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ANNEX

**Call for Advice from EIOPA for the review of Directive 2003/41/EC
(IORP II)**

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1. SCOPE OF THE IORP DIRECTIVE

1.1. Introduction

The IORP Directive deals only with occupational retirement provision. However, not all occupational pension schemes are covered. Occupational retirement provision, operating on a funded basis, is delivered through different financing vehicles and under different legal regimes in Member States. As regards book reserve schemes, it should be noted that Article 8 of Directive 2008/94/EC requires Member States to protect employees' rights, in particular outstanding supplementary occupational pension claims, in the event of the insolvency of their employer. Following the Green Paper consultation, the Commission is currently assessing the need to review this directive.

DC schemes existing in some Member States either do not fall under any EU prudential regulation or Member States have chosen to subject them to national legislation that is inspired from the provisions of EU prudential regulation for similar financial products (e.g. the IORP Directive itself or the UCITS Directive). The advice should therefore include an assessment of the provisions in the IORP Directive that could be extended to occupational DC schemes that are currently not covered.

1.2. References

- International:
 - OECD Core Principles on private pension funds
 - IOPS guidelines for private pension funds
- European Insurance and Occupational Pensions Authority (EIOPA):
 - Initial review of key aspects of the implementation of the IORP Directive (CEIOPS-OP-03-08 final), OPC, 31 March 2008, **Section 4.1.1 and Annex 1.**
 - Commission Staff Working Document accompanying the Green Paper - towards adequate, sustainable and safe European pension systems, SEC(2010) 830 final, 7.7.2010: **Table 1.**
- European Commission:
 - Green paper on pensions: summary of consultation responses (7.3.2011), question 8

1.3. Background: preliminary proposal for principles for draft Directive

The scope of the IORP Directive is contained in Articles 2 to 4.

1.4. Specific Call for Advice

The Commission Services would like EIOPA to advise on the scope of the IORP Directive, covering at least the following issues:

- The possibility to extend the scope of the IORP Directive to other occupational pension funds that operate on a funded basis.
- The provisions that would need to be amended or added (if any) in order to suit the needs for the supervision of those occupational pension funds.
- Other advise, if any.

2. DEFINITION OF CROSS BORDER ACTIVITY

2.1. Introduction

The purpose of the IORP Directive is to create an internal market for occupational retirement provision. It enables an undertaking located in one Member State to sponsor an IORP located in another Member State and, conversely, an IORP located in one Member State to accept sponsorship from two or more undertakings in other Member States. This follows from Article 20(1) of the Directive.

Three different approaches are used by Member States when defining cross-border activity of IORPs: location of the sponsoring undertaking, nationality of the social and labour law (SLL) and nationality of the scheme.

A related issue is that the definition of the "sponsoring undertaking" in Article 6(c) of the IORP Directive may need to be clarified. There are situations where company A in one Member State is taken over by or merged with company B in another Member State. Company A becomes a branch of company B. The question is whether the IORP sponsored by ex-company A (now a branch of company B) needs to follow the procedure for cross-border activity.

Because of the differing national approaches, situations can arise where two (or more) Member States potentially involved in a cross-border activity come to different conclusions whether or not the proposed activity is actually a cross-border activity. This hampers IORPs' willingness to engage in cross-border activities.

2.2. References

- European Insurance and Occupational Pensions Authority (EIOPA):
 - Cross-border IORPs. Note to the Commission. (CEIOPS-DOC-98-10)
 - Cross-border activity of IORPs. Practical issues paper. (CEIOPS-OP-37-09 (final))
- European Commission:
 - Commission report on some key aspects concerning the IORP Directive, COM(2009) 203 final, 30 April 2009.
 - Green paper on pensions: summary of consultation responses (7.3.2011), question 5

2.3. Background: preliminary proposal for principles for draft Directive

The intention of the IORP Directive is to enable an undertaking in one Member State to sponsor an IORP in another Member State.

2.4. Specific Call for Advice

The Commission Services would like EIOPA to advice on how the wording of the IORP Directive needs to be amended in order to clarify that cross-border activity arises only when the sponsoring undertaking and the IORP are located in two different Member States.

3. RING FENCING

3.1. Introduction

The IORP Directive does not contain a definition of the term ring-fencing but refers to the concept in Recital 38 and Articles 3, 4, 7, 8, 16(3), 18(7) and 21(5). Uncertainty exists about the legal conditions and practical consequences of employing ring-fencing measures, since they are applied differently by Member States.

Ring-fencing is a regulatory tool for compliance purposes and for the protection of the rights of pension scheme members and beneficiaries.

A distinction can currently be made between administrative ring-fencing and property protection rules in the context of stressed situations. Generally, the consequences for the protection of pension benefits differ depending on the combination of the legal form of the IORP, the various stress situations directly or indirectly related to a pension scheme and different levels of protection offered by patrimony protection rules and administrative ring-fencing measures.

Therefore, legal clarity at EU level regarding the scope and legal implications of ring-fencing measures may enhance the protection of pension benefits in various situations.

3.2. References

- European Insurance and Occupational Pensions Authority (EIOPA):
 - Initial review of key aspects of the implementation of the IORP Directive (CEIOPS-OP-03-08), 31 March 2008.
 - Report on Ring Fencing in Stress Situations (CEIOPS-OP-08-09 Rev6), July 2010.
- Directive 2009/138/EC (Solvency II Framework Directive): Article 99

3.3. Background: preliminary proposal for principles for draft Directive

The scope and legal implications of ring-fencing measures in various cases such as cross-border activity of IORPs and stress situations so as to protect pension benefits need to be properly assessed in the light of Directive 2009/138/EC, which for example states that ring-fenced fund structures give one class of policy holders greater rights to assets within their own fund.

3.4. Specific Call for Advice

The EIOPA advice should address at least the following subjects:

- The scope of ring-fencing measures needs to be clarified in the context of cross-border activity of IORPs.

- The text of an article to be inserted into the Directive with the aim of establishing the general principles which warrant ring-fencing measures in the case of stress situations, including the legal implications and common safeguards, which would improve adequate protection of pension benefits.

4. PRUDENTIAL REGULATION AND SOCIAL AND LABOUR LAW

4.1. Introduction

It is essential to establish at EU level the scope of prudential regulation so as to make a proper distinction between prudential regulation and social and labour law (SLL), whose scope is determined by Member States. A clear and uniform scope of prudential regulation would render cross-border activity of IORPs easier and less burdensome.

Directive 2010/78/EC (Omnibus I) introduced into the IORP Directive a requirement to develop binding technical standards (BTS) for the reporting of the scope of prudential regulation to EIOPA. However, the BTS solely introduce a common format but do not aim to clarify the scope of prudential regulation.

4.2. References

- European Insurance and Occupational Pensions Authority (EIOPA):
 - Overview of legal requirements under the IORP Directive (2003/41/EC) with which a guest IORP operating a pension scheme in a host Member State must comply, October 2009.
- European Commission:
 - Green paper on pensions: summary of consultation responses (7.3.2011), question 5
- Directive 2009/138/EC (Solvency II Framework Directive): Article 30

4.3. Background: preliminary proposal for principles for draft Directive

The scope of prudential regulation may need to be specified in the IORP Directive so as to distinguish clearly between prudential legislation and SLL. Inspiration may be found in Article 30 of Directive 2009/138/EC, which refers to the scope of supervision as executed by supervisory authorities in the case of insurance legislation.

4.4. Specific Call for Advice

The EIOPA advice should address at least the following subject:

- The IORP Directive needs to determine the scope of prudential regulation, as administered by the home Member State.

5. VALUATION OF ASSETS, LIABILITIES AND TECHNICAL PROVISIONS

5.1. Introduction

At the heart of a modern risk-based supervisory regime are market-consistent valuation rules for assets and liabilities. Technical provisions are the most important liabilities of pension funds.

The IORP Directive contains some references to valuation rules, but they remain vague. **Article 10** requires that IORPs give a "true and fair" view of their assets and liabilities in accordance with national law. In most cases this will be national GAAP (generally accepted accounting principles).

