Key Principles of Good Governance for Workplace Defined Contribution Pension Plans throughout Europe

- Core features
- Value for money
- Investments
- Fit and proper persons
- Accountability
- Administration
- Communication
- Employer engagement
- Conflicts of interest
- Managing risk
- Handling queries and complaints
- Contributions and other core financial transactions
- Decumulation
- Termination

PENSIONS EUROPE

Foreword

Across Europe there is a growing trend towards the establishment of defined contribution (DC) pension plans for second pillar, workplace pension provision. Millions of citizens across Europe already rely upon workplace DC pension plans to supplement the pension benefits that they receive from the State. In light of the increasing reliance on workplace DC pension plans throughout Europe, it is essential that individuals can have confidence that workplace pension plans operate in their interests, are robust, well run and offer value for money.

For employers to continue to offer workplace DC pension plans they too need to have confidence that these plans are robust, well run and offer value for money. Employers also need confidence that their plan will remain affordable, that it will not expose them to unforeseen risks and that it will be flexible enough to enable them to achieve their HR and business objectives and accommodate how these develop over time.

Good governance is therefore essential if workplace DC pension plans are to retain the confidence of employees and employers. This paper sets out 14 key principles of good governance to which we believe all workplace DC pension plans throughout Europe should adhere (as a minimum) in order to ensure this.

PensionsEurope aims to be the thought leader in Europe and beyond on DC issues and we present this paper as a contribution to the evolution of DC schemes, and a natural follow on from our previous paper on Pension Design Principles applied to modern Defined Contribution solutions. Through our Member Associations and our Corporate and Supporter members we have access to resource and expertise that we will use to further the debate on DC schemes and help to ensure better outcomes for members.

I would like to thank all the members of the Board and Secretariat of PensionsEurope who contributed to this paper with thanks to the members of the DC Committee, and in particular Francois Barker (Eversheds), Withold Galinat (BASF) and Tim Smith (Eversheds).

PensionsEurope's Chair
Janwillem Bouma
23 June 2016

1. Introduction

Across Europe there is a growing trend towards the establishment of defined contribution (DC) pension plans for second pillar, workplace pension provision. Millions of citizens across Europe already rely upon workplace DC pension plans to supplement the pension benefits that they receive from the State. This number is likely to continue to increase significantly in the coming decades, as employers look for a less risky alternative to defined benefit pension plans and Governments across Europe seek alternatives to help close the gap that is emerging – for economic and demographic reasons - between state pension provision and citizens' income needs in retirement.

In light of the increasing reliance on workplace DC pension plans throughout Europe, it is essential that individuals can have confidence that workplace pension plans operate in their interests, are robust, well run and offer value for money.

Generally speaking, it is for an employer to decide whether to offer a workplace DC pension plan to its employees and employer engagement is critical to the success of such plans. Employer contributions are a key incentive to encourage their employees to join, and remain in, the plan and they help to boost their employees' retirement funds. For employers to continue to offer workplace DC pension plans they too need to have confidence that these plans are robust, well run and offer value for money. Employers also need confidence that their plan will remain affordable, that it will not expose them to unforeseen risks and that it will be flexible enough to enable them to achieve their HR and business objectives and accommodate how these develop over time. A stable fiscal, legal and regulatory environment is an important element of this.

Good governance is therefore essential if workplace DC pension plans are to retain the confidence of employees and employers. This paper sets out 14 key principles of good governance to which we believe all workplace DC pension plans throughout Europe should adhere (as a minimum) in order to ensure this. In setting out these principles, we are seeking to stimulate further debate about the minimum standards of governance that should be expected from workplace DC pension plans throughout Europe. These principles would also be relevant in the development of a 29th regime for workplace DC pension plans within Europe, should this happen.

For the purposes of this paper we have treated a workplace DC pension plan as an arrangement:

- that is established or chosen by an employer for its employees
- under which employees build up their own individual pension account, and
- where there is no promise about the level of benefits that an employee's account will ultimately deliver – and, therefore, no liability on the employer or the plan to deliver a particular level of pension benefit.

