

DC Project

# RISK MITIGATION MECHANISMS FOR DC RELATED RISKS

---

## Table of Contents

- I. Introduction**
- II. Responding countries**
- III. Analysis of the responses**
  - A. Investment risk (No.3) – accumulation**
  - B. Insufficient contribution level (No.4) – accumulation**
  - C. Inefficient administration (No.6) – accumulation**
  - D. Poor information provision:**
    - 1. Information documents – joining and accumulation (risk No.2,5,7)**
    - 2. Education – joining and accumulation (risk No. 2,5,7)**
    - 3. Choices around life styling –joining and accumulation (members proactivity)**
    - 4. Other mechanisms – joining and accumulation (risk No. 1,2,4,5,7)**
- IV. Conclusions**

## I. INTRODUCTION

DC focused project consists of two stages. First stage - mapping of risks to members of defined contribution schemes at key stages of the lifecycle of a participating member was developed to select the risks with higher risk value at each phase of the lifecycle. On the basis of this first stage mapping exercise the second stage of the project was developed when the selection of the risks which need further work and analysis was made. The second stage of the project looked deeper into the subject analysing specific risks highlighted in the mapping exercise as key issues for decision making process. The purpose was to look at specific risk mitigation mechanisms used by MS to mitigate respective risks and what the role of supervisors should be to ensure individuals avoid shortfall of the retirement benefits. The report also tries to map the differences or similarities between approaches taken by the Member States (MS) for specific risks. The effect of this exercise was to collect information from MS to obtain the full picture of legal and supervisory tools used.

The scope of the second stage of the project is wider than that of the 1<sup>st</sup> stage which looked only on "pure" DC occupational schemes. 2<sup>nd</sup> stage has taken into account all occupational pension schemes to analyse if there is a possibility to profit from risk mitigation mechanisms used for DC schemes with guarantees, hybrids, and DB schemes.

## II. RESPONDING COUNTRIES

<i>Code</i>	<i>Country</i>	<i>questionnaire</i>
AT	Austria	answered
BE	Belgium	answered
BG	Bulgaria	answered
CY	Cyprus	answered
CZ	Czech Republic	informed - no IORPS
DK	Denmark	answered
EE	Estonia	informed - no IORPS
ES	Spain	answered
FI	Finland	answered
FR	France	answered
DE	Germany	answered
GR	Greece	answered
HU	Hungary	answered
IE	Ireland	answered
IS	Iceland	answered
IT	Italy	answered
LV	Latvia	answered

LI	Liechtenstein	informed - no reply
LT	Lithuania	informed – no IORPS
LU	Luxembourg	answered
MT	Malta	answered
NL	The Netherlands	answered
NO	Norway	answered
PL	Poland	answered
PT	Portugal	answered
RO	Romania	answered
SK	Slovakia	answered
SI	Slovenia	answered
SE	Sweden	answered
UK	United Kingdom	answered

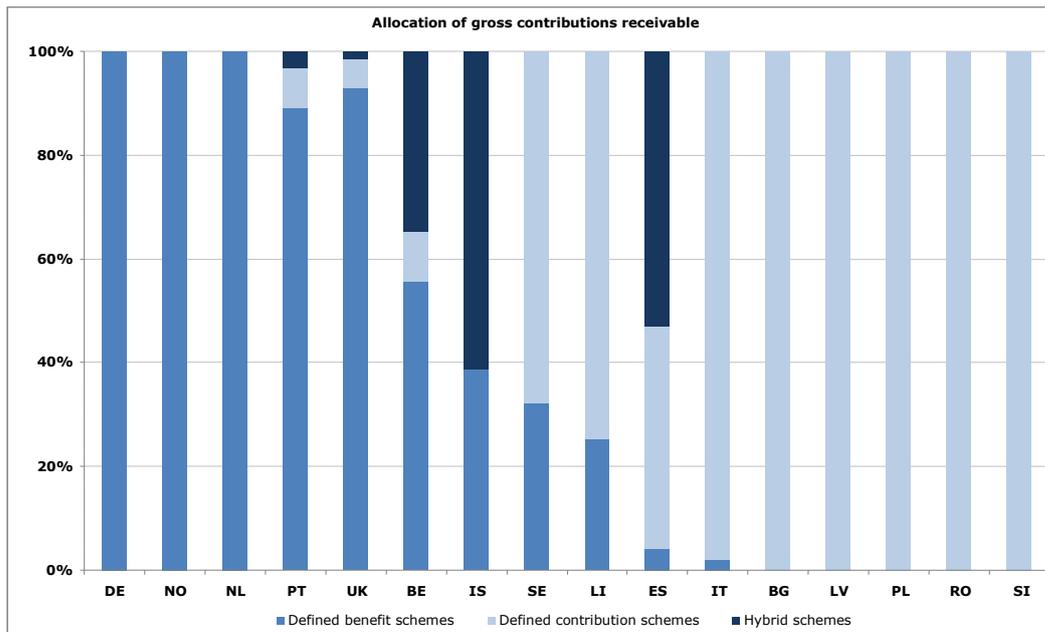
In total 30 replies out of 30 expected were received. CZ, EE and LT informed that they are out of the scope because no IORPS exist in their countries. LI informed that it is not possible to provide answer because their IORPS mainly operate in other jurisdictions and the rules or mechanisms of the host country are applicable.

DE stressed that it provided answers from the perspective of a DB country because only defined benefit schemes are permitted in Germany. This means that some risk mitigation mechanisms automatically apply, such as e.g. minimum guarantee by the employer, and that not all risk mitigation mechanisms mentioned are relevant, such as e.g. the creation of an appropriate default fund.

### III. ANALYSIS OF THE RESPONSES

The answers of the questionnaire provide information on risk mitigation mechanisms identified by respondents for the selected risks in all three life-cycle phases. However it was decided due to the high risk value score for accumulation phase risks to focus report mainly on accumulation phase risks with reference to those joining phase risks which have direct impact on respective accumulation risks and their mitigation. Payout phase risk mitigation mechanisms could be analysed at later stage if appropriate OPC request would arise.

When reading this report one should bear in mind the differences in design of pension schemes among the MS. Some of the risk mitigation mechanisms could not be relevant for countries where only pure DC or only DB pension schemes are provided. (see graph below for relevant pension scheme design in particular countries)



Source: EIOPA

It also should be borne in mind that this report is written from the perspective of pure DC schemes although some of the mechanisms described could not be applied to pure DC schemes. Therefore the focus of the report is to provide information on how MS mitigate the risks which in pure DC schemes are borne by members themselves and which have been identified in stage 1 of this project as being most valuable.

Selected risks used in this analysis are the following:

Risk No.	Name	Phase
1	Insufficient contribution level	Joining
2	Lack of member's understanding	Joining
3	Investment risk	Accumulation
4	Insufficient contribution level	Accumulation
5	Lack of member's understanding	Accumulation
6	Inefficient administration	Accumulation
7	Poor information provision	Accumulation

MS were asked to identify existing mechanisms for mitigation of the selected risks and provide further information on the rationale for the use of the respective mechanisms as well as way of implementation, assessment of the adequacy, and supervision of these mechanisms. There is a difference between mechanisms which are mandatory implemented by regulation or voluntary used. For mandatory use of mechanisms adequacy of the mechanisms is ensured by legal requirements and supervised by competent authorities in respective MS. For the mechanisms that are instead voluntary implemented among the MS and used on best practice

basis there are different ways of assessing whether the mechanism is adequately used and monitoring in these cases usually is done by social partners.

Responses received show a variety of risk mitigation mechanisms that exist in MS and how these mechanisms are implemented and supervised as well as popularity of mechanisms identified among MS. It has to be borne in mind that some mechanisms automatically apply in a MS or in opposite are not relevant to MS because of the pension scheme design introduced.

The analysis below is structured in the following manner:

- Information on investment, insufficient contribution and inefficient administration risk mitigation mechanisms is provided separately for each selected risk at accumulation phase.
- Mechanisms used to mitigate poor information provision risk have connection also to the risk of lack of member's understanding as well as insufficient contribution level in both joining and accumulation phases. Information on these mechanisms in their turn are structured into sections providing information on mechanisms related to information handouts, education, contribution, and other related mechanisms. This information in each section is provided including all risk mitigation mechanisms having relation to the respective section.

### **III.A. Investment risk – accumulation**

#### **Investment risk – accumulation phase**

In pure DC pension schemes investment risk is seen as the one having significant impact on ability to accrue adequate pension benefits. Seeing that 1<sup>st</sup> stage results showed market risk (being a component of the investment risk) is rated as the risk with highest risk value according to the respondents.

There are number of risk mitigation mechanisms which are used by Member States to mitigate impact of investment risk to potential pension benefits. When looking at those mechanisms one can conclude that significant role in risk mitigation is played by provision of some guarantees provided externally that can eliminate impact of the investment risk for pension plan members' accrued rights. These mechanisms are popular among MS but providing the guarantees requires pension plan to convert design from pure DC to other type of scheme. Nevertheless MS also use other risk mitigation mechanisms which do not

necessarily lead to conversion of the scheme design and could be used also for pure DC schemes.