Given the importance of technical provisions, the rules in the IORP Directive are somewhat more specific. **Article 15** requires IORPs to establish an adequate amount of liabilities corresponding to the financial commitments arising out of the pension contracts (point 1). Where IORPs cover against risk, they are required to establish technical provisions (point 2). The minimum amount of these technical provisions is to be calculated on a forward-looking going-concern basis, including a margin for adverse deviation (point 4a). The directive does not require a risk-free discount rate. It allows the use of asset-based rates, high-quality corporate bond yields and government bond yields (point 4b). Biometric tables are scheme-specific (point 4c).

Moreover, the home Member State may make the calculation of technical provisions subject to additional and more detailed requirements (Article 15(5)).

The Directive also requires the Commission to issue a report at least every two years on the need to harmonise technical provisions to facilitate the development of cross-border activity (Article 16(6)). A first report was issued on 30 April 2009 (see references). The second report will be delivered in the context of the Commission proposal to review the IORP Directive. In its Report on the Pensions Green Paper, the **European Parliament** underlines Article 15(6) of the IORP Directive, which states that with regard to the calculation of technical provisions, 'the Commission shall propose any necessary measures to prevent possible distortions caused by different levels of interest rates and to protect the interest of beneficiaries and members of any scheme'.

An EIOPA report (see references) has shown that IORPs use different methods to calculate technical provisions. Some Member States provide for the use of a market-consistent risk free discount rate and biometric tables without additional prudence (e.g. for longevity risk). Some Member States require IORPs to take account of future inflation and salary increases and make an allowance for future expenses (e.g. cost for administration and asset management). Risk margins are not calculated explicitly. While the EIOPA report shows that Member States have adopted the principles set out in the IORP Directive, it also underlines that there are stark differences in the method to calculate technical provisions. A stylistic illustration in the EIOPA report (pg. 24-26) shows that the differences in the discount rate used and in

the approaches to inflation/salary indexation (mandatory or not) have a large impact on the level of technical provisions across Member States.

5.2. References

- International:
 - OECD Recommendation on the Core Principles of Occupational Pension Regulation, June 2009: Core Principle 3 (measurement of plan liabilities) and Core Principle 4 (valuation of assets).
 - OECD Recommendation on Guidelines on Funding and Benefit Security in Occupational Pension Plans, May 2007 (**for the annotations to Core Principle 3**).
 - OECD Recommendation on Guidelines on Pension Fund Asset Management, January 2006 (**for the annotations to Core Principle 4**)
- European Insurance and Occupational Pensions Authority (EIOPA):
 - Survey on fully funded, technical provisions and security mechanisms in the European occupational pension sector (CEIOPS-OPSSC-01/08 final), OPC Solvency Subcommittee, 31 March 2008: **Section 5**.
- European Commission:
 - Commission report on some key aspects concerning the IORP Directive, COM(2009) 203 final, 30 April 2009.
 - Green paper on pensions: summary of consultation responses (7.3.2011), question 8 and 10
- Directive 2009/138/EC (Solvency II Framework Directive): **Article 75** (valuation of assets and liabilities) and **Articles 76-86** (technical provisions).

5.3. Background: preliminary proposal for principles for draft Directive

Article 15 of the IORP Directive has to be amended in the light of the new supervisory regime and in order to facilitate cross-border activity. The following two articles of Directive 2009/138/EC could be applied, at least as a starting point, *mutatis mutandis*, to the IORP Directive:

Article 75 of Directive 2009/138/EC contains high-level principles to value assets and liabilities on a market-consistent basis, building, as much as possible, on international accounting standards;

Articles 76-86 of Directive 2009/138/EC contain the rules relating to technical provisions. In general terms, they consist of a best estimate (probability-weighted average of future cash-flow) discounted by a risk-free rate plus an explicit risk margin to take account of valuation uncertainty (reflecting the cost of capital above the risk-free rate). The best estimate is to be calculated gross (Article 77(2)); deductions of the amounts recoverable

from reinsurance contracts and special purpose vehicles are to be calculated separately and must take account of counterparty default risk (Article 81). Under certain circumstances approximations in the calculation of the best estimate are allowed (Article 82).

5.4. Specific Call for Advice

The Commission Services would like EIOPA to advise, in close cooperation with the actuarial profession, on detailed rules by which supervisors can ensure that IORPs have proper rules to value assets, technical provisions and other liabilities.

The EIOPA advice should address at least the following subjects:

- The material elements of Article 75 of Directive 2009/138/EC that should be amended or removed to adequately address the specificities of IORPs in relation to the valuation of assets and liabilities;
- The consistency between the rules to establish prudential balance sheets of IORPs and the rules for general accounting purposes, taking into account where necessary the financial reporting rules (national or international) applicable to the sponsoring undertaking.
- The material elements of Articles 76-86 of Directive 2009/138/EC that should be amended or removed to adequately address the specificities of IORPs in relation to the technical provisions. This should include advice on the circumstances under which approximations in the calculation of the best estimate should be allowed;
- The need to maintain Article 15(5) of Directive 2003/41/EC;
- The application of the rules to calculate technical provisions to the calculation of the "adequate amount of liabilities" (in the meaning of Article 15(1) of the IORP Directive) to be able to pay pension benefits as and when they fall due. This should include advice on the feasibility to treat sponsor covenants like reinsurance contracts (see Article 81 of Directive 2009/138/EC) with due account for counterparty default risk;
- Other requirements for IORPs, if any.

6. SECURITY MECHANISMS

6.1. Introduction

Article 16 of the IORP Directive requires a level of assets to match the technical provisions (**full funding**). Where IORPs cover risks themselves (rather than the sponsoring undertaking), the IORP Directive requires assets above technical provisions – i.e. **regulatory own funds** - as specified in **Article 17**. The own fund requirements applicable are those that previously applied to life insurance undertakings (i.e. Solvency I) to maintain a regulatory consistency. Article 303 of the Solvency II Directive has maintained the Solvency I regime for IORPs by inserting **Articles 17a-d** directly into the IORP Directive. These articles deal in broad terms with the eligible assets to cover the solvency margin (assets above technical provisions) and the level of the required solvency margin.

An EIOPA report (see references) has shown that financial commitments arising out of pension schemes, whether technical provisions or other liabilities, can be secured in different ways. Some Member States have chosen regulatory own funds (in the same way as a bank or an insurance undertaking), while others rely on sponsor covenants and reinsurance in pension protection funds.

The level of protection of the scheme members and beneficiaries should be similar irrespective of the security mechanisms used.

What is important to establish precisely is who bears the risk and in which way the pension schemes enable the IORP or the sponsoring undertaking to reduce benefits on a going-concern basis. The EIOPA report on risk management (see references) provides detailed information about eight types of **risk-sharing** features, focusing in particular on which entity (IORP, sponsor or member/beneficiary) takes on the risk (investment and biometric) and if necessary provides support (either in terms of more contributions or less benefits). The most common types of risk-sharing are pure DB schemes in which either the sponsor or the IORP itself bears all the risk and pure DC schemes in which the members/beneficiaries bear all the risk. In between these extremes, there are pension schemes with a minimum guarantee on asset returns during the accumulation phase (where the risk is borne by either the IORP or the sponsor), while the risks during the payout phase are borne by the member/beneficiary.

The EIOPA advice should also address recovery plans. Article 16(2) of the IORP Directive allows underfunding subject to a concrete and realisable recovery plan for a limited period of time. Article 16(3) suggests that for cross-border activity the recovery period might be shorter. The strength and especially the length of recovery plans can have a significant impact on the effectiveness of supervision. Moreover, the EIOPA report (see references) has highlighted that there are large differences between the rules set out in Member States.

