clearly stated in the pension entity's statutes, by-laws, contract or trust instrument, or in documents associated with any of these. If a pension fund is established as a separate fund managed by a financial institution, the pension plan or contract between plan sponsors/members and beneficiaries and the financial institution should clearly state the responsibilities of the latter with respect to the management of the pension fund. As good pension fund governance should be 'risk-based', the division of responsibilities should reflect the nature and extent of the risks faced by the pension fund.

### *Governing body*

- 3.2** Every pension fund and entity, and where applicable, pension plan, should have a governing body vested with the power to administer the pension fund. The governing body should be ultimately responsible for ensuring the adherence to the terms of the arrangement and the protection of the best interests of plan members and beneficiaries. The responsibilities of the governing body should be consistent with the overriding purpose of serving the best interests of members and delivering on eventual obligations, taking into account the profile of the plan and, where relevant, the role of the sponsor. Profitability and other objectives and incentives should be properly aligned with this overriding purpose. The governing body should retain ultimate responsibility for the pension fund, even when delegating certain functions to external service providers or authorised agents. The governing body should retain the responsibility for monitoring and oversight of such external service providers and authorised agents. Appropriate oversight mechanisms should also be established where the governing body is a commercial institution.

**3.3** The governing body should set out the key goals or mission of the pension fund, identify the main risks and lay out the main policies, including the investment policy or the strategic asset allocation, the remuneration policy, the risk management policy, and the funding policy, especially where one is required by the legal provisions.

**3.4** The governing body of a pension fund or pension entity should observe its fiduciary duties towards the members and beneficiaries. Such duties, when applicable, should include the prudent and efficient management of any long-term assets and the informed and effective use of their investor rights, including shareholder and creditor rights. Those persons and entities involved in the management of the assets should act in consistency with those fiduciary duties or their associated contractual obligations.<sup>2</sup>

### *Accountability*

**3.5** The governing body of the pension fund or entity and, where applicable, pension plan, 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. In occupational pension plans, the governing body should 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 any actions which fail to be consistent with the obligations imposed on it, including prudence. Where accountability is subject to safe harbour rules, these should clarify the responsibilities and liabilities of the governing body.

### *Suitability*

**3.6** Membership in the governing body of the pension fund or entity should be subject to minimum fit and proper standards in order to ensure a high level of integrity, competence, experience and professionalism in the governance of the pension fund. The

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<sup>2</sup> See also the [G20/OECD High-Level Principles of Long-Term Investment Financing by Institutional Investors](#).

governing body should collectively have the necessary skills and knowledge to oversee all the functions performed by a pension fund and/or pension entity, and to monitor any external parties to whom such functions have been delegated. It should also seek to enhance its competence and knowledge, where relevant, via appropriate training. Any criteria that may disqualify an individual from appointment to the governing body should be clearly laid out in the regulation.

### *Delegation and expert advice*

- 3.7** The governing body of a pension fund or entity may rely on the support of sub-committees and may delegate functions to internal staff or to external service providers. Where it lacks sufficient expertise to make fully informed decisions and fulfil its responsibilities, the governing body should be required by the regulator or supervisor to seek expert advice or appoint professionals to carry out certain functions. Delegation or outsourcing of functions and seeking of expert advice should not in any way discharge the governing body of its ultimate responsibility for the pension fund. The governing body should be able to understand the advice. The governing body should assess the advice received, including its quality and independence. It should verify that all its professional staff and external service providers have adequate qualifications and experience. The governing body should oversee remuneration for any delegated responsibilities to ensure alignment with the objectives of the pension fund.

### *Auditor*

- 3.8** An independent auditor should be appointed by the appropriate body or authority to carry out a periodic audit consistent with the needs of the arrangement. Wherever the auditor becomes aware, while carrying out his or her tasks, of certain facts which may have a significant negative effect on the financial situation or the administrative and accounting organisation of a pension fund or entity, he or she should promptly inform the governing body. If the governing body does not take any appropriate remedial action, the auditor should report this to the competent authorities and other appropriate persons without delay and in accordance with the supervisory framework.

### *Actuary*

**3.9** The governing body of a pension fund or entity should, as relevant, appoint an actuary to provide advice regarding, at a minimum, the calculation of liabilities, funding levels and compliance with related requirements. Should the actuary realise, in performing his or her professional or legal duties, that the fund does not or is unlikely to comply with applicable legal requirements, and depending on the general supervisory framework, he or she should inform the governing body. If the governing body does not take any appropriate remedial action, the actuary should report this to the competent authorities and other appropriate persons without delay where this is in accordance with the supervisory framework.

### *Custodian*

**3.10** Custody of the pension fund assets may be carried out by the pension entity or by an independent custodian. If an independent custodian is appointed by the governing body of the pension fund to hold the pension fund assets and to ensure their safekeeping, the pension fund assets should be legally separated from those of the custodian. The custodian should not be able to absolve itself of its responsibility by entrusting to a third party all or some of the assets in its safekeeping.

### **Risk-based internal controls**

**3.11** There should be adequate internal controls in place to ensure that all persons and entities with operational and oversight responsibilities act in accordance with the objectives set out in the by-laws, statutes, contract, trust instrument, or documents associated with any of these, of the pension plan, fund or entity and that they comply with the law. Such controls should recognise the nature of the risks faced by the pension plan and cover all basic organisational and administrative procedures. Depending upon the scale and complexity of the plan, these controls may include performance assessment, compensation mechanisms, information systems and processes and risk management procedures and internal audit function. The governing body should develop a code of conduct and a conflicts-of-interest policy for themselves and the staff of the pension entity as well as for

any party with operational responsibilities. There should also be appropriate controls to promote the independence and impartiality of the decisions taken by the governing body, to ensure the confidentiality of sensitive information pertaining to the fund and to prevent the improper use of privileged or confidential information.

### ***Reporting***

**3.12** Reporting channels between all the persons and entities involved in the administration of the pension fund should be established in order to ensure the effective and timely transmission of relevant and accurate information needed to make decisions and carry out operations in an appropriate manner.

### **Disclosure**

**3.13** The governing body should disclose relevant information to all parties involved (notably pension plan members and beneficiaries, supervisory authorities, auditors, etc.) in a clear, accurate, and timely fashion.

## Core Principle 4. Investment and risk management

Investment by pension funds and pension entities should be adequately regulated. Investments should be aligned with the specific attributes and liabilities of the pension plan and the institutional and market environment in which it operates. Investment regulations should take into consideration principles related to risk diversification and dispersion and asset-liability management. Pension funds and pension entities should be required to act in line with the investment horizon and risk-return objectives of the plan, and take into account the long-term nature of saving for retirement and of eventual liabilities.<sup>3</sup>

Quantitative requirements and prudent-person principles for investment should be carefully assessed, having regard to the security, liquidity and profitability objectives of the pension fund or pension entity. Self-investment should be strictly controlled or prohibited in cases where there are no appropriate safeguards in place to ensure diversification or otherwise avoid undue risks or costs to members. Self-dealing should also be strictly controlled in order to ensure that transactions are made in the best interest of members. Investment abroad by pension funds and pension entities should be permitted, subject to prudent management principles.

Increased reliance on modern and effective risk management techniques and industry-wide risk management standards for pension funds and pension entities should be promoted. The development of asset liability management techniques should be given proper consideration.

### Introduction to Core Principle 4

The investment of pension fund or pension plan assets is one of the core activities of a pension fund or entity. The fundamental premise of the Core Principles is that the regulatory framework should take into account the retirement income objective of a pension fund or pension plan. A prudent investment strategy would entail that the pension assets are invested in such a manner as to promote both the performance and the financial security of the pension plan. Cost-efficient management (focusing on risk-adjusted returns net of costs) of pension plan assets can help to achieve this. In meeting this goal, self-dealing (transactions where the asset manager is a counterparty and that could raise conflicts of interest), among other measures, should be strictly controlled. The fund manager, administrator

<sup>3</sup> See also the [G20/OECD High-Level Principles of Long-Term Investment Financing by Institutional Investors](#).

and/or custodian should aim to act in the best interests of the plan members rather than their own when carrying out any transactions. Transactions should be made at the best conditions available in the market.

The fund's investment strategy will tend to vary depending on the objectives and type of pension plan. In plans offering a defined benefit or return promise, the goal of the investment function is to help the governing body generate the targeted risk-adjusted return, consistently with the nature of the liabilities and liquidity needs of the pension plan. In unprotected defined contribution plans, the main goal of the investment function is to maximise the rate of return on individual accruals, giving consideration to the investment goals and the risk tolerance of plan participants. Where members are obliged to make investment decisions, they should be offered investment options which give them a sufficiently diverse and clearly disclosed range of risk-return characteristics from which to select according to their preferences.

Investment regulation should be based on prudential principles such as diversification, dispersion, maturity and currency risk management. The regulatory framework should facilitate the matching of the characteristics of assets and liabilities. Investment regulations can take the form of static rules such as investment limits in certain classes of assets (e.g. foreign investment) or vehicles (e.g. alternatives). Minimum levels of investment in certain assets are not consistent with these principles as they leave asset managers no or little ability to walk away from inappropriate investments. In maintaining diversified portfolios, but also preventing conflicts of interest, regulations should ensure that self-investment (for example, investing in the sponsor or affiliated companies) is strictly controlled or prohibited.