The risk mitigation mechanisms for investment risk could be structured into the following groups which are:

- 1) Mechanisms related to provision of guarantees, e.g.
  - a. minimum guarantees by the IORP
  - b. minimum guarantees by the insurers
  - c. minimum guarantees by other financial institutions
  - d. minimum guarantees by the employer
- 2) Mechanisms related to investment limits, e.g.
  - a. maximum limits on investment in risky assets, such as equity, derivatives and alternatives
  - b. other limits on investments, such as diversification and geographical restrictions
- 3) Mechanisms related to asset allocation, e.g.
  - a. life-styling within investment
  - b. appropriate default funds with a long term view
- 4) Other mechanisms, e.g.
  - a. mechanisms related to governance
  - b. mechanisms related to risk management and internal control
  - c. information to members

The risk mitigation mechanisms identified for mitigation of investment risk are as follows (Please note that not all risk mitigation mechanisms could be applied to a MS because of the pension scheme design that exist in particular MS):

Risk mitigation mechanism	Exist	Mandatory	Supervised
Minimum guarantees by the IORP	AT, BE, DK, , DE (PK always, PF sometimes), IS, LV, LU, NL, RO, SI, , SE	AT, DE (PK), NL and SI	AT, BE, DK, DE, IS LV, LU, NL, RO, SI, , SE
Minimum guarantees by the insurers	BE, FR, NL	FR (for some particular products)	BE, FR, NL
Minimum guarantees by the other financial institutions	ES, IT, PT	IT (under certain conditions)	ES, IT, PT
Minimum guarantees by the employer	AT, BE, DE, FR, IS, LV, LU, NL, PT, SE and UK	BE, DE	BE, FR, IS, LV, LU, NL, PT, SE and UK
Maximum limits on investments	AT, BG, CY, DE, DK, FI, FR, GR, IS, IE, IT, LV, LU, MT, PT, RO, SK, SI, ES and	AT, BG, CY, DE, DK, FI, GR, IS, IE, IT, LV, LU, MT, PT, RO, SK, SI, ES and	AT, BG, CY, DE, DK, FI, GR, IS, IT, LV, LU, MT, PT, RO, SK, SI, ES and

	SE	SE	SE
Life-styling within investment	AT, FR, IS, IE, IT, LU, NL, PT, SE, ES and UK	UK (for default fund in stakeholder schemes only)	AT, IS, IT, LU, NL, SE, ES and UK (for stakeholder requirements)
Appropriate default funds with a long term view	IE, PL, PT, SE and UK	PL	PL
Single investment policy for all members (no investment options)	CY, FI, LV and GR		CY, FI and LV

It would be concluded from the table above that the most popular risk mitigation mechanism used among MS is to set the maximum limits on investments. This risk mitigation mechanism is not only the most widely used but also mandatory requirement for most of respondents. Provisions of minimum guarantees are also widely spread risk mitigation mechanisms although for most of respondents these mechanisms are applied by common practice instead of mandatory requirement. In the same time such mechanisms as life-styling and appropriate default fund are not widely used for mitigation of investment risk.

#### Minimum guarantees by IORP

12 respondents (AT, BE, DE (PK always, PF sometimes), DK, IS LV, LU, NL, RO, SI, SE) reported minimum guarantees provided by IORP is used as risk mitigation mechanism in their pension system.

Some respondents (AT, DE (PK), DK, NL and SI) indicated mandatory use of this mechanism. In Luxembourg, it is mandatory in case of voluntary contributions. Albeit AT indicated the mandatory use of this mechanism their legislation still provides possibility to opt out of this guarantee and in reality most of the members use this possibility. SI indicated that there is possibility for IORPS to offer higher guarantee as prescribed by law. IS informed that only government pension fund is providing minimum guarantees. The rest or majority of the respondents (BE, DE (PF), LV, LU, RO, SE) indicated voluntary use of this mechanism in their countries although infrequently used.

All respondents also reported that these requirements are implemented through formal way via legislation or secondary regulation, informal formats such as guidelines and best practice are not used. As regard the question to inform who has responsibility to ensure existence and adequacy of the respective mechanism AT, SI and RO informed that adequacy of these mechanisms is ensured by supervisor, in PT it is carried

out by sponsors while the rest of the respondents indicated this responsibility lays on IORPs (or pension funds if appropriate) themselves.

With regard to supervision matter all respondents confirmed that respective risk mitigation mechanism is supervised by supervisory authority. Most of the supervisors (AT, BE, DK, DE, LV, LU, PT, RO and SI) have specific reporting and information requirements to apply off-site analysis, some of them (AT, DE, LV, LU, PT) are also using on-site inspections as the supervisory technique but ES use on-site inspections as the only supervisory technique. The main focus of supervisors as regard supervision of this mechanism is to ensure compliance with solvency requirements and adequacy of actuarial assumptions used in calculations.

i. Minimum guarantees provided by insurers

In addition one respondent (NL) informed that in their jurisdiction some guarantees by an insurance company could also be identified where insurers operating DC schemes include minimum guarantee to the contract on voluntary basis although this mechanism is used very seldom. In BE this mechanism also exist and even is very commonly used. FR and ES also indicated guarantees by insurer to be a common practice. In FR for some products, the participant can choose an investment unit where minimum value is guaranteed and the insurer is required by legislation to guarantee the value of the investment unit. Also for some specific hybrid schemes, the participant purchases a deferred annuity (where minimum amount is known from the date of purchase) and the insurer is required by legislation to guarantee the amount of the lifetime pension that will be paid.

ii. Minimum guarantees by other financial institutions

In ES and PT the minimum guarantees have to be given by a financial institution different from IORP (pension fund managing companies) that manages operationally and financially the pension scheme assets. In ES this financial institution is normally an insurance company but it can be other kind of financial institutions. There is a frequent use of this mechanism and it is supervised by supervisory authority. In Italy a minimum guarantee is offered as a default option by pension funds to accept tacit adhesion (see automatic enrolment). Guarantees are not paid by IORPs but by the investment managers, selected to manage assets of contractual pension funds, or that set up open pension funds.

Minimum guarantees by employer

Another well-known risk mitigation mechanism is minimum guarantees provided by employer to ensure potential benefits of their employees occupational pensions are not exposed to fluctuations of financial markets. 12 respondents (AT, BE, DE, FI, FR, IS, LV, LU, NL, PT, SE and UK) reported provisions for this mechanism used to mitigate investment risk. At the same time IS reported that only government scheme provides such guarantee while LV reported that although this mechanism is allowed by legislation it is not used in practice. NL and PT indicated that this mechanism is used very infrequently. On the other hand in BE this mechanism should be applied mandatory by requirements of social and labour law. DE also informed that this mechanism is a mandatory legal requirement set in Labour Law because only DB schemes are permitted in Germany. The rest of respondents indicated this to be voluntary approach and in most cases also no legal requirements are laid down. Only in AT there is legal basis for the contract between employer and employee while in LV if employer decides to provide minimum guarantees legislation requires IORP to develop specific pension plan for employees of respective sponsor. In FR and FI this mechanism is applied to group insurance DB products only where benefits are paid only if the employee stays in scheme by retirement (no benefits are entitled for early leavers). In FI only DB schemes exist, and DC schemes are allowed only from the beginning of 2010. The respective requirements of the DB group pension insurance are stated in the pension fund law.

With regard to question on who has responsibility to ensure existence and adequacy of this mechanism only few respondents confirmed monitoring of the adequacy. In BE adequacy of the mechanism is ensured by Ministry of Pensions and Ministry of economics, in LV, LU and PT this is done by employer itself while the rest of the respondents indicated that such monitoring is not provided at all.

In the same time with regard to supervision matter DE reported this mechanism is not supervised by supervisory authority while others reported ongoing supervision is provided to check sustainability. In LV and PT in addition a pension plan committee for each pension plan has to be set up that has responsibility to monitor funding status. In UK the sponsor covenant and PPF would apply to schemes where there is a promise to pay a definite level of benefits. The covenant is the promise that the sponsor makes to the employees about the level of benefits they will enjoy on retirement. The PPF is the guarantee fund if the employer becomes insolvent and cannot stand behind the pension promise.

#### Maximum limits on investments

Another mechanism to mitigate investment risk is to apply investment limits for investments of IORP assets. It has to be stressed that all MS had

to implement Article 18 of the IORP Directive that refers to investment rules. This means that prudent person rule is implemented. The following section provides information on investment limits applied in accordance to the IORP Directive that might help to mitigate the risks borne by members. Particularly this is used for investment in risky assets such as equities, derivatives, alternatives, etc. A significant number of respondents (20) (AT, BG, CY, DE, DK, FI, FR, GR, IS, IE, IT, LV, LU, MT, PT, RO, SK, SI, ES and SE) confirmed use of this mechanism. The mechanism is used for limiting exposures to risky assets and diversification purposes. The use of the mechanism is mandatory for all answering countries (except FR where for unit-linked products, the participant can choose up to 100% risky assets), implemented through legislation and regulation consistent with IORP Directive. Being mandatory mechanism implemented via legislation this mechanism is applied for all IORPs of the respective countries. Some respondents reported that IORPs are required themselves to determine additional limits to risky assets as part of risk management function. IORPs are requested to set up these investment limits in investment policy.

