

Best practices and guidelines for pension supervision

V Encuentero de Supervisores
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Agenda

- The brief
- Basic concepts of pension supervision
- Risk-based and digital supervision concepts
- Updating the IOPS Guidelines for PLAC supervisors
- Addressing the heterogeneity of pension systems and supervisors
- Proposed content
- Next steps

The brief

- To provide the PLAC Network with some draft guidelines on pension supervision, paying particular attention to:
 - Risk-based supervision
 - Digital pension supervision
 - The particular circumstances and pension systems encountered by PLAC members
 - The diversity in development of pension supervisory approaches

A regulator



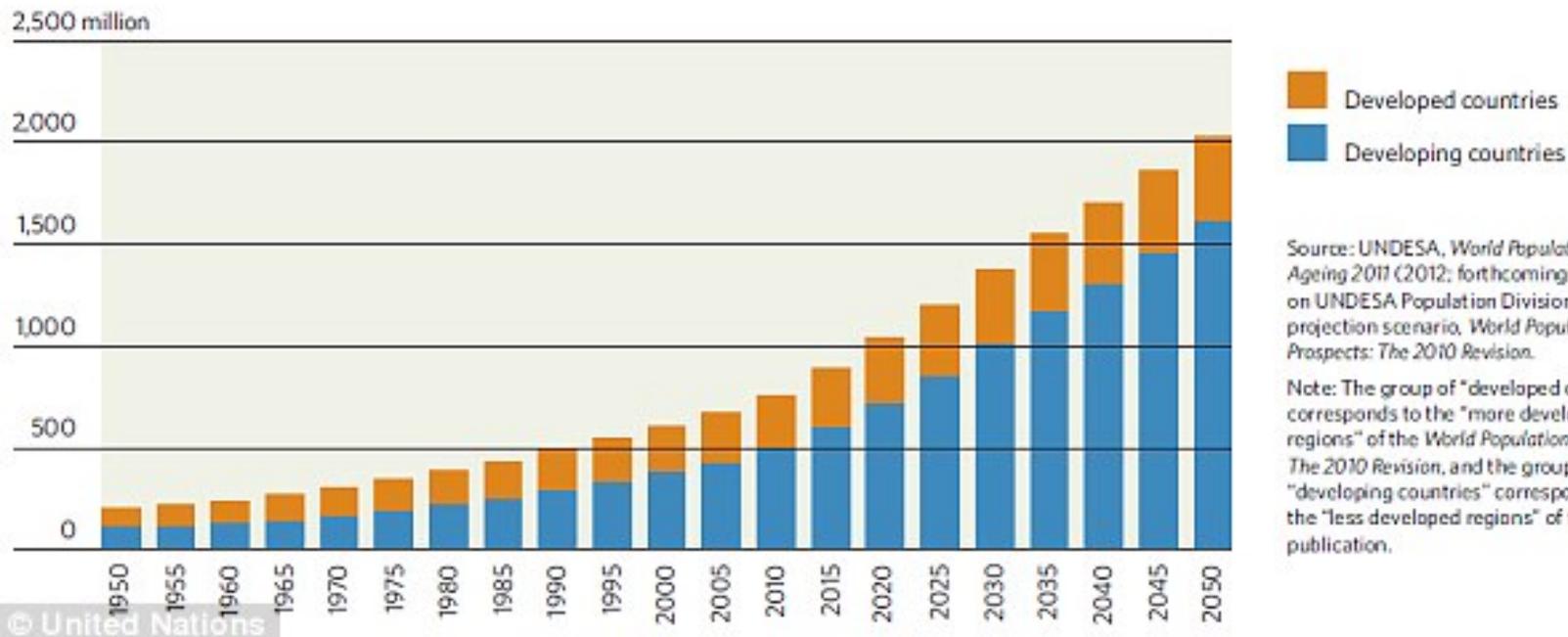
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What is pension supervision

- Differs from regulation although the border-line is often blurred and some PLAC supervisors are also regulate
- Most simply, seeks to ensure that regulation is enforced, substituting for regulation where this is absent/weak
- Better perspective is to see it as ensuring pension system achieves its objectives (at least those within supervisor's control)...
- ...taking account of the risks to those objectives
- And hence maintaining the essential confidence
- Should also recognise systemic risk (to and from the sector)
- Supervisory assessment is central to this vision