Regulation should also ensure that a structured risk management process is put in place. This is essential to measure and control portfolio risk appropriately. Portfolio risks should be evaluated in relation to the overall risk profile of the pension fund, including the extent of matching between assets and eventual liabilities. The risk management process should identify the most critical risks that face each pension fund, including subjective risks like those related to the governance of the plan.

Regulation should establish appropriate methodologies for valuing assets. Market value is commonly used; the use of alternative methodologies should be accompanied by adequate disclosure of the assumptions used and the current market value of the pension assets. Furthermore, regulation should ensure that performance is clearly and comparably disclosed. Benchmarking tools can be used to enhance comparability, but such tools are more useful for measuring performance if they are net of fees and costs.

## Implementing Guidelines for Core Principle 4

### *Retirement income objective and prudential principles*

- 4.1** The regulation of pension fund investment management should be aligned with the retirement income objective and the eventual liabilities of a pension fund. Regulation should require that the investment management function be undertaken in accordance with the prudential principles of security, profitability and liquidity. Risk management concepts, such as diversification and asset-liability matching, should be appropriately employed in order to achieve the best outcome for the plan members and beneficiaries. Regulations should reflect the particular risk characteristics of less liquid, long-term assets (e.g. infrastructure) appropriately.<sup>4</sup>

### *Prudent person standard*

- 4.2** The governing body of the pension fund and /or pension entity, and other parties exercising authority or control, 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.<sup>5</sup> Self-dealing by those undertaking investment management of pension assets should be strictly controlled. Appropriate safeguards should be put in place to ensure that the best interests of members are protected during the execution of transactions.
- 4.3** The governing body of the pension fund and/or pension entity, and other appropriate parties should be subject to a fiduciary duty towards pension plan 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.
- 4.4** The legal provisions should require the governing body of the pension fund or pension entity to establish a rigorous investment process (see Guidelines 4.5-4.12 on investment policy). These

<sup>4</sup> Following the [G20/OECD High-Level Principles of Long-Term Investment Financing by Institutional Investors](#) .

<sup>5</sup> See also [OECD/IOPS Good Practices for Pension Funds’ Risk Management Systems](#).

should include the establishment of appropriate internal controls and procedures to effectively implement and monitor the investment management process.

### ***Investment policy***

**4.5** The governing body of the pension fund and/or entity should actively observe an overall investment policy set forth in a written statement.

**4.6** The investment policy should establish clear investment objectives for the pension fund consistent with its retirement income objective and specific attributes. The investment objectives should take into consideration the acceptable degree of risk for plan members and beneficiaries, the pension plan and, where applicable, the plan sponsor, to an extent commensurate with its responsibility as benefit provider. The investment objective should also be consistent with the characteristics of the liabilities of the pension fund where applicable. The approach for achieving those objectives should satisfy the prudent person standard taking into account the objectives of the fund, the need for proper diversification and risk management, the maturity of the obligations, the liquidity needs of the pension fund, balancing long-term risks and returns, and any specific legal limitations on portfolio allocation.

**4.7** The investment policy should, at a minimum, identify the asset allocation strategy for the pension fund (the long-term asset mix across the main investment categories), the overall performance objectives for the pension fund or plan, and the means of monitoring performance. The investment policy should also identify when deviations from the asset allocation strategy and performance objectives (e.g. in the light of changing liabilities and market conditions) may be tolerated and to what extent. The investment policy should also include any overarching decisions regarding tactical asset allocation, security selection and trade execution.

**4.8** The investment policy should address whether, why, to what extent and how more complex and less transparent classes of asset, and investments in markets or instruments that are subject to

limited governance or regulation, including alternative investments and derivatives, will be used.<sup>6</sup> The investment policy should also address the appropriate extent of exposure to counterparty risk.

**4.9** A sound investment risk management process that supports the achievement of the investment objectives should be established. It should measure and seek to appropriately control portfolio risk and to manage the assets and eventual liabilities in a coherent and integrated manner. This should be part of a comprehensive risk management system.<sup>7</sup>

**4.10** The investment policy for pension plans in which members make investment choices should ensure that an appropriate array of investment options, including a default option, are provided for members and that members have access to the information necessary to make investment decisions. In particular, the investment policy should classify the investment options according to the nature, scale and extent of the investment risks that members bear. The default investment strategy should be consistent with the pay-out phase.<sup>8</sup>

**4.11** Parties who are responsible for the overall implementation of the investment policy should be identified together with any other significant parties that will be part of the investment management process. In particular, the investment policy should address whether internal or external investment managers will be used, the range of their activities and authority, and the process by which they will be selected and their performance monitored. An investment management agreement should be required if external investment managers are used.

**4.12** The governing body of the pension plan, fund, entity or other responsible party should establish procedures and criteria by which it periodically reviews the effectiveness of the investment policy and determines whether there is a need to change the

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<sup>6</sup> See also the [OECD/IOPS Good Practices on Pension Funds' Use of Alternative Investments and Derivatives](#).

<sup>7</sup> See also [OECD/IOPS Good Practices for Pension Funds' Risk Management Systems](#).

<sup>8</sup> See the [OECD Roadmap for the Good Design of Defined Contribution Pension Plans](#).

policy, its implementation procedures, the decision-making structure, as well as the responsibilities linked to its design, implementation and review.

### ***Portfolio limits and other quantitative requirements***

**4.13** Where there are legal provisions that stipulate maximum levels of investment by category (ceilings), these should promote and balance 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.

**4.14** Portfolio limits that inhibit adequate diversification or impede the use of asset-liability matching or other widely accepted risk management techniques and methodologies should be avoided. The matching of the characteristics of assets and liabilities (such as maturity, duration, currencies, etc.) should not be impeded.

**4.15** Where the legal provisions establish maximum levels of investment by category (ceilings), there should be an established procedure for correcting breaches within specified time limits. The legal provisions should provide appropriate flexibility to avoid forced selling of assets under unfavourable market conditions.

**4.16** Self-investment by those undertaking investment management of pension funds should be prohibited or, where appropriate safeguards exist, strictly controlled. Investment in the assets of the plan sponsor, in parties related or affiliated with the governing body of pension fund, the pension entity or pension fund management company should be prohibited or strictly limited to a prudent level so as to ensure diversification (e.g. 5 percent of the pension fund assets) or otherwise avoid undue risks or costs to members. When the plan sponsor, the pension entity or the pension fund management company belongs to a group, investment in entities belonging to the same group should also be limited to a prudent level of diversification, which may be a slightly higher percentage (e.g. 10 percent of the pension fund

assets). In the case of pension funds specifically designed to invest in employer stock, to ensure sufficient diversification of the employee's pension assets, such funds should not be the sole type of pension plan made available to employees by the sponsor and such funds should reduce their investment in the plan sponsor's stock to a prudent level as retirement approaches.

**4.17** Investments in assets issued by the same issuer or by issuers belonging to the same group should not expose the pension fund to excessive concentration of risk.

**4.18** Investment abroad by pension funds and pension entities should not be prohibited and, among other risks, should take into account the currency matching needs between pension plans assets and liabilities.<sup>9</sup>

**4.19** The legal provisions should avoid specifying the minimum risk rating of issuers - as reported by credit rating agencies - in which pension funds can invest. They should instead make reference to the creditworthiness of issuer. Regulations should encourage and facilitate an appropriate credit risk assessment process by pension funds and pension entities in which the mechanistic reliance on ratings provided by credit rating agencies is avoided.

**4.20** Legal provisions should address the use of more complex and less transparent classes of assets, and investments in markets or instruments that are subject to limited governance or regulation, including alternatives, derivatives and other similar commitments, taking into account both their utility and the risks of their inappropriate use. The use of derivatives that involves the possibility of unlimited commitments should be strictly limited, if not prohibited.

**4.21** Any and all legal provisions setting forth quantitative portfolio limits should be regularly assessed to determine whether they unnecessarily inhibit the ability of pension fund managers to

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<sup>9</sup> These limitations on investments abroad should also be consistent with the OECD Codes of Liberalisation of Capital Movements and of Current Invisible Operations. Existing restrictions are identified in the document "Portfolio Investment Abroad by Insurance Companies and Private Pension Funds: Widened Application of the OECD Code of Liberalisation of Capital Movements and Related Amendments" [[C\(2002\)30](#)].

implement optimum investment strategies, and should be amended to the extent necessary.

### *Valuation of pension assets*

**4.22** The legal provisions should establish a proper, transparent and disclosed basis for valuing pension assets. The transparency, consistency, relevance and reliability of valuation methods for long-term assets should be promoted, as well as the development of appropriate benchmarks for such assets.

**4.23** Where national rules do not require valuation at current market value or under a fair valuation methodology, the valuation should be accompanied by the disclosure of the results that would have been obtained using current market value or another acceptable methodology based on established national or international standards.

**4.24** The legal provisions should require pension assets to be valued for accounting, reporting, actuarial and funding purposes. Ideally, permitted valuation methodologies for these purposes should be consistent, and where inconsistent, the differences in methodologies should be transparent. In appropriate circumstances, valuation rules may permit methods that reduce short-term volatility of values for actuarial and funding purposes.