6.2. References

- International:
 - OECD Recommendation on the Core Principles of Occupational Pension Regulation, June 2009: **Core Principle 2 (capital requirements), Core Principle 3 (funding rules)**.
 - OECD/IOPS Good Practices for Pension Funds' Risk Management Systems, January 2011: **Good practice 3 (Funding and Solvency Risk Control) and Good practice 5 (operational risk control)**.
 - OECD Recommendation on Guidelines on Funding and Benefit Security in Occupational Pension Plans, May 2007 (**for the annotations to Core Principle 3**)
 - IOPS paper on Managing and Supervising risks in defined contribution pension systems, October 2010: pages 32-33 (operational risk)
- European Insurance and Occupational Pensions Authority (EIOPA):
 - Survey on fully funded, technical provisions and security mechanisms in the European occupational pension sector (CEIOPS-OPSSC-01/08 final), OPC Solvency Subcommittee, 31 March 2008: **Section 5**.
 - The EIOPA report on risk management: **Section II.1**
- European Commission:
 - Green paper on pensions: summary of consultation responses (7.3.2011), question 8 and 10
- Directive 2009/138/EC (Solvency II Framework Directive): **Articles 87-99** (own funds), **Articles 100-127** (SCR) and **Article 304** (duration approach), **Article 128-131** (MCR).
- Other:
 - EFRAG paper "The financial reporting of pensions", January 2008.

6.3. Background: preliminary proposal for principles for draft Directive

Article 17 of the IORP Directive has to be amended in the light of the new supervisory regime and in order to facilitate cross-border activity. The following articles of Directive 2009/138/EC could be applied, at least as a starting point, *mutatis mutandis*, to the IORP Directive:

- **Articles 87-99** of Directive 2009/138/EC contain the provisions on own funds: basic own funds (including subordinated liabilities), ancillary own funds (e.g. call for supplementary contributions) and their classification into three tiers. This should include advice on the inclusion of contingent assets such as a statutory subsidiary liability of the sponsor.

- **Articles 100-127** of Directive 2009/138/EC contains the provisions on the SCR to cover unexpected losses with the following main features:
 - Value-at-Risk of 99.5% over a one-year period in going-concern;
 - the standard formula for the calculation of the SCR:
 - risk modules for life underwriting risk, market risk, including for equity risk the equity dampener in **Article 106** and the duration approach in **Article 304**, and the counterparty default risk;
 - the operational risk module;
 - Adjustment for the loss-absorbing capacity of technical provisions (e.g. reduction in benefits to cover unexpected losses when they arrive) and deferred taxes.
 - internal models for the calculation of the SCR
- **Articles 128-131** of Directive 2009/138/EC contain the provisions on the MCR.
- **Articles 136-142** of Directive 2009/138/EC contain the provisions for the recovery plan and the finance scheme.

6.4. Specific Call for Advice

The Commission Services would like EIOPA to advise, in close cooperation with the actuarial profession, on detailed rules by which supervisors can ensure that IORPs have proper rules to protect pension liabilities.

The EIOPA advice should address at least the following subjects:

- Where the IORP itself covers risk (in the meaning of Article 17(1) of the IORP Directive):
 - The material elements of Article 87-99 of Directive 2009/138/EC that should be amended or removed to adequately address the specificities of IORPs in relation to own funds; the advice should include an assessment as to whether there is an advantage to keep a three-tier system;
 - The adequacy of using subordinated debt as own funds in the light of the borrowing restriction for IORPs contained in Article 18(2) of the IORP Directive;
 - The material elements of Articles 100-127 and 304 of Directive 2009/138/EC that should be amended or removed to adequately address the specificities of IORPs in relation to the SCR (including the duration approach for the equity risk sub-module). Particular attention should be paid to the adjustment for the loss-

absorbing capacity of technical provisions and deferred taxes to take into account the specificities of pension schemes;

- The material elements of Article 128-131 of Directive 2009/138/EC that should be amended or removed to adequately address the specificities of IORPs in relation to the MCR.
 - As a particular treatment of this, the extent to which a similar approach can be adopted for pension schemes where the risk is covered by the IORP and the sponsoring undertaking.
- Where the risk (in the meaning of Article 17(1) of the IORP Directive) is covered by the sponsoring undertaking:
 - The possibility to restate the value of assets in the IORP and liabilities of the sponsoring undertakings into a single balance sheet, including the possibility to recognise sponsor covenants and claims in pension protection schemes as an asset similar to reinsurance.
 - The level of protection of the scheme members and beneficiaries provided by the security mechanisms in the various systems.
 - The treatment of operational risk where the investment risk is borne by the scheme member or beneficiary;
 - The material elements of Articles 136-142 of Directive 2009/138/EC that should be amended or removed to adequately address the specificities of IORPs in relation to the recovery plan and, where necessary, the finance scheme; particular attention should be paid to (i) the length of the recovery period allowed and (ii) the need to maintain a specific wording for cross-border activity.
 - Other requirements for IORPs, if any,
 - Proportionality: e.g. simplifications in the standard SCR formula.

7. INVESTMENT RULES

7.1. Introduction

The investment rules in the IORP Directive are based on the prudent person principle (Article 18) complemented with mandatory and optional quantitative restrictions.

EIOPA has made a first assessment of the investment rules in Article 18 (see references) which has shown that only a few Member States have implemented a pure prudent person rule. There is a persistence of quantitative investment limits (see also the annual surveys of the OECD mentioned in the references). Moreover, there is a lack of common understanding on the scope of the single issuer rule in Article 18(1)(e) and the definition of "risk capital markets" in Article 18(5)(c). The need to continue to monitor the operation of the investment rules also in the light of any lessons to be learnt from the economic and financial crisis was taken up in the Report from the Commission of April 2009 (see references).

In particular, there is a need to assess whether the investment rules contained in the IORP directive are suitable for the regulation of DC schemes, which expose the scheme members/beneficiaries to investment risk. In some Member States, DC schemes allow for investment options with different risk-return characteristics and for a default option if the scheme member does not make an investment choice. Investment regulation takes the form of a quantitative portfolio ceiling: different quantitative restrictions for specific assets (e.g. equity) apply to the various fund options. Life-styling investment approaches are common in some Member States.

At the level of the entire portfolio, Mexico has introduced investment regulation in the form of a quantitative risk limit: it requires pension funds to remain below a certain Value-at-Risk measure (95% over one day). If that limit is breached the supervisor may require the pension fund to sell the riskiest assets.

7.2. References

- International:
 - OECD Recommendation on the Core Principles of Occupational Pension Regulation, June 2009: **Core Principle 4**.
 - OECD/IOPS Good Practices for Pension Funds' Risk Management Systems, January 2011: **Good practice 4 (investment/market risk control)**.
 - OECD Recommendation on Guidelines on Pension Fund Asset Management, January 2006 (**for the annotations to Core Principle 4**)
 - OECD/IOPS Good Practices on Alternative and Derivative Investments by Pension Funds (forthcoming).

- OECD Survey of investment regulation of pension funds, October 2010.
- European Insurance and Occupational Pensions Authority (EIOPA)¹:
 - Initial review of key aspects of the implementation of the IORP Directive (EIOPA-OP-03-08 final), OPC, 31 March 2008: **Section 4.5** and **Appendix 9**.
 - Report on risk management rules applicable to IORPs (EIOPA-OP-22-09), 6.11.2009: **page 9** (on life cycle options)
- European Commission:
 - Report from the Commission on some key aspects concerning Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision (IORP Directive), COM(2009) 203 final, 30.4.2009
 - Green paper on pensions: summary of consultation responses (7.3.2011), question 8 and 13
- Directive 2009/138/EC (Solvency II Framework Directive): **Article 132** (prudent person principle) and **Article 133** (freedom of investment).

7.3. Background: preliminary proposal for principles for draft Directive

Article 18 of the IORP Directive may need to be amended in the light of the new supervisory regime and the more recent approach taken in Directive 2009/138/EC as regards the prudent person principle.

7.4. Specific Call for Advice

The Commission Services would like EIOPA to advise on detailed rules by which supervisors can ensure that IORPs have proper investment rules.