Existence and adequacy of the mechanism is ensured by entities themselves being IORPs or their administrators/managers/trustees if applicable in most of the countries (BG, DE, DK, FI, GR, IS, IE, IT, LV, LU, MT, RO, SI, SK, ES) while the rest of the countries (AT, CY, PT) this is done by supervisor.

With regard to supervision matter all respondents except IE reported this mechanism being supervised by supervisory authority. In SI in addition supervision is provided also by Ministry of Labour while in LV and IT where IORPs should use external asset managers supervision should be done not only by supervisory authority but monitored also by IORPs themselves and custodians and whistle-blowed to supervisor in case of breaches. The main commonly used supervisory technique is regular reporting to supervisors which is used by all but IE where supervisor will react on complaints only and MT where supervision is done during scheme registration process. 6 respondents (AT, DE, FI, LV, SI and ES) perform also on-site inspections. In LV, IT and RO in addition there is also whistle blowing requirement on the custodian. Supplementary in CY, ES and PT also management committee needs to be set up to monitor compliance with investment limits.

Limits on maximum investments in risky assets could not be designated as a solely risk mitigation mechanism related to investment limits. Respondents have also referred to the investment restrictions that prescribe diversification limits (limits referred to single issuers, industry) as well as qualitative restrictions limiting investments in assets like non

traded securities, non traded derivatives, hedge funds and non quoted UCITS.

In BG, DE and PL legislation sets up list of category of instruments into which IORP assets are allowed to invest. PL reported this to be legal requirement that is used to limit investment risk profile.

In SK maximum concentration limits are used as risk mitigation mechanism to avoid high exposure to single issuer, industry and geographic region. This is mandatory requirement implemented through legislation and being subject to ongoing supervision. Similar risk mitigation mechanisms are reported also by BG, DE, ES, FI, LV and SI. SK has also applied qualitative limits (e.g. ratings) on investments to limit investments in low quality assets. Similar mechanisms are used also in DE, ES, SI and LV.

#### Life-styling within investment

Although life-styling within investment (automatic switching facility from funds with higher volatility over the longer period to ones with less volatility as retirement approaches) could be used as an effective tool to calibrate investment risk borne by members to the age of the members this mechanism does not seem widely used among MS where DC schemes are provided. 10 respondents (AT, FR, IS, IE, IT, LU, NL, PT, SE and UK) confirmed use of this mechanism.

At the same time only in FR, UK and IE this mechanism is commonly used while others indicated infrequent use of respective mechanism. All respondents confirmed voluntary use of this mechanism. However, for the UK, the exception applies for the default fund in stakeholder schemes, where it is mandated by law.

Responsibility of ensuring adequacy of the mechanism in all cases is delegated to IORP or trustees depending on countries pension system design.

As regard supervision in IE this mechanism is not supervised, in PT this is responsibility of the sponsor while other respondents confirmed supervision done by supervisory authority where ongoing supervision is mainly provided by both off-site and on-site reviews but UK indicated whistle-blowing is the primary supervisory tool used.

#### Appropriate default fund with a long term view

Investment risk also could be mitigated by use of appropriate default fund in cases when participants reject to choose investment options. However this is not found widespread risk mitigation mechanism among MS where pure DC schemes are provided. Some countries (CY, GR, LV) instead of

default fund have implemented requirement providing single or common investment policy for all members where no investment options are offered to members for choice.

Only 5 respondents (IE, PL, PT, SE and UK) reported this mechanism is in use in their pension system. In PL this mechanism should be applied mandatory while in IE and UK this is common practice but PT informed on infrequent use of this mechanism. Consequently all except PT reported wide use of this mechanism in their countries.

In PL and UK use of default fund is implemented through legislation (in the UK for stakeholder schemes) while in IE this is done on best practice basis and is best practice for the UK in non stakeholder schemes.

Adequacy of the mechanism is assessed by IORPS themselves or trustees/management committees where appropriate. In PL this responsibility subsequently is delegated also to the custodian but in PT the respective responsibility lies on sponsors only.

IE, PT and UK do not perform supervision of this mechanism while in PL it is supervised. Supervision is done as ongoing supervisory review checking compliance with investment policy.

#### Other mechanisms

Some of the respondents have identified several other supporting mechanisms which are used to mitigate investment risk in their countries but these mechanisms could not be considered very widespread because in general one or several countries have implemented the respective mechanism. Most of the mechanisms indicated are related to or derived from risk mitigation mechanisms described above in accordance to particularities of respondents pension system and have been added to the related mechanisms above.

In addition respondents (e.g. DE, IT, LV, NO, UK) stressed the importance of information to be provided to pension scheme members as crucial tool to improve members' knowledge and understanding (please, see also risk of lack of members understanding). They also referred to requirements related to risk management and internal control that are used to improve quality of the investments (please see also risk of inefficient administration).

##### *i. Mechanisms related to governance*

Respondents have also referred to the mechanisms related to governance being part of investment risk mitigation process that provides adequate level of professionalism and ensures involvement of members' representation to the investment process.

Some countries provided more detailed information on governance mechanisms. E.g. Poland (PL) identified regulatory requirements for the members of Executive Board of the IORP being part of risk mitigation process. This is a mandatory mechanism when fit and proper test each of the Board Members is done *via* licensing process. As of January 2011, RO has also implemented governance requirements such as fit and proper test for Board members and managers. Similar mechanisms are used also in other MS (e.g. BG, LV)

Another mechanism used in PL is requirement that half of the Supervisory Board should be elected from pension fund members representatives, in addition, the second half of the members of Supervisory Board should also have fit and proper test *via* licensing process. In DE, fit and proper rules apply to the members of the Management Board and the Supervisory Board.

IORP Directive provides that investments should be made in best interest of pension plan members. Respondents indicated this requirement implemented among MS also helps to mitigate investment risk. For instance, UK reported, that there are requirements regulating trustee fiduciary duties stating that investments should be in interests of the scheme members and beneficiaries. This mechanism is part of risk based supervision provided by supervisory authority.

### **III.B. Insufficient contribution level – accumulation**

#### **Contribution levels in the accumulation stage**

An adequate level of retirement income is very heavily dependent upon the member making adequate contributions over their working lifetime (although other factors, such as appropriate investment decisions, also play a part).

In Stage 1 of the DC project 'insufficient contribution level' for accumulating an adequate pension in retirement was identified as a key risk by most respondents. This risk was given the highest level of importance, and was thought to affect the greatest number of members.

Stage 1 therefore demonstrates agreement for the view that this is the main risk for DC members. In spite of the importance of this risk to the member, Stage 1 also showed that the members themselves may not be able to influence the level of contribution. The contribution level is often a decision made between the sponsor and the member, although practice on how this is set varies between Member States.

In Stage 2 of the DC Focused project, Member States were encouraged to identify what mitigation mechanisms were employed to reduce the impact of the risk of too low a level of contribution for an adequate income. The nature of the mechanism was also asked about – was it mandatory in law, common practice, entirely voluntary and so on and what supervision was brought to bear on the risk, and what rights the members enjoyed in relation to that risk.

The risk mitigation mechanisms for insufficient contribution level could be structured into categories as follows:

- 1 Fixed contribution levels
- 2 Minimum contribution levels
- 3 Mandatory progressive contribution levels (and automatic increases through lifecycle)
- 4 Tax incentives to increase contribution levels
- 5 Limited withdrawal opportunities before retirement
- 6 Restrictions on reducing/stopping contributions
- 7 Recovering unpaid contributions

#### Fixed contribution levels

Fixed contribution levels were not a commonly reported risk mitigation mechanism in law. However some member states identified fixed contribution levels as a risk mitigation approach.

One Member State (SK) reported a fixed contribution level (2%) in law; Iceland reported a fixed level of 12% (which was also the minimum); another reported that the contribution had to be fixed between employer and representatives of employees up to 7% of the salary at the start of the scheme (PL). 3 Member states reported fixed contributions as a 'not used' approach (NL, PT, IE).

Other States (AT, ES, SE, CY, LU) require agreed amounts to be set up between the sponsor and the employees which were then legally enforceable through contract/collective agreement arrangements. In IT private employee may adhere to a pension fund by paying a minimum contribution (7% of the salary). Changes to agreed amounts could be made only through established in law procedures (PL). One State (RO) reported that some pension funds would publish a minimum in their

prospectus, and that this document became part of the agreement that was enforceable between the fund and its members.

Where agreements had legal force (SE) they were supervised by the financial services supervisor who expected changes in technical guidelines, including premiums, to be reported. Where the agreed amount did not carry the force of law (LV) the monitoring was carried out by employer and pension plan representatives. Or, there was no legal requirement, but the Supervisor did review the agreement (LU).

