GROOM LAW GROUP
CHARTERED

BENEFITS BRIEF

August 10, 2015 www.groom.com

Author: David W. Powell

If you have questions, please contact your regular Groom attorney or one of the attorneys listed below:

Louis T. Mazawey
lmazawey@groom.com
(202) 861-6608

David W. Powell
dpowell@groom.com
(202) 861-6600

OECD Revises "Core Principles of Private Pension Regulation" - Expanded to Cover Personal/IRA-Type Pensions, Discourage ESOPs, Give Plan Sponsors Due Process

In July, 2015, the Working Party on Private Pensions (WPPP) and Council of the Organisation for Economic Cooperation and Development (OECD) made available for public comment a significantly revised and updated version of what was previously named the Core Principles of Occupational Pension Regulation. The recommended new Core Principles can be found online at http://www.oecd.org/daf/fin/private-pensions/core-principles-private-pension-regulation.pdf.

These revisions were negotiated among the OECD member countries of the Working Party over a number of years. Though not binding as a treaty would be, such Principles are nevertheless influential to public policy makers, and also frequently form the basis for regulation among countries that aspire to membership in groups such as the OECD or the G-20. Applicants for accession to the OECD, for example, are frequently measured against how well they follow such guidelines. As a result, it would be worthwhile for those involved with global pension governance or financial institutions that provide plan services around the world to review the new Core Principles, and consider commenting on any issues of concern. Below, we outline the general structure of the new Core Principles, and point out some areas that may be of particular interest. We have identified in particular the expansion of the principles to personal pension products such as U.S. IRAs, a provision discouraging ESOPs as not providing sufficient diversification, and a provision stressing due process for plan sponsors in dealing with regulators.

Many of these principles will be familiar to U.S. readers, but these are global principles that would be new to many countries.

Structure of the New Core Principles

The new Core Principles, as suggested by their name change, are no longer limited to "occupational", or employment-based pensions. They now cover personal or individual pensions as well, which exist in many countries, notably with IRAs in the US.

The principles are thus now separated into three main sections. Six Core Principles in Part I form the general principles applicable to all types of private pension plans. Part II encompasses two Core Principles specific to occupational pension plans. Part III specifies two Core Principles relating to personal private pension plans.

GENERAL PRINCIPLES APPLICABLE TO ALL TYPES OF PRIVATE PENSION PLANS

Core Principle 1: Conditions for effective regulation

This principle emphasizes that a pension system must exist in an effective legal framework and well-functioning capital markets and financial institutions. Notably, it also states that the regulatory framework should not impose excessive burden on pensions markets, institutions, or employers.

Core Principle 2: Establishment of pension plans, pension funds, and pension entities

This emphasizes that pension plans should be subject to an adequate, transparent, and coherent set of legal, accounting, technical, financial, managerial and governance requirements, without imposing excessive administrative burden. There should also be a legal separation of pension fund assets from those of the pension entities managing the pension plan or plan assets. This principle discusses:

- Legal provisions for the establishment of pension plans, pension funds and pension entities
- Governing documents
- Risk control, reporting and auditing mechanisms
- Funding policy
- Investment policy
- Capital requirements
- Governance
- Business plan
- Registration and license withdrawal
- Guidance materials to be furnished to sponsors

  Observation on Cross-Border Activity. Interestingly, Sections 2.27 and 2.28 of this principle provide that where a pension entity is seeking to establish a branch or subsidiary in a foreign jurisdiction, the licensing authority in the host country should consult the appropriate authorities in the home jurisdiction before the issuance of a license, and where a pension entity is seeking to conduct cross border activities without a physical presence in a foreign jurisdiction, the appropriate authorities in the host country should consult with the appropriate authorities in the home jurisdiction of the pension entity before allowing such activities.

Core Principle 3: Governance

This principal emphasizes governing in the best interests of plan members and beneficiaries, appropriate division of operational and oversight responsibilities, accountability and suitability of those with such responsibilities, appropriate controls, communication, and structures that encourage good decision-making, proper and timely execution, transparency, and regular review and assessment. Areas covered include:

- Identification of responsibilities
- Governing body
- Accountability
- Delegation and expert advice
- Auditor

- Actuary
- Custodian
- Risk-based internal controls
- Reporting
- Disclosure

Core Principle 4: Investment and risk management

This principle takes into consideration risk diversification and dispersion and asset-liability management. Pension funds and pension entities should be required to act in line with the investment horizon and risk-return objectives, and take into account the long-term nature of saving for retirement and of eventual liabilities. Self- investment should be strictly controlled or prohibited in cases where there are no appropriate safeguards in place to ensure diversification or otherwise avoid undue risks or costs to members. Self-dealing should also be strictly controlled in order to ensure that deals are made at the best conditions available in the market and in the best interests of members. Investment abroad by pension funds and pension entities should be permitted, subject to prudent management principles. Subjects include:

- Retirement income objective and prudential principles
- Prudent person standard
- Investment policy
- Portfolio limits and other quantitative requirements
- Valuation of pension assets
- Performance assessment

Observation: ESOPs Discouraged. Section 4.16 of the Core Principles discourages investment in employer stock, such as with employee stock ownership plans in the U.S. (ESOPs). That section provides that:

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

Previous comments during the drafting of the Core Principles that language be added to the effect that an exception to the diversification requirement be made for employer stock in plans expressly designed by national law to hold employer stock, such as ESOPs, were not taken up.