However, some or all of these principles may equally apply to other types of workplace or individual pension plans.

This paper focuses on the governance and operational aspects of workplace DC pension plans and it should be read alongside our paper on the design principles for DC plans, *Pension Design Principles applied to modern Defined Contribution solutions.*

> *"Good governance is therefore essential if workplace DC pension plans are to retain the confidence of employees and employers."*

2. Key stakeholders

There are several parties that have an interest in workplace DC pension plans being well run and delivering good outcomes. These include:

Employers

Generally speaking, it is the employer who chooses a workplace DC pension plan for its employees and agrees to bear some or all of the related costs. Good plan governance is an important concern for employers making this decision. Many employers will want to ensure that the pension plan they choose and contribute to on behalf of their employees is well run, offers value for money, and delivers a good quality service.

In any event, all employers have a self-interest in ensuring good governance of workplace DC pension plans, as a well governed plan should:

- help an employer to recruit and retain its staff
- help an employer get maximum value from its pensions spend and stand out from its competitors when seeking to attract and retain talent
- help an employer to achieve its HR objectives related to succession planning by making it more likely that its employees will be able to afford to exit the labour market at the end of their working lives
- mitigate the risks to the employer of any potential liability arising from the poor operation of the plan, and
- enhance the employer's reputation with its employees and externally.

Employees and other beneficiaries

Given the increasing reliance on workplace DC pension plans throughout Europe, it is crucial that they deliver good outcomes for individuals and help them to plan and prepare for their retirement. It is also essential that individuals know that someone is charged with ensuring that the plan is operated in their interests and that it is delivering value for money. This is particularly important in the context of workplace DC pension plans where competition alone cannot be relied upon to deliver this due to:

- the complexity associated with different pension plans, which can make it difficult for individuals and employers to make the right choices,
- employers (not individuals) deciding which pension plan to use, and
- employees typically not having the opportunity to shop around to find a better pension plan or being in a position to negotiate better terms.

With vast sums being invested in workplace DC pension plans it is also essential, both for employees and the European economy, that these sums are invested appropriately and safeguarded to ensure the security of individuals' retirement savings. It is also critical that individuals are given the right information at the right time during their saving lifecycle to enable them to manage their savings, plan for their retirement and make informed decisions about how best to use their savings in later life.

Those responsible for running or overseeing the plan

Those legally responsible for running or overseeing workplace DC pension plans – which may, depending on the jurisdiction, include insurance companies, asset management companies, other commercial entities, employers, independent fiduciaries (such as trustees) or employer and employee representatives - also have a clear interest in the success of these plans, and in the long-term success of and confidence in pensions saving in general. In particular, they have an interest in ensuring that plan members receive good quality service, good outcomes and value for money. Without this, those who run or oversee such plans face criticism and potential liability for poor performance. They also jeopardise the retirement prospects of their members, risk their reputation, increase the need for regulatory intervention and risk undermining trust and confidence in workplace pensions.

Policymakers and those responsible for regulating workplace pension plans

Policymakers, regulators and supervisory authorities have an interest in ensuring that workplace pension plans are well run, well governed and are trusted by individuals and employers. They also have an interest in ensuring that workplace pension plans deliver good outcomes and contribute to long-term economic stability.

> *"It is critical that individuals are given the right information at the right time during their saving lifecycle"*

3. Key principles

Principle 1: Core features

Workplace DC pension plans should be designed to be affordable, robust, sustainable, flexible and non-discriminatory. Plans should be run or overseen by persons who are under a legal or regulatory obligation to act in the interests of members and beneficiaries and in a way that minimises risks to the employer. Plan assets should not be accessible to the creditors of the employer or creditors of the persons or entities responsible for running or overseeing the plan or for investing plan assets.