Variations to the agreement had to be reported to the supervisor (PL), and individual members had recourse to the court system (PL) and to enforce the legal agreement for the contribution (SK). The supervisor may have the power to recommend an increase in the fixed contribution level (GR).

### Minimum contribution levels

Norway, Italy and Slovenia reported mandatory minimum DC contributions for different reasons. For Norway and Italy it was to facilitate an adequate retirement income for members. For Slovenia it was to avoid unreasonably small contributions for tax incentives. For France it is mandatory for specific pension schemes for self-employed, where the minimum contribution level determined at joining cannot be reduced. In case of reduction of the contribution below the minimum level set at joining, the tax benefit can be withdrawn.

Other states (RO, UK, GR) reported minimum contribution as common practice for voluntary contributions. The minimum requirement would fall on the employer and/or employee, and be enforceable if part of a prospectus (RO).

Generally, minimum contribution levels were designed to ensure that an adequate pension was received by the retirement member.

The UK reported a move away from voluntary systems to mandatory minimum levels for both sponsor and employee in a pension reform starting next year which is designed to encourage pension saving.

Some enforcement of minimum levels was by the tax authority (FR and SI) and others by the supervisory authority (UK).

### Mandatory progressive contribution levels (and automatic increases through lifecycle)

This mechanism allows for greater contributions to be made in accumulation, as the member heads towards retirement age. It was described as common practice for most respondents and generally linked to the age/length of working experience when entering a plan (SL, RO, SE) progression could be linked to inflation and earnings (SE and FI -DB only, and UK).

Where contributions were fixed as a percentage of pay (or agreed voluntarily) then the contributions automatically increased as pay increased (AT, GR, LV, NL, PL, PT, SE).

Where it was mandatory (SI), the contribution was supervised by the Labour Ministry and the Tax authority, and on site inspections could be used.

For the progression and increased contributions, there was the same range of enforcement and supervision mechanisms as reported for fixed contributions.

### Tax incentives to increase contribution levels

As a form of social policy, Governments can use tax mechanisms to mitigate the risk to the member of being unable to build up sufficient contributions in the accumulation stage to result in an adequate income in retirement. Tax incentives were reported in 20 MS.

In the survey questionnaire, Member States were also asked if tax advantages incentivise the contributors to increase contribution levels in the accumulation phase. The survey looked at risk mitigation mechanisms with a comparison of the nature, requirements, supervisory and enforcement techniques across the respondent countries. In general, taxes can produce a variety of intentional or unintentional consequences, thus tax incentives should encourage employers and employees to pay contributions into IORPS.

Regarding the survey questionnaire, the results show that except in Malta, tax incentives are in place in all the Member States responding to the question. The majority of countries showed commonalities on the use of tax incentives as a mechanism to promote employee and employer's

interest in increasing the level of contribution. It is usually established by legislation and the responsibility for ensuring the existence and adequacy of tax incentives remains with the tax authority. The rate of contributions to a pension plan are, to a limited extent tax advantageous for the contributors.

Regarding supervision mechanisms, in fourteen of the responding countries, the mechanism is supervised by an authority. In BG, FR, LU, DE, NL, CY, IT, PT, RO, SI and the UK, the tax authority is in charge of the supervision. In PL the Social Insurance Institution is in charge of the supervision regarding proper deduction (made by employer) of basic contributions from the salary taken as the base for calculating mandatory social security contributions of employees (into PAYG system); in relation to tax reliefs – tax authorities are in charge of the supervision. HU currently has no supervisory body. As for enforcement techniques, in SI the IORP must report annually to the tax authority on contributions paid.

#### Limited withdrawal opportunities before retirement

Allowing early withdrawal of contributions and funds built up in pension schemes can limit the overall income of members from pension schemes when they reach retirement. However, allowing access under defined circumstances may help to incentivise workers to contribute to plans where they will know that the funds are not 'untouchable' should life circumstances change. This will be also dependent on the nature of the plan and the role it plays in overall retirement income of members. The UK Government is currently consulting on whether allowing early access will help encourage greater levels of saving.

All respondents highlighted that they have in place some limits and prohibitions on when members may access funds built up for retirement. This is set at differing levels and circumstances but is normally attached to a defined age – although set at differing levels across Member States. Although in GR this follows the spirit of the law rather than being a legal obligation.

However, SI and SK allow access at any age before retirement but large penalties apply in most of the countries to discourage members from doing this. For SI, this is allowed only after 10 years membership and is valid only for contributions paid by the employer.

In BG for voluntary schemes, members may withdraw their contributions at any time. In BE access to funds is allowed when buying a house or to be used as mortgage collateral.

In two Member States (DE and FI) it is forbidden to withdraw money out of the IORP before retirement if the rights are vested.

Three Member States (AT, NL, UK) have a *de minimis* limit for 'trivial' pensions where the funds built up are deemed too small and so may be paid as lump sums. This means that regulation in these countries provides that in these particular situations, withdrawals before retirement are allowed.

Six Member States (FR, LV, PT, RO, ES and UK) allow access if the member suffers serious ill health. Three Member States (FR, PT and ES) allow members to access funds in case of unemployment. In PT and FR this is applicable in case of long term unemployment after specific number of years in that situation.

#### Restrictions on reducing/stopping contributions

Eight Member States have also highlighted requirements in the area of **sponsors wanting to reduce or stop contributions** to their schemes.

In PT there are restrictions on reducing or stopping contributions because once the pension plan is established the required contributions have to be met. However, there can be supervisory measures to overcome this rule but this is decided on a case by case basis..

In AT it is permitted if the economic circumstances of the sponsor justify this. A period of 3 months consultation with employees must be adhered to first and this is regulated by the social affairs ministry.

In FR for some group insurance products, contributions are mandatory during all the employment contract lifetime and this applies on roughly about 60% of pension schemes (including DB). For group insurance products which are specific to self-employed, the amount of contributions is determined in the contract and it cannot be reduced.

In GR sponsors and members of IORPs can reduce contributions if they choose to. The decision of reducing the contributions paid to the IORP is taken by the Governing Board or the General Assembly of the Fund, after the control of the National Actuarial Authority, regarding its viability (based on an actuarial study). This is also the case in LU under exceptional circumstances and is supervised by the CSSF.

In PL contributions can be reduced or stopped for up to six months in a 12 month period. After that, the employer must agree any reductions with the members and submit this to the supervisor.

In RO and also FI, contributions can be reduced or stopped at any time, in case of voluntary pension funds.

### Recovering unpaid contributions

Part of ensuring that sufficient contributions are made in order for members to build up adequate retirement incomes from DC schemes is the requirement for employers to honour their agreement to make contributions into the scheme.

Five Member States have highlighted that they have specific requirements and supervisory techniques to **ensure that contributions promised are paid** over to the scheme.

In BE and the UK there is a requirement for pension schemes to report to the supervisor if there are concerns or issues with unpaid contributions. In BE it is up to the IORP, if necessary through court, to order the sponsor to make good any outstanding contributions subject to a 3 year limit in claims. In the UK the supervisor has the power to enforce this so that the employer is required to make the contributions.

In IS an annual check is made by the IRS.

In NO offering a pension scheme is a legal obligation and the supervisor can act if employers do not honour this. This is supervised mainly through complaints received by the supervisor.

### Other mechanisms

Several Member States (BE, DE, FR, IE, IT, UK) highlighted a further mechanism that aims at tackling the issue of ensuring appropriate contribution levels.

This is the sending of the annual statement of the individual account that, in general, provides information regarding contributions paid as well as the annual pension projections to members that estimate the retirement income from current funds and contribution levels. The latter mainly aims to give the member an idea of the likely income that will be generated from the IORPs based on current contribution rates and to give options for adjusting the current levels of contributions to target a different level of pension (see also section III D.1 pension projections).

In DE, the employee gets information about the expected benefits from the social security system and occupational pension system once a year. Based on this information and the estimation of other financial assets the employee should be able to assess the necessity for additional old age provision.

Fixed assumptions to be used in this estimation are set by the Government on advice from the Faculty and Institute of Actuaries in the UK or by the SA in IT. In BE the assumptions are fixed in law with the possibility to deviate by Royal Decree after advice by the Pensions Commission (an advisory body to the government).

In FR for some group insurance products, the employer pays an additional contribution for each employee's contribution. This is a common practice set in the contract between provider and employer. In addition in France for some specific voluntary retirement products, there is a possibility to contribute for past school years although this mechanism is not widely popular. In this case it is possible to pay an extra contribution, corresponding to the contribution the participant could have paid during his college years. The tax incentive (deduction from participant taxable income) works for this extra contribution.

### **III.C. Inefficient administration – accumulation**

#### **Risk mitigation mechanisms for inefficient administration**

Inefficient administration composes a risk for all pension schemes, irrespective of whether they are DC, DB or hybrid. Poor administration can see to various stages of the process: (i) collection and administration of contributions paid, (ii) administration of benefits, and (iii) the administration of the investments that are acquired with the contributions.