The EIOPA advice should address at least the following subjects:

- The material elements of Article 132(2) of Directive 2009/138/EC that should be amended or removed to adequately address the specificities of IORPs in relation to risk assessments;
- The application of the quantitative restriction on investment in the sponsoring undertaking in Article 18(1)(f) of the IORP Directive when the IORP is sponsored by two or more undertakings;
- The necessity from a prudential perspective to maintain Article 18(5) first and second sub-paragraphs of the IORP Directive enabling Member States to lay down more detailed investment rules;

¹ <http://www.EIOPA.org/>

- The necessity from a prudential perspective to maintain Article 18(5)(b) of the IORP Directive enabling IORPs to invest up to 30% in **foreign currencies**;
- The necessity from a prudential perspective to maintain Article 18(5)(c) of the IORP Directive enabling IORPs to invest in **risk capital markets**;
- The necessity from a prudential perspective to maintain Article 18(6) of the IORP Directive enabling Member States to lay down more stringent investment rules on an **individual basis**;
- The necessity from a prudential perspective to maintain Article 18(7) of the IORP Directive enabling, in the event of **cross-border activity**, the host Member States to require IORPs in the home Member State to comply with stricter investment rules as regards assets traded in regulated versus non-regulated markets, exposure to a single issuer or group and currency risk;
- The adequacy of the investment rules in Article 18(5)(a) of the IORP Directive where the pension scheme members bear the **investment risk**. This should include advice on at least:
 - The material elements of Article 132(3) first to third subparagraphs of Directive 2009/138/EC that should be amended or removed to adequately address the specificities of IORPs in relation to retirement products where the members bear the investment risk;
 - The involvement of the supervisory authorities where pension schemes provide for multi-funds (relative weights of different asset classes in the investment portfolio are decided by the scheme members rather than by the IORP itself), default options (where members in a multi-fund do not make a choice), or life-styling (the relative share of risky assets decreases over time). The supervisory involvement may for example comprise of verifying compliance with specific investment rules for assets such as quantitative restrictions for different investment options, the default fund and life-styling.
 - The usefulness from a supervisory perspective of a Value-at-Risk type upper limit on the entire portfolio below which the supervisor may require the pension fund to take action (e.g. sell the riskiest assets).
- The necessity from a prudential perspective to introduce specific investment rules for pension schemes where the members and/or beneficiaries bear risks other than investment risk, in particular **biometric risk** and **inflation risk**.
- Other requirements for IORPs, if any.

8. OBJECTIVES AND PRO-CYCLICALITY

8.1. Introduction

The current IORP Directive does not contain references to the main objective of supervision and the potential pro-cyclicality of supervisors' actions.

Article 27 of Directive 2009/138/EC states that supervisory authorities are provided with the necessary means, and have the relevant expertise, capacity, and mandate to achieve the main objective of supervision, namely the protection of policy holders and beneficiaries.

Article 28 of Directive 2009/138/EC states that supervisory authorities shall take into account the potential pro-cyclical effects of their actions in times of exceptional movements in the financial markets. Directive 2009/138/EC provides for an SCR (soft target) and an MCR (hard target) which enables supervisors to follow a gradual ladder of intervention. Pro-cyclical effects are avoided by two mechanisms: 1) the equity dampener in the quantitative pillar implies that insurance companies build up more capital (reflecting movements in equity prices) in good times; 2) the dampener in the qualitative pillar enables supervisors to extend recovery periods to avoid that insurance undertakings are unduly forced to raise additional capital or sell their investments as a result of unsustainable adverse movements in financial markets.

8.2. References

- International:
 - The Impact of the Financial Crisis on Defined Benefit Plans and the Need for Counter-Cyclical Funding Regulations, OECD Working Papers on Finance, Insurance and Private Pensions, No. 3, July 2010.
- European Commission:
 - Green paper on pensions: summary of consultation responses (7.3.2011), question 10
- Directive 2009/138/EC (Solvency II Framework Directive): **Article 27** (Main objective of supervision), **Article 28** (Financial stability and pro-cyclicality); for pro-cyclicality: **recital 61** and the related Articles for the pillar 1 and 2 **dampeners**.

8.3. Background: preliminary proposal for principles for draft Directive

Articles 27 and 28 of Directive 2009/138/EC could be applied, at least as a starting point *mutatis mutandis* to the IORP Directive.

8.4. Specific Call for Advice

The EIOPA advice should address at least the following subjects:

- The inclusion of the main objective of supervision into the IORP Directive;
- The inclusion of the principle to take into account the potential procyclicality into the IORP Directive.

9. GENERAL PRINCIPLES OF SUPERVISION, SCOPE AND TRANSPARENCY AND ACCOUNTABILITY

9.1. Introduction

Effective pension fund regulation should be based on supervision that is prospective and risk-based, proportionate as well as transparent and accountable. These principles are currently not required by the IORP Directive.

9.2. References

- International:
 - OECD Recommendation on the Core Principles of Occupational Pension Regulation, June 2009: Core Principle 7 (supervision)
 - OECD/IOPS Good Practices for Pension Funds' Risk Management Systems, January 2011: **Good practice 2 (management oversight and culture)**.
- European Commission:
 - Green paper on pensions: summary of consultation responses (7.3.2011), question 10
- Directive 2009/138/EC (Solvency II Framework Directive): **Article 29** (general principles of supervision), **Article 31** (transparency and accountability).

9.3. Background: preliminary proposal for principles for draft Directive

Articles 29 and 31 of Directive 2009/138/EC could be applied, at least as a starting point *mutatis mutandis* to the IORP Directive.

9.4. Specific Call for Advice

The EIOPA advice should address at least the following subjects:

- The material elements of Article 29 of Directive 2009/138/EC that should be amended or removed to adequately address the specificities of IORPs in relation to the **general principles of supervision**;
- The material elements of Article 31 of Directive 2009/138/EC that should be amended or removed to adequately address the specificities of IORPs in relation to **transparency and accountability**;
- Other rules for IORPs, if any.

10. GENERAL SUPERVISORY POWERS

10.1. Introduction

The IORP Directive already contains some provisions on the general supervisory powers of pension fund supervisory authorities: Article 14(2) first paragraph enables supervisors to take measures against the IORP or its management; Article 13(a) and (c) provide access to information; Article 13(d) enables supervisors to carry-out on-site inspections. A recent EIOPA report (see references) mentions that on-site inspections are an important instrument to supervisory compliance with general governance requirements, risk management rules and internal control. The IORP Directive also has provisions concerning preventive and corrective measures (see Article 14(2) second paragraph and 14(4)). As regards outsourcing, the IORP Directive also provides for supervisory powers in relation to on-site inspections as mentioned in Article 13(d). But for outsourcing in general a recent EIOPA report (see references) has concluded that the wording of Article 13(b) is not sufficiently clear. This will be dealt with in other sections of this Annex.

The IORP Directive does however not contain provisions to enable supervisors to require stress tests or to impose administrative sanctions on IORPs.

As regards cross-border activity, Article 20(10) of the IORP Directive provides that the host Member State may take action against an IORP in a home Member State if its social and labour law is not respected.

10.2. References

- European Insurance and Occupational Pensions Authorities (EIOPA):
 - Report on management oversight and internal control rules applicable to IORPs (EIOPA-OP-37-10 Rev1), OPC, 9 June 2010: **section II.2**
- Directive 2009/138/EC (Solvency II Framework Directive): **Article 34** (general supervisory powers).
- Commission Communication on Reinforcing sanctioning regimes in the financial services sector (COM(2010) 716 final of 8 December 2010) (sanctions)
- Proposal for a Regulation of the European Parliament and of the Council on amending Regulation (EC) No 1060/2009 on credit rating agencies (COM(2010) 289 final).

10.3. Background: preliminary proposal for principles for draft Directive

- Article 34(4) of Directive 2009/138/EC enables supervisors to require stress tests. This article could be applied, at least as a starting point *mutatis mutandis* to the IORP Directive.

