MFSA MALTA FINANCIAL SERVICES AUTHORITY

Circular

11 May 2020

Circular on the Implementation of the IORP II Directive

1.0 Introduction

1.1 Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs) (hereinafter referred to as the "IORP II Directive") is a minimum harmonisation Directive and is a recast of Directive 2003/41/EC of the European Parliament and of the Council of 3rd June 2003 on the activities and supervision of institutions for occupational retirement provision (the "IORP I Directive"). Member States were required to bring into force the laws, regulations and administrative provisions necessary to comply with the IORP II Directive by 13th January 2019.

The IORP II Directive introduces a new regulatory framework for an occupational retirement scheme, (hereinafter referred to as "Scheme" or "Schemes") and its main objective is to provide for adequate protection of members and beneficiaries of the said Scheme. It aims to ensure higher standards of governance and a risk-based governance system to improve risk management and transparency of institutions for occupational retirement provision.

On the 22nd of October of 2018, the MFSA issued a Consultation Document on the proposed amendments to the Retirement Pensions Act (MFSA Ref: 14 – 2018) highlighting the main changes proposed to be carried out to the Retirement Pensions Act (Cap. 514), primarily as a consequence of transposing the IORP II Directive. The said Consultation closed on the 16th November 2018. Furthermore, on the 4th February 2019, the MFSA published a Consultation Document (MFSA Ref: 02-2019) on the proposed amendments to regulations issued under the Act. The said Consultation closed on the 25th February 2019.

Following the aforementioned consultations, on the 15th July 2019, the MFSA issued a Consultation on Amendments to Pension Rules for Occupational Retirement Schemes issued under the Retirement Pensions Act (MFSA Ref: 11-2019), in order to complete the transposition of the IORP II Directive. Various amendments were also required to be made to the Pension Rules for Occupational Retirement Schemes issued in terms of the Retirement Pensions Act, 2011 (hereinafter referred to as the "Pension Rules") to transpose the remaining provisions of the IORP II Directive, which had not been included in the Act and regulations issued thereunder. The amendments also aligned the Pensions Rules for Occupational Retirement Schemes with some of the requirements that have been introduced in the Pension Rules for Personal Retirement Schemes. It is to be noted that following the said consultation documents, no feedback was received from the market.

Following the said Consultation Documents, Part X of Act No. V of 2020 which amends the Retirement Pensions Act (Cap.514) was published on the 3rd March 2020 in the Government Gazette of Malta No. 20,357. The Regulations supplementing the Retirement Pensions Act were published on the 13th March 2020 in the Government Gazette of Malta No. 20,366. Furthermore, on the 18th March 2020 the MFSA published the amended Pension Rules.

The MFSA is issuing a Circular to provide Retirement Scheme Administrators with guidance in relation to the provisions found in the Act, Regulations and Pension Rules issued thereunder. It is to be noted that the guidance in this Circular is based on four Opinions published by EIOPA on the 10th July 2019 entitled Opinion on the supervision of the management of environmental, social and governance risks faced by IORPs, Opinion on the use of governance and risk assessment documents in the supervision of IORPs, Opinion on the supervision of the management of operational risks faced by IORPs and Opinion on the practical implementation of the common framework for risk assessment and transparency of IORPs. It should be noted that the information of this Circular is not exhaustive and as such, Retirement Scheme Administrators are required to review the opinions in detail.

2.0 Governance and Risk Assessment Documents

The IORP II Directive introduces new requirements on the written policies and procedures which Retirement Scheme Administrators are required to maintain. The said requirements have been transposed in the Retirement Pensions Act, Regulations and Pension Rules issued thereunder. The aim of this Circular is to provide Retirement Scheme Administrator with guidance as to what such policies are required to include, as a minimum. It should be noted that once the Occupational Retirement Scheme is granted a licence by the MFSA, the Retirement Scheme Administrator is expected to ensure that all policies are in place and approved by the Board of Directors of the Retirement Scheme Administrator.