Inefficient administration can cause a number of 'leakages' for plan members in DC schemes. Examples of these leakages are: (i) paid contributions are not or not correctly registered for the individual, (ii) the investments are not administered correctly for the individual, and (iii) the fees and costs related to the administration are unnecessarily high.

The responses to the questionnaire have provided a number of possible ways to deal with the problem of inefficient administration. These solutions can be divided into two main areas: (i) the functioning of the administration and the controls to it, and (ii) the costs related to administration. As inefficient administration can be an issue in any

pension scheme, none of the solutions presented will change the nature of a pension scheme.

The functioning of the administration and the controls to it

A number of mitigation mechanisms is available in respect of the functioning of the administration. The mechanisms can be scaled according to the impact of regulation and (external) supervision:

- a. central administration through a public body;
- b. supervision of external administrators;
- c. licensing of external administrators;
- d. possibility of performing on-site visits to external administrators;
- e. use of pension fund management companies who perform the administration on behalf of the IORPs.
- f. only dependence on the accountability of the IORP itself even if functions are outsourced to external administrators.

In addition, the way a pension system is set up can also imply some mitigation of the risk of inefficient administration. This is e.g. the case for countries that have a separation between the assets of a pension scheme and the administration and management of the pension scheme. In these countries, such as ES and PT, the administration is performed by pension fund management companies. In this case pension fund management companies instead of IORPs have a complete array of risk management and internal controls procedures and functions (internal audit, compliance) that help reduce the risk of inefficient administration

In RO and BG, pension fund administrators must be licensed and are subject to fit and proper testing.

The following table provides an overview of the approaches of the different Member States towards external administrators:

Central administration through public body	Supervision of external administrators	Licensing of external administrators	Performing on-site visits to external administrators	Use of pension fund management companies	Only dependence on accountability of the IORP itself
UK (from 2012)	MT, PL, SK, UK	IE, SI	DE, ES, LU, LV, NL, NO, PT	BG, ES, IT, PT, RO	AT, CY, DK, FI, GR, HU, IS, IT

1	4	2	7	5	8
---	---	---	---	---	---

### *Central administration through a public body*

The most far-reaching way of controlling the administration of a pension scheme is by setting-up a public body to administer the scheme. So far, no country has used this option. However, the UK is in the process of introducing it, as the NEST Corporation (National Employment Savings Trust) is going to administer a special pension scheme as of October 2012. NEST is a government sponsored body that is tasked with a public service obligation to provide a low cost pension scheme for those employers who must from 2012 enrol their employees into a scheme and make an employer contribution to that scheme. There is also experience with administration through a public body in the so-called pillar 1-bis schemes, which are being operated in a number of European countries (f.i., Hungary, Latvia and Slovakia). This experience can be useful for IORPs as well.

### *Supervision of external administrators*

In some Member States, external administrators are supervised in a way similar to the supervision of IORPs themselves. This may include supervisory powers like sanctions and redress, information requests and on-site visits.

In MT, pension fund administration can by law only be performed by persons that are 'registered under this Act as a retirement fund administrator or a scheme administrator as the case may be, or is otherwise registered by the Authority to perform any such services'. The Maltese supervisor supervises these administrators.

PL states that the 'Supervision authority may conduct control of the activity of fund, company, depositary as well as a third party entrusted with the performance of some activities by the fund or the company'.

The UK Pensions Regulator may issue improvement notices on 3rd parties, requiring administrators to change their practices.

### *Licensing of external administrators*

In some countries, IORPs are only allowed to outsource their administration to licensed administrators. Although these administrators are not supervised, there is some supervisory control over them. After all, their business model is checked when judging their licensing application. Licensed administrators are also typically subject to on-site inspections. The main difference with actual supervision of external administrators is

that supervisors can not use sanctions or redress mechanisms on licensed administrators.

In IE, the Pensions Board has a direct regulatory relationship with licensed pension administrators. This relationship includes annual registration, reporting and on-site visits.

#### *Performing of on-site visits to external administrators*

Some Member States allow supervisors to perform on-site visits to the external administrators. These on-site visits can be focused only on the way the administrator performs the administration of a specific IORP, as the administrator itself is in general not supervised (cases when the administration is performed by an institution falling under prudential supervision of the integrated supervisor are not considered here).

In DE, legal requirements ensure that the supervisory authority is authorised to request information from the external administrator and to perform on-site inspections at the premises of the external administrator.

In LV, the outsourcing contract between IORP and external administrator must allow the supervisor to supervise outsourced activities as well. This includes on-site inspections.

In LU, 'if an IORP delegates functions which have significant importance in terms of efficiency of control or which may affect the IORPs financial situation, to another entity, the CSSF may have a right of intervention'. This right of intervention includes the possibility of an on-site visit to the external administrator.

In NL, legal obligations ensure that the supervisor has the possibility to perform on-site inspections at the premises of the external administrator.

NO states that 'the regulation on risk management and internal control authorises Finanstilsynet to make on site inspection in service providers'.

In PT, outsourcing of pension administration is not used frequently. However, if cases arise, the supervisor has the right to perform on-site inspections on the service providers.

#### *Use of pension fund management companies*

In ES, the pension fund management company stays responsible for the performance of the external administrator. However, the supervisor is allowed to perform on-site visits at the administrators' premises.

#### *Only dependence on the accountability of IORPs themselves*

In this case, since there is no particular extra regulation as regards outsourcing of administration, the supervisor can only address the IORP for questions and issues related to inefficient administration.

Under this option, the control of the administration is basically in the hands of the IORP, as the IORP stays fully responsible for the administration. Supervision of the efficiency of the administration is then performed exclusively through the IORP. The IORP's responsibility is obvious if the IORP administers the pension scheme itself, but is also laid upon the IORP if the administration is outsourced.

### Costs related to administration

Several approaches are applied within Member States to deal with costs and fees of administration. For the most part, fees are negotiable between social partners, the sponsors (the 'contract partners' of pension plans) and the IORP, but some Member States have identified maximum limits on the fees that can be negotiated. Also, in most Member States disclosure of the negotiated fee structure is mandatory, in some cases with use of a standardised methodology for this disclosure.

The following table provides an overview of the different solutions:

Maximum limits on fees, disclosed in contract	Fees in contract, using standardised methodology for disclosure	Fees in contract
BG, ES, SK, RO, PL, SI	IT	AT, LV, LU, MT, NL, PT,RO, IT
6	1	8

### Maximum limits on fees

Some Member States have set maximum limits on the fees and costs that are allowed for the administration of pension schemes. Such limits are beneficial for the plan members, as they force IORPs to administer the pension scheme efficiently.

In BG, legislation exhaustively lists the types of fees the pension insurance company may charge for the management of the pension funds and sets their maximum limits'.

In SK, 'IORPs can charge only four types of fees all of them are capped'.

In ES, legislation sets a limit over the managing fee (2% of the patrimony) and on the deposit fee (0,5% of the patrimony).

In RO, maximum limits for administration fees (up front fee and monthly fee on assets under administration) are provided by law.

In SI maximum limits on fees are set in such way that allows only 3 types of costs that may be charged to members: entry fee, management fee and withdrawal fee.

#### Standardised methodology for disclosing fees and costs

Only one Member State uses a standardised methodology for fees and costs. In IT, regulation requires that all pension funds disclose costs according to a well definite structure of charges and using a synthetic cost indicator, based on a standardized methodology. These requirements are set to make pension products more comparable, and also serve to stimulate IORPs to work as efficiently as possible.

#### Fees in contract

Most countries 'only' use an obligation to put fees and costs in the contract between social partners and the IORP. Even though there is no automatic comparability, due to the lack of a standardised methodology, disclosure in itself serves as an incentive to ensure efficient administration.

### **III.D. Poor information provision – accumulation and joining**

Poor information provision is a significant risk for pure DC schemes bearing in mind that risks are mostly on members. To mitigate this risk several mechanisms could be introduced: such as to provide adequate, transparent and timely disclosure; to promote financial initiatives as well as other mechanisms that could help to reduce the risk that members take inappropriate decisions because of inadequate information provision.