- The Commission Communication on Reinforcing sanctioning regimes in the financial services sector (COM(2010) 716 final of 8 December 2010) sets out how further convergence could be reached in the sanctioning regimes applicable to infringements of the provisions of EU financial services legislation. These principles could be applied to the IORP Directive.

10.4. Specific Call for Advice

The Commission Services would like EIOPA to advise on detailed rules by which supervisors can ensure that IORPs have proper stress test systems in place. EIOPA should also reflect on the possibility for national supervisors to impose administrative sanctions on IORPs which are sufficiently high to have a deterrent effect.

The EIOPA advice should address at least the following subjects:

- The material elements of Article 34(4) of Directive 2009/138/EC that should be amended or removed to adequately address the specificities of IORPs in relation to stress test;
- The material elements of Article 36 of Regulation No 1060/2009 on credit rating agencies that should be amended or removed to adequately address the specificities of IORPs in relation to administrative sanctions;
- The effectiveness of Article 20(10) of the IORP Directive in practice;
- Other general supervisory powers for IORPs, if any.

11. SUPERVISORY REVIEW PROCESS AND CAPITAL ADD-ONS

11.1. Introduction

The supervisory review process and, in exceptional circumstances for IORPs that cover risks, the possibility to impose capital add-ons are key components of the qualitative pillar of the supervisory system. Although neither component is covered by the IORP Directive, some Member States have established elements of the supervisory review process. The EIOPA reports on risk management and management oversight and internal control (see references) indicates that most supervisors use regulatory reporting and analysis to evaluate compliance with the rules concerning general governance requirements, risk management, the risk management function, investment risk (based on the statement of investment principles) and internal control.

11.2. References

- International:
 - OECD/IOPS Good Practices for Pension Funds’ Risk Management Systems, January 2011: **Good practice 8**.
- European Insurance and Occupational Pensions Authority (EIOPA):
 - Report on risk management rules applicable to IORPs CEIOPS-OP-22-09), 6 November 2009: **section II.4**
 - Report on management oversight and internal controls rules applicable to IORPs (CEIOPS-OP-37-10 Rev1), 9 June 2010: **section II.4**
- European Commission:
 - Green paper on pensions: summary of consultation responses (7.3.2011), question 10
 - Directive 2009/138/EC (Solvency II Framework Directive): **Article 36** (supervisory review process) and **Article 37** (capital add-ons).

11.3. Background: preliminary proposal for principles for draft Directive

Article 36 of Directive 2009/138/EC contains the provisions for the supervisory review process and Article 37 of Directive 2009/138/EC contains the provisions for capital add-ons. These two articles could be applied, at least as a starting point *mutatis mutandis* to the IORP Directive.

11.4. Specific Call for Advice

The EIOPA advice should address at least the following subjects:

- The material elements of Article 36 of Directive 2009/138/EC that should be amended or removed to adequately address the specificities of IORPs;

- The material elements of Article 37 of Directive 2009/138/EC that should be amended or removed to adequately address the specificities of IORPs (where they are subject to own fund requirements); the advice should also consider whether similar requirements should be applied to the level of funding of technical provisions.
- Other rules for IORPs, if any.

12. SUPERVISION OF OUTSOURCED FUNCTIONS AND ACTIVITIES

12.1. Introduction

Outsourcing of functions is widely practised in the pension fund industry. In many Member States IORPs can also outsource their activity to another IORP.

The IORP Directive already contains some provisions to ensure that supervisors have the necessary powers and means to supervise outsourced entities or activities (article 13(b)) and to carry-out on-site inspections (article 13(d)).

The EIOPA report on outsourcing (see references) has illustrated that most supervisors have powers vis-à-vis third party service providers, although the approaches differ. Moreover, the report mentions that the IORP Directive is not very clear on what should be considered the relationship between IORPs and third-party service providers (Article 13b).

12.2. References

- European Insurance and Occupational Pensions Authority (EIOPA):
 - Report on outsourcing by IORPs (CEIOPS-OP-12-08M final), OPC, 30 October 2008: **section II.3**
- Directive 2009/138/EC (Solvency II Framework Directive): **Article 38** (supervision of outsourced functions and activities).

12.3. Background: preliminary proposal for principles for draft Directive

Article 38 of Directive 2009/138/EC requires the regulated entity to ensure that service providers are cooperative and that they provide access to data and business premises. The article is more specific as to the conditions to carry-out on-site inspections on the premises of the service provider. This article could be applied, at least as a starting point *mutatis mutandis* to the IORP Directive in order to clarify and strengthen the current provisions.

12.4. Specific Call for Advice

The EIOPA advice should address at least the following subjects:

- The way in which Article 13(b) of Directive 2003/41/EC should be clarified. Particular attention should be paid to determine whether the material elements of Article 38(1) of Directive 2009/138/EC could be used for this purpose;
- The way in which Article 13(d) of Directive 2003/41/EC should be clarified. Particular attention should be paid to determine whether the material elements of Article 38(2) of Directive 2009/138/EC could be used for this purpose;

- Other rules to supervise outsourced functions and activities, if any: e.g. location of main administration, sub-contracting of the transferred activity by the third-party service provider (chain outsourcing).

13. GENERAL GOVERNANCE REQUIREMENTS

Governance of pension funds is key. Governance systems should have clear organisational structures with a clear allocation of responsibilities. Key governance functions should be documented in writing and pension funds should have contingency plans. A further aspect relates to remuneration policy. Remuneration policies which give incentives to take risks that exceed the general level of risk tolerated by pension funds can undermine the sound and effective risk management of such undertakings. It is therefore necessary to provide for requirements on remuneration for the purpose of the sound and prudent management of the pension fund and in order to prevent remuneration arrangements arising which encourage excessive risk-taking. This section looks at these two general issues.

The subsequent sections will look at requirements for specific governance aspects including, risk management, ORSA, internal controls, internal audit, actuarial function and outsourcing.

13.1. Introduction

The IORP Directive does not contain rules concerning the clear allocation of responsibilities, written documentation of key governance functions or contingency plans.

A recent EIOPA report (see references) illustrates that Member States have developed national rules cover management board responsibilities, lines of responsibility and accountability, as well as conflicts of interest.

13.2. References

- International:
 - OECD Recommendation on the Core Principles of Occupational Pension Regulation, June 2009: **Core Principle 2 (governance) and Core Principle 6 (governance)**.
 - OECD Guidelines for pension fund governance, June 2009.
 - OECD/IOPS Good Practices for Pension Funds' Risk Management Systems, January 2011: **Good practice 2 (management oversight and culture)**.
- European Insurance and Occupational Pensions Authority (EIOPA):
 - Report on management oversight and internal controls rules applicable to IORPs (CEIOPS-OP-37-10 Rev1), 9 June 2010: **section II.2**
- European Commission:
 - Green paper on pensions: summary of consultation responses (7.3.2011), question 10
- Directive 2009/138/EC (Solvency II Framework Directive): **Article 41**.

13.3. Background: preliminary proposal for principles for draft Directive

Article 41 of Directive 2009/138/EC requires rules concerning the clear allocation of responsibilities, written documentation of key governance functions or contingency plans. It also requires that the system of governance shall be proportionate to the nature, scale and complexity of the operations of the IORP. Provisions on remuneration policy are contained in the Level 2 implementing measures for Directive 2009/138/EC that are currently being developed.

Article 41 of Directive 2009/138/EC, including the implementing measure addressing remuneration policy could be applied, at least as a starting point *mutatis mutandis* to the IORP Directive.

13.4. Specific Call for Advice

The EIOPA advice should address at least the following subjects:

- The material elements of Article 41 of Directive 2009/138/EC that should be amended or removed to adequately address the specificities of IORPs in relation to general governance requirements;
- Provisions to ensure a sound remuneration policy, possibly based on the Level 2 implementing measures currently being developed for Article 41 of Directive 2009/138/EC;
- Other requirements for IORPs, if any.

14. FIT AND PROPER

14.1. Introduction

A person must hold the necessary qualifications and/or experience (fit) and be of good repute (proper). Fit and proper requirements are one of the key aspects of corporate governance and of particular importance in financial services. In pension schemes, the confidence of scheme members is essential because the contributions are paid long before the benefits are received.