**4.25** Special methods may be needed to value securities in less liquid markets and assets such as real estate. The legal provisions may set out specific methodologies for valuing such assets which should, as far as possible, take into account the risk inherent to illiquid markets.

**4.26** The methodology used for valuing pension fund assets should be transparent and appropriately disclosed to the pension fund's governing body, persons and entities involved in the investment management process for the pension fund, and to members and other beneficiaries. The methodology used for valuing pension fund assets should be disclosed to the competent authorities and other appropriate persons consistently with the supervisory framework.

**4.27** Pension funds and pension entities should be permitted to borrow only under strict circumstances. The legal provisions should clearly establish the restrictions and the terms for borrowing.

***Performance assessment***

**4.28** The governing body of pension funds and pension entities should regularly monitor the performance of both external and internal fund managers. Performance should be evaluated over a period of years taking into account the long-term investment horizon, the fund's asset-liability management objectives and the level of risk implied.<sup>10</sup>

**4.29** Pension funds and pension entities should assess their performance against benchmarks that are clear and objective and reflect their investment policy. Both gross and net investment performance should be assessed against the investment objectives. All costs related to investment management should be measured and reported.

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<sup>10</sup> The text is in line with the OECD/G20 High Level Principles of Long-Term Investment Financing by Institutional Investors.

### **Core Principle 5. Plan design, pension benefits, disclosure, and redress**

Proper design of private pension plans should be promoted, especially when these schemes play a public role, through substitution of or substantial complementarity to public schemes, when they are mandatory, and when members face choices between plans or within the pension plan (for instance, the level of the contribution rate or the choice of investment option). Factors to be taken into consideration include member choice, degree of risk sharing, protection of the value of benefits, entitlements, accruals, contributions, coverage, and financial and market risks. Overall benefit adequacy should be evaluated taking into account the various sources of retirement income (tax-and-transfer systems, advance-funded systems, private savings and earnings).<sup>11</sup>

Appropriate disclosure and education should be promoted regarding benefits and members' rights and responsibilities, especially when individual choice is offered.<sup>12</sup> Plan members and beneficiaries should be informed on the impact of plan participation and contributions on overall retirement income and the potential misuse of retirement benefits (in particular in cases associated with lump sum payments and early withdrawal of benefits and accumulations). In the case of pension plans with individual accounts, disclosure of the fee structure and level, investment options and their associated performance, and benefit modalities should be promoted.<sup>13</sup>

Pension plan members should have access to appropriate complaints handling and redress mechanisms that are accessible, affordable, independent, fair, accountable, timely and efficient.

#### **Introduction to Core Principle 5**

Pension plan design may be influenced by different stakeholders. The different parties to the plan design should be in a position to determine its suitability and practicability. Plan design affects the adequacy of the plan in achieving its income objectives, the nature and scope of rights of members and beneficiaries, and the protection mechanisms that are needed to preserve

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<sup>11</sup> See also the [OECD Roadmap for the Good Design of Defined Contribution Plans](#).

<sup>12</sup> In adherence to [the OECD Recommendation of the Council on Good Practices for Financial Education Relating to Private Pensions](#).

<sup>13</sup> Individual accounts comprise the assets of a single member according to [Private Pensions: OECD Classification and Glossary, 2005](#).

these. It is key to establish whether the pension plan is (1) mandatory or voluntary; (2) if it is intended to be a primary or only a supplementary source of retirement income; (3) whether and to what extent the programme is subsidised or administered by the state; (4) whether the plan gives any benefit or return promises; and (5) whether plan members have to make investment or retirement planning decisions.

A full assessment of the pension plan design is necessary to establish if income objectives are being met given these characteristics. Such assessment should consider issues such as member choice, the degree of risk sharing, retirement income adequacy and coverage. Consideration should be given to the fact that overly prescriptive member rights and protections can lead to a decrease in pension plan formation. This concern needs to be balanced with ensuring sufficient protection for plan members, which is key for building public confidence and thereby encouraging participation in the plan.

Some basic rights should be granted to members and beneficiaries regardless of the type of plan. Members and beneficiaries should have the right to disclosure of relevant information concerning the pension plan and fund. Members and beneficiaries who have access to clear descriptions of their benefits, rights and responsibilities relating to plan or fund membership and who understand those rights and obligations, can serve an important monitoring function to assure the appropriate governance of the plan or fund. Disclosure and education also help members and beneficiaries understand (1) the extent to which their plan or fund may provide them with a satisfactory level of income in retirement; (2) the extent to which they themselves bear the risks and responsibilities of providing and protecting their expected retirement income as opposed to another party, such as the pension entity or a sponsoring employer; and (3) the decisions that they may need to make in order to plan appropriately for retirement given their individual circumstances.

Procedural rights are also more universal in character. Procedural rights include certain juridical rights, such as the right to a transparent, timely and fair claims and grievances process, whereby members and beneficiaries may be heard, appeals can be made and adequate redress obtained.

## Implementing Guidelines for Core Principle 5

### *Plan design*

- 5.1** The adequacy of the pension plan design should be reviewed in order to determine the suitability of the plan's parameters (contributions, benefits, etc.) for delivering on undertakings and for fulfilling its role in retirement income provision.
- 5.2** Appropriate parameters and plan rules for the protection of the value of accruals, entitlements and benefits should be considered and their adequacy assessed.
- 5.3** Regulations should prevent the retroactive reduction of the obligations of a pension plan to members, except in exceptional circumstances, and require that plan members obtain timely notice regarding any reduction in the rate of future benefit accruals in the pension plan.
- 5.4** Contributions to the pension plan should be transferred expeditiously. Where member participation is mandatory or required as part of automatic enrolment, plan sponsors, administrators and pension entities should ensure that new members are enrolled in the plan in a timely manner.

### *Member choice*

- 5.5** Where members direct their own investments in a private pension plan, they should have the right to a sufficient number and diversity of investment choices to permit them to construct an appropriate investment portfolio that, as far as possible, reflects their individual circumstances and in the context of the particular pension programme.
- 5.6** Where members direct their own investments in a private pension plan, they should be provided with information regarding investment choices that is standardised, readily comparable and sufficient to permit them to make appropriate choices. At a minimum this information should include disclosure of all charges, fees and expenses associated with each investment choice, as well as information about the riskiness of each choice, portfolio composition and historical investment performance.

- 5.7** Where members direct their own investments in a private pension plan, they should have the right to timely and fair execution of their investment decisions and to written confirmation of these transactions. The right (or responsibility) to make and execute investment decisions should not be inhibited by the assessment of any unreasonable charges or fees.
- 5.8** Where members direct their own investments in a private pension plan, members and beneficiaries should be provided sufficient opportunity to acquire the financial skills or education and other assistance to help them make appropriate investment and retirement decisions in their pension plans. Appropriately designed default options should be established for members who do not make an active investment choice or benefit pay-out choice, where such choice is offered.
- 5.9** Where members direct their own investments in a private pension plan and can choose between different benefit pay-out options, they should be provided with relevant information that is standardised, readily comparable, and sufficient to permit them to make appropriate choices. At a minimum this information should include disclosure of all charges, fees and expenses associated with each choice, as well as information about the extent of protection offered by each product against longevity, inflation and market risks.

### ***Disclosure and availability of information***

- 5.10** Members and beneficiaries of pension plans, as well as potential plan members, should have a legal right to ready access to or disclosure of basic information about the pension plan, including adequate information regarding their rights of access and waiting periods, anticipated contribution and/or benefit accrual rates, vesting schedules, other rights and obligations, investment policy, the names and means of contacting the parties responsible for plan administration and governance, and claims processes or procedures. If a pension plan allows for reductions in benefits or the obligations of the plan, or for the possibility to reduce or request additional contributions, these should be clearly disclosed. Members should be informed on the protection of their vested benefit accruals and accumulations in case of insolvency of the pension fund and/or pension entity or plan sponsor.

- 5.11** Plan documents, annual accounts, and annual financial and actuarial reports, if not automatically disclosed, should be made readily available to plan members (and to beneficiaries where relevant) for copying for no more than a reasonable charge or fee.
- 5.12** Members and beneficiaries should be notified in a timely fashion if required contributions have not been made to the pension plan.
- 5.13** Timely, individualised benefit statements should be provided to each plan member (and to beneficiaries where relevant). The information included on the benefit statement and the frequency of its delivery will depend on the type of pension plan. The information included should enable the plan member to identify current benefit accruals or account balances and the extent to which the accruals or account balances are vested. For pension plans with individual accounts, the information should include the date and value of contributions made to the account, investment performance and earnings and/or losses. This information and other similarly personal data should be maintained and delivered in a manner that takes full account of its confidential nature.
- 5.14** Individuals should be provided adequate information about the rules associated with the portability of their vested benefit accruals and accumulations, especially where the transfer of these assets may entail a loss of certain benefits or rights that were associated with the pension plan in which the benefit originated.
- 5.15** Plan members and beneficiaries should have access to information regarding the benefits they are likely to obtain at retirement under specific assumptions. Such assumptions should be reasonable and uncertainty should be disclosed.
- 5.16** In the event that spouses and dependents are entitled to claim benefits or accruals under the rules of the plan, they should be informed by the pension plan of their rights and obligations in the event of the death or the breakdown of marriage of a pension plan member, and should be treated in accordance with these rules.
- 5.17** Disclosure materials should be written in a manner that can be easily understood by the members and beneficiaries to whom they are directed.