Core Principle 5: Plan design, pension benefits, disclosure, and redress

Factors to be taken into consideration include adequacy of benefits, protection of the value of benefits, entitlements, accruals, contributions, coverage, and financial and market risks. Overall benefit adequacy should be evaluated. Appropriate disclosure and education should be promoted regarding benefits and members' rights and responsibilities. Topics include:

- Plan design
- Member choice
- Disclosure and availability of information
- Entitlement process and rights of redress

Core Principle 6: Supervision

This emphasizes that effective supervision of pension funds and plans must focus on legal compliance, financial control, actuarial examination and supervision of those operating or managing the plan. Core Principle 6 is structured differently than the other Core Principles because it incorporates the revised IOPS (International Organisation of Pension Supervisors) Principles of Private Pension Supervision approved in 2010. (IOPS is an organisation composed of the pension regulators of over 80 countries, much wider than the OECD membership.) It includes a number of sub-principles:

Principle 1: Objectives. National laws should assign clear and explicit objectives to pension supervisory authorities.

Principle 2: Independence. Pension supervisory authorities should have operational independence.

Principle 3: Adequate Resources. Pension supervisory authorities require adequate financial, human and other resources.

Principle 4: Adequate Powers. Pension supervisory authorities should be endowed with the necessary investigatory and enforcement powers to fulfill their functions and achieve their objectives.

Principle 5: Risk-based Supervision. Pension supervisory authorities should adopt a risk-based approach of supervision.

Principle 6: Proportionality and Consistency. Pension supervisory authorities should ensure that investigatory and enforcement requirements are proportional to the risks being mitigated and that their actions are consistent with the costs and impact on pension fund members and beneficiaries and, where appropriate, plan sponsors.

> **Observation on the importance of affording due process to the plan sponsor.** Importantly, and partly in response to comments by the private sector regarding ex post facto laws and other issues in some IOPS countries, Section 6.31 of the principle provides some protections for the pension plan sponsors: “Once a problem is identified, a clear and well-defined ‘due process’ should be followed. Due process describes the checks and balances that a supervisory authority should have in place to ensure that supervised entities are treated fairly, consistently and transparently.”

Principle 7: Consultation and Cooperation. Pension supervisory authorities should consult with the bodies they are overseeing and cooperate with other supervisory authorities domestically and internationally economic difficulty and financial system volatility, though confidentiality requirements should be met.

Principle 8: Confidentiality. Pension supervisory authorities should treat confidential information appropriately.

Principle 9: Transparency. Pension supervisory authorities should conduct their operations in a transparent manner – on the conduct of its policy, explaining its objectives and describing its performance in pursuing those objectives.

Principle 10: Governance. The supervisory authority should adhere to its own good governance practices - including governance codes, internal risk-management systems and performance measurement - and should be accountable.

PART II: PRINCIPLES SPECIFIC TO OCCUPATIONAL PLANS

Core Principle 7: Occupational pension plan liabilities, funding rules, winding up, and insurance

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

Core Principle 8: Access, vesting, and portability of occupational pension plans

Nondiscriminatory access should be granted to occupational pension plans. Regulation should aim to prevent exclusions based on age, salary, gender, period of service, terms of employment, part-time employment, and civil status. It should also promote the protection of vested rights and proper entitlement process, as regard to contributions from both employees and employers. Policies for indexation should be encouraged. Portability of pension rights and the possibility to consolidate accumulations from different plans should be facilitated with the aim of enabling job mobility. The decision to offer portability rights to members should avoid imposing excessive costs. The protection of members' rights in case of early departure should be respected.

PART III: PRINCIPLES SPECIFIC TO PERSONAL PENSION PLANS

Core Principle 9: Funding of personal pension plans, wind-up and insolvency

Personal pension plans should be adequately funded at all times. Such plans may be funded through the establishment of pension funds, pension insurance contracts or the purchase of other authorised retirement savings products from financial institutions, or a combination of these mechanisms. Competitive markets should be promoted in personal pension provision in order to provide a greater choice amongst financial services and promote cost-efficient provision of pension services. Individuals should be able to search, compare and, where appropriate, switch between products and providers easily and at reasonable and disclosed costs.

Core Principle 10: Equal treatment, business conduct, competition and portability

Access to personal plans does not have to be linked to an employment relationship. Personal plans may be mandatory or voluntary. Any individual should be able to join a personal pension plan. Pension entities and their intermediaries should promote personal pension plans in a manner that is clear, fair and not misleading. They should ensure that any conflicts of interest are properly addressed and, where appropriate, avoided. Pension funds, pension entities and/or their authorised agents or service providers should also provide information on conflicts of interest associated with the sale or marketing of any pension product. Pension funds, pension entities and/or their authorised agents or service providers should ensure that, where individuals receive advice before concluding a personal pension plan contract, such advice is appropriate taking into account the individuals' disclosed circumstances.

Summary

OECD principles, guidelines and best practices have a way of becoming or influencing rules over time. The recommended Core Principles of Private Pension Supervision merit careful review. Of particular interest is the expansion of pension supervision and fiduciary duties to personal pension plans. The U.S. has already begun to see that implemented with IRAs. Another area of interest is ESOPS, which the principles indicate that regulators would like to discourage. Those interested in these and other issues may wish to comment on the recommended principles before the deadline of October 20, 2015. And finally, on the positive side, multinational companies that provide pension benefits in jurisdictions where laws and regulators do not meet these principles may want to consider their usefulness in challenging local regulation, such as by asserting the right to due process when local law is arbitrary or ex post facto.