Paragraph 3.1.3 of the Pension Rules states that the Retirement Scheme Administrator shall at least have written policies in relation to risk management, internal audit and, where relevant, actuarial and outsourced activities. When drafting the policies and procedures, the Retirement Scheme Administrator is required to take into account the nature, scale and complexity of its business and the Schemes it administers. Retirement Scheme Administrators are required to ensure that every policy clearly sets out at least:

(a) the goals pursued by the policy;

(b) the tasks to be performed and the person or role responsible for them;

(c) the processes and reporting procedures to be applied;

(d) the obligation of the relevant organizational units to inform the risk management, internal audit, and where applicable, the actuarial function of any facts relevant for the performance of their duties.

2.1 Risk Management Function

Article 13A(2)(b)(i) of the Retirement Pensions Act requires a Retirement Scheme Administrator to have in place an effective risk management system, which includes a Risk Management Function. In this respect, a Retirement Scheme Administrator which is already in possession of a licence from the MFSA, is required to identify a natural or legal person who will be responsible to carry out the Risk Management Function of the Retirement Scheme Administrator and the Scheme/s and submit a Personal Questionnaire of such person to the MFSA by the 30th June 2020. Retirement Scheme Administrators who already have a person performing the Risk Management Function are also required to submit a Personal Questionnaire to the MFSA of the natural or legal person who is carrying out the said function by the 30th June 2020. The person proposed to perform the Risk Management Function should ideally be in possession of the following relevant qualifications:

(a) risk management qualification from a reputable professional or tertiary education institution; or

(b) financial services qualification from a reputable professional or tertiary education institution; or

(c) engineering/scientific qualification from a reputable professional or tertiary education institution.

The Risk Management Function is required to adopt the strategies, processes and reporting procedures necessary to identify, measure, monitor, manage and report regularly the risks at an individual and at an aggregated level, to which the Schemes are or could be exposed, and their interdependencies. In order to ensure the Risk Management Function operates effectively, and in line with the requirements of paragraph 3.1.3 of the Pension Rules, the Retirement Scheme Administrator is required to ensure that it also has in place a Risk Management Policy.

2.2 Risk Management Policy

The Retirement Scheme Administrator is required to ensure that the Risk Management Policy sets out the relevant responsibilities, objectives, processes and reporting procedures which the Retirement Scheme Administrator will apply. The Risk Management Policy should be readily available to the MFSA upon request. The said policy should categorize material risks by type, depending on whether the Retirement Scheme Administrator or the Scheme is exposed to such risk.

One of the risks which the Retirement Scheme Administrator should take into account, in the Risk Management Policy is cyber risk, including risks and threats emanating from the use of cloud services. The use of Information Communications Technology can expose the Retirement Scheme Administrator and the Scheme/s to other types of operational risks. Annex 3 entitled Supervision of Cyber Risks of the EIOPA Opinion on the Supervision of Management of Operational Risks Faced by Retirement Scheme Administrator provides guidance to the manner in which supervisory authorities are required to supervise a Scheme's cyber risk. Retirement Scheme Administrators are encouraged to review the said Annex when drafting their Risk Management Policy.

Where the Retirement Scheme Administrator outsources important operational[1], critical[2] or key functions, the Retirement Scheme Administrator is required to conduct an assessment on its risk

[1] Operational functions include but are not limited to the Administration function, Investment Management function, Custodian function.

[2] Critical functions are those functions which if they fail, they would be detrimental to the business as well as to the service to be provided to the members and beneficiaries.

profile and that of the Scheme/s in order to obtain a good understanding of the impact which such outsourcing might have on the Retirement Scheme Administrator and the Scheme/s. Following such assessment, the Retirement Scheme Administrator is required to document how identified risks are to be mitigated, controlled and managed in the Risk Management Policy.

Retirement Scheme Administrators are also expected to take into account the potential long-term impact of investment decisions on ESG factors in their Risk Management Policy, in order to support society's sustainability goals. It is highly recommended for Retirement Scheme Administrators to take into account ESG risks in their overall contingency planning. For example, by considering its communication strategy in the event of a public controversy involving a company included in the IORP's investment portfolio.