On this basis information obtained on risk mitigation mechanisms regarding risks of poor information provision could be structured into the following groups:

1. Information documents – joining and accumulation
2. Education – joining and accumulation
3. Choices around life-styling – joining and accumulation (members proactivity)
4. Other mechanisms – joining and accumulation

Respective information on risk mitigation mechanisms is structured as seen in the table below:

	Joining phase	Accumulation phase	Encouraging proactivity in members choices (joining-phase)	Encouraging proactivity in members choices (accumulation-phase)
<b>D.1. Information documents</b>	<p>Delivery of pension projections (risk 2)</p> <p>Maximum limits on expected return that can be expected (risk 2)</p> <p>Maximum limits for the projection of possible capital value/annuities (risk 2)</p> <p>Standardized and comparable information (risk 2)</p>	<p>Delivery of pension projections(risk 5)</p> <p>Maximum limits on expected return that can be expected (risk 5)</p> <p>Maximum limits for the projection of possible capital value/annuities (risk 5)</p> <p>Standardised and comparable information (risk 7)</p> <p>Standardized information on returns on investment (risk 5)</p> <p>Scheme design (risk 4)</p>	<p>Disclose of choices available</p> <p>Design of application forms</p>	<p>Disclose of choices available</p>
<b>D.2. Education</b>	<p>Pension education in specialized education centres (risk 2)</p>	<p>Pension education in specialized education centres (risk 5)</p> <p>Use of financial planners specialized in retirement planning (risk 5)</p> <p>Dedicated member information websites operated by</p>	<p>Education by government/regulator</p>	<p>Education by government/re regulator</p>

	<p>supervisors and quasi-public organizations (risk 7)</p> <p>Guide on pension products, their characteristics (risk 7)</p> <p>Creating an independent body to provide free (risk 7)</p>		
<b>D.3. Design investment options</b>		Choices around life-styling	Choices around life-styling
<b>D.4. Other mechanisms</b>	<p>Automatic enrolment (risk 2)</p> <p>Other mechanisms (risk 1) (risk 2)</p> <p>Tax incentives (risk 1)</p>	<p>Other mechanisms (risk 7) (risk 5)</p> <p>Mandatory progressive contribution levels/automatic increase throughout life cycle (risk 4)</p> <p>Tax incentives (risk 4)</p>	

It has to be stressed that all MS had to implement Article 9 (c) and (f) and 11 of the IORP Directive that refers to information to be given to members and beneficiaries. This means that all members and beneficiaries in the EU/EEA receive at least a minimum set of information. The following sections provide additional information requirements besides the ones set in Article 9 (c) and (f) and Article 11 of the IORP Directive that may help to mitigate the risks borne by members.

### III.D.1. Information documents

Adequate and good quality information handouts to be provided for pension scheme members is a significant matter to improve members understanding about points where they need to make the decisions or have powers to influence outstanding issues. Therefore it could not only mitigate risks related to poor information provision but also sophisticate elimination of lack of member understanding. This could also have some impact on insufficient contribution level risk because in case when pension

scheme members would have sufficient and easy to understand information they could better make decision whether to pay additional contributions on individual basis to achieve adequate level of accrued benefits.

There are a number of handouts that could be provided to members at joining to support increase of their knowledge and awareness of decisions they are expected to make and how these decisions could influence their potential retirement benefits. The following risk mitigants are identified for joining phase:

#### A) Joining Phase

- Delivery of pension projections, including maximum limits on expected returns that can be suggested, and maximum limits for the projection of possible capital value/annuities
- Standardised and comparable information at joining

#### Delivery of pension projections

As in the DC context, the retirement income is uncertain and depending on several factors, members have difficulties to understand how much they are likely to receive at retirement, how much to contribute, which option to select, etc. To help member in making these choices, IORPs provide at joining projections of the annuity that may be reasonably expected by individual members at retirement. Using projections might increase the awareness of members regarding the level of the pension they will receive at retirement, and to encourage members to make their choices (investment options, contributions).

The answers regarding delivery of pension projections show a wide variety.

It is *recommended* by the supervisory authority to give information on the pension projections in AT, it is common practice in the UK to have generic examples and it is also common practice in IS to publish the projections on the website.

In NL it is part of the pre-contractual financial information leaflet and is used in all DC schemes. It is also mandatory in IE, IT and MT. In IE the projections provide a guide to the type and possible amount of benefits provided by the scheme, in IT all potential members receive at joining an estimate of pension they will receive at retirement. In FR, for some kind of hybrid products, the participant purchases a deferred annuity (which minimum amount is known from the beginning). In this case a pension

projection can be derived. In Malta's case, it is details of a retirement scheme's investment policy and any risk parameters applied by the Scheme to its investment policy which are to be provided to potential members on a mandatory basis rather than pension projections.

As for the supervision of pension projections both on-site and off-site inspections are used.

To avoid too optimistic and unrealistic provisions some countries set a maximum limit on expected returns that can be suggested to members.

In IT in its turn the SA set the maximum limit on the expected return on equity and on bond to be used by all pension funds in their computation. In AT the supervisory authority recommends the maximum discount rates to be used.

In DE, a member should get at least annually, beginning with the start of the contract, the information about his future benefits which includes at least the guaranteed benefits. If the information about the guaranteed benefits includes an estimation of the surplus it is supervised by BaFin that these estimations are not too optimistic.

#### Standardised and comparable information at joining

In order to facilitate the comparison of information related to different options/products/providers, often pre-contractual information documents are standardised. Standardised documents exist in some MS (i.e. DK, IT PT (only for open pension funds) NL). In FR for schemes where the participant has to make a choice for investment, information will be provided about available investment options. In LV the information is not standardised but legislation contains what information should be provided at joining and also prior to signing the affiliation contract the IORP should explain rules of the pension plan especially related to transfers, payout and fees and charges. In RO documents are not standardised but the pension scheme prospectus with key information for members is approved by the supervisory authority. As of January 2011, is mandatory according secondary legislation provision a minimum content of the prospectus to be handed out to the members at joining the fund. As mentioned earlier in the NL providers have to set values in the precontractual financial information leaflet which makes it possible to compare offers and to prevent providers from being unrealistically optimistic.

Pension projections — as an important piece of information for members joining an IORP — are used in some MS, irrespective of the fact if it is a mandatory regulation or not.

## B) Accumulation Phase

Provision of adequate information documents is very fundamental issue not only at joining but also at accumulation phase. Regular and adequate information delivered to pension scheme members would encourage them to review their choices regularly to ensure their choices made are up to date and still meeting their expectations.

The risk mitigation at accumulation phase would be done by using the same or similar mechanisms as for joining:

- Delivery of pension projections, including maximum limits on expected returns that can be suggested, as well as maximum limits for the projection of possible capital value/annuities
- Standardised and comparable information
- Standardised information on returns on investment
- Scheme design

### Delivery of pension projections

At the accumulation phase the approach is very similar to the joining phase.

15 MS responded questions regarding delivery of pension projections. No projections are used in RO, whereas in some MS projections are provided upon request of the members (CY, LU and PT). In LU delivery of pension projections is done on voluntary basis. In other MS projections are mandatorily delivered i.e. AT, BE, FR, DE, IE, IT, NL, NO and the UK. In these countries delivery of projections is done annually.

The responsibility for ensuring calculations of such projections are made is borne by the IORP in AT, DE and LU; in case of BE and SI it is the responsibility of the Ministry of Pensions and the Ministry of Economics (Belgium) and the Ministry of Labour (Slovenia). In other MS it is the supervisory authority's responsibility (PT, IT) whereas in IE and the UK the trustees of the scheme are responsible.

The content of the projections is very varied: in AT the Minimum Standards are published by the supervisory authority, in BE the content and format of the statement are standardised, in the NL a Uniform Pension Statement is provided which ensures comparability, whereas in NO the employer shall give its employees i.e information on what retirement pensions can be expected. In the UK projections must be sent to members showing expected income based on contribution level,

expected returns, economic and demographic assumptions. In the UK also, a maximum rate is set for projections. A lower rate should be used if investments are lower risk. In FR annual report sent to participant is presenting the evolution of his savings during the year, along with the level of the annuity that would be paid at the retirement date, based on this accumulated capital.

The general rationale for using the mechanism is that projections provide a guide to the type and possible amount of benefits provided by the scheme, and to allow members to make their choices (investment options, contributions).

As for the supervision of pension projections both on-site and off-site inspections are used, in BE supervision is done on a case by case basis upon complaints just as in NO.

There are also several approaches among the MS as regard maximum limits on expected returns that can be suggested.

The supervisory authority in AT recommends using at the utmost the maximum discount rates as agreed in the contracts as well as in BE with regards to the maximum limit to be adopted to the guarantee offered by the employer (i.e. 3,25% or 3,75%) . The maximum limit on the expected return on equity and on bonds is set by the regulator in IT. (Please, see also "maximum limits on expected return for joining phase) In DE, a member should get at least once annually, beginning with the start of the contract, the information about his future benefits which includes at least the guaranteed benefits. If the information about the guaranteed benefits includes an estimation of the surplus it is supervised by BaFin that these estimations are not too optimistic.

### Standardised and comparable information

To allow members to make aware choices regarding their retirement, especially when pension plans/products are highly standardized and individuals are free to choose between different providers, the standardisation of information is important.

In some MS the information to be provided to members is fixed by law or by law and supervisory regulations (AT, BE, FR, IT, LU, RO and SI). There are no specific guidelines in PT, whereas in DK the IORP has to have guidelines for providing information. The regulation is similar in PL where the employer shall inform its employees, in accordance with its standard procedure, of the terms and conditions of the scheme. The pension rules

and the technical note in LU and LV have to be approved by the supervisory authority. In CY information is given upon request.

