

# OPSG Discussion Paper on Occupational Pension Scheme Governance

## Contributors and acknowledgements

This report has been written and compiled by the members of the Occupational Pension Stakeholder Group (OPSG) sub-group on pension scheme governance.

This project has had the very bold ambition of examining the governance structures of pension schemes across the European Union, to distil from those structures common themes of operation, to propose a generic European structure and set the principles around a proportionate regime.

I am entirely grateful for the time and contributions made by my fellow sub-group members that have made this project possible. It is our hope that this work is embraced by policymakers as a pan-European project in the spirit of furthering the single market and helps inform them their decisions.

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## Introduction

At the OPSG stakeholder meeting of 14 February 2013, it was proposed and adopted to form a sub-group of the OPSG to investigate the governance of occupational pension schemes in the EU. The purpose of the sub-group was to offer a generic governance structure for European schemes and to consider the minimal functional structure that gave adequate protection to members and beneficiaries, as well as giving advice on these issues.

The sub-group tackled the task by adopting a multi-layered analytical approach. Firstly group members analysed the existing structures within their own Member States. This analysis became the main source of reference in this document and is presented in the appendices. The second stage required the group to work in two clusters, comparatively examining the structures of three Member States (six in total) highlighting their respective strengths and weaknesses. At the third stage the sub-group defined pension schemes – in general – as taking a four form functional pattern: non-executive (representatives of the employer, members and beneficiaries), executive (strategy and operations), integrity (actuary and audit) and services (investment management, benefit administration and payments, risk management and so forth). Finally the group collectively worked towards the creation of a generic governance structure, using the four form structure, and considered what could be pared back for the purposes of a proportionate regime.

## Observations of the OPSG to sub-group paper

This report makes a valuable contribution to the debate on IORP governance. Quite possibly it is the most comprehensive analysis of scheme governance currently available in Europe.

It should be seen as a contribution to the debate rather than a report with agreed recommendations from OPSG.

A number of issues need further discussion and the points below represent a non-exhaustive list of observations made at the OPSG meeting of 4 July 2013 when the paper was tabled for a first debate.

- Some members expressed concern that the proposed fit and proper tests for the non-executive could impose disincentives that may exclude lay members, who may have much to contribute. It is acknowledged that the non-executive need to have the skills to effectively challenge every aspect of the scheme, however where to draw the line between technical competence and worldly experience remains unresolved.
- The report advocates for greater professionalism within IORPs. At the same time the acid test for all schemes is that they must add value over and above what an individual could do for themselves. The risk is that the drive for professionalism will substantially increase the cost base of smaller schemes and make them fail the acid test, before the value that these schemes can offer is fairly appraised.
- The role and the duties of a custodian were questioned by some members. It was agreed that the custodian had become an increasingly important feature of European legislation,

most recently in the Alternative Investment Funds Directive and UCITS V. With IORPs, some felt that extending the role and duties of a custodian was an additional cost in excess of the expected risk.

- Some members felt the report sounding quite prescriptive and wanted a more flexible approach.

A consensus was reached on the approach to future pension scheme governance. The OPSG supported the view that targets of governance should be set at a high level and that schemes should be given an extended transition period to adapt to the new requirements.

It was also acknowledged that there is no single correct model to be recommended and that a plurality of governance systems should be possible.

### Executive Summary

The sub-group's recommendations are numerous, but can be summarised under the four form function theme.

- The non-executive should have a fiduciary obligation to the scheme's members and beneficiaries. It should fairly represent the interests of the employer(s), members, deferred members and beneficiaries (the stakeholders). This function should have the scope to scrutinise every aspect of the pension scheme and must be totally accountable to the stakeholders, through reports and presence at the general meeting. Members and beneficiaries must be considered equally. To be effective the non-executive function must fulfil standards of fitness and propriety. The non-executive should appoint and approve reports from the auditor, the actuary and key members of the executive; they should also set or approve their respective remuneration or fees.
- The executive function, provides the strategic direction, oversees the day-to-day management and organises the scheme's administration and functions. The executive should consult the non-executive on all significant decisions. The executive function needs to contain all aspects of professional knowledge and experience in order to effectively fulfil its duties. EIOPA in consultation with supervisory authorities should set standards for fitness and propriety: qualifications, experience and personal integrity.
- The integrity function, as its name suggests, plays a vital role in protecting the interests of the stakeholders, by reporting on, commenting and certifying upon the underlying assumptions of the pension promise (where this is a feature) and the financial activities of the IORP. Professional integrity, independence, knowledge and experience are key requirements for the people or organisations that serve these respective roles. The integrity function works with the executive and service functions, but reports to the non-executive.

- The services function contains all the parties that provide services to the scheme. These can be internal or external resources depending on the size of the scheme and the direction of the executive. The executive must provide the service function with precise service agreements, which should be reviewed, by the executive, on a regular basis.

With respect to proportionality our basic principle is that a proportionate structure must add value beyond what the individual members and beneficiaries of a pension scheme could do for themselves. We find that the Portuguese model provides a functioning system that could provide a template for proportionality. Here the whole process of managing the scheme is contracted out to a management entity, which provides the executive and service functions. Whilst in Portugal the management entity appoints the actuary and auditor, we recommend that these positions are appointed by the non-executive function (the monitoring committee as it is called in Portugal). As stated above the effectiveness of the non-executive function rests on its collective knowledge and understanding of the strategic management of a pension scheme. Therefore, members of this function must be able to demonstrate competence before the national regulator on their fitness and propriety to serve in this function. These skills are indivisible and determine the minimum governance efficient size for a pension scheme.

Lastly, all IORPs should be open to public scrutiny on their operational performance. Hence it is the sub-group's opinion that the executive of each scheme should annually report 'common' operating data to their national supervisor, for transmission to EIOPA and publication. It is hoped that the publication of this operating data will accelerate competitive forces in the pensions sector, driving operational efficiencies and the allocation of retirement savings, thereby creating greater welfare for IORP members and beneficiaries.

## Generic governance structure & Recommendations

### Non-executive

**Preamble** – *in some Member States, there is no clearly defined non-executive and executive structure, for the purposes of this report we recognise that two tier board structures, where there is a supervisory board and a governing board, fulfil the respective non-executive and executive functions. Where there is single tier, the representatives of the members and beneficiaries are considered to represent the non-executive function.*

The non-executive function provides a key bridge between the wishes of the stakeholders, the strategy that actions the occupational pensions process and the eventual pension outcome. The stakeholders who make up this body should be able to scrutinise every aspect of the pension scheme. They should assert their authority by having the power to hire, dismiss and set the remuneration of key people in the pension scheme. Lastly the non-executive function should approve the investment strategy.

The investment strategy should contain a targeted rate of return and level of risk. The strategy should describe how these measures were derived and how the strategic asset allocation of the portfolio supports these goals.

For the non-executive to function, its powers responsibilities and obligations must be set down in legal form. It should be held accountable to the stakeholders for the pension outcome. As part of a risk management process, the rules governing the IORP, its investment policy and its obligations to members should also be set down in writing and approved by the national supervisor as fit for purpose.

As the representative body of stakeholders, with ultimate responsibility for the pension outcome, the non-executive has the potential to wield considerable influence over the management of the scheme. However, invariably it is composed of non-experts, and hence is vulnerable to being led by the interests of service providers rather than championing the interests of stakeholders.

To be representative of stakeholder interests, the non-executive body needs to be appointed proportionately by members, beneficiaries and employers. However the selection process and the asymmetric availability of resources often establishes a hierarchy of influence within the non-executive team. The employer representatives are supported by the employer's resources and often drawn from the executive function. Frequently these representatives have a business education and access to support staff that the employees, both in terms of education and resources, cannot match. Beneficiaries are often in the weakest position, suffering similar disadvantages as employee members, but possibly more so. It is here that intergenerational solidarity is tested. Intergenerational solidarity needs to be laid down in legal form to protect its existence; in the UK, trustees (effectively the non-executive of member and beneficiary interest) must treat both members and beneficiaries fairly and equally. The UK has the concept of fiduciary duty<sup>1</sup>, which means that trustees must act for the sole benefit of the members and beneficiaries.

However the standard of fiduciary care described in the UK is considerably weaker than the standard set in the United States. The key difference in the legal texts is that in the UK the trustee should approach the management of the scheme as "**... that of an ordinary man of business ...**" in the US the fiduciary is "**... a prudent man acting in a like capacity and familiar with such matters ...**"<sup>2</sup>. The US standard is more prescriptive, in that the fiduciary clearly has to have some previous experience and knowledge of the task, whilst in the UK there is no similar requirement. Indeed in practice, new UK trustees are obliged to undergo training to bring them up to the legislative standard of having knowledge and understanding of law relating to pensions, trusts, funding and investment.

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<sup>1</sup> See "Fiduciary responsibility" p.96

<sup>2</sup> See "Prudent person principle", p.102

The clear message across Europe is that employee and retiree representatives at non-executive level are at a disadvantage in terms of knowledge and experience relative to employer representatives and the agents that they jointly scrutinise. Therefore employees should choose with care the people that represent their interests, if they wish those interests to be effectively served.

The sub-group spend a considerable amount of time discussing the needed skills and experience of trustees and made the following conclusions:

- A necessary competence for every member of the non-executive is common sense and good judgement;
- Hiring skills to support the knowledge and experience of the non-executive is no guarantee of a better outcome;
- Hired skills bring their own interests, which can never be fully aligned with the interests of members and beneficiaries;
- The non-executive must be collectively responsible for its decisions, it should not rely on the skills of one to lead the decision making of a topic, without the merits of the argument being fully challenged by the rest;
- The capabilities of the non-executive should be control the classes of asset in which the scheme can invest;
- The scheme should only invest in classes of asset, where the non-executive can demonstrate competence of understanding (before the supervisor) of the risk and return characteristics of that class of asset and why and in what circumstances a specific asset class may add value to the portfolio;
- Adding value to the portfolio will be judged in terms of, either increasing long-term expected returns with a non-proportionate increase in risk, or reducing risk with a non-proportionate decrease in long-term expected return.

### Recommendations

1. The powers, responsibilities and obligations of the non-executive are set down in legal form.
2. A similar document should also be drafted describing the IORP rules, investment policy and obligations to members. The national regulator should approve the document as fit for purpose.
3. There should be a mixture of employer and employee interests on the non-executive body.
4. At least two members of the non-executive body should be professionally qualified. One in asset management, the other in liability management.
5. All members of the non-executive should have fiduciary duty to IORP members and beneficiaries, set at the US standard<sup>3</sup>.

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<sup>3</sup> Ibid

6. The Executive function, actuary and external auditor should all report to the non-executive representatives.
7. The non-executive function should be responsible for preparing and distributing an annual report to members and the employer(s), which describes the IORP's activities during the year, its financial position and statements of authenticity from the auditor and actuary.

## Executive

The executive function is responsible for developing policy and the strategic direction of the IORP in consultation with the non-executive. The executive is also responsible for the day-to-day management of the scheme and creating the appropriate administrative structure. Like the non-executive, the executive needs a clear legal framework which describes its powers, responsibilities and obligations.

The members of the executive board must be professional qualified; this must be demonstrated by the successful completion of relevant exams and experience. The executive team must be aligned to the interests of the members and beneficiaries. Whilst the obligations need not be that of a fiduciary, the executive board is expected to act with absolute professional integrity.

The EIOPA in consultation with supervisory authorities should set standards for fitness and propriety: qualifications, experience and personal integrity. In the Netherlands, the supervisor conducts regular tests on the competencies of the board (non-executive and executive) as a whole and on the individual. Our opinion is that this examination should be applied to the executive function, with slightly lesser standards for the non-executive.

Whereas the non-executive is composed of generalists; the executive should be composed of specialists. These specialisms shape the organisational structure of the scheme: asset management, liability management, compliance and legal, internal audit and so forth. Many functions of the IORP, if not all, can be delegated out to third parties by the executive, on the approval of the non-executive. However the executive needs to retain the necessary skills and knowledge to be able to measure and monitor the performance of all delegated functions, so that it may be able to effectively manage these resources.

It is not assumed that the executive body has knowledge and experience in all matters, therefore where it needs additional input, it should be able to call on the experience of external agents (consultants).

The IORP should be open to public scrutiny, not only from all the stakeholders, but also including the general public, to help inform retirement decisions of the public at large. The sub-group consider it important that the operations or the IORP are open stakeholder scrutiny and public comparison. Therefore the sub-group consider it necessary that there is a common reporting mechanism for all IORPs, which produces comparable data for comparing the operational efficiency of schemes. The following is a non-exhaustive list of reportable metrics

that should be compiled by the executive and reported to the IORP's national supervisor, for transmission to EIOPA, who should make this information available to the general public via its website<sup>4</sup>:

- Name of the scheme, contact details and supervisory authority;
- Assets under management;
- The present value of the technical provisions and the applicable discount rate;
- The funding ratio current and historical over the last five years;
- The average age of contributors, the average age of beneficiaries and life expectancy;
- Asset allocation;
- Portfolio percentage returns over the last ten years;
- Portfolio turnover over the last ten years;
- Portfolio yield;
- Total expense ratio as a percentage of assets and as monetary value per member and beneficiary.

The sub-group see EIOPA playing a vital role in setting common disclosure rules for all EU IORPs, the collection of information from national supervisors and its publication for public analysis through a commonly available database. It is hoped that by presenting operational data of the complete universe of European IORPs, that schemes, retirement savers and opinion formers will be able to make informed judgement and comment upon the operational efficiency of the universe as a whole and of individual schemes. This process of comparison and analysis should create competitive forces which will drive operational efficiencies and the allocation of retirement savings, thereby creating greater welfare for IORP members and beneficiaries.

### Recommendations

1. The powers, responsibilities and obligations of the executive are set down in legal form.
2. Fit and proper rules should be adopted by the supervising authority. These rules should cover all people in the executive body who have authority to decide on important issues.
3. The executive body shall be composed of qualified experts, who are held responsible for the management of a specific function within the IORP.
4. If the executive body is lacking vital skills in certain areas they should be obliged to use third party skills to secure the work.
5. EIOPA shall adopt rules for the executive body to report on the operation of the IORP, this disclosure will be enforced by national supervisors.
6. These rules shall be expressed in detail so that the operation of the IORP is transparent and comparable, and available for scrutiny by the members and beneficiaries of a pension scheme, their representatives and the general public.

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<sup>4</sup> This statement is consistent with the "Letter box entity" threshold defined in Article 82 of Commission Delegated Regulation (EU) no.231/2013 - AIFMD

## Integrity

### **Function or person?**

Depending on the subject and on the source, some references consider the function and other the person in charge. As far as audit and actuarial functions are considered all sources – with the exception of Solvency II – consider primarily the person in charge, in particular for the “fit and proper” test (see box). It is also our recommendation to do so, possibly covering several persons if the fulfilment of the function is split among different persons (as recommended in OECD insurance recommendations<sup>5</sup>).

#### **Box: Fit and proper**

A person should prove good reputation (meet the “proper” test) and appropriate qualification (meet the “fit” test). According to OECD recommendation for insurers, the actuary should be a member in good standing in a professional association that requires adherence to sound standards of actuarial practice, quality control and ethics.

Sanctions should preferably be organised by the professional organisation and not by the supervisor responsible for the supervision of the IORP. The professional organisation should have an ethic code and should enforce adherence to the code.

Here are considered both auditor and actuary as a minimum position. Preferably, these are supported by a compliance officer and the custodian<sup>6</sup>. Although Solvency II recommendations are limited to internal audit, both audits (internal and external) are usually considered. All sources referred above mention audit and actuarial functions (here designed as “integrity” functions), with different purpose, similar duties for each function, but different recommended organizations. OECD Guidelines on Insurer Governance stresses “The independence of the actuarial and internal audit function should be especially promoted”. For each function will be addressed purpose, comparative analysis, conflicts of interests and weaknesses, and suggestions (including best practice or preferred model).

### **External auditor**

#### Purpose

Carry out a periodic audit consistent with the needs of the arrangement (at least financial accounts). Depending on the general legal and supervisory framework, the auditor should report promptly to the governing body and – if the governing body does not take any appropriate remedial action – to the competent authorities and other appropriate persons wherever he or she 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.

#### Comparative analysis

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<sup>5</sup> OECD (2011), ‘OECD Guidelines on Insurer Governance’, OECD Publishing.

<sup>6</sup> See Custodian section p15

See clusters report

### Conflicts of interests and weaknesses

Heavily regulated and controlled profession, with own register and which should comply with professional regulation. The pension fund auditor should be independent of the pension entity, the governing body, and the plan sponsor.

### **Recommendations**

- Different external auditor for plan sponsor and IORP.
- Regular change of external auditor (5-10years)

Mandatory

### **Internal auditor**

#### Purpose, including distinction from external auditor

The adoption of an internal audit to check and review the entire business organisation of the IORP could serve as a useful addition to the risk management function in a comprehensive governance system allowing for a consistent self-analysis within the internal structures of an IORP. An internal audit should deliver reports and especially act by recommendations. The effective implementation of an independent internal audit function therefore requires a strict separation from other key functions of the IORP and will therefore inevitably lead to the appointment of an internal auditor. The implementation of an internal auditor will lead to improved level of competences of the governing board and thereby also of its countervailing power towards external stakeholders.

#### Comparative analysis

See clusters

### Conflicts of interests and weaknesses

Act usually under potential control of external auditors, which limits weaknesses of employee position.

### **Recommendation**

The internal audit function should be mandatory for large schemes, exemptions for smaller schemes should be considered on demonstration that there are systems and controls in place that give assurance that the scheme can manage its risks.

### Actuary

#### Purpose

The role of the actuary should include at least the evaluation of the fund's present and future pension liabilities in order to determine the financial solvency of the pension plan following recognised actuarial, legal and accounting methods. The actuary should also identify the funding needs for the pension plan, and estimate the required level of contributions taking account of the nature of the liabilities of the pension plan. The actuary should certify the compliance with these mathematical standards and the financing plan and furthermore **provide the (annual) actuarial reports** containing the results / observations of his screenings / examinations, such as valuation of liabilities and of annual contributions. As soon as the actuary realises, on performing his or her professional or legal duties, that the fund does not or is unlikely to comply with the statutory requirements and depending on the general legal and supervisory framework, he or she shall inform the governing body and – if the governing body does not take any appropriate remedial action – the supervisory authority and other appropriate persons without delay.

#### Comparative analysis

See clusters

#### Conflicts of interests and weaknesses

All sources stress the importance of potential conflict of interest. This is of particular importance when the actuary is internal. OECD insurance recommendation is the most accomplished in that respect (recommending that the actuary is member of a professional organisation with a code of ethics). When it comes to discipline enforcement, UK supervision of the actuarial professional organisation (actuarial board of standards and disciplinary cases) seems to provide the best practice and thereby organises the best level of compliance.

Another possible conflict could be between certifying the IORP and consulting for the IORP. This can be circumvented by appointing two different, mutually independent actuaries for these two roles.

#### **Recommendation**

Mandatory; from our point of view, the implementation of an actuary should be legally binding for IORPs, irrespective if this is an internal or external person. A candidate should prove good reputation (meet the “proper” test) and appropriate qualification (meet the “fit” test) and be favourably appointed by the supervisory body of the IORP. The appointment could additionally have to be approved by the Supervisory Authorities. According to OECD recommendation for insurers, the actuary should be a member in good standing in a professional association that requires adherence to sound standards of actuarial practice, quality control and ethics.

### Recommendations

1. Both the actuary and auditor must be professionally qualified.
2. Each pension IORP actuary and auditor must affirm that they will perform their duties with independence and professional integrity.
3. The actuary and auditor should report to the non-executive function of the IORP. Some Member States may require that the actuary and the auditor report to their national supervisor. Where this is required under national law, then national law should acknowledge a dual reporting structure.
4. The Non-executive function should appoint and fix the remuneration of the actuary and auditor.
5. The IORP auditor should not be the same firm or individual that audits the financial statements of the employer.

### Service functions

#### Purpose

There are some functions that assure the proper management of the pension fund and pension scheme, like Investment Manager, Consultants and several control functions.

The **Investment Manager** will invest the scheme's contributions, according with the Investment Policy defined and comply with the legal restrictions on investments. The Investment Policy is established in a written document, defining the authorized structure of assets, as well as the reference measures relating to comparison returns and risk, where appropriate.