- 5.18** Consideration should be given to adequate forms of delivery of disclosure materials that are appropriate to the nature of the information, including mail, delivery at the workplace and via electronic mail or websites.
- 5.19** Amendments or changes to the pension plan that will significantly impact the rights and benefits of members and beneficiaries, should be disclosed to them in timely and comprehensible fashion.
- 5.20** Members' pension plan and personal information should be protected through appropriate control and protection mechanisms. These mechanisms should define the purposes for which the data may be collected, processed, held, used and disclosed (especially to third parties). The mechanisms should also acknowledge the rights of members to be informed about data-sharing, to access data and to obtain the prompt correction and/or deletion of inaccurate, or unlawfully collected or processed data.

### *Entitlement process and rights of redress*

- 5.21** Pension plans, pension funds, pension entities, providers and authorised agents should have in place mechanisms for complaint handling and redress.
- 5.22** Members and beneficiaries (and individuals claiming the right to be deemed a member or beneficiary of a pension plan) should be entitled to a fair and timely process or procedure in which their entitlements, rights and benefits under the pension plan may be claimed or asserted.
- 5.23** The claim process or procedure and the provision of information relevant to the procedure should be expeditious and transparent. The process and the relevant information should be easy to understand and have only reasonable or no cost to the individual claimant.
- 5.24** The process should include independent administrative or judicial recourse if initial claims of rights or benefits are denied by the pension plan administrator, fiduciary, or employer. This process should provide for adequate remedial measures to redress the loss of rights or benefits suffered by the member or beneficiary whose claim has been found to be valid.

## Core Principle 6. Supervision

Private pension supervision should promote the stability, security and good governance of pension funds, pension entities and/or pension plans with the aim of protecting the interests of plan members and beneficiaries. Effective supervision of pension funds and plans must be set up and focus on legal compliance, financial control, actuarial examination and supervision of those with the responsibility of operating or managing the plan. Appropriate supervisory bodies, properly staffed and funded, should be established in order to conduct when relevant off and on site supervision, in particular when problems are reported or identified. Supervisory bodies should be endowed with appropriate regulatory and supervisory powers over private pension plans, pension funds and pension entities, including powers over the functions that are outsourced.

### Introduction to Core Principle 6

The Implementing Guidelines of Core Principle 6 on Supervision contain the revised IOPS (International Organisation of Pension Supervisors) Principles of Private Pension Supervision,<sup>14</sup> approved in 2010.

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. It includes the enforcement and promotion of compliance with regulation relating to the operation of pension plans. A main goal is to promote 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). As such, pension supervision should be mindful of financial innovation.

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

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<sup>14</sup> Find the IOPS Principles online at [www.iopsweb.org/principlesguidelines/](http://www.iopsweb.org/principlesguidelines/).

problematic with regard to pensions due to the 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 and 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;
- sometimes limited competition and choice, with decisions often made collectively by employers and/ or unions;
- their potential impact on financial markets and economic stability given their large and increasing size relative to financial markets and countries' GDP;
- their 'social' as well as financial roles, 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.

As a consequence, 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. It also faces challenges in terms of the *depth* of supervision which is required, due

to the vulnerability of members and beneficiaries, the complexity of financial products and, in many cases, the mandatory nature of the system.

The IOPS Principles of Private Pension Supervision are designed to cover occupational and personal pension plans and/ or pension funds.<sup>15</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. Supervisory activities vary depending on the regulatory 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>16</sup>

Pension Supervisory Authorities referred to in the Implementing Guidelines below are defined as any entity, responsible in whole or in part for the supervision of pension entities, funds and plans. The Principles are designed to cover different types of supervisory structures (specialised, 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>15</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 are provided by the International Association of Insurance Supervisors: ‘Insurance Core Principles and Methodology’ – see [Insurance Core Principles, Standards, Guidance, and Assessment Methodology](#).

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

<sup>16</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.

## Implementing Guidelines for Core Principle 6 (IOPS Principles of Private Pension Supervision)

### ***Principle 1: Objectives***

*National laws should assign clear and explicit objectives to pension supervisory authorities*

- 6.1** 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.
- 6.2** 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*

- 6.3** The pension supervisory authority should have operational independence from both political authorities and commercial interference in the exercise of its functions and powers.<sup>17</sup>
- 6.4** 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).

<sup>17</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.

- 6.5** The pension supervisory authority should also be funded in such a way as to ensure independence and there should be a transparent budgetary process.
- 6.6** 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.

***Principle 3: Adequate resources***

*Pension supervisory authorities require adequate financial, human and other resources*

- 6.7** Pension supervisory authorities should be granted adequate staff and access to resources.<sup>18</sup>
- 6.8** 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.
- 6.9** The pension supervisory authority should hire, train and maintain sufficient staff with high professional standards and expertise, including appropriate standards of confidentiality and disclosure.
- 6.10** The directors, head of the authority and senior management should be suitably qualified, with sufficient education, experience, capacity and reputation.
- 6.11** If its own capacities are insufficient, or for other reasons deemed necessary, the pension supervisory authority should have the authority to outsource supervisory tasks to third parties (e.g. auditors, actuaries), or to second ('borrow') 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 ensure they maintain the required level of confidentiality, assess their

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<sup>18</sup> For details see [IOPS Guidelines for Supervisory Intervention, Enforcement and Sanctions](#) and [IOPS Guidelines for the Supervisory Assessment of Pension Funds](#).

competence, monitor their performance and ensure their independence from the pension fund or any other related parties in order to avoid conflicts of interest. 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.

### ***Adequate powers***

*Pension supervisory authorities should be endowed with the necessary investigatory and enforcement powers to fulfill their functions and achieve their objectives*

**6.12** Pension supervisory authorities should be legally empowered to undertake supervision and should be granted adequate powers and the capacity to exercise these powers.<sup>19</sup>

**6.13** 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 soundness and control, minimum capital requirements, investment activity, good governance and integrity, actuarial examination, the supervision of pension plan or fund managers, and the provision for adequate disclosure of information to members. Powers should allow for relevant off-site and on-site inspection.

**6.14** 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.

**6.15** 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 make documents and information available. Necessary powers include the ability to

<sup>19</sup> For details see IOPS Guidelines as above.

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.

**6.16** 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.

**6.17** 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.

**6.18** 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.

**6.19** 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).

***Risk-based supervision***<sup>20</sup>

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

- 6.20** 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>21</sup>
- 6.21** The move towards risk-based supervision can be undertaken gradually, combining this technique with more traditional rules-based supervision as the supervisory authority and pension industry develop the necessary expertise.
- 6.22** The introduction of risk-based supervision should be seen as a movement along a continuum from one extreme of complete reliance on a rules-based system to one where the emphasis of supervision is a function of risk. Risk-based supervision does not mean having no rules or compliance procedures.
- 6.23** A legal framework allowing suitable discretion in terms of interpretation and exercise of supervisory powers is required, which should also provide pension supervisory authorities with the necessary powers to adopt a risk-based approach.
- 6.24** Staff reorganisation 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.
- 6.25** 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.

<sup>20</sup> As outlined in the [IOPS Toolkit for Risk-based Pension Supervision](#), risk-based supervision (RBS) is a structured approach which focuses on the identification of potential risks faced by pension plans or funds and the assessment of the financial and operational factors in place to minimise and mitigate those risks. This process then allows the supervisory authority to direct its resources towards the issues and entities which pose the greatest threat.

<sup>21</sup> For further details see [IOPS Toolkit for Risk-based Pension Supervision](#) and [IOPS Guidelines for Supervisory Intervention, Enforcement and Sanctions](#).

- 6.26** 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.
- 6.27** Where quantitative risk assessment tools are used, the models involved should be carefully designed and their limitations fully understood.
- 6.28** 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 (including the size and number of pension fund overseen), and a risk-score derived from the probability and impact of their occurrence.

### ***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*

- 6.29** 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>22</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>23</sup> The long -term nature of pension funds should be taken in consideration and unnecessary pro-cyclical behaviour should be avoided.

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<sup>22</sup> For further details see [IOPS Toolkit for Risk-based Pension Supervision](#).

<sup>23</sup> [IOPS Guidelines for the Supervisory Assessment of Pension Funds](#).

- 6.30** 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 and, where appropriate, plan sponsors.
- 6.31** 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.
- 6.32** 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.
- 6.33** 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.
- 6.34** 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.
- 6.35** 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.

### ***Consultation and co-operation***

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

**6.36** The pension supervisory authority should consult, as appropriate, with the pensions sector when determining its approach to supervision.<sup>24</sup>

**6.37** The pension supervisory authority should be empowered to exchange information with other relevant supervisory authorities, subject to legal and confidentiality requirements. This includes co-operation 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. Co-operation 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).

**6.38** Pension supervisory authorities should ensure that intensified, coordination between financial sectors and internationally takes place when necessary and particularly during periods of economic difficulty and financial system volatility, though confidentiality requirements should be met.

### ***Confidentiality***

*Pension supervisory authorities should treat confidential information appropriately*

**6.39** 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.

**6.40** IT systems used by supervisors should include limited access restrictions to protect confidentiality and special care should be

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<sup>24</sup> For further details see [IOPS Guidelines for Supervisory Intervention, Enforcement and Sanctions](#).

taken regarding the security of the supervisory authority's database for reasons of effective data protection.