### Standardised information on returns on investment

As members have to evaluate the returns on investment of their individual accounts, standardised information on returns on investment makes this evaluation more admissible.

There were 17 responses in this topic. Information is provided on an annual basis but in case of BG the pension insurance companies publish daily the value of the unit in each pension funds they manage. In IT, LV and PL information is standardised to ensure comparability. In PT there are no requirements to publish standardized information on investment returns. In ES the returns are calculated for the last year, the previous three years, the previous 5, 10, 15 years. In RO rate of return is published quarterly by all funds' administrators and the supervisor (calculated for previous 24 months)

### Scheme design

The risk mitigation mechanism "scheme design" could be another mechanism to ensure that the interests of pension scheme members are safeguarded. The answers of the Member States do not permit to draw a conclusion. Only seven Member States answered the question of the survey, where NL reported that they do not use it. IT and PT highlighted the fact that the design schemes offer different options - in the former to seize member' investment risk-return appetite and in the latter by matching contributions in which sponsor contributes proportionally to employee contribution. These two countries described the mechanism, as being common practice. As per requirements, in AT the levels of contribution have to be written down in the contract. AT and CY reported that the contribution levels depend on the agreement concluded between the employer and employee.

### C) Encouraging proactivity in members choices (joining-phase)

There is also a number of tools that could be used to encourage members proactivity and to ensure that members are aware of choices they are expected to make and they know how to do this. The examples of these tools are:

- Disclosure of choices available
- Design of application forms

#### Disclosure of choices available

To provide that the members take the most suitable and appropriate decision at joining choices available are disclosed.

9 respondents provided information on disclosure of choices. In the majority of the MS the choices available are disclosed (IE, IT, PT, BE and SK). In the aforementioned countries regulations on disclosure are specified in legal regulations or in legal regulations and minimum standards of the supervisory authority. In BE if there are choices, they should be disclosed but they are almost non existing. In PT there is a special emphasis within the pension communication packages on the explanation of differences and the risks between different investment options (if they exist).

#### Design of application forms

8 respondents provided information about respective mechanism. The application forms are not standardised among Member states. The application forms are approved by the supervisory authority in BG, in PL the documents including application forms have to be submitted in the licensing procedure. The rest of respondents informed that there is no regulation or supervisory approval on the (minimum) contents of application forms (AT, IT and PT).

D) Encouraging proactivity in members choices (accumulation-phase)

It is essential to ensure that members are active in evaluating of the choices available and making appropriate choices not only at joining but also regularly review these choices during accumulation. Disclosure of choices available would help encouraging members activism also at accumulation phase.

#### Disclosure of choices available

In the accumulation phase the regulations on disclosure are similar to those described for the joining phase. In PT on-going pension communications usually are accompanied by pension forms that allow members to change the investment options (new ones as well as account values). The disclosure of investment options is common practice in MS.

In SK management companies are required by law to publish information about funds performance on their websites and in the press.

The general rationale for the disclosure of choices is that the availability of information should facilitate decision making of members whether to switch between IORPs and/or investment options.

In the majority of the MS the choices available in the accumulation phase are disclosed.

### **III.D.2. Education**

Education is another important issue to ensure pension scheme members are adequately guarded from inadequate decisions. Sufficiently educated members can then make decisions which are adequate for their risk appetite and pension expectations and to evaluate their decisions according to their age.

#### **1. EDUCATION**

Providing education on pension products/funds represents a continuous process, with concrete periodical actions with the scope to enhance the knowledge of members/future members in this field and the public awareness with respect to an important social matter.

An independent body to provide free, trustworthy and impartial advice on managing day-to-day finances and avoiding debt does not exist in the member states, except in the UK a statutory Money Advice Service was set up with responsibility for helping consumers to understand financial matters and manage their finances better.

Some large companies (mainly multinationals), especially when setting up the DC plan or changing the plan, create communication/information packages for the purpose of providing information and education on the plan rules and options. These packages usually include plenary communication session and/or one-on-one communication session with pension experts (PT)

Supervisory authorities from PL and BG offer periodically seminars and presentations, one member state (SI) mentioned a financial education program conducted by the government through Ministry of Finance, in order to enhance public awareness in financial issues.

Six countries (PL, IT, RO, BG, PT, LV) reported that supervisory authorities published pension guides on pension products and IORPs, devoted to provide information to members in a clear and simple format.

In one member country (IT), trade unions are also involved in providing pension education.

One member country (CY), supervisory authority, according to secondary legislation provision, organizes training programs for the managing committee, an attendance certificate being issued.

The overview of the answers received in the mapping exercise, presented above, identified different entities that provide education:

- Specialized independent body (UK)
- Supervisory authorities ( CY, PL, IT, RO, BG)
- Trade unions (IT)
- Employers (PT)
- Ministry of Finance (SI)

Means for providing education:

- guides ( IT, PL, RO, BG, LV, PT)
- seminars and conferences ( PL, BG, RO, CY)

## 2. MEMBERS PROACTIVITY - Joining

In order to encourage members to make their own choices regarding their potential retirement benefits, at each phase of the life-cycle, during the joining period, education by government/regulator could play a significant role.

### Education by government/regulator

9 respondents confirmed that this tool is used in their countries. Mainly, the supervisory authorities ensure the provision of general information on IORPs, as best practice, through web sites (IE, BG, RO, IT, PT, PL, ES); some countries published guides on pension products, in a simple and understandable way (LV, PL, IT, RO, BG, ES); 3 member countries supervisory authorities organize periodical seminars and presentations (BG, CY, PL, RO), in one member state (SI) the government has organized an information campaign in order to enhance public awareness.

## 3. MEMBERS PROACTIVITY – Accumulation

### Education by government/regulator

Also during accumulation phase education by government/regulator could play a significant role. At the same time this does not seem very widely used tool among MS. Six countries (LV, IT, PT, RO, BG, ES) mentioned

that supervisory authority published pension guides aiming to provide information to members. One country (UK) mentioned that an independent institution is set up to provide education and financial advice services in order to ensure a better understanding of financial matters to the public.

#### Other mechanisms

Generally, the requirement of providing annual information to members is a legal provision (AT, BG, CY, DE, DK, FR, LV, IS, PT, RO, IE, IT, ES, RO) and can be considered a useful information in order to allow members to actively make their choice; in ES the annual information refers also to funds' performance (ES), while in UK pension projections or maximum limits on expected returns are presented to members.

Three countries (BG, LV and PL) reported that members have the possibility to pay additional contributions, unless the employer pension scheme agreement provides otherwise.

### **III.D.3. Choices around life-styling (members' proactivity)**

The approach on providing choices around life-styling is very different throughout member states: from no mechanisms in place to standardization/regulation of application forms and periodical mandatory detailed information provided to the members.

There are countries where the investment choice in occupational schemes is not possible. In many cases, the employer in cooperation with the union choose the pension company, thus the employer and the union define the type of pension commitment.

If the pension plan has a life cycle mechanism all their members take part of it (ES).

At the joining phase, there are countries where a high degree of standardization of the information provided exists and there is no significant difference between the pre-contractual information to be supplied to members between occupational and personal plans (IT) in other countries (BG, RO) all application forms have to obtain prior approval from Supervisor.

Application form must indicate the choices available, this being mandatory according law provisions (IS, IE, SK).

At the accumulation phase, changes of the investment option is possible (IE, IS, IT, AT - only into a less risky strategy). In some countries the transfer of members between funds (RO, SK) is regulated.

From the answers of member states, we cannot identify a common specific relevant mechanism in place to encourage members to make their choices at each phase of the life-cycle.

In order to encourage members to make their own choices that would better fit members' expectations and risk appetite, at each phase of the life -cycle, choices around life styling could be used as effective risk mitigation mechanism:

#### Choices around life styling

Although considered as effective tool to encourage members' proactivism and better fit member's individual need this does not seem widely used mechanism among MS. 6 respondents confirmed use of this tool.

2 countries reported that during accumulation period the members can change investment options (AT, IS), in two countries (RO, SK) periodical information about funds performance should facilitate member decision to transfer to another fund (RO), to another fund or different investment strategy (SK).

Investment options as part of life-cycle funds - options for higher risk during the first accumulation years and then changing it to lower risk investment options as the retirement age closes - are used in PT and in the UK, but is not a common practice.

### **III.D.4. Other mechanisms**

#### Auto-enrolment

Other relevant risks which participants have to bear at joining phase are connected to the fact that they do not really understand the scheme rules, they do not contribute sufficiently, or they do not adhere at all. A mechanism to mitigate this risk could be auto-enrolment. Auto-enrolment means that employees will be automatically enrolled into their employer's qualifying pension scheme, with the right to opt-out within a period of time.

Fourteen countries answered this survey question. The majority of the responding Member States answered that the auto-enrolment mechanism exists in their country. Nevertheless auto-enrolment is not used in MT, PT and RO, while it is a common practice in SE, ES, IT, DK and in the NL.