The current IORP Directive already contains the general principle that management must be fit and proper (**article 9b**). The application of these requirements varies in the EU as documented in several EIOPA reports (see references below). It seems necessary to define the scope of these criteria more precisely and, possibly, extend them in order to increase the level of harmonisation.

14.2. References

- International:
 - OECD Recommendation on the Core Principles of Occupational Pension Regulation, June 2009: Core Principle 2 (governance)
- European Insurance and Occupational Pensions Authority (EIOPA):
 - Report on management oversight and internal controls rules applicable to IORPs (CEIOPS-OP-37-10 Rev1), OPC, 9 June 2010: **pg. 15/16**.
- European Commission:
 - Green paper on pensions: summary of consultation responses (7.3.2011), question 10
- Directive 2009/138/EC (Solvency II Framework Directive): Articles 42 and 43.

14.3. Background: preliminary proposal for principles for draft Directive

More precise fit and proper requirements are contained in articles 42 of Directive 2009/138/EC. Article 43 of that directive concerns additional rules for the proof of good repute. These could be applied, at least as a starting point *mutatis mutandis* to the IORP Directive.

14.4. Specific Call for Advice

EIOPA is invited to provide advice on at least the following questions:

- Scope: to whom should the fit and proper criteria be applied? The current directive states that it applies to the persons that "effectively run" the IORP. Should it apply only to the management board members or also to other people such as those carrying out functions: risk management, internal control, internal audit, compliance, actuarial and outsourced.

- Timing: when should fit and proper requirements be applied?
- What procedures and ongoing controls should be set up by the supervisory authority to check the continued respect of fit and proper criteria?
- What powers should the supervisor exercise when fit and proper requirements are not fulfilled?

15. RISK MANAGEMENT

15.1. Introduction

A risk-based supervisory approach can only be built on the basis of a thorough knowledge by the IORP of the risks it incurs. A solid risk management is therefore key. This is already recognised to some extent in the IORP Directive, which makes several references to risk management: article 12 requires that the statement of investment principles describes the risk management processes; the investment rules in Article 18 presuppose the existence of an effective risk management system. But there are currently no specific rules on risk management in the IORP Directive.

A recent EIOPA survey (see references) illustrated that most Member States have risk management rules for IORPs, but that there are considerable differences.

15.2. References

- International:
 - OECD Recommendation on the Core Principles of Occupational Pension Regulation, June 2009: Core Principle 2 (risk control).
 - OECD Guidelines for pension fund governance, June 2009.
 - OECD/IOPS Good Practices for Pension Funds' Risk Management Systems, January 2011: **Good practice 1.**
- European Insurance and Occupational Pensions Authority (EIOPA):
 - Report on "Risk Management Rules applicable to IORPs (CEIOPS-OP-22-09)", 6 November 2009.
- European Commission:
 - Green paper on pensions: summary of consultation responses (7.3.2011), question 10
- Directive 2009/138/EC (Solvency II Framework Directive): **Article 44**

15.3. Background: Preliminary proposal for principles for draft directive

Article 44 of Directive 2009/138/EC (Solvency II Framework Directive) requires that an effective risk management system is in place and that it is well integrated into the decision-making process. It specifies the scope of the risk management system and requires a risk management function and proper documentation.

15.4. Specific Call for advice

The Commission Services would like EIOPA to advise on detailed rules to ensure that IORPs have proper systems in place to identify, measure, monitor, manage and report the risks incurred and has a prospective view on the risks that might possibly occur.

The EIOPA advice should address at least the following subjects:

- The material elements of Article 44 of Directive 2009/138/EC that should be amended or removed to cater for the specificities of risk management practices in IORPs;
- Differences, if any, in the risk management rules depending on the risk-sharing mechanism of the pension scheme: e.g. DB, DC and hybrids.
- Specific risk management rules governing life cycling in DC schemes, if necessary.

16. OWN RISK AND SOLVENCY ASSESSMENT

16.1. Introduction

As part of their risk management system, pension funds should have, as an integral part of their business strategy, a regular practice of assessing their overall solvency needs with a view to their specific risk profile. The own risk and solvency assessment (ORSA) has a twofold nature. It is an internal assessment process within the institution and as such embedded in the strategic decisions of the institution. It is also a supervisory tool for the supervisory authorities. The ORSA is currently not required by the IORP Directive.

16.2. References

- European Commission:
 - Green paper on pensions: summary of consultation responses (7.3.2011), question 10
- Directive 2009/138/EC (Solvency II Framework Directive): **Article 45**

16.3. Background: Preliminary proposal for principles for draft directive

Article 45 of Directive 2009/138/EC (Solvency II Framework Directive) could be applied, at least as a starting point *mutatis mutandis* to the IORP Directive.

16.4. Specific Call for advice

The EIOPA advice should address at least the following subjects:

- The material elements of Article 45 of Directive 2009/138/EC that should be amended or removed to suit the specificities of IORPs;
- Other rules, if any.

17. INTERNAL CONTROL SYSTEM

17.1. Introduction

The current IORP Directive already contains the general principle that "competent authorities shall require every institution located in their territories to have sound administrative and accounting procedures and adequate internal control mechanisms" (**article 14(1)**). There is currently no explicit requirement for a compliance function.

The application of these requirements varies in the EU as documented by EIOPA (see references below). Many Member States also require IORPs to establish a compliance function. It seems necessary to define the scope of these criteria more precisely and, possibly, extend them in order to increase the level of harmonisation.

17.2. References

- International:
 - OECD Recommendation on the Core Principles of Occupational Pension Regulation, June 2009: Core Principle 6 (risk-based internal controls)
 - OECD Guidelines for pension fund governance, June 2009.
 - OECD/IOPS Good Practices for Pension Funds' Risk Management Systems, January 2011: **Good practice 6 (control and monitoring mechanisms)**.
 - OECD Pension Funds' Risk Management framework: regulation and supervisory oversight.
- European Insurance and Occupational Pensions Authority (EIOPA):
 - Report on management oversight and internal controls rules applicable to IORPs (EIOPA-OP-37-10 Rev1), OPC, 9 June 2010: **section II.3**
- European Commission:
 - Green paper on pensions: summary of consultation responses (7.3.2011), question 10
- Directive 2009/138/EC (Solvency II Framework Directive): Article 46.

17.3. Background: preliminary proposal for principles for draft Directive

Article 46 of Directive 2009/138/EC requires an internal control system, which includes at least **administrative and accounting procedures**, an **internal control framework**, **reporting arrangements** and a **compliance function**. This article could be applied, at least as a starting point *mutatis mutandis* to the IORP Directive.

17.4. Specific Call for Advice

The Commission Services would like EIOPA to advise on detailed rules by which supervisors can ensure that IORPs have proper internal control systems and a compliance function in place.

The EIOPA advice should address at least the following subjects:

- The material elements of Article 46 of Directive 2009/138/EC that should be amended or removed to adequately address the specificities of IORPs in relation to internal control systems and the compliance function;
- Other internal control requirements for IORPs, if any.

18. INTERNAL AUDIT

18.1. Introduction

While the current IORP Directive contains a few references to an "auditor", they remain fairly vague. The directive does not explicitly require for an internal auditor that evaluates all the elements of the pension fund governance system, including the internal control system.

At the national level, most Member States have rules on an internal audit function, although in practice they vary from one country to another (see EIOPA references below). It seems necessary to define the scope of the internal audit function more precisely in order to increase the level of harmonisation.

18.2. References

- International:
 - OECD Recommendation on the Core Principles of Occupational Pension Regulation, June 2009: Core Principle 6 (auditor)
 - OECD Guidelines for pension fund governance, June 2009.
 - OECD/IOPS Good Practices for Pension Funds' Risk Management Systems, January 2011: **Good practice 6 (control and monitoring mechanisms)**.
- European Insurance and Occupational Pensions Authority (EIOPA):
 - Report on management oversight and internal controls rules applicable to IORPs (EIOPA-OP-37-10 Rev1), OPC, 9 June 2010: **section II.3**
- European Commission:
 - • Green paper on pensions: summary of consultation responses (7.3.2011), question 10
- Directive 2009/138/EC (Solvency II Framework Directive): Article 47.