The challenge for developing economies – a reminder

Number of people aged 60 or over:
World, developed and developing countries, 1950-2050



What can go wrong

- Frauds (UK, Australian and Swedish examples – fortunately not LATAM)
- Excessive charges by fund managers (common in LATAM):
 - Gives State excuse to sequester or neuter pension system (Argentina/Bolivia)
 - Aggravates public concerns about low benefits, e.g. Chile
- Excessive investment conservatism reduces returns and combines wickedly with high charges but some LATAM countries conspicuous exceptions such as Mexico, Peru and Chile
- Defined benefit funds across the PLAC countries (and globally) have failed to keep pace with reduced investment returns and increasing longevity or are brought down by failing employer
- Poor service quality identified (e.g. Mexico) that could damage reputation
- Under-pinning all these issues are ignorant or self-interested fiduciaries (a particular issue across the region)
- **All failures compromise reputation, trust and confidence**

Risk Based Supervision as defined by IOPS

Should:

- **Be structured:** so that judgments on risk are transparent, defensible and consistent
- **Identify risks:** to the supervisor's [& system] objectives – comprehensive – assessment of gravity (inherent risk)
- **Assess mitigations of those risks:** Many types of mitigations possible – but may need strengthening
- **Prioritise responses:** taking account of risk, the scope to reduce it and resources – applies to supervisory response, planning and strategies

Six pillars of RBS



1. Start with the long-run outcome focused objectives for the supervisor;
2. Focus on key system-wide and entity risks;
3. Use a range of tools to assess and understand risk and solutions – including quantitative tools;
4. Enhance entity governance and risk management as a central way to reduce risks;
5. Ensure risk-based selection of entities and subjects for supervisory focus; and
6. Prevention and remediation first with sanctions and enforcement for persistent or critical issues.

Digital pensions supervision

- New risks: cyber-crime; internet selling; data in the cloud
- New opportunities:
 - Faster more reliable data feeds to the supervisor
 - Scope for big data analysis (AI)
 - Smarter data management processes facilitating evidence gathering for legal action
- Imminent double-edged developments
 - Pension inclusion through telephone banking straight into (low cost) pension accounts
 - Blockchain?
- In practice, extent of digital enabling varies considerably

Some observations on digital transformation

- Enables regulator/supervisor to grip the tricky issues, such as costs, coverage & adequacy
- Can strengthen early warning indicators (big data and AI)
- New supervisory expertise needed
- Need to get in early
- Supervisor must revert to the fundamentals:
 - Clarity regarding risks – before things go wrong
 - Importance of reconciliations, entity assurance mechanisms and custodianship
 - Governance: how does the board know that the technology is secure and proposition adds value
 - Co-operation with other supervisors (e.g banking and telco)

Why have new guidelines?

- Emphasis & reminder of the basics
- Self-assessment tool
- Fill methodological gaps
- Assist development of RBS
- Assist response to digital transformation
- IOPS guidelines would benefit from update (next slide)