The **Compliance function** will monitor the legislation and regulations as well as the policies defined for the pension scheme (including internal policy), giving the assurance that IORP is acting in compliance with the stated requirements. Main objective of a compliance function should thus be the advising of the bodies of the IORP on compliance with the existing legislative and internal regulatory framework referring to the IORP. Usually, the respective compliance officer should provide a compliance manual that could serve as a guideline for compliant behaviour. It also provides information about the risks that may arise as a consequence of inadequate compliance, helping to identify and assess such risks and assist in the design of internal rules.

The **Risk Manager** has the obligation of defining and implementing the adequate risk management strategy and procedures, which is linked with an internal control system. An internal control system/risk management should be set up to identify, analyse, monitor, value and manage the IORPs risks (financial, operational and liabilities) at the same time establishing stable reporting procedures to the organs / bodies of the IORP. This function also comprises a standard review of the information processes as well as of the accounting and financial reporting systems of the IORP. This system must be periodically reviewed allowing for adjustments in case of future developments.

The **Pension Consultant** fulfils a key legislative role by providing the scheme with “proper advice” in the UK, not having the same relevancy on other countries. Pension consultants may provide advice and information on retirement provision to organizations; they may then be involved in setting up and running schemes on behalf of companies; they support organizations to provide for their future financial security.

The **Legal Adviser’s** primarily role is assisting the trustees in making sure the pension scheme complies with its legal obligations, which is more relevant in the UK. There may be other areas of advice, concerning the outsourcing of services, relationships with the corporate sponsor.

### **Comparative Analysis**

For the Investment Manager, Risk Manager and Compliance Officer, Portugal and United Kingdom have similar requirements, including requirements for appropriate knowledge, experience and integrity to fulfil these tasks. There are also some reporting duties, to governance structures and to supervisors.

At the moment, there is no legal obligation to set up a Compliance Function or Risk Manager in the Netherlands, Germany and Luxembourg. The setting up of such a function is part of a best practice governance approach serving as an additional sign of quality for the governance structures of an IORP in case of the implementation.

In Sweden, with insurance companies and friendly societies, the BoD should ensure that the undertaking should contain a composite function for independent risk control. The Board should also ensure that a compliance function is in place which supports the operations being conducted in accordance with governing regulations. There are no legal requirements for the institutions to have an Investment Manager, Pension Consultant or a Legal Adviser. In addition, pension foundations are neither obliged to have a Compliance function nor a Risk Management function.

In the UK the Pension Consultants and Legal Adviser represent a major role as proving the Trustees 'proper advice', has established legally (s 26 PA 1995).

In Portugal the Consultants are contracted by the Sponsor to provide specific and punctual advice, namely on investment issues, or changes on pension plan rules. Besides, for multinational sponsors, they may hire the same actuarial consultant for schemes on different countries.

### **Conflicts of interest and weaknesses**

The continuing risk with consultants is that they will always seek to increase their fees by promoting new services and change. For example, consultants could give orientation to changes in investment managers, or other services providers, more frequently than would be necessary. This is not always in the best interests of the IORP members.

There may also be a conflict between Risk Manager and the Investment Manager, as they pursue different objectives. The Investment Manager might be willing to take on risk in order to increase returns, which can be contrary to the opinion of the Risk Manager, or it could be the other way around, with the Risk Manager giving a more strict orientation which compromises future returns, leading to extra contributions or less benefits.

### **The administrative function**

This function is in charge of the day-to-day work in relation with the pension promise and the pension vehicle. It can be internal or external to the pension fund, the pension fund decides on

this based on its size. If the administrative function is outsourced, it is appointed by the executive body. In both cases, it reports to the executive body. In the case of outsourcing, a service level agreement describes responsibilities, tasks and remuneration of the company in charge of the administration of the pension fund. The administrative function needs to have a sufficient organisational structure behind it and it must possess the necessary skills and professional qualifications, in order to fulfil its tasks. An external administrative administration should ideally be approved by the supervisor.

The administrative tasks are as follows:

- Annual update of the population of members and beneficiaries, with update of all the elements intervening in the definition of the pension promise : for example : salary, civil status, seniority, category, number of children;
- Establishment of annual benefit statements;
- Monthly update of new entrants and leavers ;
- Calculation of benefits in case of leaving the company: retirement, early retirement, death, disability;
- Communication in the case of payment of benefits to members and beneficiaries and/or to the supervisor and/or the fiscal authorities;
- Execution of the financing plan to determine the contributions to the pension fund
- Communication with the plan sponsor(s) for the payment of the contributions and/or with the supervisor and/or with the fiscal authorities;
- Verification of the application of social and labour law;
- Keeping of the books of the pension fund; and
- Preparation of the annual accounts

All six countries in our cluster studies: Germany, Luxembourg, The Netherlands, Portugal, Sweden and the UK have comparable administration structures or have taken care of outsourcing to appropriate structures.

### **The custodian**

The custodian is responsible for the safeguarding and the administration of the assets of a pension fund, as well as for the tracking of the transactions within the pension fund. He has to provide a reporting on a regular basis, at the minimum once a month. He is also in charge of the verification of the respect of the legal investment limits, if any. To ensure that the custodian is independent and especially free from directives of the governing body of the pension fund, this person cannot be an employee of the pension nor of the sponsoring company. The implementation of a custodian should be legally required. The custodian should be appointed by the non-executive body and its appointment should be approved by the Competent Authorities. This implies that the custodian has to be fit and proper.

This service function could also be considered as an integrity function, because of the criterion of independence and the reporting to the non-executive body rather than to the executive body.

Currently, a legal obligation for the appointment of a custodian is already stipulated in the legal framework of Luxembourg, Portugal and of Germany.

### Recommendations

Our suggested optimal model for **Risk Manager** and **Compliance function** is as follows:

1. Both the Risk Manager and Compliance must be professionally qualified.
2. Separation of responsibility of the asset management function and the risk management and compliance function on the management board level.
3. Each Risk Manager and Compliance Officer must affirm that they will perform their duties with independence and professional integrity.
4. The Risk Manager and Compliance functions must have documentation to support the policies and procedures concerning risk and compliance management.
5. The Risk Manager and Compliance should report to the non-executive function of the scheme and supervisor.

Our suggested optimal model for **Pension Consultant** and **Legal Adviser** function is as follows:

1. The responsibilities and obligations of the Consultant are set down in legal form.
2. For each pension scheme there must be a formal written document describing the functions of the Consultant, responsibilities and fees.

Our suggested optimal model for **Investment Manager** function is as follows:

1. The powers, responsibilities and obligations of the Investment manager are set down in legal form.
2. For each IORP there must be a formal written document describing functions, responsibilities, fees and investment policy to be carried by Manager.
3. The Investment manager has to report to non-executive, scheme members and supervisor.
4. The results and procedures of the Investment Managers must be periodically audited by an external auditor.

Our suggested optimal model for the **Administrative Function** is as follows:

1. There must be a formal written document describing the functions, responsibilities and fees of the administrative function.
2. The administrative function is appointed by the executive level.
3. The administrative function must have a sufficient organisation to fulfil its tasks

Our suggested optimal model for the **Custodian** is as follows:

1. There must be a formal written document describing the functions, responsibilities and fees of the custodian
2. The custodian is appointed by the non-executive body, its appointment should be approved by the supervisor
3. The custodian must perform its duties with independence and professional integrity.

## Policy context of national governance structures

Key					
<b>1</b>	In your country, is the pension scheme a legal entity with its own rights?				
<b>2</b>	Who owns the assets of the pension scheme?				
<b>3</b>	Is the governing body of the pension scheme run as a commercial enterprise i.e. does it makes a profit from the governance function?				
<b>4</b>	Who is responsible and accountable/liable for the investment strategy of the assets of the pension scheme?				
<b>5</b>	Is the same entity, in question 4, responsible, accountable and liable for the delivery of the benefit promise?				
	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>BEL</b>	For Belgium, there is a split between the pension scheme (what we call the retirement benefit plan) which is the responsibility of the sponsoring undertaking and/or the social partners AND the pension institution (the IORP) which is the funding vehicle. The retirement benefit plan is ruled by social/labour legislation, the pension institution is ruled by prudential legislation. The IORP is a separate legal entity.	The assets linked to the retirement plan are owned by the IORP.	In Belgium, IORPs are seen as the governing body of the retirement plan. They act as not for profit organisations.	In Belgium, the IORP is responsible for the investment strategy. But ultimately, the sponsoring undertaking stays liable for the delivery of the benefit promise.	No, see 4.
<b>GER</b>	Pension funds (Pensionskassen and Pensionsfonds),	The pension funds are the owner of the assets.	The governing body of a pension funds is the board of	The investment strategy is decided by the management	The pension fund/board of management is responsible for

	<p>which are covered by the IORP-Directive, are legal entities with own rights.</p>		<p>management. They might be on the payroll of the pension funds or the sponsoring employer.</p>	<p>board in consultation with the supervisory board. However, the management board is solely responsible for making sure that the pension fund meets its legal requirements – including funding.</p>	<p>the pension promise; beneficiaries have a legal entitlement against the pension fund. However, if the pension fund cannot fulfil the pension promise, the employer is legally bound to underwrite the promise.</p>
<b>LUX</b>	<p>Pension schemes can be funded in three ways: group insurance, book reserves, or through a pension fund.</p> <p>As a pension fund it is a separate legal entity with its own rights.</p>	<p>The assets of pension fund schemes belong to the pension fund itself.</p> <p>The members and the beneficiaries of the pension scheme are shareholders (SEPCAV) or creditors (ASSEP/CAA pension fund).</p> <p>Only in specific situations can the sponsor recall assets.</p>	<p>The governing body is the Board of Directors. Usually, representatives of the sponsoring companies sit in this board and in that case they are not remunerated for this function.</p>	<p>The investment strategy is the responsibility of the Board of Directors of the pension fund.</p>	<p>The pension fund itself is responsible for the delivery of the pension promise.</p> <p>If the pension fund cannot pay the promise, then the sponsoring company underwrites the promise for CAA and CSSF schemes. Other schemes depend on the resources of the fund.</p>
<b>NED</b>	<p>Dutch legislation makes a sharp distinction between the pension promises as made by the employers, which promises are part of the labour contract (and therefore the material</p>	<p>The institutions as mentioned above own the assets, which are meant to cover their obligations towards the participants in the scheme, including the coverage of biometrical</p>	<p>Only life insurance companies and PPIs are supposed to make profits. Pension funds are only allowed to serve a “closed domain”, executing the company/sector</p>	<p>The pension institution (to be addressed via the Board) is always responsible and accountable for the investment strategy, even if the institution has contracted out its tasks. The Board is</p>	<p>Yes.</p> <p>In case of a sector wide scheme or a company scheme, social partners of the sector respectively the employer are responsible for a correct securitization of</p>

<p>core of the “scheme”) and the institution where the pension rights are “insured”. These institutions can be: (1) A company pension fund, (2) A sector wide pension fund, (3) An insurance company, (4) A premium pension institution (“PPI”), (5) A pension fund for free professionals (doctors &amp; midwives), (6) Any other IORP-institution established in another EU member state. These are all IORPs, except for the insurance companies, which operate under Solvency.</p> <p>The pension funds (1, 2, 3, 5) are legal entities and they are free to choose their legal form. With a few exemptions all of them are a foundation (“stichting”, Dutch</p>	<p>risks. Even in case of individual DC plans the pension fund formally owns the assets. In this respect the funds do not differ from a life insurance company.</p>	<p>ial pension arrangement made by social partners, who run the scheme and who are represented in the Board. Consequently their “profits” can only result in higher buffers, higher pensions or lower contributions. However, most of the pension funds have contracted out their tasks to a service provider. These providers operate on a free market and are allowed to make profits on the fees paid by the pension funds. But even then the pension fund remains the owner of the assets. The Dutch government is considering to allow company pension funds to “open their domain” by serving not only one but several employers, in which case they can be established not only by social partners but</p>	<p>forbidden to use the mandate of a third party as an “escape” for being held responsible/accountable. The only in (exceptional) cases of fraud or a serious neglect of their tasks, can members of the Board can be held accountable personally by means of private claims and/or public sanctions.</p>	<p>the pension obligations. If the obligations are secured by means of a pension fund, social partners themselves are directly responsible for the performance of the fund because the Board of the fund is paritarian.</p>
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**EIOPA - OPSG DISCUSSION PAPER ON OCCUPATIONAL PENSION SCHEME GOVERNANCE**

	<p>equivalent of the German “Stiftung”). PPI’s are free to choose between: foundation, limited company or SE.</p>		<p>also by third parties who will be allowed to make profits.</p>		
<b>POR</b>	<p>The pension fund is a legal entity with rights and obligations, not the pension scheme. The pension fund is represented by the appointed Management Entity.</p>	<p>The pension fund is owned by the participants and beneficiaries, but the sponsor takes the main decisions, like contributions and investment strategy.</p>	<p>The governing body is the staff of the appointed management entity, which charges fees for providing professional services. The fees can be paid by the sponsor or by the pension fund.</p>	<p>The investment strategy is defined by the Management Entity and the sponsor. Large funds will make use of consultants. The supervisor establishes the highly detailed content of the contract that defines the investment policy.</p>	<p>In DB plans the employer/sponsor is accountable for the delivery the benefit. This is not so for the DC schemes.</p>
<b>SWE</b>	<p>No. In Sweden the pension scheme is an agreement, a pension plan, and not a legal entity. However, the friendly societies, the pension foundations and the insurance companies, in which the employer’s pension commitment is secured, are legal entities.</p>	<p>Since the pension scheme is not a legal entity it owns no assets. The friendly societies, the pension foundations and the insurance companies are all legal entities and own assets. The friendly society itself is owned by its members and the insurance company is owned by its policyholders or its shareholders. The pension foundation has no owner.</p>	<p>Since the pension scheme is not a legal entity it has no governing body. Regarding friendly societies, pension foundations and insurance companies the members of the General meeting/Council and the Board of Directors are remunerated by the legal entity of which they are part.</p>	<p>Since the pension scheme is not a legal entity it has no assets and no investment strategy. Regarding friendly societies, pension foundations and insurance companies usually the Board of directors is responsible for the investment strategy of the legal entity.</p>	<p>Regarding friendly societies and insurance companies they are the one responsible for the delivery of benefits. The employer is responsible for the payment of premiums to the friendly society and the insurance company. Regarding pension foundations, the employer is responsible for the payment of provisions to the foundation and also for the delivery of benefits.</p>

<b>GBR</b>	A pension scheme is a trust fund, but all the rights and obligations sit with the trustees, not with the trust itself.	The trustees own the assets (in beneficial ownership). This explains why all investment responsibility remains with them.	Trustees are forbidden by law to profit from their trusteeship. They are allowed to charge reasonable fees and expenses. For individual trustees this would depend on size of scheme, e.g. from £8k pa. to £50k pa. Professional trustees are allowed to charge more, but these are a minority of trustees.	Ultimately the trustees, by law.	This is usually both the employer (contractually) and the trustee (under trust law). There is a mismatch between investment responsibility and benefit responsibility.
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## Proportionality – the minimum acceptable structure

Proportionality is an extremely thorny topic to grasp; it is estimated that there are some 140,000 IORPs in Europe and the overwhelming majority are very small. Potentially the majority could be inefficient in terms of opportunity cost. We define opportunity cost as what the individual retirement saver could achieve by approaching a financial advisor and buying an off-the-shelf retirement savings product, rather than participating in an occupational scheme. Hence, if the majority of schemes are inefficient, then reform is likely to face significant challenge.

Our view is that proportional regulatory regime must support a governance and operating structure that at least adds value to members and beneficiaries beyond what individually they could achieve for themselves. A proportionate regime must not support the ‘status quo’, if that supports an outcome which is sub-optimal to the retirement saver’s opportunity cost.

Having defined the individual saver’s opportunity cost; the value added by an occupational scheme is measured by its ability to efficiently (cost effectively) deliver the pension promise, for defined benefit schemes, and to maximising the retiree’s pension assets for defined contribution schemes.

Value added has two equally important aspects, the cost of the running the scheme, followed by maximising the risk adjusted return of the scheme’s assets. Larger schemes enjoy economies of scale and wholesale buying power when it comes to negotiating intermediary fees and charges.

However maximising the risk adjusted return on assets is not function of size, it is closely associated with the ability of the people running the scheme.

The development of the financial markets over the last 30 years has seen proliferation of financial products, often of increasing complexity. The value that these products purport to offer is supported by mathematical approaches to risk, return and portfolio management, that are beyond the understanding of many financial market professionals and indeed the people who run pension schemes. The sub-group believes that the greatest weakness in IORP governance resides in the abilities of the people who are held accountable by the members and beneficiaries to look after their interests; the function we have termed in this report as the non-executive.

The Portuguese regime offers a very good flexible proportionate model that functions well, which the sub-group recommends (subject to minor adjustments in the reporting structure<sup>7</sup>); here virtually every aspect of the scheme is outsourced to third parties. However the one feature that cannot be outsourced is responsibility for the scheme, which must always reside with the non-executive.

The sub-group has therefore adopted a very simple principle that a scheme cannot invest in any asset class without the non-executive team having a practical and theoretical understanding of the characteristics of that asset. The moot point is that the non-executive must have a collective, practical and theoretical understanding of what they invest in. Knowledge must not depend on the opinions of one expert, without every member of the non-executive being capable of challenging that expert's opinion.

The proportionate governance structure that falls from this principle requires a team of indivisible skills, which only becomes efficient beyond a certain level of assets under management. IORPs that choose simple investment policies can have small non-executive teams and be efficient at one level of assets under management. More financially complex schemes will require more expertise and only become efficient at a higher level of assets under management.

### Recommendations

Hence the sub-group proposes the following mechanisms to enforce this principle.

- That national supervisors approve persons who wish to serve in non-executive roles on the supervisory boards of occupational schemes, based on fit and proper tests designed by EIOPA to maintain a minimum standard throughout Europe;
- These fit and proper tests should identify the competency of the person to invest in prescribed asset classes;
- That national supervisors should manage a public list of the above approved persons, for the benefit of schemes in their selection of non-executive representatives;
- Every person appointed to a non-executive role on a pension scheme must demonstrate to the pension scheme's supervisory board that they have the time to commit to the role. This commitment statement must be made in writing and signed by every member of the non-executive body.

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<sup>7</sup> The Actuary and Auditor should report to and be appointed by the non-executive

- National supervisors should have the power to require additional solvency capital to be set aside by the scheme, in addition to national requirements – if applicable – where they believe the scheme is making investments in asset classes beyond its competency; and
- National supervisors must require and enforce the annual reporting of operational metrics by each pension scheme, and that this information is passed to EIOPA for publication and comparison.

A very valuable comparative metric is the annual cost of running the scheme per member. As mentioned above, we believe that EIOPA and National Supervisors play an important role in gathering and making public this information to inform retirement saver choices, if applicable.

## Cluster report of Germany, Luxembourg & the Netherlands

Cluster opinion of the “Ideal” governance structure of an IORP taking into account the systems of the Netherlands, Luxembourg and Germany

The implementation of adequate and comprehensive corporate governance structures is essential for IORPs to safeguard the accrued pension entitlements of the policy holders as well as the pension payments of the beneficiaries and also taking into account the protection of the sponsoring companies from unexpected losses.

In this section, we will primarily set up the desirable structures of the bodies/organs of an “ideal” IORP by taking into account the Dutch, Luxembourgian and German governance requirements. On a second level, we will focus on necessary key functions and required officers within the structure of an “ideal” IORP.

### **A) Bodies / organs of the IORP**

#### **I Electorate/constituency of members and sponsors**

A sufficient participation of the shareholders / (plan) members / participants / sponsoring undertakings of the IORP within its structures should be ensured by the implementation of a general assembly or an assembly of representatives. Main objectives of such an assembly will be the approval of decisions on changes of the statutes and bylaws of an IORP, the formal approval of the policy of the governing body / the supervisory body as well as the adoption of the annual financial statements and the annual business report of the IORP. A general assembly / assembly of representatives will therefore fulfil an accountability function.

Considering the legal framework of the three cluster-countries, there are assemblies / councils of the members / associates / participants legally required in all three countries.

#### **II Governing body / supervisory body**

Every IORP has to have a governing body (management board, board of directors, board of governors etc.) responsible for the policy / management and the strategic decisions / positioning of the IORP. The board members should for example decide on the administrative organization including the outsourcing of business functions or the business as such to a third party, the asset allocation or the investment objectives / guidelines of the IORP. The members of the governing body respectively the executive board-members should furthermore represent the IORP (both in legal proceedings and extrajudicial matters). Additionally, it could also be useful to stipulate an individual (private) liability of the (executive) board members so that the IORP has a right of recourse in case of mismanagement. Body members should have a good reputation, appropriate qualification and be approved by the national Supervisory Authority prior to an appointment.

