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The supervision of DC pensions – from first principles

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IOPS principles of private pension supervision

- **The presentation focuses on the red principles**
  - Objectives
  - Independence
  - Adequate resources
  - Adequate powers
  - Risk orientation
  - Proportionality and consistency
  - Consultation and co-operation
  - Confidentiality
  - Transparency
  - Governance
- **And, DC systems where the pension is intended to be a major part of retirement income**

Objectives

National laws should assign clear and explicit objectives to pension supervisory authorities

- Needed to enable focus on the important
- Directional objectives needed – unlikely to be in legislation
- Ultimate objective is to change (or reinforce) behaviour
- Implies approaches that are flexible and purposive rather than prescriptive

Risk orientation

Pension supervision should seek to mitigate the greatest potential risks to the pension system

- Contrasts with 100% compliance with legislation
- Has many meanings
- Focus resources on:
  - the greatest risks
  - the riskiest plans
  - promoting risk management
- The supervisor needs good evidence about the prevalence of risk
- Needs to decide where management can be trusted – and where not

The UK's five key risks to DC members

- Administration – record keeping becomes a serious risk as schemes age
- Investment allocation and choice – members are reluctant investors and investment management needs to keep up with best practice
- Fees and charges – can heavily erode benefits, but an issue of particular sensitivity
- Retirement options (annuitisation) – a big determinant of final income – members need to access a competitive market
- Member understanding – a common risk - difficult to mitigate

Alternatively focus on pension fund risk management (as in Australia)

Proportionality

Pension supervisory authorities should ensure that investigatory and enforcement requirements are proportional to the risks being mitigated

- Should flow naturally if a supervisor has clear objectives and evidence-based risk orientation
- Proportionality relates:
  - resources and their disposition to the probability and impact of the risk
  - response to the potential impact (of risk and mitigation)

Low impact – High probability *e.g poor communication with members* Focus on education, guidance, and mechanistic responses	High impact – High probability *e.g members choose poor value for money annuities* Focus on intervention
Low impact – Low probability *e.g inadvertent breaches of legislation* Rely on supervised entities	High impact – Low probability *e.g fraud* Focus on monitoring and intelligence work

Transparency

Pension supervisory authorities should conduct their operations in a transparent manner

- Pension funds and their advisers will change only if they know what is expected of them
- The supervisor must win over hearts and minds
- Hence the supervisor needs to explain:
  - What behaviour is expected of supervised entities
  - Where it sees the problem
  - How it will respond
  - How it has taken industry views into account

Closing Observations

Pension supervisors should:

- Know what they wish to achieve
- Identify and focus on the most important risks
- Choose the right instrument to mitigate the risk proportionately
- Take the supervised community with them