18.3. Background: preliminary proposal for principles for draft Directive

Article 47 of Directive 2009/138/EC provides for an independent internal audit function that reports to the decision-making bodies of the regulated entity. This article could be used, at least as a starting point *mutatis mutandis* for the IORP Directive.

18.4. Specific Call for Advice

The Commission Services would like EIOPA to advise on detailed rules by which supervisors can ensure that IORPs have an internal audit function in place.

The EIOPA advice should address at least the following subjects:

- The material elements of Article 47 of Directive 2009/138/EC that should be amended or removed to adequately address the specificities of IORPs in relation to the internal audit function;
- Other internal audit requirements for IORPs, if any.

19. ACTUARIAL FUNCTION

19.1. Introduction

Actuaries are key resources for IORPs because they provide expertise for the calculation of technical provisions and the establishment of sound risk management and funding policies.

The important role of the actuary - or a suitable expert in this field - in relation to the calculation of technical provisions is recognised in the IORP Directive in Articles 9(d) and 15(4). But their tasks remain vague and do not cover risk management and funding policies.

It seems necessary to define the scope of the actuarial function more precisely in order to strengthen the existing requirements and increase the level of harmonisation.

19.2. References

- International:
 - OECD Recommendation on the Core Principles of Occupational Pension Regulation, June 2009: Core Principle 6 (actuary & delegation and expert advice)
 - OECD Guidelines for pension fund governance, June 2009.
 - OECD/IOPS Good Practices for Pension Funds' Risk Management Systems, January 2011: **Good practice 6 (control and monitoring mechanisms)**.
- European Commission:
 - Green paper on pensions: summary of consultation responses (7.3.2011), question 10
 - Directive 2009/138/EC (Solvency II Framework Directive): Article 48.

19.3. Background: preliminary proposal for principles for draft Directive

Article 48 of Directive 2009/138/EC provides for an actuarial function. This article could be used, at least as a starting point *mutatis mutandis* for the IORP Directive.

19.4. Specific Call for Advice

The Commission Services would like EIOPA to advise, in close cooperation with the actuarial profession, on detailed rules by which supervisors can ensure that IORPs have an actuarial function in place.

The EIOPA advice should address at least the following subjects:

- The material elements of Article 48 of Directive 2009/138/EC that should be amended or removed to adequately address the specificities of IORPs in relation to the actuarial function;
- Other actuarial requirements for IORPs, if any.

20. OUTSOURCING

20.1. Introduction

It is important that pension funds remain fully responsible when they outsource functions or occupational retirement provision activity. Outsourcing should not undermine governance, operational safeguards, supervision and servicing of members/beneficiaries.

The IORP Directive expressly permits outsourcing in Article 9(4). Moreover, IORPs can not be prevented to appoint investment managers or custodians/depositories located in another Member State provided that they are regulated at EU level (see Article 19). But the IORP Directive does not explicitly ensure that pension funds remain fully responsible and it does not require a written policy regarding outsourcing. An EIOPA report (see references) has shown that "overall decision making" and "taking on full responsibility" are core functions of the IORP in all Member States. The report also shows that in practice a vast number of functions are outsourced, including IT services, administration, information provision, and many others. Custody of assets and investment management is also outsourced and in many Member States this is mandatory.

The functions that can be outsourced are left to the Member States and the EIOPA report has shown that there are many national differences. This may be an issue where IORPs are prevented to use a service provider in another Member State (e.g. risk management or payment of benefits).

What is important is that the IORP retains final responsibility for outsourced activity and that supervisors are informed about outsourced activity in an accurate and timely manner.

20.2. References

- International:
 - OECD/IOPS Good Practices for Pension Funds' Risk Management Systems, January 2011: **Good practice 5 (outsourcing risk control)**.
- European Insurance and Occupational Pensions Authority (EIOPA):
 - Report on Outsourcing by IORPs (EIOPA-OP-12-08M final), OPC, 30.10.2008
- European Commission:
 - Green paper on pensions: summary of consultation responses (7.3.2011), question 10
- Directive 2009/138/EC (Solvency II Framework Directive): **Article 49**.

20.3. Background: preliminary proposal for principles for draft Directive

Article 49 of Directive 2009/138/EC provides that entities remain fully responsible when they outsource functions or activity, that outsourcing should not undermine governance, operational safeguards, supervision and servicing of members/beneficiaries, and that supervisors are informed about outsourced activity in an accurate and timely manner. This article could be used, at least as a starting point *mutatis mutandis* for the IORP Directive.

20.4. Specific Call for Advice

The Commission Services would like EIOPA to advise on detailed rules on outsourcing for IORPs.

The EIOPA advice should address at least the following subjects:

- The material elements of Article 49 of Directive 2009/138/EC that should be amended or removed to adequately address the specificities of IORPs in relation to outsourcing;
- Other outsourcing requirements for IORPs, if any.

21. CUSTODIAN/DEPOSITORY

21.1. Introduction

The IORP Directive enables an IORP to use a custodian/depository located in another Member State. **Article 19(2)** of the IORP Directive provides that "Member States shall not restrict institutions from appointing, for the custody of their assets, custodians established in another Member State and duly authorised in accordance with Directive 93/22/EEC or Directive 2000/12/EC, or accepted as a depository for the purposes of Directive 85/611/EEC."

Meanwhile the directives to which article 19(2) refer have changed:

- Directive 93/22/EEC of 10 May 1993 on investment services in the securities field has been repealed since 1 November 2007 by **Directive 2004/39/EC** of 21 April 2004 on markets in financial instruments (**MiFID**), as mentioned in Directive 2006/31/EC of 5 April 2006.
- Directive 2000/12/EC of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions has been replaced by **Directive 2006/48/EC** of 14 June 2006 relating to the taking up and pursuit of the business of **credit institutions (recast)** or **CRD** (capital requirements directive).
- Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) has been replaced by Directive **2009/65/EC** of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (**recast**) or **UCITS IV**.

The EIOPA report (see references) has found that there are differences across Member States in relation to the appointment of a custodian, the type of body which is appointed to fulfil this role and the function that it performs. Diversity also exists around the role of competent authorities, some of whom play a role in the process of the custodian's appointment. The Commission Report (see references) takes note of the analysis carried out by EIOPA, but does not exclude that there may be a need for legislative change at a later stage.

21.2. References

- International:
 - OECD Recommendation on the Core Principles of Occupational Pension Regulation, June 2009: **Core Principle 6 (custodian)**
 - OECD Guidelines for pension fund governance, June 2009.
 - OECD/IOPS Good Practices for Pension Funds' Risk Management Systems, January 2011: **Good practice 6 (control and monitoring mechanisms)**.

- European Insurance and Occupational Pensions Authority (EIOPA):
 - Initial review of key aspects of the implementation of the IORP Directive (CEIOPS-OP-03-08 final), 31 March 2008, **Section 4.6 and Annex 10.**
- European Commission:
 - Commission report on some key aspects concerning the IORP Directive, 30 April 2009

21.3. Background: preliminary proposal for principles for draft Directive

Articles 19(2) and 19(3) of the IORP Directive may need to be reviewed in order to ensure that the custodians/depositaries of IORPs, irrespective of their location within the EU, adequately protect the interest of the members/beneficiaries.

21.4. Specific Call for Advice

The Commission Services would like EIOPA to advise on the issues identified below:

- The need to create a more consistent approach, from a supervisory perspective, in relation to the appointment of a custodian/depositary, the type of body which is appointed to fulfil this role and the function that it performs.
- The need to consider rules regarding conflicts of interest or incompatibility.
- The extent to which the rules on depositaries in the UCITS IV Directive (articles 22 to 26) adequately protect the assets from IORPs from a supervisory perspective.
- The effectiveness of the powers and procedures followed by the competent authorities to prohibit the free disposal of assets by a foreign custodian/depositary, as required by article 19(3) of the IORP Directive.
- Other advice, if any.