Workplace DC pension plans should be designed for the long-term and should be run or overseen by persons who are under a legal or regulatory obligation to act in the interests of the members and beneficiaries of the plan.

Plans should be operated in a manner that respects the legal principles of non-discrimination on grounds of age, sex, religious belief, disability, sexual orientation, marital status etc. However, employers should also be able to use such plans to reward the loyalty of their employees.

Plans should seek to minimise the risks to the employers that establish and contribute to them. Employer risks will be minimised by plans being well run, having effective governance and ensuring that the employer's liability does not extend beyond the employer's contributions into the plan. Pension plans are long-term arrangements and it is essential that they are flexible enough to be modified in response to changes in the legal, regulatory and business environment, changes to the employer's financial liability and to reflect economic, demographic and social changes.

Individuals should have confidence that their pension funds will not be accessible to the creditors of their employer or the persons or entities responsible for running or overseeing the plan or for investing plan assets.

"Pension plans are long-term arrangements and it is essential that they are flexible"

Principle 2: Value for money

Those responsible for running plans are required to ensure that their plan represents value for money for members, beneficiaries and employers.

Employees are typically not in a position to select an alternative workplace pension plan, meaning the usual market forces that help to ensure value for money do not ordinarily apply. Therefore, it is essential that those who run or oversee workplace DC pension plans are required to ensure that the plan offers value for money on an ongoing basis. In particular, those running or overseeing a plan should use their expertise and bargaining position (and that of the employer) to secure a good deal with external service providers.

Value for money is not simply about securing the lowest cost. Instead, it involves an assessment of whether the costs and charges that are borne by members, beneficiaries and employers (including investment costs and charges) are justified by the quality and necessity of the services being provided.

Value for money should be assessed on a regular basis during the accumulation phase. All decumulation options offered by the plan should also be assessed to ensure that they will also deliver value for money (see principle 12).

Principle 3: Investments

Assets should be invested appropriately with suitable investment options made available where individuals make investment decisions, including a suitable default strategy where necessary. Plan investments and investment options should be monitored and reviewed regularly with costs and charges also assessed regularly to ensure they represent value for money.

Where individuals are required to choose how their funds are invested, a suitable number and range of investment options should be made available to them bearing in mind the needs and profile of the membership. It is essential that these options offer value for money (principle 2), serve members' interests (principle 1) and enable suitable diversification. Assets should predominantly be invested on regulated markets with investments on unregulated markets being kept to a prudent level.

Individuals should be provided with sufficient and timely information to enable them to make informed choices about how to invest their savings (principle 7), including relevant information about costs and charges.

Where necessary, a suitable default investment strategy should be selected by those running or overseeing the plan. This should be designed in the members' interests (principle 1) and deliver value for money (principle 2). The default strategy should be suitable bearing in mind the membership profile of the plan and the need to appropriately manage risk. Costs and other charges related to the investment of assets should be transparent to and assessed regularly by those who run or oversee the plan to ensure that they represent value for money.

The performance and ongoing suitability of the various investment funds that are made available to members and any default investment fund should be reviewed regularly by those who run or oversee the plan with changes being made where necessary. This should include a review of the investment options against the stated objective and relevant benchmarks.

Where those running or overseeing the plan are responsible for deciding how plan assets should be invested, those assets should be invested appropriately, in the members' interests (principle 1) and deliver value for money (principle 2). The plan's investment performance and strategy should be monitored and reviewed regularly.

Those running or overseeing a plan should be alive to the potential for conflicts of interest to arise in relation to the plan's investments and, where any actual or potential conflicts are identified, they should be managed appropriately (principle 8).

Principle 4: Fit and proper persons

Those legally responsible for running or overseeing a plan should understand their duties, have sufficient expertise and experience (when judged collectively) to carry them out and be fit and proper to do so.

Good plan governance will ultimately depend on the competence of those responsible for running or overseeing the plan. It is essential that between them they have sufficient expertise and experience to run or oversee the plan (as appropriate) and carry out their duties effectively.