Depending on the country involved, the legal form and the size of the IORP, there always will be one-tier and / or two-tier organization structure in place. Irrespectively of the organizational design, an adequate and comprehensive supervision of the governing body or the executive board members has to be guaranteed by a supervisory body that could either be a supervisory board, a supervisory committee or the non-executive members of the governing body of the IORP (that supervise executive board members). Besides the supervision of the IORP / the governing board, another main task of the supervisory body should / could also be the consulting of the decision making persons of the IORP as well as the mandatory involvement in case of essential decisions relating to the IORP. Required key officers of the IORP like for example the risk manager or an actuary or control functions like an external auditor should be appointed with the consent of the supervisory body of the IORP. In case of a one-tier organization structure of the IORP, appointments of key officers shall be made by the governing body. Additionally, IORPs should also be comprehensively supervised by the national Competent Authorities as well as by EIOPA on the European level.

The supervisory or the governing body (depending on a one- or two-tier solution) should be allowed to form several committees to deal with the different objectives and be given the right to adjust the compensation and benefits provided to the (executive) members of the board.

The independent members of the governing body or the paritarian members of the Board should ideally be appointed by the Board itself ("co-optation") or by the stakeholders of the IORP (employer/employee representatives).

As a general principle, one person should only be allowed to serve within one of the organs of the IORP.

### **B) Service functions of the IORP**

#### **I Administration function(s)**

Every IORP inevitably needs a sufficient administration (function) capable to execute the IORPs regular business (pension payments; accounting of the paid contributions; application of social law; providing information to the scheme members etc.). In principle, such an administration should be either a substructure of the governing body or be sourced out to an professional third party. The dimension of the administration infrastructure depends on the size of the IORP (members / beneficiaries / balance sum, asset allocation etc.). Each IORP should be free to decide whether to set up an internal staff or whether to mandate an external administration structure.

Taking into account the Dutch, Luxembourgian and the German systems, most of the IORPs have comparable administration structures or have taken care of outsourcing to appropriate structures.

## **II Risk management function / Internal control system**

Mandatory part of the accurate management business of an IORP should be the implementation of a sufficient risk management linked with an internal control system, which can be part of the outsourced functions). Such a management should enable and document an adequate risk strategy, which will periodically be reviewed allowing for adjustments in case of future developments. An internal control system should be set up to identify, analyse, monitor, value and manage the IORPs risks at the same time establishing stable reporting procedures to the organs / bodies of the IORP. The function should also comprise a standard review of the information processes as well as of the accounting and financial reporting systems etc. of the IORP. Another task of the risk management is the execution of the Asset-Liability-Management. To give a consistent overview of the IORPs risks, the risk management should be obliged to prepare an annual risk report for the governing body that could also be distributed to the supervisory body and to the national Competent Authorities. The designation of a specific risk manager should not be legally required.

## **III Internal audit function**

The adoption of an internal audit to check and review the entire business organization of the IORP could serve as a useful addition to the risk management function in a comprehensive governance system allowing for a consistent self-analysis within the internal structures of an IORP. An internal audit should deliver reports and especially act by recommendations. The effective implementation of an independent internal audit function therefore requires a strict separation from other key functions of the IORP and will therefore inevitably lead to the appointment of an internal auditor.

In Germany, there is already stipulated a legal obligation to have an internal auditor while for example in Luxembourg, there are no legal requirements for IORPs to implement an internal audit function yet. In the absence of an internal auditor, an internal control is executed for example in Luxembourg by the governing body of the IORP (board of directors), or by the third party to which the activities have been outsourced.

From the German point of view, the implementation of an internal audit function and of a specific internal auditor should be legally mandatory or at least required by the supervisory authorities. The internal auditor of an IORP should be appointed by and directly responsible to the governing body of the IORP or the third party to which the activities have been outsourced. Separate outsourcing of the function should be possible.

## **IV Compliance function**

Compliance in principle means acting in compliance with the stated requirements. Setting up a compliance function within the governance structure of the IORP or the third party to which the activities have been outsourced could therefore be an appropriate addition especially to the internal control system to prevent infringements of the rules, guidelines or codes of conduct

etc. already in advance. Main objective of a compliance function should thus be the advising of the bodies of the IORP etc. on compliance with the existing legislative and internal regulatory framework referring to the IORP. Usually, the respective compliance officer should provide a compliance manual that could serve as a guideline for compliant behaviour. In contrary to the internal audit function, there should be no legal obligation on the implementation of a compliance function or on the appointment of a compliance officer. The setting up of such a function should be part of a best practice governance approach serving as an additional sign of quality for the governance structures of an IORP in case of the implementation. If an IORP decides to implement a compliance function, a compliance officer should be appointed by and direct responsible to the governing body of the IORP.

At the moment, there is no legal obligation to set up a compliance function in the Netherlands, Germany or Luxembourg.

### **V Actuary (internal / external)**

An actuary in general has to investigate the financial situation of an IORP always considering the acknowledged mathematical standards and in respect of the financing plan set up for the IORP. As a result, the actuary has to certify the compliance with these mathematical standards and the financing plan and furthermore provide the (annual) actuarial reports containing the results / observations of his screenings / examinations, such as valuation of liabilities and of annual contributions. The implementation of an actuary will therefore be an additional security mechanism in trying to ensure that the IORP will be able to meet its liabilities which in fact means to pay the promised benefits to the beneficiaries. Consequently, there should be a legal obligation on the implementation of an actuary.

Taking a look at our three cluster-countries, there are legal requirements stipulated to have an internal and external actuary in the Netherlands whereas in Germany, the appointment of a so called responsible actuary is mandatory. In Luxembourg, for CAA funds, there is a legal obligation to appoint an actuary; for CSSF funds, there is a possibility to appoint a Liability Manager on a voluntary basis.

From our point of view, the implementation of an actuary should be legally binding for IORPs, irrespective if this is an internal or external person. A candidate should prove good reputation and appropriate qualification and be favourably appointed by the supervisory body of the IORP. The appointment could additionally have to be approved by the Supervisory Authorities.

### **VI Custodian**

A custodian should be responsible for the safeguarding and the correct administration of the assets of an IORP. For that reason, a disposal or acquisition of a security should only be possible with the consent with of the custodian. The safekeeping of the assets should be frequently verified. To ensure that the custodian is independent and especially free from the direction of the governing body of the IORP, the custodian cannot be allowed to be an employee of the IORP

or to be in a comparable relation with board members. The implementation of a custodian should be legally required. To avoid any appearance of influencing, a custodian should be appointed by the supervisory body and not by the governing body of the IORP. Furthermore, the appointment could also be approved by the Competent Authorities.

Currently, a legal obligation for the appointment of a custodian is already stipulated in the legal frameworks of Luxembourg and Germany.

### **VII External auditor**

The appointment of an external auditor is legally required for IORPs in the Netherlands, Germany and Luxembourg and should also be mandatory for an “ideal” IORP. The main objective of the external auditor is the checking and certifying of the financial reporting of the IORP and in particular of the balance sheet. Moreover, the external auditor will prepare an annual audit report for the governing body that has to be distributed to the supervisory body and the Supervisory Authorities. An external auditor has to be an approved statutory auditor and could favourably be appointed by the supervisory or the governing body of an IORP.

### **C) Conclusions**

An “ideal” IORP requires bodies, key functions and key officers. Keeping in mind that there are more than 140,000 mostly small IORPs across Europe, the principle of proportionality always has to be taken adequately into account. Small IORPs with only few members / policy holders will not be able to implement such comprehensive governance structures and may therefore need adequate exemption clauses or other measures appropriate to the size of the institution.

## Cluster report of Portugal, Sweden & the United Kingdom

Our analysis of the pension fund structures in Portugal, Sweden and the United Kingdom suggests that they all share the following four common structural characteristics set out below.

- Employer & Employee Representatives – Non-Executive
- Strategic & Operational – Executive
- Integrity
- Services

What follows is our comparative analysis of each of the four characteristics, where we outline their purpose, operation and potential conflicts of interest.

### **Employer & Employee Representative – Non-Executive**

#### **Purpose**

The employer and employee representative part of an IORP is generally non-executive. Its key role is to challenge and monitor the professional management of the pension plan, to make sure that the IORP executes ‘economically’ on its promise to IORP members and beneficiaries. These representatives have a duty to contribute to the investment strategy and risk management of the scheme. They approve the level of contributions, monitor investment performance and they appoint and set the remuneration of senior IORP personal (such as the chief executive) and agents (such as the actuary, auditor, investment manager, etc.).

#### **Comparative analysis**

Portugal – Monitoring Committee, Sweden – Life insurance companies and friendly societies: General Meeting/Council. In the case of Swedish pension foundations, there is no GM/Council – the Board of Directors is the highest governing body, United Kingdom – Trustees

The titles above approximate to the IORP’s non-executive. In Portugal the non-executive function is performed by the **Monitoring Committee (“MC”)**. It is compulsory to appoint a MC where an IORP has over 100 members. The MC is composed of employer and employee/member representatives, the latter group being no less than a third of the MC. A written document describes the rules governing the powers and obligations of the MC.

In Sweden the **General Meeting/Council (“GM/C”)** preforms this non-executive role in the friendly societies and insurance companies. Regarding friendly societies and mutual insurance companies; if a Council is chosen instead of a General Meeting (a General Meeting consists only of members), half the representatives from this body must be from members (Regarding the limited insurance companies they don’t have members but shareholders). This body has formal rules and regulated duties.

**Trustees** perform the same role in the United Kingdom. One third of trustees must be nominated by members. The duties and obligations of trustees are legally defined under UK trust law and statute. By law trustees have full executive powers, in practice these are delegated to experts, leaving trustees in a non-executive role.

### **Conflicts of interest and weaknesses**

There are two principle risks to the effectiveness of the non-executive function. The first concerns the fair treatment of scheme members and beneficiaries in the context of the employer's interest. The second concerns the risk of capture by the executive and the agents of the scheme (the service function).

With respect to the fair treatment of members and beneficiaries, a key feature of IORPs is intergenerational solidarity. However this solidarity is at risk if there is not balanced and capable representation from both scheme members (contributors) and beneficiaries (drawers). The employer's interest, particularly where it goes beyond a fixed contribution and extends to a guarantee, can divide the representatives of scheme members and beneficiaries. This can occur when the employer offers a benefits proposal that relatively favours one group at the expense of the other. Further the financial resources and collective knowledge commanded by the employer can also place members and beneficiaries at a disadvantage. We discuss this further with reference to Sweden below. In the United Kingdom, the trust based system legally requires the fair and equal treatment of members and beneficiaries. Under the same system, it is very difficult for the employer to renegotiate the scheme's benefits.

As concerns the risk of agent capture, the weakness relates to the capabilities of the representatives. In the United Kingdom these representatives are non-professional, in that they do not need to have hands-on experience in the management of an IORP. Under UK case law, pension trustees are bound to exercise reasonable care and to show the prudence and diligence that an ordinary man of business would in the exercise of his own affairs. There is no basic requirement that the non-executive representatives have any professional knowledge in managing any aspects of an IORP. The key requirement is that trustees should have an understanding of how to operate the scheme.

In Sweden there is nothing said in the law requiring the non-executive function to be qualified, under Solvency II this is supposed to be judged by the insurance/pension-undertaking. In Portugal there are no requirements in respect to professional knowledge for representatives on the MC of a Pension Plan. In practice the representatives from the sponsor are appointed by the board of the sponsor; implicitly by their appointment the sponsor believes that they are the most qualified to manage the pension plan. However, member representatives' are elected from among the members; there is no expectation that they have any expertise in pension scheme management.

With respect to agent capture, cumulative conflicts of interest develop at each step in the process of pension IORP management, where control is passed from the members to the

member's agents and from member's agents to their agents. Where a fiduciary responsibility<sup>8</sup> does not exist, the relationship of agents is purely commercial; it is set in terms of earning fees and minimising costs and risks, while observing the service agreement. If the non-executive does not have the skills to effectively challenge and interrogate the services of its agents, then the interests of the agents will take precedence over the interests of the IORP. The non-executive is particularly vulnerable when it depends upon its agents for almost all of its knowledge and advice. This is a particularly problem in the UK. Hence there is need for professional expertise within the non-executive function of a pension IORP, to make sure that the interests of members and beneficiaries are carried with vigour through the management of the scheme.

The management model existing in Portugal is centred in most cases on one provider that assures all the services (actuarial, investment and administrative), along with a consultant for some pensions plans.

### **Strategic & Operational – Executive**

#### **Purpose**

The purpose of the Executive role is to provide strategic direction and manage the daily business for the pension provider/fund. The most important task is to set up an organizational structure which is suitable to run the scale of the business, such as HR, IT and risk control.

The most important task of the executive is to deal with is the technical provisions set aside for the liabilities, for those entities where a liability is calculated. The solvency rules, where applicable, dictate the level of capital is set aside by the scheme.

The executive also makes sure that the IORP is run in accordance with prevailing legislation and the relevant rules. It is also manages communication and disclosure between the IORP and the supervisory authority.

#### **Comparative analysis**

Portugal – Management Entity, Sweden – Board of Directors and CEO, United Kingdom – Management Team

To begin with, there are major differences between the three countries. In Portugal and the UK the executive function is carried out by one level of management. In Sweden this function is separated into two levels; the highest rank, the Board of Directors (BoD), is often composed of representatives from different stake holders. It is not necessary for these delegates to have any skills in pensions' management. On the other hand, these representatives maybe skilled in topics related to Social and Labour Law. The BoD appoints a CEO, who is in charge of the daily

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<sup>8</sup> See "Fiduciary responsibility" p.96

management of the Board's guidelines and instructions. However pension foundations do not have a legal requirement to appoint a CEO.

Sweden's two tier executive structure separates the responsibilities and duties between the two levels. For instance remuneration issues are placed with the CEO except for the remuneration of the CEO which is the responsibility of the Board.

In Sweden there are general requirements of fitness and propriety for board members and CEO in the Insurance Business Act (regarding insurance companies and friendly societies) and in the Securing of Pension Obligations Act (regarding pension foundations Board of Directors) and further, loosely, mentioned in documents adopted by the local FSA.

In Portugal, the executive body, the Management Entity, has to present a list of items on how the operation is run. This is particularly detailed, with a high degree of prescription on operational administration, which is far more detailed than the experience found in the UK and Sweden.

In Sweden the bulk of occupational pensions are provided by insurance companies, which operate under the Solvency I rules. Hence, the introduction of Solvency II would lead to different rules for pensions provided by insurance companies from those offered by pension foundations.

### **Conflicts of interest and weaknesses**

In situations with small occupational pension providers, measured in number of members/schemes administrated, assets under management or similar measures, there might not be the resources to hire full time specialists in all places. This might be especially true for actuaries. The consequence might then be that actuaries work for different pension providers, some of which even might be competitors. Therefore measures have to be taken in order to reduce potential of conflicts of interest.

The executive body is probably the body that is most suitable, when it comes to insight and other skills, to monitor the prevailing legislation and other conditions for the business.

### **Integrity**

#### **Purpose**

The integrity function of a pension IORP, as its name suggests, plays a vital role in protecting the interests of IORP members by reporting, commenting and certifying upon the underlying assumptions of the pension promise and financial activities of the IORP.

The **Actuary** - will conduct and certify actuarial valuations of the IORP's assets and liabilities, set the assumptions to be used in that valuation, certify the schedule of contributions, as well as advising on day-to-day tasks such as members' benefits.

The **Auditor** - provides a report as to whether, in his opinion, the financial statements show a true and fair view of transactions, assets and liabilities; and a statement as to whether contributions have been paid in accordance with the schedule of contributions.

### **Comparative Analysis**

The global nature of the actuarial and auditing professions has led to a high degree of commonality in function and process. Therefore the tasks performed for a pension IORP in one country are very similar to the tasks provided in another. In all three countries there is a requirement to appoint an independent actuary and auditor, with one exception in Sweden, where pension foundations are not obliged to appoint an actuary. In all cases the post holders must be professionally qualified.

The significant difference in the governance of the integrity role lies in the body responsible for the appointment of these professionals. In Portugal the actuary and auditor are appointed by the executive – the management entity. In Sweden, in friendly societies and insurance companies, the (external) auditor is appointed by the General Meeting/Council and the actuary is usually appointed by the CEO. In pension foundations the auditor is appointed by the BoD (a pension foundation does not have an actuary). In the United Kingdom, both these positions are appointed by the non-executive function, the trustees.

### **Conflicts of interest and weaknesses**

The actuarial and auditing professions are co-ordinated at national level through professional bodies that set professional practice requirements, determined by the successful completion of exams and pre-determined periods of experience. Professionalism, ethics and integrity are qualities that these bodies try to instil in their members and advertise as a core attribute of their function.

While there has been no recent recorded incident that has questioned the integrity of actuaries, the integrity of the auditing profession is under considerable scrutiny. Significant events including the Enron scandal, which led to the breakup of Arthur Anderson, Parmalat in Italy and the banking crisis have tarnished the reputational of the audit profession. As a consequence the European Commission has brought forward regulatory proposals to strengthen auditor independence, as a means to restore confidence in 'public' financial statements.

The principle conflict for auditors is that auditing is usually a small part of the overall fees earned by accounting firms in their relationship with the entities that employ their services. Hence, a difficult audit could damage an overall client relationship, which could affect a much larger source of fee income.

The main weakness in the functioning of these professions is that their work is very technical and rich in professional jargon. This makes it difficult for lay people to comprehend and challenge their work. Hence, it would be prudent that the non-executive function has at least

the capability to converse at the same level of actuarial and auditing professionals, so that they can effectively scrutinise the work and advice of these professionals.

### **Service**

#### **Purpose**

There are some functions that assure the proper management of the pension fund and scheme, from investments, to consultants and controls.

The **Investment Manager** - will invest the scheme's contributions in accordance with the Investment Policy defined and comply with the legal restrictions on investments. The Investment Policy is established as a written document, defining the authorized structure of assets, as well as the reference measures relating to comparison returns and risk, where appropriate.

The **Compliance function** - will monitor the legislation and regulations as well as the policies defined for the pension scheme (including internal policy). It also provides information about the risks that may arise as a consequence of inadequate compliance, helping to identify and assess such risks and assist in the design of internal rules.

The **Pension Consultant** – In the UK, fulfils a key legislative role by providing the scheme with “proper advice”. This is not a requirement in Portugal or Sweden. Pension consultants may provide advice and information on retirement provision to organisations. They may be involved in setting up and running schemes on behalf of companies and they advise organisations on how to provide for their future financial security.

The **Legal Adviser** – primarily supports the trustees in making sure the pension scheme complies with its legal obligations, this is most relevant in the UK. There may be other areas of advice, concerning the outsourcing of services and relationships with the corporate sponsor.

**Risk Management** – is a legally required function, with the obligation of defining and implementing an adequate risk management strategy and procedures. The risk manager has to monitor and report all the risk relevant to the pension scheme, including financial risks, operational risks and liability risks.

#### **Comparative Analysis**

In the UK, Pension Consultants and the Legal Adviser play a major role as proving that the Trustees have sought ‘proper advice’. This became a legal requirement under section 26 of the 1995 Pensions Act.

In Portugal the Consultants are contracted by the Sponsor to provide specific and punctual advice, namely on investment issues, or changes on pension plan rules. Multinational sponsors may hire the same actuarial consultant for schemes in different countries.

In Sweden, for insurance companies and friendly societies, the BoD should ensure that the undertaking should contain a composite function for independent risk control. The Board should also ensure that a compliance function is in place, which supports the operations being conducted in accordance with governing regulations. There are no legal requirements for the institutions to have an investment manager, pension consultant or a legal adviser. In addition, pension foundations are neither obliged to have a compliance function nor a risk management function.

For the Investment Manager, Risk Manager and Compliance Officer, all three countries have similar requirements, including regulations for appropriate knowledge, experience and integrity to fulfil these tasks.

There are also some reporting duties, to governance structures and to supervisors.

### **Conflicts of interest and weaknesses**

With respect to **Consultants** there is a clear interest to maximise invoiced hours through promoting change and new initiatives at the pension scheme. The cost/benefits of these activities is uncertain until after the event. Potentially these activities can have a negative impact on running costs and cause disruption, which may impinge on investment returns.

There may be a conflict between **Risk Manager** and the **Investment Manager**, as they pursue different objectives. The **Investment Manager** might be willing to take on risk in order to increase returns, which can be contrary to the opinion of the **Risk Manager**. Or it can be the other way around, with the **Risk Manager** giving a more strict orientation which compromises future returns, leading to extra contributions or less benefits.