**6.41** 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.

**6.42** 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.

**6.43** 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.

**6.44** Only if agreed by the providing authority, the receiving supervisory authority may pass on confidential information to other supervisory bodies or law enforcement agencies provided they have legitimate supervisory interests and equivalent confidentiality protection standards.

**6.45** Where staff transfer between the supervisory authority and the private sector, mechanisms should exist to ensure the protection of confidential information.

**6.46** 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.

### ***Transparency***

*Pension supervisory authorities should conduct their operations in a transparent manner*

**6.47** 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.

**6.48** 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.

**6.49** Where appropriate, the broad outlines of any supervisory response framework (such as an enforcement pyramid)<sup>25</sup> should be made public by the supervisory authority, so that its actions are well understood by supervised entities and not unexpected.

**6.50** When directing or replacing the management of pension funds or plans pension supervisory authorities should explain and give due notice of the reasons for the supervisory action.<sup>26</sup>

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

**6.52** 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>25</sup> For further details see [IOPS Toolkit for Risk-based Pension Supervision](#)

<sup>26</sup> For further details see [IOPS Guidelines for Supervisory Intervention, Enforcement and Sanctions](#).

### **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*

- 6.53** Supervisory authorities should establish and operate sound governance practices in order to maintain credibility and moral authority to promulgate good practices in the entities under their supervision.<sup>27</sup>
- 6.54** 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.
- 6.55** 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.
- 6.56** 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 governing board, overseeing (parent) ministry or other statutory authority.

<sup>27</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.

- 6.57** 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.
- 6.58** 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.
- 6.59** As part of good governance practices, pension supervisory authorities should monitor their own performance using a range of measures.
- 6.60** Pension supervisory authorities should be clearly accountable for their general conduct and activity through 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.
- 6.61** Pension supervisory authorities should be subject to an external audit by a state or independent audit institution.
- 6.62** 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>28</sup>

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<sup>28</sup> For further details see [IOPS Guidelines for Supervisory Intervention, Enforcement and Sanctions](#).

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*Part II*

**Principles Specific to Occupational Plans**

## **Core Principle 7. Occupational pension plan liabilities, funding rules, winding up, and insurance**

Occupational pension plans should be adequately funded, in accordance with the relevant regulation applicable to the pension fund or pension entity. The adequacy of funding should be protected through funding rules, winding-up provisions, insurance or other types of accepted guarantees.

While full funding exists in principle for occupational defined contribution plans, other types of occupational plans should be subject to minimum funding rules or other mechanisms to ensure adequate funding of pension liabilities. Rules for minimum funding levels may be based on accrued and vested benefits (termination approach) or on projected liabilities (ongoing approach) depending on the funding objectives. The termination approach should be promoted as a minimum level and should be complemented with the ongoing approach. Flexibility can be allowed for temporary limited under-funding under restricted circumstances. Consideration should be given to the development of prudent but flexible requirements for minimum capital, reserves or other forms of guarantees 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 the individual company level should generally be prohibited.

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

Proper winding-up mechanisms should be in place and these should ensure the protection of the entitlements and accruals of members and beneficiaries. Legal provisions should ensure that contributions owed to the plan by the employer are paid in the event of the employer's insolvency, in accordance with national laws. Where necessary, the legal provisions should set out priority creditors' rights for members, sponsors, and pension funds and/or pension entities.

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

### **Introduction to Core Principle 7**

Security in both defined benefit and defined contribution occupational plans requires adequate funding of pension promises. This entails the

identification and accumulation of assets to be used exclusively to meet pension commitments and related expenses (for example, the cost of pension plan administration). Different methods of funding exist in occupational plans.

In occupational defined contribution plans where sponsoring employers, pension funds or pension entities do not make any benefit or performance commitments, full funding exists in principle. Nonetheless, the legal separation of pension plan assets from those of the employer and the pension entity should be mandatory as a minimum level of protection for the pension assets. Pension assets are most commonly held in a pension fund or managed directly by financial institutions through pension insurance contracts or other authorised vehicles. In a defined contribution arrangement, an employer's financial liability is mainly limited to paying contributions. However, there are other potential liabilities tied to the fiduciary responsibility of adhering to the terms of the plan and the duties of the managing trustee.

Occupational plans where financial obligations or biometric risks are assumed by pension funds, pension entities and/or plan sponsors, should be subject to minimum funding rules or other mechanisms to ensure adequate funding of pension liabilities. This can include plans offering savings products that provide a guaranteed rate of return, annuities, survivors' insurance, and most commonly salary-dependent benefit promises for plan members (often called defined-benefit plans). For occupational defined benefit plans, delivering on promised benefits is, depending on the jurisdiction, either entirely or largely the financial responsibility of the employer.

Pay-outs from defined benefit occupational schemes should be paid, regardless of the financial fortunes of the employer. As such, plan assets should normally be legally segregated from those of the plan sponsor through a pension fund or an insurance arrangement (a pension insurance contract) in order to ensure a minimum level of protection against the possible insolvency of the sponsor. Such rules also minimise financial uncertainty for the shareholders and bondholders of those firms that sponsor pensions, in the event of pension promises not being delivered by insolvent employers.

Where plans are financed through an autonomous pension fund, the legal provisions should establish a framework for ensuring the adequacy of the assets to meet the liabilities of the plan. Funding rules require that the value of the plan's liabilities in respect of all potentially promised benefits be calculated periodically. These calculations should take into account liabilities over time in relation to current and expected contributory years

(ongoing liability). Funding rules should seek to assure that dedicated assets – that is, past contributions and investment returns – match this potential ongoing liability as it accrues and matures over time. In addition, countries may need to have funding rules that seek to assure that plan assets would be at least equal to all promised benefits to date if the plan were to be terminated/wound-up (the termination liability). In general, holding assumptions constant, the accrued ongoing liability is greater than the termination liability. Experience from some countries shows that tighter rules for calculating the termination liability are necessary to complement the customary discretion given to trustees and actuaries in defining ongoing liability.

In some countries, instead of establishing an autonomous pension fund, the plan sponsor may buy pension insurance policies, hence shifting the risks covered by these policies from the plan to the insurance company. Notably, insurance companies do not usually provide instruments that fully insure final salary benefit promises for plan members who are still accruing benefits. Such plan formulas, therefore, would normally call for the establishment of a pension fund to meet commitments that are not covered by the insurance policy. The regulation and supervision of insurance companies is designed to ensure that these institutions build up sufficient internal reserves to meet any pension plan promises undertaken by them.

Another alternative to establishing an autonomous pension fund is for sponsoring employers to finance retirement benefits through non-autonomous pools of assets such as book reserves. Book reserve financing is not a method commonly used internationally. It is accepted in only a few countries, and mandatory insurance of employer pension liabilities through insolvency insurance, a guarantee pool, a contingency bond or similar arrangement is usually required. Private unfunded pay-as-you-go plans at the individual company level should generally be prohibited.

Funding requirements should be reinforced by regulations on priority creditor rights or insolvency guarantee schemes that protect benefits, entitlements and accruals, in the case of insolvency of the plan sponsor or pension entity. Rules should be in place to allocate any funding excess or surplus between plan sponsors, pension entities, plan members and other beneficiaries in the event that a plan is terminated. They should clearly determine how to distribute plan assets to cover benefits due to current pensioners and active workers when assets are insufficient to cover promises. Underfunded pension funds are in the same position as other creditors when their sponsoring firm becomes insolvent, having to join the queue of other claimants on the remaining assets of the firm. Bankruptcy and insolvency laws should clearly provide a priority position for due and unpaid contributions at the time of plan termination.

Funding of liabilities is a concept that pertains to both occupational and personal pension plans that assume the responsibility of providing the promise of a definable outcome and where the financing risk remains with the employer or pension entity. Most of the Implementing Guidelines below apply to employer-sponsored plans but some can be appropriately applied to personal plans that assume financial obligations to their members.

## Implementing Guidelines for Core Principle 7

### *Funding of occupational pension plans*

- 7.1 Occupational pension plans should be adequately funded, in accordance with the relevant regulation applicable to the pension fund or pension entity.
- 7.2 Occupational defined contribution plans should be funded through the establishment of pension funds, pension insurance contracts, the purchase of other authorised retirement savings products from financial institutions, or a combination of these mechanisms. Occupational defined benefit plans should be funded through the establishment of a pension fund, through an insurance arrangement, or a combination of these mechanisms.
- 7.3 Additional protection may be provided through the recognition of creditor rights of the pension plan, pension fund, or the plan members and beneficiaries against the sponsor, where the sponsor bears the risk of plan liabilities, or of the sponsor or plan members and beneficiaries against the pension fund or entity where they bear the risk of the plan liabilities. Insolvency guarantee schemes that protect pension benefits and obligations in part or in whole in the case of insolvency of the plan sponsor, the pension fund or pension entity may also be used to provide additional protection.
- 7.4 Structural underfunding of occupational plans should generally be prohibited. The establishment of an insolvency guarantee scheme should be required for occupational defined benefit plans that are financed through the book reserve system or on a pay-as-you-go basis.
- 7.5 Insolvency guarantee schemes in occupational plans should ensure appropriate pricing of the insurance provided and limitations on the level of benefits guaranteed, in order to avoid unwarranted incentives for risk-taking (moral hazard).