Advisers should be called upon where necessary to help ensure this. However, those responsible for running or overseeing the plan should be in a position to understand any advice that they receive and challenge it where necessary.

Ensuring that those who run or oversee workplace DC pension plans are fit and proper to do so is critical in order to maintain savers' trust and confidence in workplace pensions.

Principle 5: Accountability

Plans should have clear, effective and transparent operational and decision-making structures and processes in place.

In order to achieve good governance, decision-makers and those responsible for the operation of a workplace DC pension plan must be clearly recorded and identifiable and be accountable for the decisions and actions that they take. Failure to do this could undermine savers' trust and confidence in the plan.

Plans should have in place a structure and processes that facilitate transparent, effective and timely decision-making, with sufficient time and resources available to manage the ongoing operation and governance of the plan.

Where those who are ultimately responsible for running or overseeing the plan delegate or outsource any of the plan functions this should be understood and clearly recorded with appropriate internal controls in place and regular reviews to ensure the effective performance of those functions.

Principle 6: Administration

Plans should be well administered with timely, accurate and comprehensive processes and records.

Workplace DC pension plans are only as good as the data that they hold and the administrative processes that support their activities. Members will only receive their correct benefits if their personal data is accurate and up-to-date and if contributions and any choices they make are properly recorded and implemented. Complete and accurate records of contributions received and when and where they have been invested must be maintained in order to ensure members' benefits are paid correctly.

A plan should have in place adequate systems and controls (principle 9) to ensure good administration and compliance with all relevant laws and regulatory requirements. Where any aspects of the administration of the plan are outsourced those running or overseeing the plan should be satisfied that the relevant service provider has:

- the experience, expertise and resources to deliver the outsourced services effectively, and
- systems and controls in place to ensure the effective delivery of the outsourced services and to comply with all relevant legal and regulatory requirements.

In terms of data, it is essential that plans:

- ensure that plan data is as complete, accurate and up-to-date as reasonably possible and is subject to regular review and evaluation
- have processes in place to ensure that data required from the employer or third parties is as accurate and comprehensive as reasonably possible and that it is provided in a timely manner, and
- have systems in place to ensure compliance with the data protection laws.

Where the processing or storage of plan data is outsourced, those running or overseeing the plan should understand what controls are operated by the relevant third party to ensure that the integrity, accuracy and security of plan data is maintained.

Those running or overseeing the plan should have a clear record of any services that are outsourced and the role and responsibilities of the service provider (principle 5). They should also operate internal controls to monitor and manage the delivery of the outsourced services on an ongoing basis.

Those running or overseeing the plan should have an adequate business continuity plan in place and this should be reviewed regularly and tested as appropriate. Where third party service providers are used, those running or overseeing the plan, should understand the business continuity arrangements that the service provider has in place, and be confident that it adequately mitigates any risks to plan data and members' accounts.

Principle 7: Communications to members

Communications should be designed and delivered to ensure members and beneficiaries are able to make informed decisions throughout their participation in the plan.

Under a workplace DC pension plan the onus is on the member to make decisions about their retirement savings. Good communication is essential if members and beneficiaries are going to be able to make these decisions effectively. Communications should be clear and, as far as possible, kept simple.

The plan should issue timely communications which are designed to enable members and beneficiaries to make informed decisions throughout their participation in the plan. In particular, plan communications should help members and beneficiaries to:

- understand the importance of pension saving
- where relevant, make informed choices
- plan for their retirement (without giving rise to any promise or guarantee about the outcome), and
- where relevant, understand the different ways in which they can access their pensions and the relevant factors to consider when making this choice.

Principle 8: Employer engagement

Plans should facilitate employer engagement.

Employer engagement can help to ensure the success of a workplace DC pension plan and the delivery of good member outcomes. An engaged employer will also help deliver a well-run plan.