## **Definitions**

In order to support convention and clarity the sub-group has adopted the OECD pension glossary as the source of definitions.

The Private Pensions: OECD Classification and Glossary,  
ISBN 92-64-01699-6,  
© OECD/OCDE 2005

Can be found at this web link <http://www.oecd.org/insurance/private-pensions/2496718.pdf>

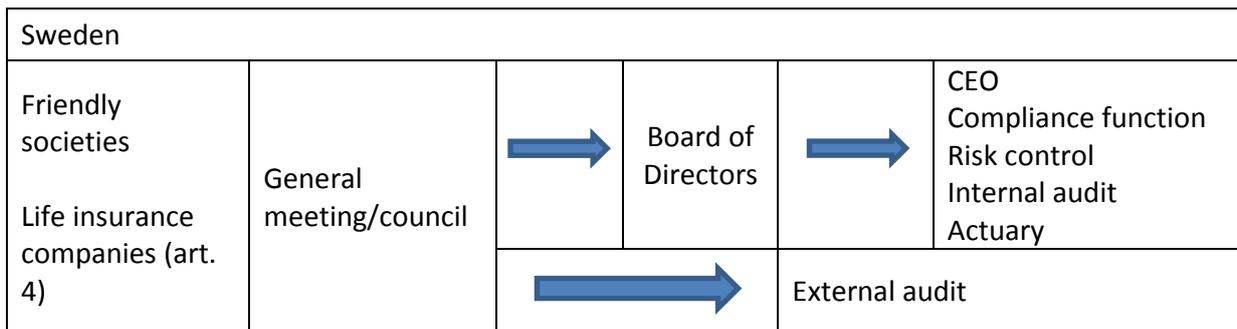
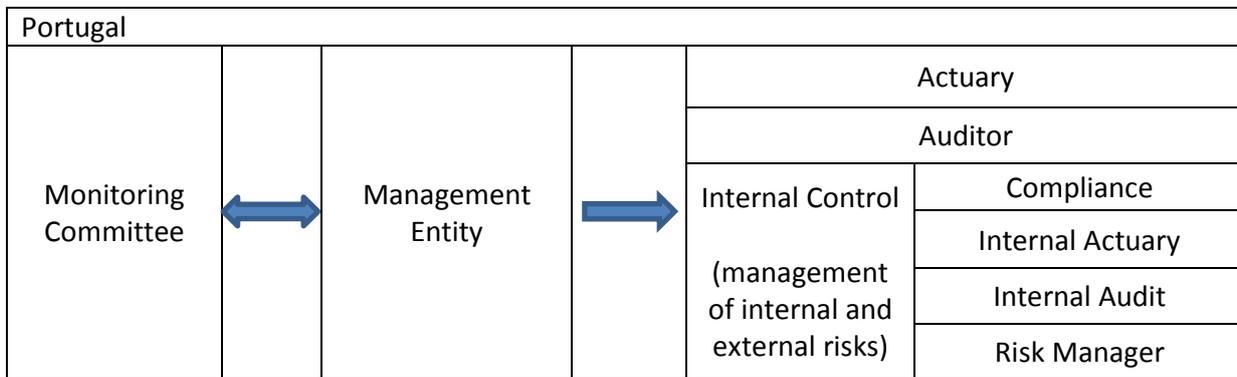
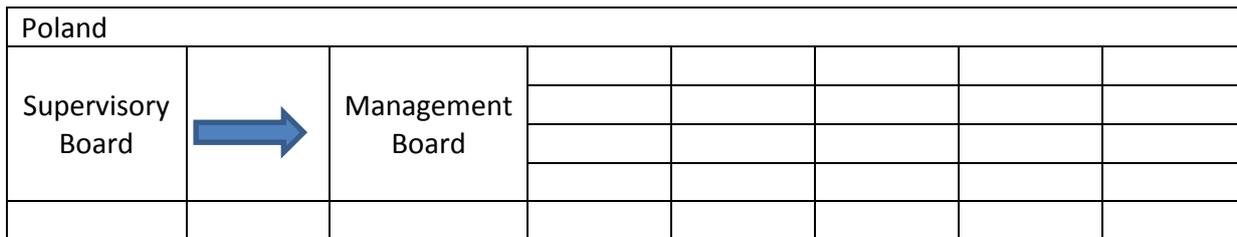
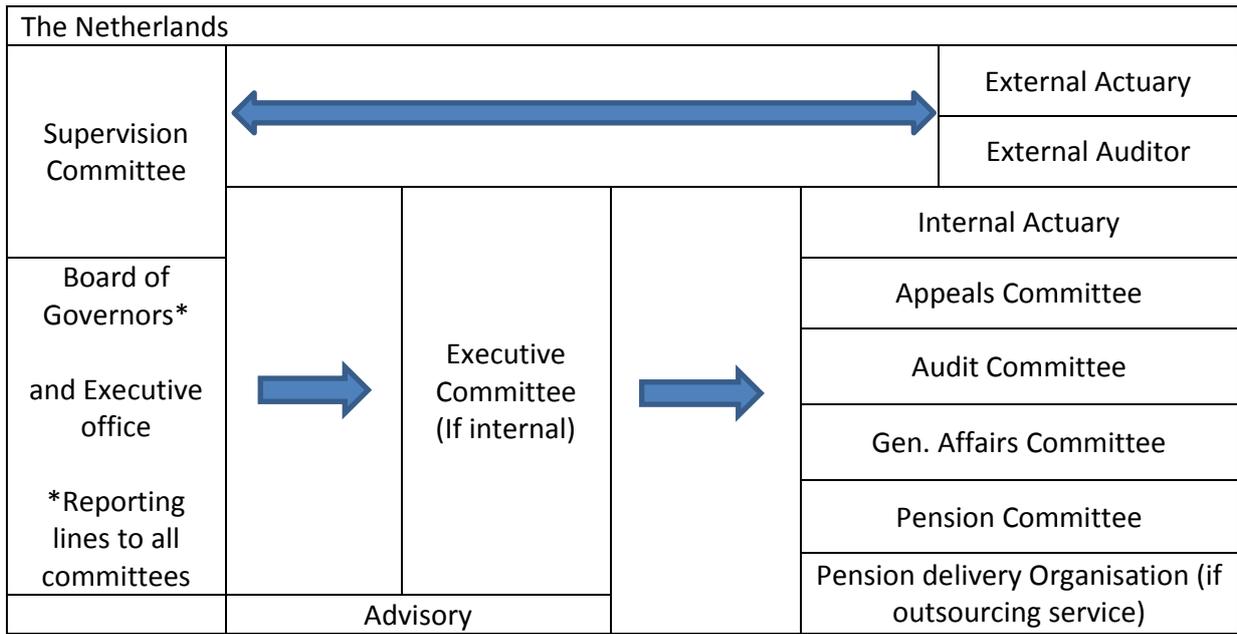
## National Organisational Structures

Belgium				
General Assembly	↔	Board of Directors includes Recognised Commissioner	↔	Appointed Actuary
			→	Internal Auditor
			→	Compliance Officer
			→	Data Security Officer

Germany						
Assembly of Members (employees) and Sponsoring Companies (employers)	↔	Supervisory Board and sub-Committees (employers & employee representatives)	↔	Actuary		
			↔	Auditor		
			→	Trustee of Assets		
			→	Board of Directors	→	Anti-money laundering Officer
					→	Compliance Officer
→	Data Protection					
			→	Internal Audit		

Luxembourg						
SEPCAV (DC only)	Governing body employers and employees (note employers control the scheme)	↔	External Auditor			
ASSEP (DC & DB)			→	Board of Directors	→	Asset Manager
						Central Admin
						Custodian – Asset safekeeping, verification of contributions & payments
CAA (DC & DB)				Liability Manager		

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<b>Pension funds</b>	Board of Directors		External audit
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United Kingdom				
Employers & Employees		Board of Trustees including sub-committees		Actuary
				Auditor
				Investment/Fund Manager
				Legal Adviser
				Investment/Pension Consultant
				

## Appendices – Country Studies

### Belgium – Yves Stevens & Ann Verlinden

#### Introduction

Herewith we give an overview of the most important IORP governance functions for Belgian IORPs. This overview is a brief summary of the note on IORP governance published by the supervisory authorities on 23 May 2007. Belgian IORPs need to install governance rules on a comply or explain basis taking into account a fit and proper approach to recognize the heterogeneity of IORPs on the Belgian market.

#### Legal framework

Belgian governance requirements for IORPs are determined in:

- Legal and regulatory provisions:
  - IORP Act of 27 October 2006 (“IORP Act”)
  - Royal Decree of 12 January 2007 on the prudential Control of IORPs (“Prudential Royal Decree”)
- Provisions determined by the Belgian Supervisory Authorities (FSMA)
  - Circular of 23 May 2007 of the Belgian supervisory authorities on the governance of IORPs (“Governance Circular”), which brings together the relevant legal and supervisory provisions accompanied by explanatory comments
  - Note of 23 May 2007 of the Belgian supervisory authorities on the prudential expectations regarding the governance of IORPs

These governance requirements had to be implemented between 1.1.2007 and 1.1.2012.

#### Key Officers

Herewith the main functions:

##### *General Assembly*

Having a General Assembly is a legal requirement.

The General Assembly consists of the sponsoring undertakings who install a benefit plan via the IORP.

The General Assembly has the most extensive powers to the actions concerning the IORP, either to carry out or to ratify. The main tasks of the General Assembly are:

- To appoint/dismiss Directors
- To appoint/dismiss Recognized Commissioner
- To exclude members
- To approve annual accounts
- To make changes to the by-laws
- To ratify funding plan, statement of investment principle, management agreement with the sponsoring undertakings, collective transfers

### *Board of Directors*

Having a Board of Directors is a legal requirement.

The representatives of the sponsoring undertakings and the representatives of the members have the majority on the board of the IORP.

Each member of the Board of Directors must have the necessary professional integrity and appropriate professional qualifications and experience to exercise his functions.

The board of directors is authorized to perform all acts necessary or useful for the achievement of the corporate purpose of the IBP, except those which the law or the statutes reserved to the General Assembly. The board of directors is authorized to represent the IBP, unless the by-laws stipulate this differently.

The main tasks of the Board of Directors are managing the following items:

- collection of contributions for pensions and the payment of retirement benefits
- investments
- asset/liability management
- providing information to the supervising authority, the sponsoring enterprises, the members and beneficiaries
- developing and assessing internal control
- the implementation of decisions of the General Assembly
- preparing the annual accounts and the annual report
- monitoring the outsourced tasks as well as the consultants which are called in
- drafting the by-laws

- developing a regulation for the management of conflicts of interest
- developing a procedure for handling complaints

In terms of good governance of the IORP, it is the Board of Directors who is responsible to ensure the IORP has:

- an appropriate internal control and internal audit
- an adequate compliance function
- a business continuity policy
- an outsourcing policy if applicable

The Board of Directors can delegate tasks to sub committees like a Direction Committee, an Investment Committee, a Social Committee, an Audit Committee.

### *Recognized Commissioner*

Having a Recognized Commissioner is a legal requirement.

The Recognized Commissioner is appointed by the General Assembly based on a list of possible candidates approved by the supervisory authority.

The Recognized Commissioner cooperates with the supervisory authority and acts independently but under their rules and guidelines. He shall ensure that

- the IORP complies with the regulations
- the IORP has taken appropriate measures for the administrative procedures, the accounting procedures and internal control

Once a year, he shall certify the technical provisions and report on the financial statements of the IORP. Furthermore he reports to the supervisory authority about

- any infringement of applicable legislation and regulations, including the social regulations
- any event that can affect the continuous functioning of the IORP could affect
- any event that may lead to the refusal of the certification of the technical provisions or of the accounts or to the formulation of a reservation on this certification

### *Appointed Actuary*

Unless the IORP does not bear any biometric risk nor any guarantee on return, the Board of Directors of the IOPR is legally required to appoint an independent and qualified actuary.

The Appointed Actuary should issue an opinion on the financial plan, reinsurance and the amount of technical provisions. In his opinion, the appointed actuary advises the Board of Directors on:

- the actuarially-technical methods used by the IORP to determine the financing, the composition of the technical provisions, insurance and reinsurance. This report is necessary to hand in before the introduction of a pension scheme or amendment of that plan, a change that may affect the funding, or to amend the financing plan
- the justification of the methods and the principles used for the calculation of the technical provisions, taking into account of the necessity to keep the commitments sustainable
- the safety of operations, the technical provisions and the profitability (annual advice)
- insurance or reinsurance contracts, before signing it

Annually, he shall submit to the supervisory authority a report on the technical provisions, together with the financial statements of the IBP.

Furthermore he notifies the Board of Directors as well as the supervisory authority in case he becomes aware of a violation on the legislation or regulation, including the social regulations.

### *Internal Auditor*

Having an Internal Auditor is a best practice based on the IORP governance principles.

The Internal Auditor has an independent role. He assesses if the IORP has an appropriate internal control policy in place and reports at least once a year to the Board of Directors.

To guarantee the Internal Auditor independency in his role, the Board of Directors approves a charter which gives him the authority to take initiative, to talk to all stakeholders, to get access to all documents in order to fulfil his tasks.

The professional competence of the internal auditors is essential. The internal auditor should be adequately qualified to investigate all areas in which the IORP is active.

The role of Internal Auditor can be outsourced but cannot be combined with the role of Appointed Actuary or Compliance Officer, furthermore there may not be an hierarchical line between the Compliance Officer and one of these functions.. The Internal Auditor may not be involved with the operational activities of the IORP.

The internal audit shall include, in general the study and evaluation of the adequacy, the effectiveness and efficiency of the internal control and the thoroughness with which assigned responsibilities are fulfilled. In particular, the internal auditor pays attention to:

- the compliance with the policies

- the risk (both quantifiable and the non-quantifiable risks)
- the reliability of the technical, financial and management information, and the external reporting
- the continuity and the reliability of electronic information systems
- the functioning of the administrative services

### *Compliance Officer*

Having an Compliance Officer is a best practice based on the IORP governance principles.

The Compliance Officer has an independent role. He coordinates and takes initiative for all items related to compliance and reports to the Board of Directors at least once a year.

To guarantee the compliance officer can independently play his role, the Board of Directors approves a charter which stipulate the coordinating, initiative taking and independent role of the Compliance Officer.

The compliance officer needs to have the appropriate knowledge, experience and integrity to fulfil his role. The appointment or replacement of the compliance officer and the reasons for this replacement must be notified to the supervising authority.

The role of a Compliance Officer can be outsourced but cannot be combined with the role of Recognized Commissioner, Appointed Actuary or Internal Auditor, furthermore there may not be an hierarchical line between the Compliance Officer and one of these functions.

The Compliance Officer reports to the Board of Directors about the following items:

- monitoring of legislation and regulations, and the interpretation thereof
- monitoring the designation of a contact person for supervisors
- if appropriate, the sensitization and training of the staff of the IBP
- monitoring the designation of a contact person for all questions or complaints from members, beneficiaries and sponsoring companies and the introduction of a procedure for complaints
- if appropriate, checking with the sponsoring companies if required legislative or regulatory procedures are followed, and if the necessary advise was consulted
- research and monitoring of violations of laws and regulations and, the internal code of ethics, the internal policy around conflicts of interest

- cognizance of the relevant internal and external documents relating to policy and execution (such as the reports of the internal audit, the minutes of the governing bodies, information and comments from supervisors)

The next function is applicable for all Belgian IORPs as they became part of the secondary network of the Belgian Crossroad Bank for Social Security.

### *Data Security Officer*

Appointing a Data Security Officer is a legal requirement for all institutions belonging to the network of the Crossroad Bank of Social Security.

The Data Security Officer will do an assessment on the information security and makes recommendations to bring the policy and procedures in line with the legal requirements.

He will focus on the following information technology items:

- Information security policy
- Organization of the information security
- Asset management
- Employee-related safety
- Physical security and protection of the IT environment
- Operational management: communication and operational management
- Access Security (logical)
- Development and maintenance of systems
- Management of incidents related to information Security
- Continuity Management
- Compliance
- Enforcement, monitoring and review

Each IORP is annually assessed based on a questionnaire to send to the competent authority

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Body	Soft/hard legislation	Task	Reports to	Composition/competence	Appointed by
General Assembly	Legal requirement	<p>To appoint/dismiss Directors</p> <p>To appoint/dismiss Recognized Commissioner</p> <p>To exclude members</p> <p>To approve annual accounts</p> <p>To make changes to the by-laws</p> <p>To ratify funding plan, statement of investment principle, management agreement with the sponsoring undertakings, collective transfers</p>		Representatives of the sponsoring undertakings who install a benefit plan via the IORP	Sponsoring undertakings
Board of Directors	Legal requirement	Bears ultimate responsibility	General Assembly	<p>The majority are representatives of the sponsoring undertakings/the affiliates</p> <p>Qualified persons</p>	General Assembly
Recognized Commissioner	Legal requirement	<p>The Recognized Commissioner cooperates with the supervisory authority and reports to them. He acts independently but under the rules and guidelines of the supervisory authority. He shall ensure that:</p> <ul style="list-style-type: none"> <li>• the IORP complies with the regulations</li> <li>• the IORP has taken appropriate measures for the administrative procedures, the accounting procedures and internal control</li> </ul> <p>Once a year, he shall certify the technical provisions and report on the financial statements of the IORP.</p>	Supervisory Authority	Recognized by the Supervisory Authority	General Assembly

Body	Soft/hard legislation	Task	Reports to	Composition/competence	Appointed by
Appointed Actuary	Legal requirement	<p>Gives advice to the Board of Directors.</p> <p>Issues an opinion on the financial plan, reinsurance and the amount of technical provisions. In his opinion, the appointed actuary advises the Board of Directors on:</p> <ul style="list-style-type: none"> <li>• the actuarially-technical methods used by the IORP to determine the financing, the composition of the technical provisions, insurance and reinsurance. This report is necessary to hand in before the introduction of a pension scheme or amendment of that plan, a change that may affect the funding, or to amend the financing plan</li> <li>• the justification of the methods and the principles used for the calculation of the technical provisions, taking into account of the necessity to keep the commitments sustainable</li> <li>• the safety of operations, the technical provisions and the profitability (annual advice)</li> <li>• insurance or reinsurance contracts, before signing it</li> </ul> <p>He has a whistle blower function.</p>	Supervisory Authority	Independent and qualified person	Board of Directors

Body	Soft/hard legislation	Task	Reports to	Composition/competence	Appointed by
Internal Auditor	IORP Governance principles	<p>He assesses if the IORP has an appropriate internal control policy in place</p> <p>The internal audit shall include, in general the study and evaluation of the adequacy, the effectiveness and efficiency of the internal control and the thoroughness with which assigned responsibilities are fulfilled. In particular, the internal auditor pays attention to:</p> <ul style="list-style-type: none"> <li>• the compliance with the policies</li> <li>• the risk (both quantifiable and the non-quantifiable risks)</li> <li>• the reliability of the technical, financial and management information, and the external reporting</li> <li>• the continuity and the reliability of electronic information systems</li> <li>• the functioning of the administrative services</li> </ul>	Board of Directors	Independent and qualified person	Board of Directors

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Body	Soft/hard legislation	Task	Reports to	Composition/competence	Appointed by
Compliance Officer	IORP Governance principles	<p>He coordinates and takes initiative for all items related to compliance:</p> <ul style="list-style-type: none"> <li>• monitoring of legislation and regulations, and the interpretation thereof</li> <li>• monitoring the designation of a contact person for supervisors</li> <li>• if appropriate, the sensitization and training of the staff of the IBP</li> <li>• monitoring the designation of a contact person for all questions or complaints from members, beneficiaries and sponsoring companies and the introduction of a procedure for complaints</li> <li>• if appropriate, checking with the sponsoring companies if required legislative or regulatory procedures are followed, and if the necessary advice was consulted</li> <li>• research and monitoring of violations of laws and regulations and, the internal code of ethics, the internal policy around conflicts of interest</li> <li>• cognizance of the relevant internal and external documents relating to policy and execution (such as the reports of the internal audit, the minutes of the governing bodies, information and comments from supervisors)</li> </ul>	Board of Directors	Independent and qualified person	Board of Directors

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Body	Soft/hard legislation	Task	Reports to	Composition/competence	Appointed by
Data Security Officer	Legal requirement	The Data Security Officer will do an assessment on the information security and makes recommendations to bring the policy and procedures in line with the legal requirements.	Board of Directors	Independent and qualified person	Board of Directors

## **Germany – Joachim Schwind**

### **I Short introduction**

We welcome the opportunity to report on the German legal framework and especially the key functions and officers required to run a German IORP. As a starting point, we would like to give a short survey of the entire German Pension System that comprises three pillars:

- There is the Statutory Pension System, operating as a pay-as-you go scheme (pillar 1) that is in principle mandatory. Retirement earnings depend on paid contributions. Employer and employees will have to contribute to the Statutory Pension System on an equal basis (2013: 18,9 %) until up to the contribution ceiling (2013: 5.800 € monthly; former West German Federal States).
- Furthermore, there are the Occupational Pension Schemes (pillar 2), in Germany solely operating as defined benefit pension plans.
- Besides that, there is the area of private pensions (pillar 3) that comprises additional retirement planning on a voluntary basis (life insurance contracts, private pension plans etc.)