### Measurement of occupational pension plan liabilities

- 7.6** Legal provisions should be in place requiring the determination of occupational pension plan liabilities corresponding to the financial commitments or obligations which arise out of the pension arrangement.
- 7.7** The ongoing liability should normally be defined as the accrued benefit rights of pension plan members and beneficiaries excluding future service. The definitions should take into account the projected benefits to be received under estimated retirement, mortality, early leaver patterns (also known as membership termination or job separation), whether plan eligibility and vesting requirements are met at the estimated time of retirement, and death or leaving service.
- 7.8** The termination liability should normally take into account the pension benefits payable if the plan itself terminates (winds up) at the time of the valuation. The determination of the termination liability should follow these principles even where the accrual of further entitlements has ceased. The termination liability should be equal to the costs of benefits payable at that time (for example, by purchasing annuities with an insurance company or payment of lump sums to members) plus the costs of termination.
- 7.9** Definitions of ongoing and termination liabilities should reflect benefit indexation factors prescribed by law or the plan terms (unconditional indexation). These should include indexation factors that apply from membership or plan termination until the annuity starting date and, if relevant, after the annuity starting date provided that these factors are predictable. These definitions should also reflect rights that become vested upon plan termination.
- 7.10** These legal provisions should require that the plan liabilities are assessed using appropriate calculation methods, including actuarial methods and amortisation rules that are consistent with generally recognised actuarial standards. The legal provisions should allow the supervisor to require additional prudence or specify additional requirements, if using established methods creates an unacceptable risk to member benefits.

- 7.11** The legal provisions should require the use of prudent funding methods and demographic, behavioural and economic assumptions which are considered appropriate for the calculation of the pension plan's liabilities and are consistent with generally recognised actuarial standards. The assumptions should include up-to-date mortality tables that present the assumed level of mortality of plan members and beneficiaries at the date at which the plan's liabilities are calculated. Future trends in mortality representing permanent changes in mortality that are assumed to occur after the date at which the liabilities are calculated should also be included, as should retirement and early leaver patterns at different ages that take into account the actual retirement and early leaver behaviour of those covered by the plan.
- 7.12** 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 market conditions and expectations and are compatible 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.
- 7.13** The calculation of pension liabilities should take place at least once every three years, while a certification or report of the adjusted development of the liabilities and changes in risks covered should be required for the intervening years. All actuarial valuations should be carried out by an actuary, or by an equivalent specialist, who is required to meet minimum suitability requirements that ensure a high level of integrity and adequate competence in the field of pensions.
- 7.14** As part of the process of defining funding policy, advice should be sought from the actuary or other relevant specialist regarding the assumptions and methods to be used in calculating pension liabilities and funding levels. This advice should be provided in a clear and timely fashion.

***Funding requirements for occupational plans and the treatment of any surplus or deficits***

**7.15** The legal provisions should require the identification and maintenance of a level of assets that should be at least equal to the target funding level after taking into account the costs of operation of the plan. The targeted funding level may be based on the termination liabilities or the ongoing liabilities, depending on the funding objectives. It should also take account of the plan sponsor's ability and commitment to increase contributions to the pension plan in situations of underfunding, and the possibility of adjusting benefits or plan obligations, fees and costs charged to members or sponsors, or retirement ages in response to underfunding. The target funding level should also take into consideration the link between the pension plan's assets and its liabilities. The funding target should balance the need for benefit security and the affordability of pension provision.

**7.16** Approved funding methods (also known as actuarial cost methods) for the ongoing liability may reduce the risk of sharply rising cost curves over time by spreading the funding of the actuarial (or accrued) liability over the expected career path of plan members. In order to ensure adequate funding levels over time, ongoing funding methods should take into account factors such as future salary growth, mortality, disability, early leaver (separation) and other relevant events.

**7.17** Contributions should cover the normal costs (the present value of benefits, accruals or entitlements of members during the valuation period). Where appropriate according to plan rules, funding arrangements or contributions should also cover other supplemental costs, including work before a plan's inception, plan amendments that increase liability attributable to past service, deviations of actual results from assumptions (experience gains and losses), and the effects of changes in assumptions (actuarial gains and losses). These supplemental costs should be amortised in a manner that appropriately balances the need for adequate funding with the possible consequences of volatile contribution requirements. Amortisation periods should in general not be longer than the expected future period of service of active plan participants.

**7.18** In defined benefit plans, the legal provisions should not prevent funding methods that dampen the short term volatility in firms'

funding contributions. Prudent amortisation of supplemental costs over time might help achieve a smoother contribution schedule and more stable funding levels.

**7.19** The legal provisions should set out acceptable mechanisms and recovery periods for correcting situations of over- or underfunding, taking into account the sources of such over- or underfunding and the plan's funding objective. The legal provisions should clearly describe the restrictive circumstances, if any, under which reprieve from contribution obligations may be possible or contributions must be accelerated. They should also take market volatility into account when limiting contributions (or their tax deductibility) as a certain funding level is reached.

**7.20** Funding requirements should take into account the extent to which the pension fund itself as opposed to the plan sponsor or the plan members is directly responsible partly or wholly for the commitments represented by the pension liabilities. Where the pension fund itself underwrites the pension liability without any commitment from the plan sponsor or members to make good on any deficit, the funding objective should require that additional assets are held over and above those necessary to fully fund the pension liabilities if the plan is terminated and benefits are extinguished. This capital requirement or solvency margin should be determined taking into account all relevant and material categories of risk, both the assets held and the liabilities due that are the responsibility of the pension plan, costs of operation of the plan, risk mitigation measures in place and the extent to which benefits may be reduced.

**7.21** Acceptable mechanisms for correcting situations of over- or underfunding should include promoting a countercyclical approach, providing incentives to build reserves against future 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.

**7.22** Temporary suspension of contribution obligations, benefit increases, or a return of the surplus to the plan sponsor should only be permitted in circumstances of high levels of overfunding.

Such actions should be subject to restrictions and controls on what is allowed, which take account of both the interests of members and beneficiaries and the security of the benefits promised by the pension plan and be communicated to members and beneficiaries.

### Winding up of occupational pension plans

**7.23** In the event that an occupational pension plan is terminated or, where applicable, the plan's obligation to pay benefits to members and beneficiaries is extinguished, the allocation of plan assets and the responsibility for underfunding should be clearly established. In the event that assets exceed plan liabilities and the costs of terminating the plan, there should be rules in place to determine the allocation of the funding excess or surplus. In the event that assets are insufficient to cover vested benefits and entitlements, there should be rules concerning the benefit payment allocation.

**7.24** The creditor rights of pension plan members and beneficiaries (either directly, via the pension plan, or, where relevant, via insolvency guaranty schemes) should be recognised in the case of bankruptcy of the plan sponsor, pension fund or pension entity. Legal provisions should be put in place to ensure that contributions owed to the plan by the sponsoring employer are paid in the event of the employer's insolvency, in accordance with national laws. Priority rights of members and beneficiaries relative to other creditors should be required for at least due and unpaid contributions. Where insolvency guaranty schemes are present, the underwriting entity may become a preferential creditor of the insolvent sponsor.

**7.25** Vested entitlements should be protected from the creditors of the plan sponsor and plan service providers (including any financial institutions or other entities managing the pension plan or plan assets or acting as a custodian of pension fund assets associated with the plan), at a minimum by the legal separation of plan assets. Vested entitlements also should be protected when the plan sponsor or a plan service provider changes ownership due to merger, acquisition, sale, or other corporate transaction, or files for bankruptcy. Similarly, the extent to which vested entitlements are protected from the creditors of individual plan members and beneficiaries should be addressed in the legal provisions.

## **Core Principle 8. Access, vesting, and portability of occupational pension plans**

Non-discriminatory access should be granted to occupational pension plans. Regulation should aim to prevent exclusions based on age, salary, gender and civil status. Agreement between labour and management might be considered in regard to period of service, terms of employment and part-time employment. Regulation 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 pension accruals and the possibility to consolidate accumulations from different plans should be facilitated within each jurisdiction with the aim of enabling job mobility. The decision to offer portability rights to members should avoid imposing excessive costs. The protection of members' rights in case of early departure should be respected.

### **Introduction to Core Principle 8**

Regulations need to ensure fair treatment of employees with regards to their non-discriminatory access to occupational pension plans. The extent of an employee's right of access to an occupational pension plan will depend on the nature of the pension plan and the particular rules of the pension system. Nonetheless, at a minimum, regulation should aim at assuring that employees are not unreasonably barred from participation in a pension plan. As a matter of public policy, it is desirable that certain types of restrictions on plan access, such as those based upon age, gender, marital status and nationality, be avoided regarding both plan access and participation.

The voluntary or mandatory nature of pension plans can affect plan access and participation. In the case where employee participation in a pension plan is voluntary on the part of the employee, the right of access should be facilitated by the employer. The employer should ensure that employees are provided the opportunity to participate in a plan. If pension plans can be voluntarily established by employers for their employees, labour market constraints and conditions, and the role of collective bargaining may impose barriers or facilitate access to plan participation.