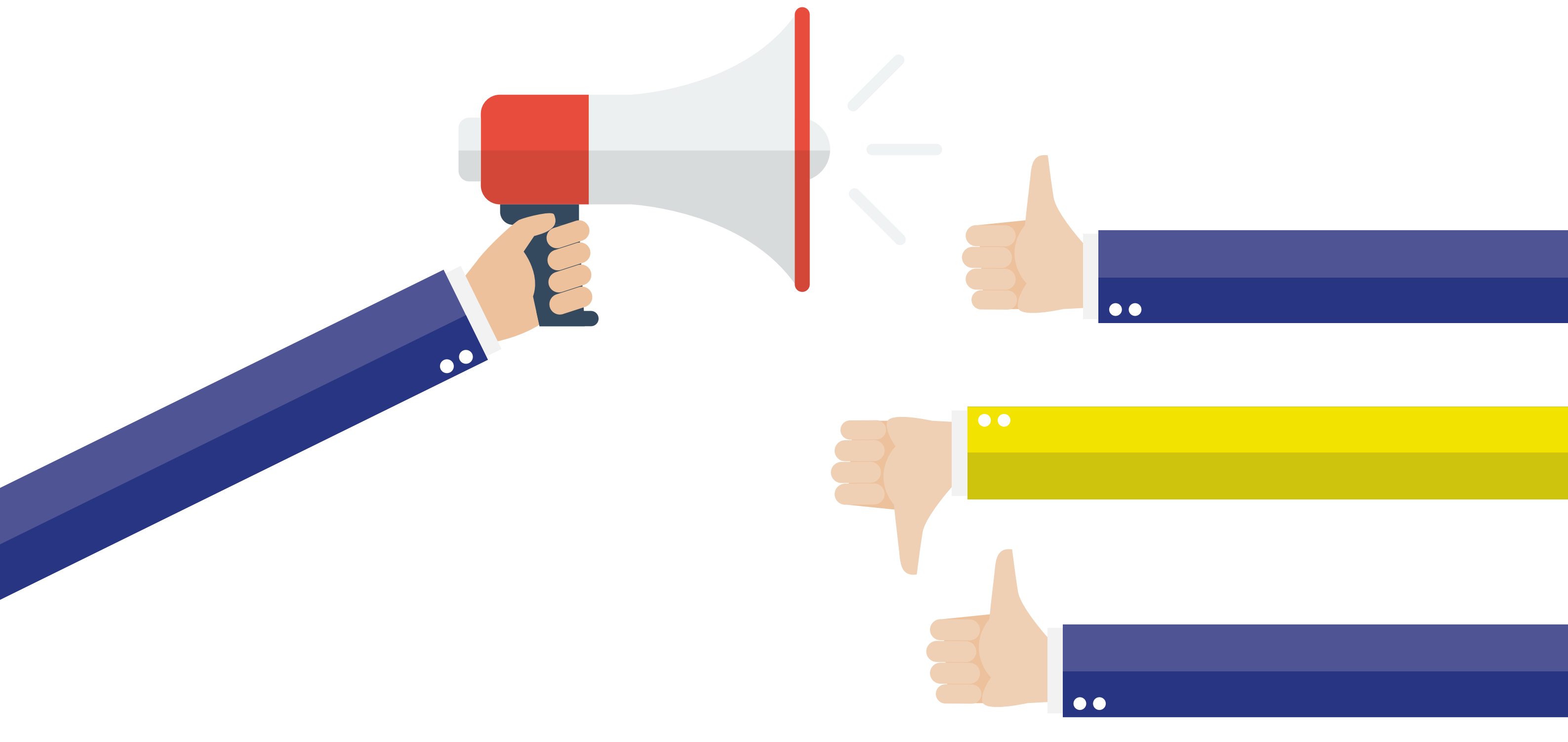
Employers may be responsible for the design of the plan and they play a key role in its ongoing operation and evolution – including through contributing to members' funds. An engaged employer can provide significant input into the running of the plan and can challenge decisions where, in its view, the outcome for its employees may not be desirable. Consequently, those running or overseeing plans should facilitate active engagement by the employer.

