

**Position paper of the EIOPA
Occupational Pensions Stakeholder
Groups (OPSG) on
Governance**

EIOPA published a paper in June 2014 “Report on issues leading to detriment of occupational pension scheme members and beneficiaries and potential scope of action for EIOPA” which stated that EIOPA intervention in the area of governance is important because of the way governance issues can manifest themselves in practices which are detrimental to members.

There are common principles of good governance which apply across Member States and which would ensure better governance for pension scheme members and beneficiaries (“pension plan participants”) both in the specific areas raised in that 2014 report and other areas of consumer protection for pensions.

This paper suggests that these governance principles should include the following:

Clear identification of responsibilities and disclosure of responsibilities

From a pension plan participant protection viewpoint there needs to be clear identification and information as to responsibilities for governance. Even where a contract, or a by-law, or a trust instrument defines the legal roles and responsibilities, pension plan participants may not by way of example, be clear as to the different responsibilities between the employer/sponsor, a provider, and a fiduciary (e.g. a trustee). This is true of both trust based and contract based pension provision. The risk is that they will not know the scope and limits of those responsibilities, which may be misunderstood or considered to be wider or different than they actually are. These responsibilities should be made clear to the employee or consumer. Where there is a provider contract, responsibilities should be made clear in the contractual information; where there is an IORP, it should be made clear in the disclosure documents and pension plan participant communications. The objectives of the pensions entity should also be made clear. The route for redress or complaint should also be evident.

The key responsibilities of a governing body will be to articulate the objectives of the pensions entity; identify and manage risk; formulate and monitor investment policy; monitor the administration and outsourced functions; ensure compliance of the entity with regulation and best practice. On investment, there should be procedures and criteria by which the governing body reviews the effectiveness of the investment policy and determines whether there is a need to change the policy, its implementation procedures, the decision making structure, as well as the responsibility linked to its design, implementation and review.

Governance and accountability

The governing entity should be clear as to the scope of its liability and accountability and the pension plan participant should be made aware of this. Governance should be transparent and include a disclosure and reporting framework. The governing entity should be accountable either under law, or by disclosure and fair and transparent election processes, to pension plan participants and to regulators. It should also be liable for failure to act in accordance with its governing terms and responsibilities. Pension plan participants and plan

sponsors should all have representation on governing board subject to dealing with the issue of conflict of interest. In some circumstances safe harbour rules could be useful for both ensuring prudent behaviour and for limiting the liability of the governing entity. There should always be a clear split between oversight and operational activity.

Standards of governance and training

In the context of IORPs, the current draft directive sets out requirements for fit and proper management. The principles of minimum suitability standards, integrity and competence should apply to both IORPs and contract based schemes. It may be that any particular minimum level of skills required will follow criteria 'owned' by the governing body itself, and could differ between member states. But in each case they should be disclosable to members. An annual skills audit should be carried out before taking on a new member of a governing body and a training plan should be in place, although these may well be member-state specific.

There are clear advantages in having independent trustees or fiduciaries in place which may or may not be professional independent entities. Requiring "professional" independence can be problematic for cost and availability reasons, but the alternative view is that without this, true independence cannot be achieved. Some countries for example have a model which does not require "professional" (paid) independence, but does require trustees and fiduciaries to act under law in the interests of pension plan participants.

Delegations

The delegations from governing bodies are usually very extensive and include operational activities, subcommittees, asset management functions and executive functions of the governing body. One model is to have an "irreducible core" of key activities which should not be delegated – for example investment and risk responsibility. In any event there is likely to be a set of core functions which the governing body is responsible for monitoring. But as investment products get more and more complicated, governance bodies can struggle with technical complexity so retaining core activities should not be a requirement in all cases.

An alternative model is that all activities can be delegated provided there are legal powers to do so and provided that that delegation is properly monitored and supervised. The governing body is responsible for the suitability and efficacy of its delegations. If the governing body delegates all its activities it must be sure that the fiduciary manager is legally and technically able to carry out this responsibility properly.

Internal controls

There needs to be sufficient internal controls in place to ensure that the purpose of the IORP is complied with. These controls should include;

- risk management procedures
- performance assessment (self – appraisal)

- administration, information, and operational processes
- remuneration, conduct and conflict of interest controls

The internal controls should be proportionate to the size of the entity.

Governance “gaps”

Wherever there is either:

- (i) a direct contractual relationship between the provider and the pension plan participant ; or
- (ii) an employer-provided scheme but where there is no contractual relationship between employee and provider,

there is likely to be no governance entity monitoring or representing pension plan participants’ interests. This may result in a governance ‘gap’. If the provider steps into this gap, there can be conflicts of interest. If there is no one stepping in, a pension plan participant may need to make complex investment choices with possibly limited knowledge. Remedying these gaps might include:

- appointment of management committees for contract based schemes, similar to those already required for occupational DC schemes (e.g. UK and France).
- facilitating employers stepping into this gap for employer provided schemes provided that conflicts of interest can adequately be managed and that pension plan participant participation is encouraged. It is possible that with the assistance of safe harbour rules, an employer can make some of the important choices e.g. choose the number and form of investment choices available to the pension plan participants.

Governance functions outside the governing board

Entities appointed by the governing board should include an auditor and an actuary. Both of these should report to the governing body with regard to compliance of the entity with regulation and the supervisory framework. For IORPs, the audit function and the actuarial function are now required to be independent entities and this principle should be supported for all other structures.

Conflict

The management of conflicts of interest is key to good scheme governance. A conflict of interest may arise when an entity is required to take a decision for which: (i) he or she is obliged to act in the best interests of the scheme’s beneficiaries and at the same time (ii) he or she has or may have in the future either: (a) a separate personal interest; or (b) another fiduciary duty owed to a different beneficiary. Conflicts of interest need to be: (i) identified; (ii) monitored; and (iii) managed.

Fiduciaries should be aware of their fiduciary obligations to pension plan participants, their requirements to exercise independent judgement and be perceived to be doing so. They should also have a clear understanding of the circumstances in which they may find themselves in a position of conflict of interest.

Fiduciaries should identify and consider any conflicts that *may* arise in the future; identify and consider and disclose any conflicts that *have* arisen; be appointed under procedures that require them to disclose any conflicts of interest; confirm that they are not aware of any further conflicts that have not been disclosed; maintain an up-to-date register of each other interests, for example financial interests and other appointments; have a means of recording conflicts that have arisen or are likely to arise, for example by using a conflicts register.

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Adopted by the EIOPA Occupational Pensions Stakeholder Group on 30 November 2015

The Chairperson of the EIOPA Occupational Pensions Stakeholder Group

PHILIP SHIER