A member's entitlements should accrue and vest immediately upon entry into a plan from the standpoint of retirement income adequacy. This applies especially to defined contribution plans where contributions paid into the plan directly translate into benefits. In other types of plan,

entitlements may vest only after a defined period of time that is typically linked to years of service with the sponsoring employer. Such vesting rules may be applied by employers in order to retain employees, but also to ensure the cost efficiency and economies of scale of the offered plan.

Like vesting rights, portability rights are often associated with labour mobility. The inability to move vested entitlements from one employer or plan to another may constrain individuals who are considering a job change. In order to promote dynamic labour markets, it is frequently a desirable goal of policy makers to avoid such constraints, without imposing unnecessary costs on employers. Portability rights may also assist individuals in managing their retirement assets as they change employers throughout their working lives by enabling their consolidation. Extending portability rights to current employees can impose an administrative burden on employers or undermine the economies of scale advantages employers may have in managing their pension plans. These factors must be considered when extending portability rights to employees.

Regardless of how portability rules are applied, the preservation of accrued and vested entitlements should be ensured for all members. Employees participating in occupational pension plans should be protected as far as possible from the retroactive reduction of the value of benefits that they have already accrued.

## Implementing Guidelines for Core Principle 8

### *Access to plan participation, equal treatment and entitlements under occupational pension plans*

- 8.1** Employees should have non-discriminatory access to occupational pension plans. Specifically, regulation should aim to prevent exclusions from plan participation that are based on non-economic criteria, such as age, gender, marital status or nationality. Possible economic conditions for plan membership may include a minimum contribution level or working in a specific sector or company. In the case of mandatory occupational pension plans, occupational plans that have a significant role in providing retirement income, and plans that are significantly subsidised by the state, regulation should aim to prevent other unreasonable exclusions from plan participation such as exclusions based on salary, periods of service and terms of employment, (e.g. distinguishing between part-time and full-time employees or those employed on an at-will and fixed-term basis). The legal provisions should not obstruct the enrolment of employees in occupational pension arrangements.

Waiting periods should be minimised and justified. Regulation of voluntary and supplementary occupational pension plans should also encourage broad access and coverage amongst employees, taking into account factors including the voluntary nature of the arrangement, the needs of the members and of the employer establishing the pension plan, and the adequacy of other pension benefits.

**8.2** Employees should be equally treated under the plan rules, at a minimum with respect to waiting periods, vesting and portability rights, disclosure requirements, governance and redress mechanisms.

**8.3** Employees should be protected from retaliatory actions and threats of retaliation by their employer or pension plan representatives with respect to pension benefits and the exercising of rights under a pension plan. For example, they should be protected from termination of employment intended to prevent the vesting of an accrued benefit under the pension plan. Similarly, individuals exercising their rights under a pension plan including, but not limited to, filing a claim or appeal or initiation of administrative or judicial action, should be protected from retaliatory action, such as termination of employment, suspension, discipline, fine or any other type of discrimination.

### Benefit accrual and vesting rights in occupational plans

**8.4** Accrued entitlements should vest immediately or after a period of employment with the plan sponsor that is reasonable. Entitlements derived from member contributions to the pension plan should be vested immediately.

**8.5** Practices that substantially undermine benefit accrual and vesting rights should be prohibited.

**8.6** Vested entitlements of those individuals who have severed employment with an employer should be protected and not subject to forfeiture, regardless of reasons for severance, except in the limited case of dismissals resulting from acts of gross malfeasance that are clearly related to the plan.

***Pension portability and rights of early leavers***

- 8.7** Individuals who are changing jobs should be able to move the value of their vested account balance in an occupational defined contribution plan, upon request, from their former employer's pension plan either to the plan of their current employer or to a similar alternative financial instrument or institution. Where feasible, a similar portability right also should be available to individuals in defined benefit plans. Excessive administrative costs associated with retaining dormant rights or transferring accruals should be avoided.
- 8.8** Individuals should have the right to timely execution of the request to transfer the value of their vested benefit accruals and account balances.
- 8.9** With respect to occupational defined benefit pension plans, where portability is feasible, the actuarial and interest rate assumptions used in valuing an individual's vested benefit accruals that are to be transferred should be fair and reasonable. These assumptions should be made readily available to the individual transferring the value of his or her accrued benefit. In occupational defined contribution plans, the transferred amount will depend on the current value of accumulations and account balances. Any guarantees that are forgone by members exercising portability rights should be clearly disclosed.
- 8.10** Accrued and vested entitlements of deferred members that are retained in the plan should be preserved in a similar manner as for active members.
- 8.11** Where portability rights are feasible, they should be available to members of an occupational pension plan when they separate from service with an employer, regardless of whether the separation is voluntary, involuntary or by mutual agreement.
- 8.12** Portability rights should not be inhibited by the assessment of unreasonable charges or fees, such as excessive transaction charges, back-end fees or penalties applied when a fund is in deficit. At a minimum, members and beneficiaries should be informed of the presence of any such charges or fees.

**8.13** Plan members should not be required to exercise their portability rights, with the possible exception of limited and defined circumstances, such as the winding-up of the pension plan or if vested entitlements are very small amounts. Generally, members should be permitted to leave their vested benefits in the pension plan of their former employer.



*Part III*

**Principles Specific to Personal Pension Plans**

## **Core Principle 9. Funding of personal pension plans, wind-up and insolvency**

Personal pension plans should be adequately funded at all times, in accordance with the relevant regulation applicable to the pension fund or pension entity. Adequate funding rules and arrangements should apply where the pension plan, pension fund or pension entity assumes any financial or biometric risks.

The merger of pension funds or pension entities and their withdrawal from the pension market should be subject to specific requirements that ensure the security and full protection of existing personal pension plan contracts. Legal provisions should clearly set out the procedures for dealing with the insolvency of pension funds and pension entities. Priority should be given to the protection of members' entitlements or accumulated savings. Insolvency proceedings should minimise disruption to the timely provision of benefits to members. Consideration should be given to the establishment of guarantee arrangements to protect pension entitlements and accruals in case of insolvency of the pension plan or entity.

### **Introduction to Core Principle 9**

In personal plans benefits are contingent on contributions paid into the plan. Salary-dependent benefit promises for plan members (commonly known as defined benefit plans) will not typically be made. The assets are most commonly held in a pension fund or managed directly by a pension entity (e.g. a financial institution) through a pension insurance contract or other authorised vehicle. The legal separation of plan assets from those of the pension entity should be mandatory to ensure a minimum level of protection of member's accumulations against the possible insolvency of the pension entity.

Personal defined contribution plans where pension plans or pension entities do not make any benefit or performance commitments are, in principle, fully funded. However, there are other potential liabilities tied to the fiduciary responsibility of adhering to the terms of the plan and providing a cost-efficient retirement savings product.

Guarantees or promises may be offered by the pension plan or pension entity, for example in the form of a deferred annuity or a guaranteed rate of return. The financial risk of such promises is borne by the pension entity or plan provider. The guarantee provider, thereby, needs to set aside capital to meet the promise. Regulation should ensure that appropriate funding rules for these liabilities are established. Implementing Guidelines 7.7 – 7.16

and 7.18 - 7.21 can be appropriately applied when measuring pension plan liabilities and establishing funding requirements. The costs of financing guarantees can have an impact on the fees charged to members and affect their net-of-costs returns on contributions. As such, costs and benefits of guarantees should also be carefully evaluated and disclosed to members.

In the event of the insolvency of a pension fund or pension entity, regulation should establish the provisions for guaranteed levels of protection for assets and entitlements accumulated by plan members. The presence of external forms of solvency and benefit protection, such as insolvency guaranty arrangements which protect benefits and accumulations, should be considered. Given that insolvency processes can be drawn out, regulations should protect the interests of personal plan members, encouraging a timely and fair repayment of their assets and entitlements.

## Implementing Guidelines for Core Principle 9

### *Funding of personal pension plans*

- 9.1** Personal pension plans should be adequately funded at all times. Such plans may be funded through the establishment of pension funds, pension insurance contracts or the purchase of other authorised retirement savings products from financial institutions, or a combination of these mechanisms.
- 9.2** Pension funds and pension entities providing personal pension plans should be subject to capital adequacy or funding requirements such that they can absorb unforeseen losses stemming from different risks (e.g. operational, liquidity, financial or biometric).
- 9.3** A total balance sheet approach should be used in the assessment of the financial situation of pension funds and/or pension entities to recognise the interdependence between assets, liabilities, regulatory capital requirements and capital resources and to ensure that risks are appropriately identified.
- 9.4** In the case of pension plans or pension entities offering minimum return or benefit guarantees in personal pension plans, or assuming any other financial obligations, the Implementing Guidelines 7.7 – 7.16 and 7.18 - 7.21 should be appropriately applied when measuring pension plan liabilities and for establishing funding requirements.

### ***Merger, wind-up and insolvency***

- 9.5** In case of mergers, liquidation or acquisitions of pension funds and entities, the legal provisions should ensure the protection of rights and accumulated savings as well as the safe and speedy transfer of assets and records between pension funds or entities.
- 9.6** The procedures for the winding-up and exit of a pension entity from the market should be clearly set out in legislation. The procedures should aim at minimising the disruption to the timely provision of benefits to members.
- 9.7** Accrued entitlements should be protected from the creditors of the pension entity (e.g. external service providers such as the custodian of pension plan assets), at a minimum by the legal separation of plan assets. Accrued entitlements should also be protected when a pension entity changes ownership due to merger, acquisition, sale, or other corporate transaction, or files for bankruptcy. Similarly, the extent to which entitlements and accruals are protected from the creditors of individual plan members and beneficiaries should be addressed in the legal provisions.
- 9.8** The bodies responsible for dealing with the winding-up of the pension entity and the insolvency proceedings of a pension entity, including possible restructuring or portfolio transfer, should be clearly set out in legislation.