Principle 9: Conflicts of interest

Plans should identify and manage conflicts of interest effectively.

In order to ensure the long-term sustainability of workplace pensions it is essential that individuals have trust and confidence in workplace pension plans. To help secure this, those who run or oversee workplace DC pension plans should be alive on an ongoing basis to the potential for conflicts of interest to arise which may affect them personally. They should also be alert to conflicts arising that may affect service providers, advisers, investment managers and intermediaries and other parties involved in the operation of the plan.

Those running or overseeing the plan should have a clear process in place for identifying, managing and recording actual and potential conflicts of interest. Any measures taken to manage conflicts should be recorded and regularly reviewed and, where necessary, updated to ensure that they remain suitable and are being implemented effectively.



Principle 10: Managing risk

Plans should have appropriate systems and processes in place to identify, monitor and manage risks.

Those running or overseeing workplace DC pension plans should identify and monitor the risks that are critical to the plan and to the value and security of members' accounts.

Areas of significant risk for a workplace DC pension plan include (amongst other things):

- inappropriate investment and/or decumulation options
- poor investment performance
- excessive costs and charges
- poor administration
- inaccurate and/or incomplete data
- inaccurate and/or misleading communications
- fraud (including the misappropriation of assets)
- breaches of legal and/or regulatory requirements
- poor performance or default by a service provider or counterparty, and
- reputational risk.

Once risk areas have been identified suitable safeguards and controls should be implemented to mitigate these risks.

Risk management is an ongoing process and those running or overseeing a plan should regularly identify, monitor, review and evaluate the risks to the plan (and its exposure to new and emerging risks) and the suitability and effectiveness of the plan's safeguards and controls.

Principle 11: Handling queries and complaints

Plans should have effective processes in place to handle queries and complaints from members and beneficiaries promptly and fairly

In order for members and beneficiaries to be able to manage their workplace DC pensions effectively and make informed decisions, plans should have systems in place (consistent with the applicable legal and regulatory framework) to:

- enable members and beneficiaries to raise queries and ask questions about the plan and their savings, and

- ensure queries from members and beneficiaries are responded to promptly, accurately and effectively.

Although good governance should help to reduce the potential for complaints from members and beneficiaries, this risk cannot be eliminated altogether. A prompt and effective response to such complaints will help to restore and maintain trust and confidence and secure good member outcomes. Therefore, plans should have a suitable process in place to consider and respond to complaints from members and beneficiaries promptly and effectively, with prompt and appropriate action being taken to rectify plan errors. This process should be accessible, affordable, fair, accountable and efficient.

Principle 12: Contributions and other core financial transactions

There should be effective processes in place to identify and recover unpaid contributions, and to ensure that core financial transactions, including the investment of contributions, transfers and the payment of benefits, are processed promptly and accurately.

There should be an effective process in place to ensure that contributions due from the employer and members to the plan are paid on time and in full in accordance with any agreements that are in place. As part of this it should be clear who is responsible for recovering any unpaid or underpaid contributions due from the employer and/or members.

Once contributions have been received by the plan they should be invested promptly and accurately.

Failing to pay members' benefits or effect transfers correctly or in a timely manner is one of the most common causes of complaints and claims against pension plans. Therefore, effective and efficient processes should be put in place to make these payments.

Principle 13: Decumulation

Where members and beneficiaries have a choice of how to use or access their pension account, the plan should, within the constraints of the applicable legal and regulatory framework, offer appropriate decumulation options that provide value for money and help achieve good member outcomes. Appropriate and timely information should be made available to members and beneficiaries to enable them to make informed choices.