CY explained that auto-enrolment is mandatory for IORPs for semi-state organisations employees and that it is a common practice for private

sector IORPs. The requirements are laid down in the pension fund rules. They further explain that the employees have to fulfil certain criteria to become a member of the pension scheme, i.e. working on a permanent basis.

According to Luxemburg's legislation, there's requirement to enrol all employees in the pension scheme once the employer set up a pension plan. A similar practice exists in BE, the NL, ES and in PT. Hence, in PT the tax authority regulation requires that the plan covers all employees and there is no option to opt out. This means that Portuguese employees are automatically enrolled in the plan.

An employer in BE can set up a pension plan for all employees or a limited category of employees based on specific criteria which may not be discriminatory (f.i. categories based on gender, part-time versus full-time are not allowed). All employees in that category are automatically enrolled. Opting-out is only possible for the current employees at the time of the instauration of the plan, except when the plan is set-up through a collective labour agreement (f.i. industry-wide pension schemes).

In France auto-enrolment is mandatory for group insurance contracts. The participant is auto-enrolled after a defined period of services for his employer (usually 3 to 6 months). The principles of auto-enrolment is stated in the law, but the actual requirements and rules vary from an employer to another (depending on the company's "work agreement"). For some products, there could be an auto-enrolment, but no obligation for the participant to contribute.

According to Spain's regulation, there's general principle of no discrimination. That means that all members of a company have to be enrolled in the scheme. The principle of no discrimination is reviewed by the supervisor. According to the answer of NL, a pension scheme is arranged for all employees in most collective labour agreements. This means that all employees are automatically enrolled in the scheme unless they specifically choose not to take part.

In the UK, the auto-enrolment will be a mandatory requirement from 2012. All employers will be required to auto enrol their employees which also provides for an opt-out clause. IT explained that private employees when they are employed for the first time in their working life in the private sector are automatically enrolled into an occupational pension plan (typically, the industry-wide occupational plan). They contribute with a contribution rate (severance pay provision) of about 7 per cent of gross salary. However, within 6 months the individual have the right to opt-out (in 6 months time).

Regarding the supervisory activity, the present risk mitigation mechanism is supervised in six countries.

### Other mechanisms

Apart from the auto-enrolment mechanism, there are also other methods that could be used to provide a better understanding of the pension scheme to the members. The answers of the survey questionnaire show that the Member States follow different approaches, have other mechanisms in place as enumerated in the survey that allow them to minimise the risks that members of the retirement scheme are facing. Hence, in this section, Member States were asked to point out their mechanisms in place.

According to the Bulgarian legislation, each fund member is entitled to receive a copy of the rules of the respective pension fund during the joining phase. It is also in IE a mandatory requirement to provide members with a copy of the pension scheme rules.

The Spanish and UK regulation prescribes a minimum of information to be given to members at joining. Similar practices exist in DE, PT and in PL. In PT, there are legislative requirements of information that need to be communicated to participants when they are joining the scheme, i.e. the delivery of plan rules, the investment policy statement, IORP regulations, benefits they are entitled and information about the financial, technical and other risks that the plan faces.

According to the Polish legislation, the potential scheme member has to receive a copy of the pension scheme agreement before the employee joins the scheme. This agreement determines the condition to be met by the employer and point out the proposed rules for accumulating and managing assets. While in LV the legislator implements a requirement for the IORPs to provide information on their web pages to ensure that the members get adequate information, the Slovakian legislation requires that the IORP publishes information in prospectus. SK explained that this mechanism ensures that members of the scheme have available and reliable information on the performance of their savings in order to decide whether to switch to a different fund.

Regarding the supervisory approach of the before mentioned methods, the answers of the member states show that these mechanisms are monitored by the supervisory authorities.

### POOR information provision risk

A reasonably clear generalisation that can be drawn from the answers received about the poor information mitigation mechanisms is that there is a mandatory obligation in all the Member States to provide the pension scheme members with adequate information.

In BG and RO each private pension fund member is entitled to receive annually free of charge an excerpt from his/her individual account. In this way the insured persons can monitor whether contributions are regularly paid, inform themselves about investment performance of the fund, fees collected, etc

In ES, yield and charges of every personal pension plan are given by the Spanish supervisor. This common practice enables a certain transparency.

In the UK, members receive annual projections of retirement income based on contributions/accumulation required in 'today's money'.

In IT, there are three documents that have the specific purpose to inform members. The so-called "*Nota informativa*", a complete description of the pension fund/plan, written as simple as possible, that includes a three-page summary of the essential features and data, to be handed to all members at the time they enter the plan or are considering to do so. The content and the format are standard for all kinds of plans and are set in detail by the SA. The primary law entrusts SA with the power to define contents and format of it. SA also offers guidance, in particular making available on its website a compiled sample of the *Nota informativa* for a "virtual" plan, for every kind of plans. A balance statement is sent annually to every member and whose contents and format are also defined by SA. The projections of the benefits have to be delivered to members at joining and annually together with the balance statement.

Other documents also have an informative content, but we do not see them as having the main purpose to inform members: this is the case of fund contract rules and of the annual report which might be delivered on request and are available on the IORP web-site.

While in CY, annual reports and accounts, statement of investment principles could be obtained after request, annual reports and annual individual account statements, information on annual report and annual accounts has to be published on IORP web page in LV. In the before mentioned country, there are rules on what information should be included in annual individual account statement. That's why an IORP in Latvia is obliged (mandatory requirement) to provide to the members annual information on individual account and legislation provides what should be included in this statement.

In SI, minimum requirements about annual information to be provided to members and beneficiaries are set in the law and for mutual pension funds additional rules are set in by law. Each member shall get at least information about contributions paid by employer and himself within the year, value of the fund at the beginning of the year and value of the fund at the end of the year. Poland reported that their legislation requires that the employees are informed by the employer on the rules governing the functioning of occupational pension scheme.

In NL, yearly members receive a pension statement. This document (Uniform Pension statement) makes it possible for members to compare and add up other pension scheme in which they participate. Next to that they receive a statement on their current capital. Also in PT, some information (like pension projection, initial information disclosure, annual information disclosure) are established through principles but there are not guidelines or specific templates on how it must be presented while other types of information (like the pension funds annual accounts) are regulated and have a minimum set of information that must be provided although the format is not prescribed.

In FR every year, the insurer sends to each member an annual report presenting the evolution of his savings during the year, along with the level of the annuity that would be paid at the retirement date, based on this accumulated capital. This is a mandatory requirement for all DC products.

The results show that each responding Member State of the survey questionnaire has procedures in place to guarantee that the members receive sufficient information on their scheme.

Regarding the supervisory approach of the before mentioned methods, the answers given by the Member States show that these mechanisms are monitored by the supervisory authorities (on-site and off-site inspections).

#### IV. Conclusions

The report shows that there is variety of different risk mitigation mechanism implemented among MS to mitigate risks faced by DC pension scheme members. It could also be concluded that there are different ways of implementation as well. While some countries require mandatory use of the mechanism in other countries this is used as voluntary common practice instead. In the same time it would also be concluded that most of the mechanisms in place are adequately monitored by IORPs or specially set committees according to the structure of each MS pension system.

Also most of the mechanisms are supervised by supervisory authorities or government bodies.

Results of the 1<sup>st</sup> stage analysis showed that in many cases pension scheme members of the pure DC schemes bear all the risks arising from the decisions made during their journey but members' possibilities to influence these decisions in many cases are quite limited. The analysis made during the 2<sup>nd</sup> stage of the project runs to the ground of the rationale for such an approach.

Analysis of the information provided by the respondents shows that there are different approaches among the MS influenced firstly by pension system design of the respective country but also by the approach taken to help pension scheme members to mitigate the risks they face while accumulating funds for retirement benefits. Since majority of the risks arise from the decisions made in relation to accumulation of the funds there are two main tendencies. One is to furnish the members with all the presumptive information and offer the choices members are able to make as the facilitation of members' decision making process according to their risk appetite and future benefits expectations. Another approach is to minimize the decisions and choices members need to make and form the system when decision making process is shifted from the members to other persons being professionals in the respective field.

There would be odds and shortages for both approaches taken. This report is not going to weight which approach would better meet the individuals' expectations in respective risk area.

The individuals are very different in their attitude to the retirement benefits accrual process. Some of them would expect direct involvement into this process and would be ready to actively make necessary decisions. Others on their turn would appreciate possibility to stay passive and allow other persons to make the necessary decisions for them.

The good balance between risks mitigation mechanisms providing both choices for members to decide themselves and mechanisms shifting responsibility away from members would probably lead to the best results facilitating the accrued benefits are in line with individual's expectation.

Results of this survey mark also another notable issue. Albeit there are risk mitigation mechanisms which are mandatory provided by MS legislation at the same time the analysis highlighted that part of the mechanisms are introduced voluntary on best practice basis. This approach could be more flexible and therefore able to duly react to the changes in individuals' attitude to the risk mitigation process. That could in some circumstances provide better results in achieving the aim to provide sufficient retirement benefits to the individuals.