On the following pages, we will focus on pillar 2 and take a look on the requirements for the German Occupational Pension Schemes.

### **II Legal framework (Occupational Pensions System)**

In Germany, there is in general no legal obligation to offer or participate in an occupational pension scheme. Employers are therefore free to implement Occupational Retirement Provision for their employees. The roots of occupational pension schemes in Germany can be traced back to the 19th century, when socially motivated employers started to set up Pensionskassen. Besides the traditional employer based pension schemes, there were first tariff agreements on providing pension benefits in 1998. At present, there are additional tariff agreements in all significant industry branches. In addition to these structures, employees have since 2002 a legal claim against their employers on the implementation/execution of salary conversion schemes. The German government is promoting Occupational Retirement Provision especially by fiscal incentives (i.e. EET<sup>9</sup>). The legal framework for IORPs in Germany is embedded within the national Social and Labour Law (SLL) and especially comprises the Employers Retirement Benefits Act. It stipulates various security mechanisms for occupational pension pledges like for example a subordinated statutory liability of the pension promising employer if the respective IORP would have to cut down employee's benefits.

There are five differing ways for the implementation and the financing of Occupational Retirement Provision in Germany. The final decision on the design of the pension scheme remains with the sponsoring employer. Employers can choose a book reserve scheme, a support

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<sup>9</sup> Exempt contributions, Exempt investment income and capital gains of the pension institution, Taxed benefits.

fund, a direct life insurance, a pension fund or a mutual insurance association to run an occupational pension scheme. Taking into account the current European regulation, pension funds and mutual insurance associations are considered as IORPs falling within the scope of the IORP-Directive. Considering all five ways to finance occupational pensions, there were total German occupational pensions covering funds at a height of 482.9 Bn. € in 2010.

The German Supervisory Authority responsible for IORPs is the German Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin).

### III Key officers / observations

There are several bodies/organs of the IORP and key officers required to run a German IORP.

Organs/bodies of the IORP

Type(s) and composition of the bodies of the IORP depend on the IORPs legal form. In principle, a regular IORP has three organs, the Management Board (Board of Directors/SE), the Supervisory Board and the Assembly of members/representatives/ shareholders:

The **Management Board** (Board of Directors/SE) consists of board members that are appointed/removed by the Supervisory Board or the Assembly. There is also the possibility to appoint a chairman. The implementation is legally required. Every board member has to prove a good reputation and appropriate qualification. An intended appointment has to be reported to the Supervisory Authority (BaFin) accompanied by documents that prove the essential personal and appropriate occupational qualification while the Supervisory Authority can raise objections to the intended appointment. The management board, in case of the legal form of a mutual insurance association or a pension fund, shall not comprise less than two persons. The main objectives of the Management board are the representation of the IORP (in court/out of court) and the development/implementation of the strategic positioning/orientation of the IORP. The board members are direct responsible for the management of the undertaking, there is legally stipulated a private and individual liability of the board members in case of mismanagement.

Current regulation (depending on the IORPs legal form):

- § 34 Insurance Supervision Act
- § 53 Insurance Supervision Act; §§ 24-53 German Civil Code
- § 76 ff. Stock Corporation Act
- Art. 38 ff. reg. 2001/2157/EC; §§ 15 ff. SE Implementation Act
- §§ 34,112 ff. Insurance Supervision Act

General requirements:

- Art. 9 I b IORP-Directive; § 7a I Insurance Supervision Act

The **Supervisory Board** is (depending on the IORPs legal form) also legally required and shall comprise at least three, at most 21 members (exception: smaller mutual insurance association). In principle, board members are appointed/removed by the assembly of

members/representatives/shareholders. There are differing nomination procedures; pension funds acting as social institutions for example will have to recognize the legal requirements of co-determination as provided for by the Works Constitution Act. An intended appointment has to be reported to the Supervisory Authority accompanied by documents of personal and necessary qualification while the Supervisory Authority can raise objections to the intended appointment. The main objective of the supervisory board is the appointment/removal of the management board members and the consulting/supervision of the management board/the management of the IORP. Furthermore, also the auditor, the responsible actuary and the trustee(s) of the IORP are appointed by the supervisory board members. In case of essential decisions of the management board, the supervisory board also has to be mandatorily involved. To fulfil its tasks, the supervisory board is also allowed to form/build different subcommittees (human resources committee; investment committee etc.).

### Current regulation (depending on the IORPs legal form):

- § 35 Insurance Supervision Act
- § 53 Insurance Supervision Act; German Cooperatives Act
- § 95 ff. Stock Corporation Act
- Art. 38 ff. reg. 2001/2157/EC; §§ 15 ff. SE Implementation Act
- §§ 35,112 ff. Insurance Supervision Act

### General requirements:

- § 7a IV Insurance Supervision Act

The **Assembly** of members/representatives/shareholders is also legally required. Its composition is always depending on the IORPs legal form while different representation procedures are legally possible. Pension funds acting as social institutions for example will have to recognize the legal requirements of co-determination as provided for by the Works Constitution Act. The assembly has to formally approve the actions of the management board (board of directors)/supervisory board. Another objective is the appointment/removal of the members of the supervisory board. The assembly is furthermore the body governing the statutes and bylaws of the IORP that is also responsible for decisions on fundamentally resolutions of the IORP. Therefore, the organ also has to adopt the annual balance sheet and the recent reports which have to be submitted to the Supervisory Authorities.

### Current regulation (depending on the IORPs legal form):

- § 36 Insurance Supervision Act
- § 53 Insurance Supervision Act; §§ 24-53 German Civil Code
- § 118 ff. Stock Corporation Act
- Art. 38 ff. reg. 2001/2157/EC; §§ 15 ff. SE Implementation Act
- §§ 36,112 ff. Insurance Supervision Act

### Key functions/required officers of the IORP

There are various key functions within the structure of a German IORP. Some of these functions and necessary officers are already stipulated by law (German Insurance Supervision Act) while others are still not required yet, but can already be implemented by IORPs on a voluntary basis.

In Germany, the implementation of a **Risk Management Function** is legally required while there is at the same time no obligation to also have a specific risk manager. IORPs only have to make sure, that there is a separation of the responsibility for the asset management function and the risk management function on the management board level. The main objectives of a risk management are the supervision, monitoring and the adjustment of the internal processes of the IORP as well as the implementation and adequate documentation of a business and risk strategy that has to be annually reviewed and discussed with the supervisory board and the Supervisory Authority. Moreover, the risk management has to prepare an annual risk report for the management board that will also be distributed to the supervisory board and the supervisory authority. Besides that, the risk management is also executing the Asset-Liability-Management of the IORP.

#### Current regulation:

- §§ 64a I s. 3; 55c I no. 1 Insurance Supervision Act
- BaFin Circular 3/2009 (VA) minimum supervisory requirements to risk management (MA Risk)

Also mandatory is the implementation of an Internal Control System that however does also not require a special (internal-control system-) officer. Such a system has to contain a comprehensive risk-capacity-concept/limit system and also to determine processes to adequately identify, analyse, monitor, value and supervise the IORPs risks. Additionally, sufficient communicating and reporting procedures to the management board have to be established.

#### Current regulation:

- §§ 64a I s. 4 no. 3; 55c I no. 1 Insurance Supervision Act
- BaFin Circular 3/2009 (VA) minimum supervisory requirements to risk management (MA Risk)

In Germany, there is at the moment no legal obligation for IORPs to add a **Compliance Management Function** or a Compliance Officer to their governance systems. Large pension funds might have such a system in place as part of the internal control system.

On the other side, every IORP in Germany has to have an Internal Audit Function and especially a responsible officer (internal auditor) while an outsourcing of this function is also permissible. An internal auditor has to be independent with a direct responsibility to the management board. With respect to other key functions, there has to be a strict separation from the internal audit function. The main objective of the internal auditor is the checking/control of the entire

business organization of the IORP. To fulfil this task, the internal auditor of an IORP has comprehensive rights on information and inspection. Every year, the officer additionally has to prepare an annual risk report for the management board that also has to be distributed to the supervisory board as well as to the Supervisory Authority.

### Current regulation:

- §§ 64a I s. 4 no. 4; 55c I no. 2 Insurance Supervision Act
- BaFin Circular 3/2009 (VA) minimum supervisory requirements to risk management (MA Risk)

The implementation of the Actuarial Function of an responsible actuary is legally stipulated. An intended candidate will be appointed and removed by the supervisory board of the respective IORP and has to be primarily reported to the Supervisory Authority before the appointment. If essential good repute/appropriate qualification cannot be proofed, the Supervisory Authority will ask for the appointment of another candidate. A responsible actuary executes a public office and can either be an employee of the IORP or an external person (outsourcing). A main objective is the investigation of the financial situation of the IORP because every undertaking has to meet its liabilities at any time at the same time fulfilling the solvency capital requirements. In case of mismanagement within the IORP, the responsible actuary furthermore has the obligation to report directly to the Supervisory Authority. Furthermore, the responsible actuary is also safeguarding that premiums and technical provisions are calculated according to the legal requirements including a certification at the end of the balance sheet as well as a specification within an annual report to the management board. Besides that, he is also presenting proposals for an adequate surplus-participation of the members in case of such profits.

### Current regulation:

- § 11a Insurance Supervision Act
- Art. 9 I d); 15 IV IORP-Directive
- German Regulation on Actuaries

In Germany, every IORP also needs (a) Trustee(s), responsible for the safeguarding of the IORPs assets. A trustee for security assets and his deputy trustee are thus appointed and also removed by the supervisory board of the IORP. Before the appointment, the intended candidate(s) has/have to be reported to the Supervisory Authority, which can ask for the appointment of another candidate in case of concerns related to the intended one. A disposal of security assets is only possible in consent with the trustees. They also have to confirm at the end of the balance sheet that the security assets have been invested and kept in compliance according to the legal requirements. Therefore, the trustees have to investigate the quality of the security assets investments and are thus equipped with comprehensive information rights relating to security assets. Another main objective is the custody/administration of the security assets. Trustee and deputy trustee of the security assets execute a public office.

### Current regulation:

- § 70 ff. Insurance Supervision Act
- BaFin Circular 13/2005 VA trustee for security assets

The function of an (external) auditor is also legally required in Germany. The auditor will be appointed by the supervisory board and has to check and verify that the annual balance sheet/account has been calculated in line with the legal requirements. As a further objective, he will prepare the audit report for the management board that has to be distributed to the supervisory board as well as to the Supervisory Authority. The Supervisory Authority can ask for the appointment of a different auditor in case of concerns.

### Current regulation:

- §§ 118b; 58; 59 Insurance Supervision Act
- § 341k German Commercial Code
- Art. 10 IORP-Directive

The **Data Protection Function** is among others also legally required for IORPs and will be executed by a data protection official. A candidate has to have a good repute and necessary expertise on this area. The data protection official shall work to ensure compliance with the Federal Data Protection Act and with other data protection provisions and may consult the competent authority responsible for monitoring data protection. An outsourcing of the function is possible.

### Current regulation:

- § 4f ff. Federal Data Protection Act

An **Anti-Money-Laundering-Function**/an anti-money-laundering-official is legally not required for German IORPs falling within the scope of the IORP-Directive.

### Current regulation:

- German Anti-Money Laundering Act

**IV Table**

Organs of the IORP	mandatory	composition	tasks / appointed by
Management board/ Board of directors	Y	- board member  - chair	<ul style="list-style-type: none"> <li>• legally required</li> <li>• appointment/removal by the supervisory board or the assembly of shareholders</li> <li>• good repute/appropriate qualification essential</li> <li>• shall comprise not less than 2 persons (mutual insurance associations/pension funds)</li> <li>• representation of the IORP (in court/out of court)</li> <li>• direct responsibility for the management of the undertaking</li> <li>• development/implementation of the strategic positioning/orientation of the IORP</li> <li>• private and individual liability in case of mismanagement</li> <li>• the intended appointment has to be reported to the Supervisory Authority accompanied by documents of personal and appropriate occupational qualification; the Supervisory Authority can raise objections to the intended appointment</li> </ul>
Supervisory board <u>subcommittees:</u> (not mandatory)  - human resources  committee	Y           N	- board member  - chair	<ul style="list-style-type: none"> <li>• legally required</li> <li>• good repute/necessary expertise essential</li> <li>• shall comprise at least three, at most 21 members; (exception: smaller mutual insurance association)</li> <li>• appointment/removal in principle by</li> </ul>

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<p>- investment committee - etc.</p>			<p>the assembly of members/representatives/shareholders; different nomination procedures: pension funds acting as social institutions will have to recognize the legal requirements of co-determination as provided for by the Works Constitution Act</p> <ul style="list-style-type: none"> <li>• appointment/removal of the members of the management board</li> <li>• consulting/supervision of the management board/ the management of the IORP</li> <li>• appointment of the auditor, the responsible actuary and the trustee(s) of the IORP</li> <li>• mandatory involvement of the supervisory board in case of essential decisions of the management board</li> <li>• formation of supervisory board committees on different topics</li> <li>• the intended appointment has to be reported to the Supervisory Authority accompanied by documents of personal and necessary qualification; the Supervisory Authority can raise objections to the intended appointment</li> </ul>
<p>Assembly of members/representatives/shareholders</p>	<p>Y</p>	<p>-members/ -representatives/ - shareholders - chair</p>	<ul style="list-style-type: none"> <li>• legally required</li> <li>• composition depending on the IORPs legal form:             <ul style="list-style-type: none"> <li>- members/shareholders of the IORP</li> <li>- representatives, in general elected by the members of the IORP; different procedures of representation</li> </ul> </li> </ul>

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			<p>legally possible: pension funds acting as social institutions will have to recognize the legal requirements of co-determination as provided for by the Works Constitution Act</p> <ul style="list-style-type: none"> <li>• appointment/removal of the members of the supervisory board</li> <li>• formal approval of the actions of the management board/supervisory board/board of directors</li> <li>• adoption of the annual balance sheet and the reports</li> <li>• body governing the statutes and bylaws of the IORP</li> <li>• decisions about fundamentally resolutions of the IORP</li> <li>• annual reports have to be submitted to the Supervisory Authority</li> </ul>
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<b>Key functions</b>	<b>mandatory</b>	<b>composition / officer / position</b>	<b>tasks / appointed by</b>
Risk management	function: Y officer: N	- risk manager	<ul style="list-style-type: none"> <li>• risk management function legally required</li> <li>• risk manager not mandatory; separation of responsibility of the asset management function and the risk management function on the management board level</li> <li>• implementation/adequate documentation of a business and risk strategy; annual review/discussion with the supervisory board/the Supervisory Authority</li> <li>• supervision/monitoring/adjustment</li> </ul>

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			<p>of the internal processes of the IORP</p> <ul style="list-style-type: none"> <li>• Asset-Liability-Management</li> <li>• preparation of an annual risk report for the management board that has to be distributed to the supervisory board as well as to the Supervisory Authority</li> </ul>
Internal control system	function: Y officer: N	-compliance officer/ risk manager/ internal auditor	<ul style="list-style-type: none"> <li>• implementation of an Internal control system legally required</li> <li>• special officer not mandatory</li> <li>• implementation of a comprehensive risk-capacity-concept/limit system</li> <li>• implementation of processes to adequately identify/analyze/monitor/evaluate/supervise the IORPs risks</li> <li>• establishing of sufficient communication/reporting procedures to the management board</li> <li>• preparation of an annual risk report for the management board that has to be distributed to the supervisory board/Supervisory Authority</li> </ul>
Compliance management system	N	- compliance officer	<ul style="list-style-type: none"> <li>• function/compliance officer legally not required yet</li> <li>• large pension funds might have a compliance management system in place as part of the internal control system</li> </ul>
Internal audit	Y	- internal auditor	<ul style="list-style-type: none"> <li>• function and officer legally required</li> <li>• outsourcing of the function is possible</li> <li>• independent; strictly separated with</li> </ul>

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			<p>respect to other key functions</p> <ul style="list-style-type: none"> <li>• direct responsibility to the management board</li> <li>• checking/control of the entire business organization of the IORP</li> <li>• comprehensive rights on information and audit/inspection</li> <li>• preparation of an annual risk report for the management board that has to be distributed to the supervisory board as well as to the Supervisory Authority</li> </ul>
Actuarial function	Y	- responsible actuary	<ul style="list-style-type: none"> <li>• function/responsible actuary legally required</li> <li>• appointment/removal by the supervisory board</li> <li>• good repute/appropriate qualification essential</li> <li>• the intended candidate has to be reported to the Supervisory Authority before the appointment; Supervisory Authority can ask for the appointment of another candidate if good repute/appropriate qualification cannot be proofed</li> <li>• appointment of an employee of the IORP or outsourcing of the function possible</li> <li>• responsible actuary executes a public office</li> <li>• obligation to report directly to the Supervisory Authority in case of mismanagement within the IORP</li> <li>• investigation of the financial</li> </ul>

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			<p>situation of the IORP; undertaking has to meet its liabilities at any time at the same time fulfilling the solvency capital requirements</p> <ul style="list-style-type: none"> <li>• safeguarding that premiums and technical provisions are calculated according to the legal requirements; certification at the end of the balance sheet and specification within an annual report to the management board</li> <li>• presentation of proposals for an adequate surplus-participation of the members in case of such profits</li> </ul>
Trustee/ safeguarding of assets	Y	<p>- trustee for security assets</p> <p>- deputy trustee</p>	<ul style="list-style-type: none"> <li>• function/trustee for security assets/deputy trustee legally required</li> <li>• appointment/removal by the supervisory board</li> <li>• the intended candidate has to be reported to the Supervisory Authority before the appointment; in case of concerns regarding the intended candidate, the Supervisory Authority can ask for the appointment of another candidate</li> <li>• disposal of security assets only possible in consent with the trustee</li> <li>• certification at the end of the balance sheet that the security assets have been invested and kept in compliance according to the legal requirements</li> <li>• investigation of the quality of the security assets-investments</li> <li>• custody/administration of the</li> </ul>

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			<p>security assets</p> <ul style="list-style-type: none"> <li>• comprehensive right of information relating to security assets</li> <li>• trustee/deputy trustee executes a public office</li> </ul>
Auditor	Y	- auditor	<ul style="list-style-type: none"> <li>• legally required</li> <li>• appointment by the supervisory board; Supervisory Authority can ask for the appointment of a different auditor in case of concerns</li> <li>• checking/verification that the annual balance sheet/account has been calculated in line with the legal requirements</li> <li>• preparation of the audit report for the management board that has to be distributed to the supervisory board as well as to the Supervisory Authority</li> </ul>
Data protection function	Y	- data protection official	<ul style="list-style-type: none"> <li>• legally required</li> <li>• written appointment by the management board of the IORP</li> <li>• good repute/necessary expertise essential</li> <li>• outsourcing of the function possible</li> <li>• data protection official shall work to ensure compliance with the Federal Data Protection Act and with other data protection provisions</li> <li>• data protection official may consult the competent authority responsible for monitoring data protection</li> </ul>
Anti-money laundering function	N	- anti-money laundering official	<ul style="list-style-type: none"> <li>• legally not required for IORPs falling within the scope of the IORP-Directive</li> </ul>

## Luxembourg – Martine Van Peer

### 1. INTRODUCTION

#### INTERNATIONAL PENSION FUNDS IN LUXEMBOURG<sup>1</sup>

##### HISTORY OF PENSION FUNDS

In 1999, The Luxembourg parliament passed a law on international pension fund vehicles which anticipated the 2003 European Directive on pension funds. As the legislation aspires to attract foreign employers / sponsors, the characteristics of the law allow a high degree of flexibility in plan design and the investment of plan assets. In 2005, parliament enacted a law implementing the IORP directive, which amended the 1999 law.