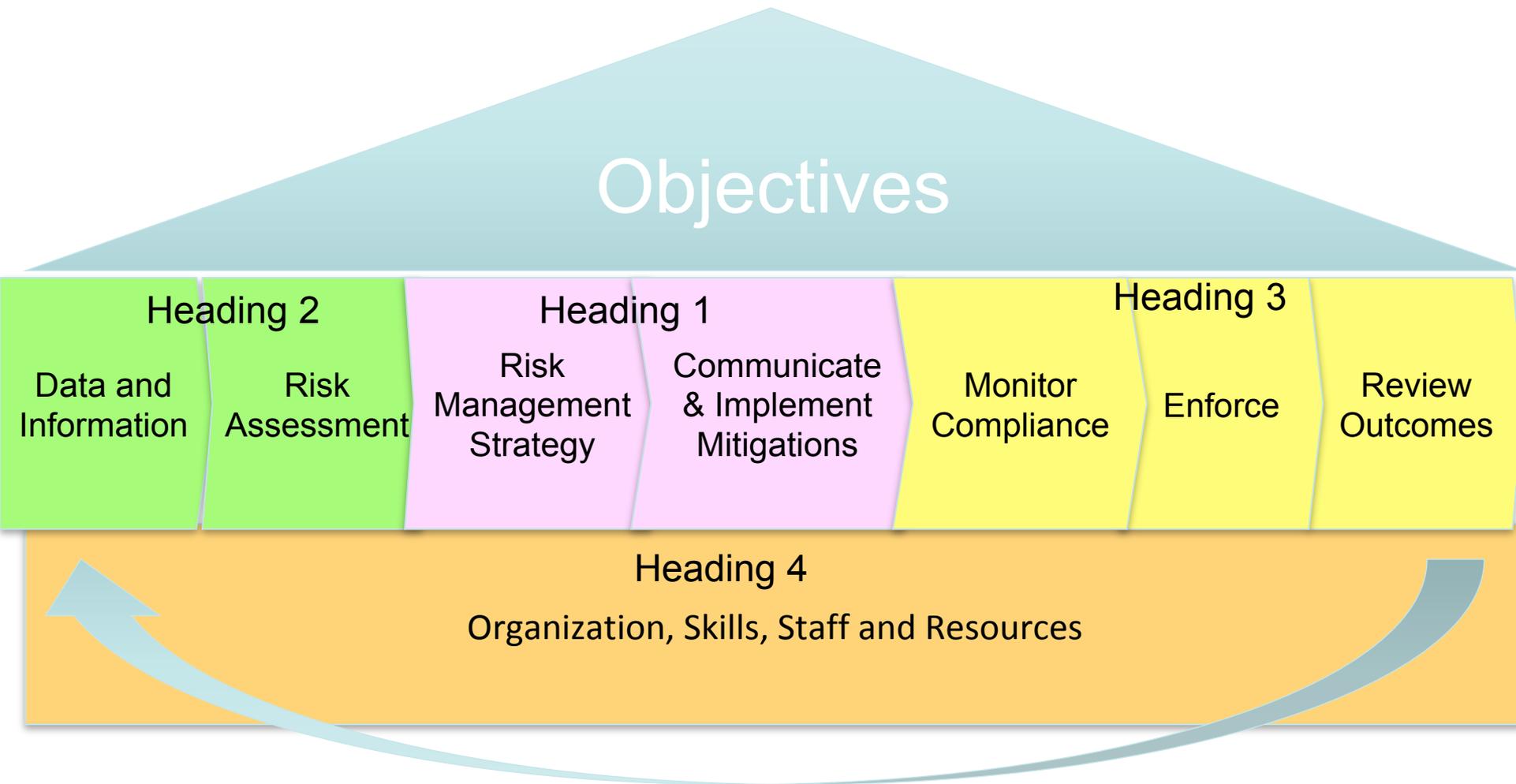
Planned Guidelines follow in footsteps of IOPS supervisory assessment guidelines

- Issued 2008 – early IOPS publication
- Effectively 13 Guidelines each with a few supporting paragraphs
- Pre-dates requirement for risk-based supervision
- Strong Western European/Australian bias
- Descriptive more than normative – should this emphasis change?
- Limited focus on the Defined Contribution fund system prevalent in LAC
- Little reference to corporate governance!!!
- Limited reference to digital issues

Structure of the Guidelines

- The four headings used by IOPS appear to be broadly appropriate but could be tweaked to read:
 1. Strategic approach
 2. Data collection and analysis
 3. In-depth evaluation of risk mitigation
 4. Resources and organisation
- Material under each heading needs to recognise diversity within PLAC

Mapping the Guideline headings onto the supervisory value chain



The revised guidelines need to recognise variation in pension provision across the PLAC Network

- Defined Benefit (DB) and Defined Contribution (DC)
- Private sector (mostly DC) and public sector (mostly DB) - but excluding State pension funds (as in CR)
- Compulsory State-sponsored (privatised social security) and voluntary employer sponsored
- Commercial fund management companies and trustee/employer-nominated boards
- Very large (many millions of participants) through to a handful of participants
- Highly complex investments through to basic portfolios