Where appropriate, bearing in mind the plan design and subject to the applicable legal and regulatory framework, members and beneficiaries should be given the ability efficiently and cost effectively to select their own decumulation option from the open market or transfer their pension fund to an alternative plan.

Where members and beneficiaries do not have a choice, the plan should, within the constraints of the applicable legal and regulatory framework, offer a suitable decumulation option that offers value for money and helps achieve a good outcome for members.

In order to achieve good outcomes for members and beneficiaries, where under a workplace DC pension plan individuals have a choice over how to use or access their pension account, the plan should offer suitable options for how they can do this. These options should be assessed by those running or overseeing the plan to ensure that, as far as possible within the constraints of the applicable legal and regulatory framework, they offer value for money (principle 2) and deliver good outcomes. The suitability of these options and whether they continue to offer value for money should be reviewed regularly.

Plans should provide members and beneficiaries with clear, appropriate and timely information to enable them to make informed choices about how to use or access their pension account (principle 7). Where appropriate, members and beneficiaries should be encouraged to seek suitable advice or guidance to assist them in this.

Where appropriate, bearing in mind the plan design and subject to any constraints within the applicable legal and regulatory framework, members and beneficiaries should be given the ability to:

- select their own option from a provider of their choice, and/or
- transfer their pension fund to an alternative pension plan.

Where these rights are available members and beneficiaries should be made aware of them and plans should have efficient and cost effective processes in place to effect a member's or beneficiary's decision to select a decumulation option from the open market or to transfer their accumulated fund.

Where under a workplace DC pension plan members and beneficiaries do not have a choice over how they can use or access their pension account, the plan should offer a suitable decumulation option. This option should be assessed by those running or overseeing the plan to ensure that, as far as possible within the constraints of the applicable legal and regulatory framework, it offers value for money (principle 2) and delivers good outcomes. The suitability of this option and whether it continues to offer value for money should be reviewed regularly.

Principle 14: Termination

Plans should have suitable arrangements in place to ensure that members' and beneficiaries' pension funds are safeguarded and that their benefits will continue to be paid in the event that the pension plan is wound up.

Although workplace DC pension plans should be designed to be around for the long-term there may be circumstances in which the plan will need to be wound-up. In these circumstances it is essential that members' and beneficiaries' pension funds are safeguarded and that their benefits will continue to be paid. Plans should have suitable arrangements in place to ensure this. It should also be clear who has the power to wind-up a plan, in what circumstances and who will bear the costs and charges associated with this.

About PensionsEurope

PensionsEurope represents national associations of pension funds and similar institutions for workplace pensions. Some members operate purely individual pension schemes.

PensionsEurope has **24 member associations** in EU Member States and other European countries with significant – in size and relevance – workplace pension systems. In addition to this, PensionsEurope's members include corporate and supporter organisations such as leading European pension funds, asset managers, banks, custodians, investment advisers, insurers, lawyers and social partners.

PensionsEurope has established a **Central & Eastern European Countries Forum (CEEC Forum)** to discuss issues common to pension systems in that region.

PensionsEurope member organisations cover the workplace pensions of **about 70 million people in Europe**. Through its Member Associations PensionsEurope represents approximately **€ 3.5 trillion of assets** managed for future pension payments.

PensionsEurope Members are large institutional investors representing the **buy-side** on the financial markets.

Workplace pensions offer:

- Economies of scale in governance, administration and asset management;
- Risk pooling and often intergenerational risk-sharing;
- Often "not-for-profit" and some/all of the costs are borne by the employer;
- Members of workplace pension schemes often benefit from a contribution paid by the employer;
- Wide-scale coverage due to mandatory participation, sector-wide participation based on collective agreements and soft-compulsion elements such as auto-enrolment;
- Good governance and alignment of interest due to participation of the main stakeholders.

What PensionsEurope stands for:

- A regulatory environment encouraging workplace pension membership
- Ensure that more and more Europeans can benefit from an adequate income in retirement
- Policies which will enable sufficient contributions and good returns

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