The pan-European pension funds envisaged by this law are also appropriate to fund employee benefit programs in countries outside the EU.

On January 30<sup>th</sup> 2013, 18 pension funds exist in Luxembourg.

### 2. LEGAL FRAMEWORK

#### LUXEMBOURG HAS THREE TYPES OF PENSION FUNDS

##### PRELIMINARY

The Luxembourg pension laws were introduced in 1999 and 2000 to create a flexible and secure environment for domestic and pan-European pensions. The legislation has focused on the establishment of three pension funding vehicles within a robust regulatory environment to provide security to beneficiaries and sponsors.

##### SEPCAV (Pension Savings Company with Variable Capital)

Main characteristics:

- « Société d'épargne-pension à capital variable ».
- Corporate form of an IORP.
- Board and annual shareholders' meeting.
- Supervised by the Luxembourg financial supervisory authority, the CSSF ("Commission de Surveillance du Secteur Financier").
- Suitable only for defined contribution (DC) plans.
- Umbrella structure allows share classes for different nationalities and employers.

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<sup>1</sup> This chapter is based on the brochure prepared by the ALFI (Association of the Luxembourg Fund Industry). This brochure was prepared in collaboration with the ALFP (Association of the Luxembourg Pension Funds).

- Beneficiaries are shareholders.
- Can only have an obligation of means.
- Minimum capital = 1 million of Euro.

### ASSEP (Pension Savings Association)

- « Association d'épargne-pension ».
- Associative form of an IORP.
- Supervised by the Luxembourg financial supervisory authority, the CSSF.
- Suitable for defined benefit (DB) and defined contribution (DC) plans.
- Umbrella structure allows share classes for different nationalities and employers.
- Beneficiaries are creditors to the fund.
- Can also fund survivors and disability benefits.
- Minimum capital = 5 millions of Euro.
- Can have an obligation of means or an obligation of result (in the latter case, a solvency margin has to be set up).

### CAA pension fund

- Four legal forms can be chosen: a mutual insurance association, a cooperative company, a cooperative company organized as a public limited company and a non-profit making association.
- Supervised by the Luxembourg Insurance Authority, the CAA (“Commissariat Aux Assurances”)
- Suitable for defined benefit (DB) and defined contribution (DC) plans.
- Umbrella structure allows multiple share classes.
- Can also fund benefits in case of death or disability of members. These benefits are totally reinsured.
- Can have an obligation of means or an obligation of result (in the latter case, a solvency margin has to be set up).
- No minimum capital required.

### 3. KEY OFFICERS

#### CUSTODIAN

##### Responsibilities/functions:

The custodian will be in charge of the safekeeping and current administration of the assets of the pension fund. The custodian has to verify that the contributing companies proceed punctually to the payment of contributions in conformity with the pension regulations / funding plans. Similarly, it is expected that the custodian oversee the payment of capital or pensions to scheme beneficiaries.

This implies putting into place a structured communication between the entity in charge of the central administration and the custodian.

Appointed by the Board of Directors, appointment has to be approved by the supervisory authorities

Reports to the Board of Directors

There is a legal requirement to have this function.

#### ASSET MANAGER

##### Responsibilities/functions:

Where asset management is delegated to an external asset manager, this entity is nominated by the Board of Directors. Although some or all asset decisions can be delegated to an external party, the Board of Directors is still responsible for the investment principles in general and the specific practices of Asset and Liability Management (ALM) applicable to the fund.

The asset manager must comply with the investment principles (on the basis of the statement of investment policy principles) and restrictions defined in the pension regulations and the funding plan.

Appointed by the Board of Directors, appointment has to be approved by the supervisory authorities

Reports to the Board of Directors

There is no legal requirement to have this function, but the articles of association may provide that the SEPCAV/ASSEP delegate management of the assets.

### LIABILITY MANAGER

#### Responsibilities/functions:

The liability management includes the valuation of liabilities, actuarial reporting to the supervisory authorities, the issuing of certificates to affiliated members and handling right transfers and redemptions. It can also include the whole coordination with the actors involved: custodians, asset managers, auditors and insurers.

Appointed by the Board of Directors, appointment has to be approved by the supervisory authorities

Reports to the Board of Directors

There is no legal requirement to have this function for a SEPCAV, nor for an ASSEP, but the articles of association may provide that the SEPCAV/ASSEP delegate management of the liabilities. There is however a legal requirement for the CAA Pension Fund.

### CENTRAL ADMINISTRATION

#### Responsibilities/functions:

SEPCAVs and ASSEPs are managed by a central administration under the supervision of the board of the pension fund and as approved by the supervisory authority. The central administration has to be established in the Grand-Duchy of Luxembourg.

The central administration fulfils the following tasks:

- keeping of the accounts of the SEPCAV or ASSEP;
- preparation of the annuals accounts and periodic financial statements;
- calculation of the asset value to SEPCAVs;
- CSSF regulatory reporting and establishment of tax returns and tax provisions;
- provision of the transfer agency and registrar services;
- provision of domiciliary agent services.

Depending on the plan design and the organisation of the pension fund, the central administration can also provide the affiliates with information regarding benefit entitlement and arrange for payment of the benefits in accordance with legal and regulatory provisions and as foreseen in the pension plan rules.

For CAA funds, the central administration function is enlarged and is called the “Approved Manager of the Pension Fund” (“gestionnaire agréé du fonds de pension”):

- runs effectively the pension fund
- approved by the CAA
- coordinates all the activities of the pension fund
- single point of contact and responsible entity for the CAA

- established in the Grand-Duchy of Luxembourg
- assists at all meetings of the Board of Directors of the Pension Fund and general assembly
- can delegate certain tasks

Appointed by the Board of Directors, appointment has to be approved by the supervisory authorities

Reports to the Board of Directors

There is a legal requirement to have this function.

#### INTERNAL AUDITOR

##### Responsibilities/functions:

- internal control /audit performed by:
  - o Board of Director
  - o Approved Manager of the pension fund or
  - o Central Administration

There is no legal requirement to have this function.

#### EXTERNAL AUDITOR

##### Responsibilities/functions:

- external audit of the accounting information in the annual reports of the pension fund performed by an approved statutory auditor

Appointed by the Board of Directors, appointment has to be approved by the supervisory authorities

Reports to the Board of Directors and to the supervisory bodies (CSSF and CAA)

There is a legal requirement to have this function

#### **Governing Bodies: BOARD OF DIRECTORS and GENERAL ASSEMBLY**

#### BOARD OF DIRECTORS

##### Responsibilities/functions:

- defines investment objectives / investment principles
- defines asset allocation (by means of ALM study if necessary)
- appoints:

- Asset Manager
  - Custodian
  - Liability Manager
  - Central Administration
  - External Auditor
- the articles of association can define other roles/limit roles for the board of Directors
- Appointed by the Sponsoring Companies;
  - Reports to the General Assembly; and
  - There is a legal requirement to have this body.

#### GENERAL ASSEMBLY/BOARD OF ASSOCIATES

##### Responsibilities/functions:

This body bears the ultimate responsibility for the pension fund. It approves the annual accounts of the pension fund. Its role and its composition are defined by the articles of association of the pension fund. A change in the articles of association has to be decided by the General Assembly.

Multi-compartment pension funds can have a General Assembly at the level of each compartment; this is also defined in the articles of association.

Appointed by the Sponsoring Companies in principle, unless otherwise stipulated in the articles of association

Reports to the Sponsoring Companies and to the supervisory bodies (CSSF and CAA)

There is a legal requirement to have this body.

#### **4. OBSERVATIONS**

Corporate governance rules for pension funds in Luxembourg are very pragmatic. Pension funds should be well organised in terms of administration, accountancy and internal control procedures. The central administration must be based in Luxembourg. Representation of employees, as affiliated members and beneficiaries, at the level of the governing bodies of the pension fund, is stipulated in the Luxembourg legislation on pension funds.

However the law allows the employer to keep control of the vehicle. General meetings of shareholders or associated members can be organised at the level of the sub-funds for matters relating to such sub-funds only. If needed or required under the local legislation of the employer, special committees can be set up either at the level of a pension fund or at the level of a sub-fund. The Luxembourg legislation provides a maximum of flexibility in terms of creation, membership and powers of such committees. For a CAA pension fund, usually established under the form of a non-profit making association, a mixed representation of employees and the employer is not necessary.

5. TABLE OF FUNCTIONALITIES OF IORP GOVERNANCE

Body	Mandatory	Task	Composition	Appointed by
<b>Board of Directors</b>	y	Defines: asset allocation investment principles  Appoints key Officers	Employer representatives and usually employee representatives (although not required)	Sponsoring Companies
<b>General Assembly / Board of Associates</b>	y	Bears ultimate responsibility	Employer representatives and usually employee representatives (required for ASSEP)	Sponsoring Companies
<b>Custodian</b>	y	Safe keeping and current administration of the assets Verify payment of contributions / benefits	External service provider	Board of Directors
<b>Asset Manager</b>	n	Management / investment of assets according to investment principles	External service provider	Board of Directors
<b>Liability Manager</b>	n	Valuation of liabilities / actuarial reporting to supervisory authorities / issuing of annual information for members	External service provider	Board of Directors
<b>Central Administration</b>	y	Account keeping / Annual accounts For CAA pension funds, the Central Administration = the Approved Manager of the Pension Fund This Manager runs effectively the Pension Fund and coordinates all the activities of the fund Responsible entity for the CAA	External service provider	Board of Directors
<b>Internal Auditor</b>	n	Responsible for the respect of the legislation and regulations	Central Administration	Board of Directors
<b>External Auditor</b>	y	Certifying annual accounts		Board of Directors

## **The Netherlands – Niels Kortleve & Wim van Zelst**

### **Introduction**

For a good understanding of the socio-economic backgrounds we memorise that the Dutch pension system is of the three pillar type:

- The State provides a flat rate old age pension (pay-as-you-go). For a couple this pension amounts to 100% of the legal minimum wage (after taxes);
- The second pillar (funded) represents the occupational pensions and is mainly run by (organisations of) employers and employees (see next section);
- Private households effect private pensions via life insurance contracts and saving accounts, often resulting in annuities.

The table on page 70 shows which officers play a key role in pension fund governance, as practiced in The Netherlands. The tables on pages 74 and 75 are meant to give also examples of what can be seen as good practice; it shows a large number of functionalities and services and is inspired on the practice of some large funds.

### **Legal framework concerning the second pillar**

Basically, Dutch legislation (the Pensions Act in particular) does not contain a general obligation to participate in a pension scheme. An important exception to this is the *Act on mandatory participation in a sector wide pension fund*, according to which the minister of Social Affairs and Employment can declare a sector wide fund to be mandatory for all enterprises within a certain sector of industry, and then only on the request of representative organisations of employers and employees.

This means that social partners, employers and employees, play a primary role in the second pillar. So the government's role is actually restricted to facilitate the pension schemes fiscally (contributions are tax deductible) and to take care of legislation in order to protect pension rights.

Crucial elements in the *Pensions Act* (which complies with the IORP-Directive) are the obligation to apply the principle of funding, combined with the obligation to separate the money from the undertakings, which means that a pension scheme must be secured by means of:

- a) a life insurance company
- b) a company pension fund
- c) a sector wide pension fund
- d) a Premium Pension Institution (PPI; only for DC arrangements)

e) an IORP from another EU member state

All parties mentioned under b, c, and d are IORPs.

This rich choice of possibilities reflects the diversity of manners in which pension schemes are being negotiated: on a sectorial level, company level (with or without a role for trade unions) or a purely individual level.

According to the *Act on mandatory participation in a sector wide pension fund*, as already mentioned, the minister of Social Affairs and Employment can declare a sector wide fund to be mandatory, which means that all enterprises belonging to the sector must participate in the fund. The minister only does so, on the common request of representative trade unions and employers' organisations. As a result, 70% of the Dutch workers are participating in a sector wide fund. About 10% of the workers do not accrue any pension rights in the second pillar, as they belong to what is called a "white spot" on the pension landscape. The other 20% is participating in a directly insured pension plan, in one of the 300 company funds, or in a PPI.

Additionally 11 sectorial funds for free professionals, with 55,000 participants, operate under the *Act on mandatory participation in a pension scheme for free professionals*. Examples are the funds for notaries, doctors, physical therapists and midwives. A fund of this type can only be established on the request of at least 60% of the professionals involved. These funds are IORPs as well.

### Key officers

<b>Key officer</b>	<b>I.r.<sup>10</sup></b>	<b>Responsibilities</b>	<b>Reporting</b>	<b>Appointed by</b>
<b>Member of (paritarian) Board of governors</b>	Y	responsible for policy (f.e. ALM, general investment policy) and correct application of pension scheme;  expertise: minimum standards for individual member + minimum standards for Board as a whole	reports to supervisory authorities (DNB; AFM), supervisory body and council of participants	employer (company fund) or employers' organization (sector wide fund)
				employees (company fund) or trade unions (sector wide fund)
<b>Independent chairman Board of governors</b>	N	presiding over meetings of the Board, without voting right;  only functioning at some large funds (ABP;		Board of governors

<sup>10</sup> I.r. = legal requirement

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		PFZW); qualifying for this function are persons of excellent repute		
<b>Supervisory body</b>  Two possibilities:  - own supervisory body;  - periodical visitation by committee of experts	Y	assessing a.o. policy and management processes, checks and balances, risk exposure;  officers are experts on pensions management, accountancy and investments	reports to the Board of governors	
<b>Executive Board</b>	N	running the organization;  qualifications depend on size of fund	reports to Board of governors	Board of governors
<b>Internal actuary</b>	Y	advising the Board of governors on mathematical standards;  only legally qualified actuaries	reports to Board of governors	Board of governors
<b>External actuary</b>	Y	certifying mathematical standards and actuarial reports;  only legally qualified actuaries	reports to Board of governors	Board of governors
<b>External auditor</b>	Y	certifying of financial reporting;  only legally qualified accountants	reports to Board of governors	Board of governors

## Observations

Under pressure of the legislator, supervisory authorities, scientists and public opinion, pension fund governance is subject to an ever growing set of requirements. As a consequence of an ageing population, the funds are required to admit representatives of retirees to their boards. Because of the increasing complexity of investment techniques and of IT-systems the board members must meet ever higher standards of professionalism. At the same time the funds have to deal with stronger demands in the field of communication, transparency and control.

Consequently, the Dutch legislator is preparing a package of amendments on the *Pensions Act*. These amendments, laid down in the *Act on reinforcement the governance of pension funds*, aim a.o. on more professionalism, participation of retirees in the Board of governors and councils of participants.

Pension funds will be offered the possibility to opt for a Board of governors, which fully consists of independent professionals, instead of a paritarian Board.

As a result of pressure from both the Socio-Economic Council (SER) and the Parliament a third possibility will also be introduced: a one tier board, consisting of either representatives of social partners and independent professionals, or purely independent professionals. In that case the non-executive members of the board fulfil the role of supervisory body.

Another major amendment concerns the compulsory participation of representatives of retirees in the boards.

### *Functionalities of IORP governance (NL)*

<b>Body</b>	<b>I.r.</b>	<b>Task</b>	<b>Composition</b>	<b>Appointed by</b>
<b>Board of governors</b>	Y	responsible for policy and administrative organisation  <i>(in case of one tier board non-executives will have supervisory role; see below)</i>	- paritarian or - fully/partly independent <sup>11</sup>	- social partners or - Board itself ("co-optation")
<b>Supervision committee</b>  <i>(not necessary in case of one tier board, with non-</i>	Y	assessing a.o. policy and management processes, checks and balances, risk exposure;  directs it's "critics" tot the Board of governors	professionals of good repute, independent from stakeholders	Board of governors

<sup>11</sup> new; to be introduced from 2014; fund is free to choose

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<i>executives in supervisory role)</i>				
<b>Executive board</b>  <i>(not necessary in case of one tier board with executives, or in case of full outsourcing)</i>	N	managing of staff and administrative organisation	CEO, CIO, CFO, COO	Board of governors
<b>Appeals committee</b>	N	judgements in individual cases of participants/employers/retirees vs. the fund;  independent of Board of governors and organisation	professionals from outside the organisation, independent from stakeholders	Board of governors
<b>Audit committee</b>	N	advising Board of governors on financial/economic policy; assessment of implementation of legislation and regulations, and external reporting	some members of the B.o.g. + independent professionals	Board of governors
<b>General affairs committee</b>	N	preparing meetings of the Board of governors, orienting on strategy; discussing general matters	some members of the Board o.g. + officers of the organisation	Board of governors
<b>Investments committee</b>	N	advising the Board of governors in the investment field, implementation of policy, and specific proposals	some members of the Board o.g. + independent professionals	Board of governors
<b>Pensions committee</b>	N	advising Board of governors on decisions regarding design and application of the pension scheme	some members of the Board o.g. + officers of the organisation	Board of governors
<b>Council of participants</b>	Y	issuing recommendations with regard to decisions of general effect; functioning as an	representatives of scheme members,	trade unions, organisations of elderly,

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		accountability body	retirees and employers	associations of employers, or direct election of participants' candidates
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<b><i>Special body in case of integral outsourcing<sup>12)</sup></i></b>	<b>Mandatory?</b>	<b>Task</b>	<b>Composition</b>	<b>Appointed by</b>
<b><i>Pension delivery organisation</i></b> <i>(counter party of fund on basis of service level agreement)</i>	N	collecting contributions, administration of pension rights, investments, communication  <i>(also possible: distributing tasks over 2 or more organisations, or partial outsourcing)</i>	commercial or not-for-profit organisation	Board of governors
<b><i>Executive office</i></b> <i>(dedicated to the Board of governors of the fund)</i>	N	supporting the Board of governors; judging and assessing the content of proposals put forward by the pension delivery organisation; monitoring the correct fulfilment of tasks by the ;  <i>in general: providing balance of powers by strengthening the countervailing power of the Board of governors towards the “almighty” pension delivery organisation</i>	staff of professionals, familiar with all kinds of aspects of pensions administration; in service of the fund (and Board of governors) and not of the pension delivery organisation	Board of governors

<sup>12</sup> also possible: outsourcing single tasks, such as asset management, in which case no special fund-related body is required.

## **Poland – Dariusz Stańko**

Information about Polish occupational pension plans

### 1. Legal framework

The occupational pension plans are described in the Law of 20 April 2004 on occupational pension plans [Ustawa z dnia 20 kwietnia 2004 r. o pracowniczych programach emerytalnych, (Dz. U. 2004 nr 116 poz. 1207)] and by the IORP Directive. Part of their activities is regulated by the law that concerns mandatory pension funds (Law of 28 August 1997 on organisation and functioning of pension funds [Ustawa z dnia 28 sierpnia 1997 r. o organizacji i funkcjonowaniu funduszy emerytalnych, (Dz. U. 1997, nr 139, poz. 934 with latter amendments)]. The occupational pension plans in Poland can operate only as DC type.

The occupational pension plans can be run in the following forms:

- occupational pension fund (in-house or external)
- agreement with life insurance company (unit-linked life group insurance)
- agreement with investment fund managing company
- foreign management (IORP – an entity, regardless of its legal form, with its registered office in a Member State of the European Union, subject to the supervision of the supervisory authority of this country. The activity of entity is the collection of funds and investing them for the purpose of payment to pension plan participants after they reach retirement age). Theoretically it can be DB type as well.

In the case of occupational pension fund, it is managed by authorities of the Occupational Pension Society (PTE, Pracownicze Towarzystwo Emerytalne). The authorities of PTE are: the board of directors (at least 3 persons), supervisory board and general meeting of shareholders). It is a joint-stock company that cannot operate for profit. The shareholders of PTE are not entitled to participation in the yearly profit. Assets are deposited in a depositary bank with minimal capital 30m euro or in the National Depository for Securities.

### 2. Occupational pension plans market

As of the beginning of 2012 there were 1,116 occupational pension plans (789 insurance, 291 investment funds, 36 corporate pension funds run by 5 PTEs), but there was no IORP (foreign management) plan. Total assets reached some 1.5bn euro. Members of such plans consisted only 2.13% of economically active people (345 thousand).

### 3. Key institutions in occupational pension plans and their responsibilities

- collecting and investing employer's (mandatory) and employee's (voluntary) pension contributions
- control of the above functions if outsourced
- management of the database

- risk management and anti-money-laundering procedures
- information disclosure to members and supervisory office
- management of benefit payments (to members and their heirs) and transfers (to other plans or to voluntary saving vehicles such as individual retirement accounts or spouses in case of divorce)

Voluntary pension funds are obliged – just like the mandatory pension funds – to publish once a year an information prospectus in a national daily newspaper. The information covers: the statute, the performance of the fund's investment and the approved annual financial statements of the fund. (art. 189 Law of 28 August 1997 on organisation and functioning of pension funds, Dz.U. 1997, No. 139, Pos. 934).