How the Guidelines seek to tackle this heterogeneity

- Approx 18 High level Guidelines (standards) drafted to apply in all circumstances
- Supported by more detailed good practices, covering:
 - What all PLAC supervisors can do to meet the Guideline
 - Additional practices (analysis, data feeds, methodologies etc) for more advanced supervisors,
 - Case studies of most sophisticated practices could be added as appropriate

Scope and coverage

- Relevant to pensions supervisors that supervise occupational pension funds or pension management companies who administer individualised accounts or occupational pension funds, along with their associated service providers
- Includes governmental occupational funds
- But not social security funds or personal pension funds
- Members, participants or affiliates?
- Exclude licensing and other approval processes
- How far should it stray into systemic rather than entity-specific approaches?

Preamble

- Sets out to explain why the guidelines cover the subjects they do
- Some broader objectives of pension supervision could be included in this section, such as:
- *Sustain and build trust in the pension system and promote its healthy development and stability, by in particular:*
 - *Protecting affiliate assets and benefits;*
 - *Ensuring benefits delivered as promised;*
 - *Promoting good administration and governance; and*
 - *Ensuring orderly and legally compliant management of the system.*
- The regular assessment of the risks to pension system objectives, especially those arising or mitigated at supervised entities central to effective risk-based pension supervision
- Purposes of monitoring & analysis
- Seeking reliance on entity governance and risk management
- Purposes of in-depth evaluation
- Importance of coherent justifiable strategy
- Variation in balance between off-site and on-site

Maybe refer also to:

- Desired outcomes of pension systems
 1. Coverage – inclusion
 2. Adequacy – more pension saving
 3. Sustainability – confidence/affordability
 4. Efficiency
 5. Security - including supervision
- Change mechanisms
 - Culture/social norms
 - Regulation
 - Market structure
 - Supervision

Source: Outcome-based assessment framework – World Bank Group

Guidelines on strategic approach (1.1-1.4)

Could be made fairly normative if PLAC is content:

- Evaluation of the landscape of risks to pension system objectives to identify and rate inherent risks
- Could be structured around a matrix
- Strategies for mitigating most serious risks (e.g. DB funding, lack of inclusion or saving, fees, sales intermediaries, investment strategy and its implementation)
- Agility as circumstances, e.g. technology change
- Promote and advance the application of proportionate and effective remedies to systemic problems
- Identify primary focus of entity supervision/assessment
- Assess how well entities know how to mitigate risks
- Ensure entities know what is expected of them, maybe including publication of methodology/strategy

Guidelines on monitoring and analysis (2.1-2.5)

- What data:
 - List – drawing on questionnaire responses
 - Sufficient data collection powers
 - Obtain data electronically
 - Collect data for specific analyses & landscape overview, including for key risk and outcome indicators
 - Could include complaints and performance data
 - Ensure reliable and timely and respond where not
- What analyses
 - List – drawing on PLAC Member responses
 - Assessments of inherent risk
 - Indicators needed for all significant entities (and risk factors)
 - Early warning indicators for high impact risks
 - Can use a formal risk model or less formal approaches
 - Ideally, some analyses undertaken by entities themselves
- What response
 - Rapid for big issues
 - Proportionate

Guidelines on in-depth evaluation (3.1-3.6)

- Planning, level of sophistication can vary
- Good process
- Focus on governance
- Testing key mitigations/controls
- Substance not form
- Use of digital surveillance (for intractable risks?)
- Assessment of residual risk and level of supervisory response
- Reporting to entities to entities so as to change behaviour

Guidelines on resources and organisation (4.1-4.3)

- IOPS say little of substance – so are these needed.
- Maybe yes, if they highlight:
 - **Expertise**, including digital and ability to buy-in where necessary. Multi-disciplinary teams
 - **Organisation**: co-ordination team, linkage of teams to risk areas. Processes for review and ensuring consistency (IT enabled)
 - **Communication** between departments and with other supervisors – IT enabled
 - **Secure and effective IT** aspiring to digital transformation

Next steps

- Fully analyse questionnaire responses (with report on what this shows)
- Receive comments on the first draft and this presentation
- Revise and circulate
- Third iteration may be needed
- Network to consider and approve
- Disseminate