22. INFORMATION TO SUPERVISORS

22.1. Introduction

The information to be provided to the supervisory authorities is a key element of the third pillar of the supervisory framework. Pension funds need to provide the information underpinning the supervisory review process and have appropriate and well-documented reporting systems in place. Supervisory authorities need to have the necessary powers to obtain accurate and relevant information in an adequate format.

The IORP Directive already provides for some elements of supervisory reporting. Article 13 of the IORP Directive requires that supervisory authorities have the necessary power and means to obtain all business documents (point a), the statement of investment principles, the annual accounts and the annual reports and other documents such as actuarial valuations or asset-liability studies (point c).

The EIOPA report (see references) has shown that reporting requirements differ widely between Member States. This difference concerns the amount of information, its content and timing. While in most Member States the information needs to be submitted by the IORP itself, the reporting obligations can also be attributed to other parties (e.g. fund manager, administrator or custodian). Most of the Member States have gone beyond the minimum requirements in the IORP Directive (e.g. whistle-blowing reports, composition of membership, benefit payments, return on investment based on standardised formulae, stress tests, projections, asset allocation and commissions).

As supervisory regimes and practices gradually convergence, there will be less pronounced need for differences in reporting requirements.

22.2. References

- International:
 - OECD/IOPS Good Practices for Pension Funds' Risk Management Systems, January 2011: **Good practice 7**.
- European Insurance and Occupational Pensions Authority (EIOPA):
 - Initial review of key aspects of the implementation of the IORP Directive (EIOPA-OP-03-08 final), OPC, 31 March 2008, **Section 4.3.1 and Annex A**.
- European Commission:
 - Green paper on pensions: summary of consultation responses (7.3.2011), question 10
- Directive 2009/138/EC (Solvency II Framework Directive): **Article 35** (information to be provided for supervisory purposes).

22.3. Background: preliminary proposal for principles for draft Directive

Article 35 of Directive 2009/138/EC could be used *mutatis mutandis*, at least as a starting point, to strengthen the provisions in the IORP Directive.

22.4. Specific Call for Advice

The Commission Services would like EIOPA to advise on detailed rules on information to be provided for supervisory purposes.

The EIOPA advice should address at least the following subjects:

- The material elements of Article 35 of Directive 2009/138/EC that should be amended or removed to adequately address the specificities of IORPs in relation to supervisory reporting;
- Other requirements for IORPs, if any: e.g. specific reporting requirements for DB, DC and hybrids schemes.

23. INFORMATION TO MEMBERS/BENEFICIARIES

23.1. Introduction

The provision of accurate and relevant information to members and beneficiaries is key. People need to have access to information to make informed decisions about their retirement plans. Information should be simple and easy to understand. The need for information has become even more pronounced as the prevalence of DC schemes has increased significantly in the EU over the past decade. Moreover, the public disclosure of such information through a report on solvency and financial condition may also be useful.

The IORP Directive contains minimum information requirements in several places. **Article 9** requires IORPs to inform their members about the rules (point c) and the conditions (point f; e.g. rights and obligations, risks) of the pension scheme. These are part of the rules on the conditions of operation and constitute the provisions on "pre-contractual" information disclosure. **Article 11** requires the provision of information on financial conditions, investment principles and investment options, risks and benefits and costs. Most of this information is to be made available on request and constitutes the information that needs to be available on a continuous basis. **Article 20(7)** enables the host Member State to impose additional information requirements referred to in Article 11 for cross-border IORPs.

The EIOPA report (see references) showed that, as far as Article 11 of the IORP Directive is concerned, most Member States have gone beyond the minimum requirements and that the approaches differ widely. The report concluded that more work is needed to ensure a level playing field.

The Solvency II Directive introduces new rules on public disclosure (report on solvency and financial condition; Articles 51-56) but does not address consumer information. Although members and beneficiaries of occupational pension schemes are neither retail investors nor consumers, inspiration might be sought from the following initiatives:

- The UCITS IV Directive requires UCITS to provide a Key Investor Information Document (KIID) in a harmonised and standardised form to the investor. On the basis of consumer testing that fed into advice from the Committee of European Securities Regulators (CESR), the Commission has adopted Level 2 implementing measures in the form of a Regulation on 1 July 2010 (see references).
- The KIID Document is the benchmark for the process of developing improved mandatory disclosures for retail investment products. This is stated in the Commission Communication of 30 April 2009 on Packaged Retail Investment Products (PRIPs). The Commission is committed to introducing a new horizontal approach to the regulation of sales and pre-contractual disclosures for these products, so as to ensure a level playing field between different types of investment products offered in the retail market. The aim is to ensure that consumer protection measures are effective and appropriate. Following the Communication, the Commission

will focus on developing specific legislative proposals for this new horizontal approach, possibly in spring 2011.

23.2. References

- International:
 - OECD Recommendation on the Core Principles of Occupational Pension Regulation, June 2009: **Core Principle 2 (statement of investment policy) and Core Principle 5 (disclosure and availability of information).**
 - OECD Guidelines for the protection of rights of members and beneficiaries in occupational pension plans, September 2003 (**for the annotations to Core Principle 5**)
 - IOPS paper on Managing and Supervising risks in defined contribution pension systems, October 2010: pages 11-14 & 27-31 & 35-38
 - IOPS Working Paper No. 5, "Information to Members of DC Pension Plans: Conceptual Framework and International Trends", September 2008.
- European Insurance and Occupational Pensions Authority (EIOPA):
 - Initial review of key aspects of the implementation of the IORP Directive (CEIOPS-OP-03-08 final), OPC, 31 March 2008, **Section 4.3.1 and Annex A.**
- European Commission:
 - Green paper on pensions: summary of consultation responses (7.3.2011), question 8 and 12
 - Key Investor Information Document (KIID):
 - Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (recast of the UCITS Directive): **articles 78-82.**
 - Commission Regulation (EU) No 583/2010 of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards key investor information and conditions to be met when providing key investor information or the prospectus in a durable medium other than paper or by means of a website
 - CESR Guidelines Guideline on the methodology for the calculation of the synthetic risk and reward indicator in the Key Investor Information Document (Ref. CESR/10-673), 1 July 2010.

- CESR Consultation paper - Template for the Key Investor Information document, 20 July 2010.
- Communication from the Commission on Packaged Retail Investment Products, 30.4.2009, COM(2009) 204 final
- Directive 2009/138/EC (Solvency II Framework Directive): **Articles 51-56** (report on solvency and financial condition).

23.3. Background: preliminary proposal for principles for draft Directive

The Commission Services do not make a firm proposal at this stage. As far as pre-contractual information disclosures are concerned, it should be envisaged to build on the work done for the KII Document for UCITS. But this is not the only solution. Regarding public disclosure, inspiration could be found in Articles 51-56 of the Solvency II Directive 2009/138/EC.

23.4. Specific Call for Advice

The Commission Services would like EIOPA to advise on how to strengthen the information requirements to provide useful information on a consistent basis across the EU. This should at least cover the issues identified below:

- The extent to which the KII Document can be used for IORPs as regards pre-contractual information disclosure. This includes advice on the material elements of Articles 78-82 of Directive 2009/65/EC that should be amended or removed to adequately address the specificities of IORPs with a view to replacing Article 9c and 9f of Directive 2003/41/EC;
- The content, format and timing of ongoing information disclosures to strengthen and make more consistent the current provisions of Article 11a and 11c. This should also include advice on the possibility to delete Article 20(7) of Directive 2003/41/EC.
- The extent to which Articles 51-56 of Directive 2009/138/EC can be used for IORPs as regards public disclosure through the report on solvency and financial condition.
- Other requirements for IORPs, if any: e.g. specific reporting requirements for DB, DC and hybrids schemes.