Voluntary funds provide information prospectus together with the last half-year financial report to a new member at joining the fund and at the request of the member (art.190).

Sponsors of occupational pension plans as well as each occupational pension fund must send to each member at regular intervals, but not less frequently than every 12 months, information about savings gathered at the member's account, the dates of payment contributions and withdrawals transfer, conversion of those contributions and calculation of payments into accounting units, and the results of the fund's investment activities. Information is transmitted in a manner and a form agreed with a member of the fund. Modes and forms of transmission of information that can be used in the fund is determined in its statute. In case of dispute, the burden of proof to provide above information rests with the fund (art.191).

4. Practical case – a multi-national company that set up its occupational pension plan in Poland

I have done an interview with ex-president of one of occupational pension funds in Poland.

- size of assets:
  - around 5m euro (c.f. with smallest mandatory pension fund with NAV 550 m euro)
- board of directors:
  - initially 5 persons, later reduced to 3 persons in line with legal requirements. Members of the board came from the sponsoring company.
- supervisory board:
  - 10 persons, half of them are representatives of the sponsor, another are delegates of employees (members of the fund) chosen in democratic elections
- asset management:
  - outsourced to an asset managing company; mandate was given by supervisory board (according to legal requirements and internal sponsor's regulations)
- depositary bank:
  - performed supervisory role over the PTE (pension plan managing company), investment operations etc.
- transfer agent:

- an outsourced company that was in charge of maintaining the register, member's data base, accounting of the plan and of the PTE (pension plan managing company itself)
- supervision over outsourced activities was performed by the board of directors
  - main problems:
    - the fund was too small to manage it internally (both in terms of asset management and clients' service), the number of board members was bigger than actual workload (but had to be in line with the legislation)
    - the Polish law on pension funds mixes huge mandatory ones and small voluntary occupational funds. In result the law is quite strict and daily supervision (performed by supervisory office) quite intense
    - in the initial stage of operations there was a lack of know-how, partly offset by the help of the Polish supervisory office, as well as a strong reluctance amongst workers to opt into the pension plan. After the communication campaign the latter problem was solved
    - it was necessary to establish some communication procedure between plan managing company (board), depositary and transfer agent – flow of information: who, whom, when
    - risk management activity practically was not performed due to strong regulations by the pension law and investment limits (for example a ban on foreign investments or derivatives)
    - members tend to compare results of their fund with results of mandatory pension funds - tendency to run a similar asset allocation policy as mandatory pension funds

## **Portugal - Maria Isabel Semião**

Key functions and required officers needed to run an IORP.

### **1. Introduction**

Following the work plan for the Governance sub-group, I am presenting the key governance functions for the Portuguese Pension Funds, according with legally requirements.

Before describing the functions, I will just give you some brief words regarding the Portuguese format for IORP management, because it is quite different from the UK model. In fact, if a company wants to implement a pension plan for its employees it can choose to have an insurance policy or a pension fund. If the company chooses to finance its pension plan with a pension fund, then it will comply with IORP Directive.

After deciding to create a pension fund for their employees, the company has to choose a Management Entity, from the list of authorised firms approved by the Supervisor, which can be a Pension Fund Manager or Life Insurance Company.

The Management Entity is the administrator and manager of the pension fund and legally represents the fund and acts in the name of the sponsor and members (participants and pensioners).

To be authorised to act has a Management Entity, it is necessary to present to the supervisor a list of items:

- Rules of Procedure
- Criminal registration for the board and managers
- Non insolvent record for owners and board members
- No debts to tax administration or Social Security
- Economic Group structure
- Activities program and business plan, including all the resources (human, financial, IT, buildings...)

The Management Entity has to have a minimum capital and solvency margin, according with the type of contract:

- 4% for asset with performance guarantees;
- 1% for contracts with more than 5 years;
- 1% until 75€ million;
- 1%0 for the rest.

Some of the tasks carried by the Management Entity can be outsourced, but it is not very usual to do so. A typical Portuguese pension plan sponsor prefers to have only one pension provider for all the services.

## 2. Legal Framework

The Portuguese pension fund legal framework is supported on the IORP Directive, which was transposed by the Decreto-Lei n.º 12/2006, from 20 January. This main law was complemented by several regulations published by the supervisor, the most relevant are:

- Norma Regulamentar N.º 7/2007-R, from 17 May Pension Fund Governance
- Norma Regulamentar N.º 9/2007-R, from 28 June Investment policy, assets and assets valuation
- Norma Regulamentar N.º 8/2009-R, from 4 June Pension Fund Governance - risk management and internal control

## 3. Key Officers

### Management Entity

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- 1% until 75€ million;
- 1%0 for the rest.

The main tasks of the Portuguese Pension Fund Manager are:

- All contractual issues and accounting
- Supervisor contacts and reporting
- Asset management
- Actuarial calculation and reporting
- Administrative, including individual accounts for DC plans and benefits payments and tax procedures (BD and DC)

- Contracting a custodian bank

### **Monitoring committee**

For pension plans with more than 100 members it is necessary to have a monitoring committee, with sponsor representatives and also people in representation of the members (employees and pensioners).

The number of the members' representatives should be no less than one third of all the committee. If the plan results from an union agreement, the union should appoint their representative, otherwise the employees should do it by an election. There are also rules to comply in performing this election.

According with the Portuguese law, the main tasks of the monitoring committee are:

- verify the investment strategic and financing level;
- to verify the delivery of information to members;
- to give opinion on proposals on management transfer, changes on investment policy or pension plan rules;
- to give opinion on the actuary and external auditors appointments.
- To have at least two meetings per year.

The monitoring committee is entitled to receive official documents from the manager, like annual accounts of the Pension Fund, actuarial reports and external auditor report.

All the rules of the monitoring committee must be established in a written document, which is a part of the management contract. These rules must be delivered to the participants and pensioners. Apart from this there are a lot of deadlines defined in respect to members' notification and also about the communication of election of the participants' representatives.

### **Actuary Responsible**

For each defined benefit pension plan the Management Entity has to appoint an actuary responsible, on an individual capacity. The actuary must be previously certified by the supervisor, according with his academic and professional experience, which cannot be less than 5 years working on pensions.

According with the Portuguese law, the tasks of the actuary responsible are to certify:

- the actuarial valuation, methodology and assumptions;
- financing level and minimum solvency requirements;
- matching of the assets of the pension fund to the underling liabilities.

The actuary must do an annual report with all the requirements defined by the supervisor, including a detailed risk analysis to the portfolio and liabilities, as well as projection scenarios. This report has to be delivered directly to the supervisor.

### **External auditor**

For each pension fund the Management Entity has to appoint an external auditor. The external auditor has to certify the annual accounts report and supervisor's reporting.

The external auditors must communicate to the supervisor if any legal regulation is not being complied.

The annual auditor report must present the auditory results for all the information reported by the manager to the supervisor, concerning:

- Pension Fund accounts
- Pension Fund portfolio
- Liabilities
- Technical analysis of the population

In terms of guidance, the external auditor must know the administrative procedures, accounting and risks management system of the manager.

### **Internal control system**

The Management Entity must implement and maintain policies and procedures that allow them identify, access and manage continually all the internal and external risks.

The definition of policies and procedures should take into account all kind of significant risks for the activity of pension fund management, including operational and financial risks.

The supervisor regulation on internal control systems has a special focus on the organizational structure and on the definition of the executive board and top management functions. It details all the risks that must be addressed:

- Investment
- Operational
- Pension plan
- Market
- Credit
- Concentration
- Liquidity

Connected to the risks system and internal control there are some functions that must exist on the Management Entity organization:

- Risks manager
- Actuary
- Internal auditor
- Compliance

For all these key function it is mandatory to have competent and qualified staff, with clear definition of responsibilities and autonomy, which have to be formally recognized by the board and reported to all the structures of the Management Entity.

All this rules and procedures for internal control must be audited by an external auditor, whom has to write a specific report to be delivered to the supervisor.

**4. Observations**

In general the Portuguese companies provide pension benefits for their employees on a voluntary base. As there are no tax incentives for companies or for employees, only a small portion of the working population will beneficiate from a II pillar pension funds.

This will be a major subject to address in Portugal, following the recent changes on the Portuguese Social Security pensions, which implemented one of the biggest cuts on public pension on Europe.

**5. Table**

Body	Mandatory	Task	Composition	Appointed by
Management Entity	Yes	<ul style="list-style-type: none"> <li>• Asset management,</li> <li>• Assets Valuation,</li> <li>• Actuarial calculations,</li> <li>• Administrative procedures,</li> <li>• Benefits Payment,</li> <li>• Contributions collector,</li> <li>• Contracting a custodian bank,</li> <li>• Supervisor reporting and</li> <li>• Provide information to members</li> </ul>	Executive Board Asset managers Actuaries Client support Administratives Risk Managers Others	Sponsor
Monitoring Committee	Yes for IORP with more than 100 members	<ul style="list-style-type: none"> <li>• Verify the investment strategic,</li> <li>• Verify financing level,</li> <li>• Verify the delivery of information to members,</li> <li>• Give opinion on proposals on management</li> </ul>	2/3 Sponsor representatives 1/3 Members representatives	Sponsor  Unions or elected among the population

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		<p>transfer, changes on investment policy or pension plan rules,</p> <ul style="list-style-type: none"> <li>• Give opinion on the actuary and external auditors appointments,</li> <li>• To have at least two meetings per year</li> </ul>		
Actuary Responsible	Yes for BD plans	<ul style="list-style-type: none"> <li>• Actuarial valuation</li> <li>• Financing level and minimum solvency requirements</li> <li>• Matching of the assets of the pension fund to the underling liabilities</li> <li>• Annual report to Sponsor, Supervisor and monitoring committee</li> </ul>	Individual capacity, previous certified by sponsor	Management Entity, but with Sponsor agreement
External Auditor	Yes	<ul style="list-style-type: none"> <li>• Certify Pension Fund accounts</li> <li>• Certify Pension Fund portfolio assessment</li> <li>• Certify Liabilities reporting</li> <li>• Certify technical analysis of the population</li> <li>• Annual report to Manager, Sponsor, Supervisor and monitoring committee</li> </ul>	Independent	Management Entity
Actuary	Yes	<ul style="list-style-type: none"> <li>• The function is legally required</li> <li>• Competent and qualified staff</li> <li>• Actuarial valuation</li> <li>• Adequate</li> </ul>		Management Entity

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		documentation		
Internal Auditor	No, dependent on the dimension	<ul style="list-style-type: none"> <li>• Competent and qualified staff</li> <li>• Report directly to the Board</li> <li>• Control procedures and activities</li> <li>• Annual report</li> </ul>		Management Entity
Risk Management	Yes	<ul style="list-style-type: none"> <li>• The function is legally required</li> <li>• Competent and qualified staff</li> <li>• Apply the risk policies defined by the Board, including analyses, monitoring and reporting</li> <li>• Present measures of risk control</li> <li>• Adequate documentation</li> </ul>		Management Entity
Compliance	Yes	<ul style="list-style-type: none"> <li>• Competent and qualified staff</li> <li>• Regular assessment of risk procedures</li> <li>• Legal framework</li> <li>• Anti-money laundering procedures</li> <li>• Adequate documentation</li> <li>• Annual report</li> </ul>		Management Entity

## **Sweden – Gunnar Andersson & Peter Berggren**

### **Introduction**

In order to understand the Swedish system we need to start with an overview of the pension system as such.

In Sweden there has been a long tradition of funding occupational schemes. The size of money set aside in different pension funds is about 3 000 billion SEK (close to 340 billion euro). Remembering that the population of Sweden is fairly small (9 million) the size of funds set aside for pension purposes is substantial. All funded parts are vested rights. The pension system consists of three pillars.

1. The first pillar is the state system and paid by the employer. The employer pays 18.5% of the employees' salary. The fee can be divided in two parts; 16% covers the cost for a pay-as-you-go system and the remaining 2.5% is funded where the employee can chose fund to invest in.
2. The second pillar is the occupational pension system where the employer pays the fee in accordance with current collective pension agreement. This is a fully funded system and used to be true DB schemes up until (more or less) 15-20 years ago. Today most schemes are converted to DC systems (where the employee still can decide (hybrid) how to invest the money, including in products with guarantees), however old premiums are still in DB solutions. The fee level is approximately 3-5% of salary depending on the benefits of the pension scheme.
3. The third pillar is the private option to build up your pension level. The employee pays the fee, tax-deductible when paid and taxed when withdrawn. There also exist products without the tax-feature but they are not so common to invest in.

All together the employee can expect a pension level, from the first two pillars, somewhere in the neighbourhood of 50-65% of final salary.

Providers of occupational products on the Swedish market can be separated in three groups, each of which briefly presented in the following table:

### **Legal framework concerning the second pillar**

As indicated in the table above, in Sweden occupational pension (i.e. where the premiums are paid by an employer for the benefit of a former employee when retired) can be managed by:

1. Friendly societies for occupational pension.
2. Pension foundations (also called Occupational pension funds).

3. Life insurance companies that apply the IORP Directive in their occupational pension activities in accordance with Article 4.

Both friendly societies and life insurance companies are insurers which is not the case regarding the pension foundations. The sole purpose of a pension foundation is to secure pension liabilities of the employers - the responsibility for paying the pensions always remains with the employers.

Friendly societies have historically been regulated by the Friendly Societies Act which is now repealed with some transitional provisions. For friendly societies established after April 1, 2011 the new Insurance Business Act is effective. For friendly societies established earlier the Insurance Business Act will become in force on January 1, 2015, unless authorization to do business under the Insurance Business Act is obtained previously (There is a ministry proposal to change the date to 1 January 2018).

Life insurance companies are regulated by the Insurance Business Act and pension foundations are regulated by the Securing of Pension Obligations Act.

Furthermore, friendly societies and insurance companies are obliged to follow (or more correct: "comply or explain") The Swedish Financial Supervisory Authority's General Guidelines Regarding Governance and Control of Financial Undertaking (FFFS 2005:1). A few pension foundations have decided to follow parts of FFFS 2005:1, without being obliged to do so.

### Key functions and key officers

It felt more natural to combine key functions and key officers in one table. Especially since a function can be carried out by one person. Consider that *function* means one or more persons, units or divisions or, specifically appointed committees, charged with the task of performing one or more of the duties mentioned in these general guidelines.

The task is presented in a tabular form, all functions not applicable to all institutes. In the second column we have pointed out in which situation each function is applicable, where

*F* stands for *Friendly Society*, *I* for *Insurance Company* and *P* stands for *Pension Foundation*.

#### Functionalities and key officers of IORP governance

<b>Body</b>	<b>Required for</b>	<b>Task</b>	<b>Composition</b>	<b>Appointed by</b>
<b>General Meeting/Council</b>	F, I	The highest decision-making body whose decisions include determining the annual report, election of board and	GM: Shareholders/policy holders/sponsors.	GM: ---- (GM consists of the owners)  Council: at least half of the members shall be

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		auditors, statute, liability for directors, allocation of profits and transfer of the insurance portfolio		appointed by the owners or by organizations who are representing the owner's interest.
<b>Board of Directors</b>	F, I, P	Responsible for organisation and the undertakings affairs;  Adopting strategy and targets for the undertaking;  Follow-up on targets;  Adopting rules of procedure for the BoD and duties for the CEO	In plc's not allowed to distribute profits and in mutual insurance companies at least half of the directors shall be independent.  In a Friendly Society each director of the board shall be a member of the society, if it not is stated otherwise in the Buy-Laws.	GM/Council  In plc's not allowed to distribute profits at least one of the directors shall be appointed by the customers or by an organization with relation to the customers.
<b>Chief Executive Officer</b>	F, I	Daily management;  Following guidelines of the affairs;  - The undertakings accounts  - Funds are managed in a secure manner	A person with certain skills, suitable for running a Friendly Society/Insurance Company	BoD
<b>Compliance function</b>	F, I	Support to the business being operated under the current rules;  Monitor compliance and provide information about the risks that may arise as	Of the undertaking appointed experts	BoD and CEO

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		<p>a consequence of inadequate compliance;</p> <p>Helping to identify and assess such risks and assist in the design of internal rules;</p> <p>Inform the Board, CEO and management on issues of compliance and ensure that the staff is informed of new or amended regulations.</p>		
<b>Risk Control</b>	F, I	<p>Inform the Board and management of the risk of the institute;</p> <p>Analyze the performance of the same and to propose amendments to the governing documents and processes that function's observations raise.</p>	Of the undertaking appointed experts	BoD
<b>Internal Audit</b>	F, I	Monitors and evaluates the internal control.	Of the undertaking appointed experts	BoD
<b>Actuary</b>	F, I	<p>Pricing products;</p> <p>Establishing technical provisions;</p> <p>Following up and securing actuarial standards;</p> <p>Securing reporting to</p>	A person holding certain qualifications according to an FSA regulation (FFFS 2011:19)	BoD or CEO

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		FSA;		
<b>External audit</b>	F, I, P	An audit professional who performs an <a href="#">audit</a> in accordance with relevant laws and rules on the <a href="#">financial statements</a> of the institute and who is independent of the institute being audited	Authorised auditor	GM/Council
<b>Complaints Manager</b>	F, I	The institution should ensure that a functioning system is in place for contacts with customers in complaints matters. The institution should have one or more complaints officers to whom dissatisfied customers can be referred. (FFFS 2002:23)	Of the undertaking appointed experts	CEO

Regarding the actuary it is an internal function, appointed by the CEO or the Board of Directors, and the appointed actuary is reported to The Swedish Companies Registration Office (*Swe: Bolagsverket*). Of course, the FSA can in principal object to an appointment, but it requires special reasons. Finally, if the Financial Supervisory Authority finds it necessary it can also appoint an actuary, but this is very unusual.

### Observations

This section explains, in words, more details the system of occupational pension in Sweden. It is divided in the three different parts; *Friendly societies*, *Life Insurance Companies* and *Pension foundations*.

#### Friendly societies:

Most friendly societies for occupational pension currently use transitionally the now repealed Act of Friendly Societies. Under the Act, there shall be appointed a highest decision-making

body, a general meeting, which consists of the members, or one council, appointed by the members or of an organization which can be considered to represent the members.

Meeting / council decisions include determining the annual report, election of auditors, statute, liability for directors, allocation of profits and transfer of the insurance portfolio.

Furthermore, there should be a Board of Directors that is responsible for the management of the affairs of the entity. The Board shall establish a strategy and goals for the business, ensuring that the entity's operations are organized and managed in ways that best meet members' and other interests of beneficiaries, the association's accounting shall be completed/conducted in accordance with law and that its financial affairs have been arranged in a reliable manner.

Furthermore, the Board adopts investment guidelines and instructions for the CEO and appointed by the Board, authorized signatory and risk control, compliance and internal audit. At least half of the directors shall be elected at general meeting / council or by an organization that can be considered to represent the members. Requirement for a CEO is not given.

For friendly societies established after April 1 2011 the new Insurance Business Act is effective. For friendly societies established earlier the Insurance Business Act as of 1 January 2015, will become in force, unless authorized to do business under the Insurance Business Act obtained previously (There is a ministry proposal to change the date to 1 January 2018).

According to the Insurance Business Act there shall be appointed a highest decision-making body to be a general meeting, which consists of members, alternate council. More than half of the council shall be appointed by the members or by organizations that can be considered to represent the members.

Meeting / Council decisions include determining the annual report, statute, liability for directors, decisions on the allocation of the result, the election of directors (unless the bylaws state that members shall be appointed by other means), the appointment of auditors and the transfer of portfolio.

Furthermore, there should be a Board of Directors that is responsible for the friendly society's organization and management of the society's affairs. The Board shall establish a strategy and goals for the business and ensure that the organization regarding accounting and asset management includes a proper control. Furthermore, the Board adopts investment guidelines and instructions for the CEO and appointed by the Board, authorized signatory and risk control, compliance and internal audit.

According to the Insurance Business Act, a CEO shall be appointed, who shall have charge of the daily management of the Board's guidelines and instructions. The Executive Director shall ensure that the pension fund's accounts are maintained in accordance with law and that assets are managed in a secure manner.