## **Core Principle 10. Equal treatment, business conduct, competition and portability of personal pension plans**

Access to personal private pension plans should be non-discriminatory. Regulation should ensure that individuals are treated equally and fairly, both before a contract is entered into with a private pension entity and through to the point at which all obligations under a contract have been satisfied.

Pension funds and pension entities, their external service providers and authorised agents, and other intermediaries operating in the personal pensions market should work in the best interest of plan members and be responsible and be held accountable for upholding financial consumer protection. In general, members of personal pension plans should have the right to full portability.

Competitive markets should be promoted in personal pension provision in order to provide a greater choice amongst financial services and promote cost-efficient provision of pension services. Individuals should be able to search, compare and, where appropriate, switch between products and providers easily and at reasonable and disclosed costs.

### **Introduction to Core Principle 10**

Access to personal plans does not have to be linked to an employment relationship. They are generally established and administered directly by a pension fund or a pension entity acting as pension provider without any intervention of employers. The employer or state may nonetheless make contributions to personal pension plans.

Personal plans may be mandatory or voluntary. Individuals must join a mandatory plan. In mandatory personal plans, individuals may be required to make pension contributions to a pension plan of their choice, but usually within a certain range of choices. Participation in personal plans is voluntary if individuals are not obliged to participate in or make contributions to a pension plan by law. Individuals can often independently purchase and select material aspects of the arrangements, especially in voluntary plans. Voluntary personal plans include those plans that individuals must join if they can choose to direct part of their social security benefits to a private pension plan.

Some personal plans may have restricted membership. Regulations should, however, encourage broad access to personal private pension plans, not least to avoid income disparities between members and non-members in

old age. Restrictions on plan access based on non-economic criteria should be minimised. Regulation should ensure that individuals are treated equally both before a contract is entered into with a private pension provider and through to the point at which all obligations under a contract have been satisfied.

In personal plans, the contract is typically signed directly between the plan member and the pension fund or pension entity acting as pension provider. In order to mitigate any agency problems caused by asymmetric information between providers and members, there is a need to strengthen the fiduciary responsibilities of providers. They should encourage that personal plans are managed with appropriate care and with the interest of the members in mind. Good governance and consumer protection need to be highlighted. When the pension fund is established as a separate account managed by a financial institution, its responsibilities should be clearly stated in the plan or contract documents. It should also be the responsibility of the pension provider to ensure that consumers and members are fully aware of the terms of their contract. This includes their rights and responsibilities, and the conditions under which the plans may be sold, including marketing, advertising and distribution issues that may involve any conflicts of interest.

The accumulations of members should, generally speaking, be fully and immediately vested in personal plans and they should be fully portable. The individual should have the right to withdraw from a plan, especially in voluntary arrangements.

## Implementing Guidelines for Core Principle 10

### *Equal and fair treatment, entitlements and vesting*

- 10.1** Any individual should be able to join a personal pension plan. Regulation should ensure that individuals are treated equally, honestly and fairly with respect to all rights associated with the plan, both before a contract is entered into with a pension provider and through to the point at which all obligations under a contract have been satisfied. Regulation should aim at avoiding exclusions based on age, income, gender, period of contribution, terms of employment or civil status. Possible economic conditions for plan membership may include a minimum contribution level. Regulation of voluntary and supplementary personal pension plans should encourage broad access and coverage, taking into account factors including the voluntary nature of the arrangement, the needs of the members and the adequacy of other pension benefits.

**10.2** Accrued entitlements and accumulations should vest immediately and fully in personal plans. Accrued entitlements and accumulations linked to capital acquired by the member through illegal activity may be subject to forfeiture.

### ***Business conduct and consumer protection***

**10.3** Pension funds, pension entities and their authorised agents or service providers should establish and implement procedures that ensure the fair and equal treatment of members.

**10.4** Pension funds, pension entities, their external services providers and authorised agents, and other intermediaries should have as an objective to work in the best interest of individuals. They should be responsible and be held accountable for upholding financial consumer protection.

**10.5** Pension funds and/or pension entities should take into account the interests of different types of members and potential members when developing and marketing retirement saving and annuity products.

**10.6** Where a contract is signed between an individual and pension provider, pension funds and pension entities and their authorised agents or service providers should provide individuals with appropriate information on the fundamental benefits, risks and terms of the product, through all stages of the personal pension plan contract.

**10.7** Pension funds, pension entities and their intermediaries should promote personal pension plans in a manner that is clear, fair and not misleading. They should ensure that any conflicts of interest are properly addressed and, where appropriate, avoided. Pension funds, pension entities and/or their authorised agents or service providers should also provide information on conflicts of interest associated with the sale or marketing of any pension product.

**10.8** Pension funds, pension entities and/or their authorised agents or service providers should ensure that, where individuals receive advice before concluding a personal pension plan contract, such advice is appropriate taking into account the individuals' disclosed circumstances. Advice should be as objective as possible and should in general be based on the individual's profile

considering the complexity of the product, the risks associated with it as well as the customer's financial objectives, knowledge, capabilities and experience.

### *Portability*

**10.9** Personal pension plans should, in general, be fully portable between providers. Switching between pension funds and entities should not be subject to unreasonable fees or charges, such as excessive transaction charges or excessive back-end fees. At a minimum, members and beneficiaries should be informed of the presence of any such charges or fees. The transferred amount will depend on the current value of accumulations. Any guarantees and biometric risk coverage that are forgone by members exercising portability rights should be clearly disclosed.

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## Glossary

**Pension entity:** the independent entity with legal capacity that has ultimate legal responsibility for a pension fund, which may have a broader range of activities. A pension entity could take the form of an independent legal entity acting as a pension trustee (such as a corporate trustee in the case of pension funds established as trusts), or a pension fund with legal capacity (such as foundations and mutual associations) or a pension fund management company. An insurance company or other financial institution may be considered to be a pension entity insofar as it is legally responsible for a pension fund and otherwise fits the definition of the first phrase of this definition. The term “pension entity” does not refer to plan participants, the plan itself, or the employer (unless the employer is also the pension fund management company or otherwise directly manages the pension fund).

**Pension fund:** the 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 trust, an independent entity with legal capacity (such as a foundation or mutual association) 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. The term “pension fund” does not refer to individual pension contracts.

**Pension plan:** a pension (or retirement income) plan (arrangement or scheme) 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. The elements of the pension plan may be mandated by law or statute or set forth as pre-requisites for special tax treatment, as is the case for many tax qualified savings or retirement programmes designed to provide the plan’s members and beneficiaries with an income after

retirement. In addition to having an explicit retirement objective, pension plans may offer additional benefits, such as disability, sickness, and survivors' benefits.

**Pension fund management company:** a type of financial institution in the form of a company whose exclusive activity is the management of legally separated pension funds. In some countries, these entities only manage pension fund assets. In others, they may also have the power to pay out benefits.

**Private pension plan:** a pension plan administered by an institution other than general government. Private pension plans may be administered directly by a private sector employer acting as the plan sponsor, a private pension fund or a private sector provider. Private pension plans may complement or substitute for public pension plans. In some countries, these may include plans for public sector workers.

**Funded pension plans:** occupational or personal pension plans that accumulate dedicated assets to cover the plan's liabilities. These assets are assigned by law or contract to the pension plan. Their use is restricted to the payment of pension plan benefits.

**Occupational pension plans:** access to such plans is linked to an employment or professional relationship between the plan member and the entity that establishes the plan (the plan sponsor). Occupational plans may be established by employers or groups thereof (e.g. industry associations) and labour or professional associations, jointly or separately. The plan may be administered directly by the plan sponsor or by an independent entity (a pension fund or a financial institution acting as pension provider). In the latter case, the plan sponsor may still have oversight responsibilities over the operation of the plan.

**Personal pension plans:** access to these plans does not have to be linked to an employment relationship. The plans are established and administered directly by a pension fund or a financial institution acting as pension provider without any intervention of employers. Individuals independently purchase and select material aspects of the arrangements. The employer may nonetheless make contributions to personal pension plans. Some personal plans may have restricted membership.



## **OECD Core Principles of Private Pension Regulation**

Private pensions play a major and growing role in complementing retirement income from public sources in OECD countries and worldwide. Their importance in ensuring adequate pension provision is increasing as government revenues are less able to finance retirement promises.

The OECD Core Principles of Private Pension Regulation provide governments, regulators and supervisors worldwide with a relevant common benchmark and high-level guidance on the design and operation of private pension systems. This 2016 edition revises and expands the 2009 Core Principles of Occupational Pension Regulation. Their scope now includes all funded pension arrangements, reflecting changes in the nature of private pension provision, especially the rise in defined contribution and personal pension plans.

[oecd.org/pensions/private-pensions](http://oecd.org/pensions/private-pensions)