The Swedish Financial Supervising Authority has the power to issue further rules for how business, i.e. occupational pension business, shall be conducted. The most important, and

recent, set of rules among those in force, is the so called FFS 2005:1 (an English version is enclosed), which applies to all friendly societies managing occupational pension. There is stated that there shall be present some key functions, which are

1. A function of risk control, which shall inform the Board and management of the friendly society's risk and shall analyse the performance of the same and to propose amendments to the governing documents and processes that function's observations raise.
2. A compliance function, which will serve as a support to the business being operated under the current rules, monitor compliance and provide information about the risks that may arise as a consequence of inadequate compliance, helping to identify and assess such risks and assist in the design of internal rules. The function must also inform the Board, CEO and management on issues of compliance and ensure that the staff is informed of new or amended regulations.
3. An independent monitoring function (internal audit), which shall review and evaluate the internal control (including risk control and compliance function). This feature will ensure that the scope and focus of the operation is in line with the Board's internal rules and shall also review and evaluate the friendly society's organization and routines.
4. A friendly society for occupational pension is also under the law of the Friendly Societies/ The Insurance Business Act obliged to have access to proper actuarial resources. These actuarial resources must be of a certain quality, stated in FFS 2011:19 (not available in English).

### Life insurance companies:

By tradition life insurance products and pension products have been offered from regular life insurance companies. Within each company these different lines of business have been kept separate when it comes to the actuarial accounting and bonuses and so on.

Life insurance companies are regulated by the Insurance Business Act and can either be a limited company, which has a General Meeting, or a mutual insurance company, which has a General Meeting or a Council as described above. Furthermore they are obliged ("comply or explain") to have functions of risk control, compliance and internal audit as described above.

### Pension foundations:

A pension foundation's highest decision-making body is the Board of directors, it has no General Meeting or Council.

Pension foundations are regulated by the Securing of Pension Obligations Act which provides that there shall be a Board of Directors which is responsible for the foundation's assets are located in a prudent manner and are not used for anything other than the foundation's purpose.

The Board adopts statutes, investment guidelines and Annual Report. It decides on directors' fees, awards chairman, authorized signatories and accountants, grants compensation and decides on liquidation of the pension foundation. Foundation board members are elected in equal number of employer and the employees covered by its purpose. Any legal requirement for a CEO or other feature is not available for pension foundations. FFFS 2005:1 does not apply to pension foundations.

## **United Kingdom – Charles Cronin & Ruth Goldman**

### Introduction

Most UK schemes are set up as trusts, a legal structure connecting the contributions provided by the plan sponsor and its pension promise with the assets held for the benefit of the beneficiaries. The relationship between, the sponsor, members and trustees plus agents defines the governance structure. There are just under 6.5k pension schemes in the UK, with total assets of €1.4tn<sup>13</sup>. Only a fraction of these schemes would be considered large by leading financial intermediaries. Consequently most schemes have very limited operating resources. Typically they are either entirely outsourced or otherwise managed by a small full time staff and rely heavily on outside advice and operational support from actuaries, consultants and investment firms. Trustees are bound by fiduciary law to act in the sole interest of the beneficiaries. The general power of investment lies with the trustees, limited by statutory requirements, together with an obligation “to obtain and consider proper advice”. The 1995 Pensions Act and the financial services legislation paved the way for strong influence by investment consultants. The reliance on consultants is contentious, UK law does not require trustees to have detailed expertise, but there is an obligation to obtain proper advice. The duty of care and generally referred to as the Prudent Person Rule, requires trustees to act with 'reasonable care and skill'. Lord Myners report (2001) criticised trustees for lack of investment expertise. The short comings of trustees and consultants exposed by Myners, was academically researched by Clarke.

The relationship between the sponsor and trustees is expanded under the 2004 Pensions Act and codified by the Pensions Regulator. It is thought this has created a gap between sponsor and trustee. In respect to risk management, the sponsor of a well-funded scheme puts strong emphasis on return, whereas risk minimisation dominates under-funded schemes. However, there are exceptions to this behaviour, a sponsor may seek risk to increase the discount rate and reduce to reduce an accounting deficit. The accounting rules FRS17 and IAS19 have eroded the employers risk taking capacity (Boeri 2006) and triggered the closure of plans (Klumps 2003). Trustees have in many cases become more risk averse as they are not rewarded for risk taking. The variables considered are: status of the plan with regards to ongoing or closed, funding level and the strength of the sponsor's covenant. Risk immunising LDI strategies are usually driven by trustees. However this trend has been held in check firstly by under-funding and more lately by low bond yields, making the process prohibitively expensive.

### Legal Framework

Occupational pension schemes in the UK are mostly trust based and hence supervised under ‘the Law of Trustees’, two significant Pension Acts 1995 and 2004 and codes of practice from the UK Pensions Regulator (tPR).

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<sup>13</sup> OECD 2011

- The Law of trusts - probably originates from the 11<sup>th</sup> Century and has developed over the centuries. The **trustee** and the obligation of the trustee to act as a **fiduciary** are key components of the trust law.

A **Fiduciary relationship** is,

“where one person, in a position of relative vulnerability, reposes a high degree of confidence, good faith, reliance and trust in another, whose aid, advice or protection is sought and valued in connection with some matter of not inconsiderable importance. In such a relationship, good conscience requires the party providing support to act at all times for the sole benefit and interest of the party requiring support - with utmost loyalty, diligence and attention”.

As regards pension schemes; trustee duties can be boiled down to<sup>14</sup>:

- Act in line with the trust deed and rules
- Act in the best interests of the beneficiaries
- Act impartially
- Act prudently, responsibly and honestly

The powers of trustees, though they vary from scheme to scheme are generalised as follows:

- accept contributions into the scheme;
- decide the investment strategy and invest the scheme's assets;
- amend the rules of the scheme;
- admit members on special terms;
- agreeing the funding strategy and recovery plan and
- terminate and/or wind up a scheme.

They commonly have the following discretionary powers, such as:

- who will receive a dependant's pension;
- who will receive a lump-sum death benefit;
- whether to pay a pension on early retirement; and
- whether to accept a transfer into the scheme.
- increase (or 'augment') members' benefits

Trustees are usually, under the Trust deed, forbidden to delegate their powers, except in accordance with UK law. Trustees always remain personally liable for the consequences of delegation. However, in the case of delegated investment decisions, this liability is more restricted.

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<sup>14</sup> Duties and powers of trustees <http://www.thepensionsregulator.gov.uk/guidance/guidance-for-trustees.aspx#s1542>

- Pensions Acts 1995 and 2004 – The 2004 Act largely replaced the 1995 Act and transposes the IORP Directive (2003/41/EC) into British Law. The 2004 Act contains the following pertinent provisions with respect to governance.
  - Trustees must have knowledge and understanding of the law relating to trusts, the principles relating to the funding of occupational schemes, the investment of assets and other matters as prescribed. Note that there is no requirement for a trustee to be an expert, only to have “knowledge and understanding”.
  - One third of trustees must be member nominated
  - The provision of a Statement of Investment Principles (SoIP), this document governs the decisions concerning investments for the purposes of the scheme. SoIP, reviewed every three years or after a significant change in investment policy. Trustees are required to set out in SoIP the “ways in which risks are to be measured and managed”
  - There are only two restrictions on investment rules, the scheme must not invest more than 5% of its assets into the employer related investments and must not grant any loans to the employer. Otherwise investment rules on trustees follow the ‘prudent person rule’ and the statutory requirements under the legislation.

The following relevant sections of the 1995 Act are still in effect:

- The trustees must appoint the following professional advisors (1995 Act s.47), Auditor, Actuary, and a Fund Manager (if making individual investments). A legal adviser is not a mandatory requirement, but the appointment of one is considered as “good practice” by the Pensions Regulator.
  - “Before investing in any manner”, trustees must receive and consider “proper advice”. The definition of what is construed as proper advice is described in s.36(6), effectively it is someone who is regulated to give advice under the Financial Services Act 1986, or “a person who is reasonably believed by the trustees to be qualified by his ability in and practical experience of financial matters and to have the appropriate knowledge and experience of the management of the investments of trust schemes”.
- Codes of practice – there are both codes created by the pensions regulator and guidance by the regulator. Guidance is not a statement of the law but of the law must be taken into account by the regulator, a court or tribunal, if they are relevant to what is being decided.

The organisational structure

IORPS which are not contract-based individual schemes will typically be set up as trusts and registered with HMRC in order to benefit from favourable tax treatment. This applies to both defined benefit and defined contribution type schemes. They are governed by trust law, by statutory pensions legislation and by their scheme documentation. They are regulated by the Pensions Regulator

Contract – based defined contribution workplace schemes are increasingly common and not governed by the trustee governance structure set out below. They are governed by contract law and by legislation under a different regime – see below.

Group workplace contract based schemes

These are work based personal pensions, even if they are provided to employees on a group basis, and so currently would not be affected by legislation biting on IORPS – although their characteristics in terms of “governance need” are quite similar in many regards. They are governed by the Financial Services authorities.

Under the Financial Services Authority principles there are rules of governance in the sense of needing to maintain the appropriateness of the product for the employers workforce (PS11/08) and for example (Principle 3) a provider must “take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems”. This summary does not look at the FSA principles further.

Occupational pension schemes in the United Kingdom (UK) are going through an extended period of transition; the majority of these schemes were defined benefit (DB), but are now closed to new members, often also to further accruals and consequently many are in run-off.

Board of Trustees

The board, with its fiduciary duty, is responsible to the beneficiaries of the scheme. Contributions to a pension scheme come directly from the corporate sponsor (employer) and/or indirectly from the scheme members. The corporate sponsor, as the scheme’s guarantor, bears the investment and funding risk. The interests of the sponsor, the board and members are heavily intertwined, although conflicts of interest are prohibited. As mentioned above, at least 1/3 of the board of trustees must be member nominated. The board of trustees acts collectively and is frequently organised into sub-groups representing the key functions of the pension scheme. The table below illustrates a sample of sub-committees found in large UK pension schemes.

Sub-committees from a sample of large UK pension schemes 2011/12						
	BAE	BT	Railways	Royal Mail	Universities	Number out of 5
Assets £bn	8.9	36.0	17.7	30.7	34.2	
Members 000s	129.5	326.6	425.8	338.8	287.6	
Audit	X	X	X	X	X	5
Investment	X	X	X	X	X	5
Discretions	X	X	X	X		4
Administration		X		X		2
Funding			X	X		2
Policy		X			X	2
Internal Dispute Resolution				X		1
Advisory					X	1
Executive			X			1

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Joint Negotiating					X	1
Nomination & Governance					X	1
Remuneration					X	1
Rules					X	1

By law the board must nominate and engage professional advisers and seek “proper advice”. The following section lists and describes the professional advisers.

### Scheme Auditor<sup>15</sup>

The trustees must appoint an auditor pursuant to s 47 PA 1995. The auditor may be an individual or firm and, pursuant to regulation 4(1)(a) of the Scheme Administration Regulations, must be eligible for appointment under Part 42 of the Companies Act 2006, or otherwise approved by the Secretary of State.

Similar rules of appointment apply to auditors and for actuaries, although the bar on a trustee (or anyone ‘connected’ or ‘associated’ with a trustee) acting as auditor, is wider than the restrictions for actuaries. The auditor also has a duty to ‘whistle-blow’ (s 70 PA 1995).

An auditor is required to express an opinion as to whether or not the accounts of a scheme show a true and fair view of the financial transactions of the scheme during the scheme year, details of any dispositions of scheme assets (including the amount) during the scheme year and liabilities of the scheme, other than those relating to the payment of pensions and benefits after the end of the scheme year (The Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, reg 3). The auditor’s report will be contained in the scheme accounts.

Where the auditor’s opinion under regulation 3 is negative or qualified, he should provide a statement of the reasons (regulation 4).

The role of the auditor is to:

- Provide a report as to whether, in his opinion, the financial statements show a true and fair view of transactions, assets and liabilities (other than liabilities to pay pensions and benefits after the end of the scheme year) and contain the information required by the Regulations; and
- Provide a statement as to whether, in his opinion, contributions have, in all material respects, been paid at least in accordance with the schedule of contributions (for defined benefit schemes), or the payment schedule (for defined contributions schemes).

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<sup>15</sup> Technical Release 02/08, Actuaries’ and auditors’ inter-professional communication, pensions and other post-retirement benefits, ICAEW 2008

This statutory requirement covers the financial statements as a whole and so the scheme auditor considers the scheme actuary's work relevant to the numbers or other information included in the financial statements or to the auditor's statement about contributions.

The auditor has no responsibility for checking the basis of the actuarial statements included in the annual report. Any liaison concerning the statements will therefore be because the client has asked the auditor to carry out some specific procedures, rather than because the auditor has any duty to check the statements. However, the auditor does read the 'surround' information with the financial statements.

### Actuary<sup>16</sup>

UK IORPS must have an appointed Scheme Actuary: actuary appointed by a scheme in accordance with s47 Pensions Act 1995 (the "PA 1995". The actuary must be a named individual, whether or not he or she works with a firm of actuaries (the "Scheme Actuary") (s 47(2)(b) PA 1995). The actuary will conduct and certify regular actuarial valuations of the scheme's assets and liabilities, set the assumptions to be used in that valuation, certify the schedule of contributions, as well as advising on day-to-day tasks such as members' benefits.

In order to be appointed the Scheme Actuary, the candidate must be able to demonstrate adequate qualifications and experience (s 47(5)(b) PA 1995). Regulation 4(1)(b) of the Occupational Pensions Schemes (Scheme Administration) Regulations 1996 (the "Scheme Administrations Regulations") require the Scheme Actuary to be either: (a) a Fellow of the Institute or Faculty of Actuaries; or (b) approved by the Secretary of State. An actuary may not be appointed if she is a trustee or 'connected' or 'associated' with a trustee (PA 1995, s 27).

Actuaries have a duty to 'whistle-blow' in certain circumstances (s 70 PA 1995). The actuary should decide when to report any breaches of the law (see the Regulator's Code of Conduct).

The scheme actuary's main responsibility is to provide forward-looking information about the liabilities and likely ability of the scheme to meet the benefit promises.

Under the Pensions Act 2004, the scheme actuary's duties in relation to scheme financial statements and certification include:

- Preparing an actuarial valuation of assets and liabilities in accordance with s.224(2)(a) and the associated certificate in accordance with s.225;
- Preparing an actuarial report in accordance with s.224(2)(b);
- Preparing a valuation under s.224(1)(b) where the technical provisions basis has been set by the Pensions Regulator;
- Preparing the valuation to enable risk-based pension protection levies to be calculated in accordance with s.179;
- Certifying the schedule of contributions in accordance with s.227;

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<sup>16</sup> Ibid

- Preparing the valuation of a closed scheme in accordance with s.156;
- In accordance with s.230(1), advising the trustees or managers of a scheme before they:
  - Make any decision as to the methods and assumptions to be used in calculating the scheme's technical provisions (s.222(4));
  - Prepare or revise the statement of funding principles (s.223);
  - Prepare or revise a recovery plan (s.226);
  - Prepare or revise the schedule of contributions (s. 227); and
  - Modify the scheme as regards the future accrual of benefits under s.229(2).

### Fund Manager

The duty of the fund manager is to invest the scheme's contributions, in accordance with the SIP. The portfolio manager's chief concerns are managing the risk and return of the investments, in a manner appropriate to the profile of the scheme's liabilities.

The Financial Services and Markets Act 2000 ("FSMA 2000") prohibits any person from carrying on a regulated activity unless they are authorised or exempt to do so under FSMA 2000. This includes the Trustees of IORPS set up under trust. Trustees will generally appoint an investment manager as opposed to seeking authorisation themselves (although note that trustees generally allow trustees to deal with trust assets – see paragraph 2.5 (s 34 PA 1995)).

An investment manager must be appointed where a scheme has 'investments' which include 'any asset right or interest' (as defined by s 22 of FSMA 2000) (s 47(2) PA 1995).

PA 1995 s34 permits the trustees to delegate investment decisions to fund managers authorised under FSMA 2000 (as well as other prescribed persons, such as a sub-committee). Trustees cannot otherwise delegate any investment decision (PA 1995, s 34(2)(b)). The appointed investment manager should be delegated a wide discretion to deal with day-to-day matters arising in connection with the scheme's investments.

Trustees may be treated as carrying out the regulated activity of managing investments by way of business where assets are held for the purposes of an occupational pension scheme (Article 4 Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001 (SI 2001/1177)). An exception to this is where all 'day-to-day' decisions are taken by an authorised or exempted person. Trustees will usually delegate investment management to investment managers in order to benefit from this exemption. There is no definition of 'day-to-day' decisions, but it is the nature as opposed to the frequency of the decision which will be the important factor.

### Custodians

A custodian holds the assets of a pension fund pursuant to the trustee's duty to keep trust assets safe. Investment managers will rarely hold assets, although there is no legal requirement

to appoint a custodian. The decision of whether a custodian should be appointed will usually be made by the fund manager. However, where the fund manager so decides, the trustees should ensure that the custodian is formally appointed in accordance with s 47 of the PA 1995 and regulations 4 and 5 of the Occupational Pension Schemes (Scheme Administration) Regulations 1996 (SI 1996/1715) in order to avoid potential sanctions in the form of a fine and/or removal when relying on his skill or judgment.

### Investment and Pension Consultants

The investment consultants can fulfil a key legislative role by providing the scheme with “proper investment advice”. More generalist pension consultants also provide advice and information on retirement provision to organisations, but there is no legislative requirement to have them. They can be involved in reviewing an organisation's current pension provision for staff members and recommending a range of options for consideration. They may then be involved in setting up and running schemes on behalf of companies. If the scheme outsources its fund management and scheme administration service, the pension consultant can play a key role in advising on the evaluation, specification and selection of these services.

### Legal Adviser

The legal adviser role is not a legislative requirement. It can be extremely broad, the primary role usually being to draft scheme documentation and to assist the trustees in making sure the pension scheme complies with all its legal obligations. Other areas of advice concern the outsourcing of services, funding arrangements, investment work and relationships with the corporate sponsor, which can be complex.

### The Pensions Regulator

The Pensions Regulator has published a number of Codes and Guidance relating to internal controls, risk and responsibilities. These Codes do not introduce new functions but do set certain compliance standards.

The Regulator is currently consulting on a Code of practice to ensure good governance standards for trustees of DC occupational schemes, including ensuring a comprehensive governance framework is established.

### Prudent Person Principle

Under UK law –

“Generally, in carrying out their powers and obligations, pension trustees in the UK are bound to exercise reasonable care and to show the prudence and diligence that an ordinary man of business would in the exercise of his own affairs. In the words of a 19th century court, the duty is to “take such care as an ordinary prudent man would take if he

were minded to make an investment for the benefit of other people for whom he felt morally bound<sup>17</sup>".

In accordance with common law principles, pension trustees also have a general duty to invest the pension scheme's assets and not allow them to sit idle, unless immediately required for the payment of benefits or other purposes.

Prudent Person Principle under US law is set forth in the Employee Retirement Income Security Act of 1974 (ERISA). ERISA Section 404 sets forth the general standards of fiduciary conduct, of which the level experience is set at a higher standard than in the UK:

"With the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character with like aims".

Body	Mandatory	Task	Composition	Appointed by
Board of Trustees	Y	Overall control of scheme	Individuals acting in a personal capacity or a corporate body. Trustees must have knowledge and understanding of law relating to pensions, trusts, funding and investment. Expertise is not required. At least 1/3 must be member nominated.	Employer and Employees
Actuary	Y	Conducts and certifies actuarial valuations of assets and liabilities. Certifies schedule of contributions	Must be a named individual, who is professionally qualified and demonstrate appropriate experience	Board of trustees
Auditor	Y	Provides an opinion on whether the financial statements are true and fair. Provides a statement that all contributions have	May be an individual or a firm. Must be professionally qualified	Board of trustees

<sup>17</sup> "Prudent Person Rule", Standard for the investment of pension fund assets – Russell Galer, OECD 2002

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		been paid in accordance with the payment schedule.		
Fund Manager	Y <sup>18</sup>	Invests the schemes assets and contributions according to the SIP.	Must be authorised under the FSMA 2000. Under the Act, authorised persons are required to be fit and proper, having had the appropriate training, competence and qualifications	Board of trustees
Legal Adviser	N – good practice	To assist trustees in legal compliance of the scheme	Professionally qualified	Board of trustees
Investment Consultant	Y	Fulfil the key a role of providing the scheme with “proper advice”	Investment consultants don’t have prescribed qualifications on the pensions compliance side (though they may have professionally)	Board of trustees

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<sup>18</sup> Mandatory appointment, if the scheme is making individual investments