In line with the requirements of paragraph 3.1.3 of the Pension Rules, the Retirement Scheme Administrator is to ensure that the Risk Management policy is reviewed at <u>least once every three years</u> and adapted in view of any significant change in the system or area concerned, including but not limited for instance to following;

(a) change in the Retirement Scheme Administrator or the Schemes' risk profile, risk appetite and risk tolerance limits;
(b) change in the Scheme's funding position;
(c) any organisational change;
(d) a change in the Retirement Scheme Administrator or the Scheme's business plan;
(e) outsourcing of the Retirement Scheme Administrator's activities;
(f) cross-border transfers or activities.

Apart from a Risk Management Policy, the Retirement Scheme Administrator is also required to have in place a Risk Appetite and Risk Tolerance Statement and a Risk Register.

<u>2.3 Risk Appetite and Risk Tolerance Statement</u>

The Retirement Scheme Administrator is required to ensure that the statement is a separate document from the Risk Management Policy. The statement is to include detail on the specific maximum risk that the Retirement Scheme Administrator is willing to take regarding each relevant risk. The Risk Appetite and Risk Tolerance Statement should be readily available to the MFSA upon request. The said statement should establish risk limits and be able to prompt the Retirement Scheme Administrator of any breach of tolerable risks.

Risk tolerance limits can be expressed in absolute terms and can also be limited by legal or regulatory requirements. The Retirement Scheme Administrator may express the risk tolerance in absolute terms, for *instance "The Retirement Scheme Administrator will not accept a delay in investing contributions that exceed x days."*. The Risk Tolerance statement may also be limited by legal or regulatory requirements, for instance *"The Retirement Scheme Administrator has zero tolerance on fraud."*

Retirement Scheme Administrators are required to *inter alia* carefully consider the risks associated with the membership structure, both when identifying material risks in the Own Risk Assessment policy and when reporting the outcome of their Own Risk Assessment ("ORA") in the results report. Relevant risks stemming from the characteristics of membership should help the Retirement Scheme Administrator establish tolerance limits. Membership structure is only one of the factors which define a Scheme's risk profile. Demographic data and longevity projections by age cohort are amongst the relevant membership information which Retirement Scheme Administrators of a Scheme underwriting biometric risk should make use of to establish their risk profile.

2.4 Risk Register

The risk register should identify and describe all quantitative and qualitative risks together with an assessment of their probability/impact before and after risk mitigation measures[3]. The risk register shall include but not be limited to the following information: identification of the risk owner(s), the controls implemented to manage the risks and the effectiveness of such controls.

The risk register should be a living document that gives a comprehensive overview of the Retirement Scheme Administrator's exposure to existing and new, emerging risks and their interdependencies. This risk register document is to be attached as an annex to the Own Risk Assessment submitted to the Authority.

2.5 Internal Audit Function

Another key function which a Retirement Scheme Administrator is required to have is the Internal Audit Function. Article 13A(2)(b)(ii) of the Retirement Pensions Act states that a Retirement Scheme Administrator is required to have in place an effective Internal Audit Function (hereinafter referred to as "IAF"), which shall be independent from the other key functions. This implies that the Retirement Scheme Administrator should ensure that the IAF does not perform any operational functions and is free from undue influence by any other functions including key functions. In this respect, Retirement Scheme Administrators which are already in possession of a licence from the MFSA are required to submit a Personal Questionnaire of the natural or legal person who will be responsible to carry out the Internal Audit Function, by the 30th June 2020. Retirement Scheme Administrators who already have a person performing the Internal Audit Function are also required to submit a Personal Questionnaire to the MFSA of the natural or legal person who is carrying out the said function by the 30th June 2020.

The person proposed to perform the Internal Audit Function should ideally be in possession of the following relevant qualifications:

(a) internal/quality auditing qualification from a reputable professional or tertiary education institution; or

(b) financial services (including accounting) qualification from a reputable professional or tertiary education institution; or

(c) scientific qualification from a reputable professional or tertiary education institution.

Paragraphs 3.5.1 and 3.5.2 of the Pension Rules state that a Retirement Scheme Administrator is to provide for an effective Internal Audit Function in a manner that is proportionate to the size and

[3] In case of cyber risks, the assessment should also be expressed in terms of threat and vulnerability.

internal organisation, as well as to the size nature, scale and complexity of the activities of the Scheme/s administered by the Retirement Scheme Administrator.

2.6 Internal Audit Policy

In order to ensure the Internal Audit Function operates effectively and in line with the requirements of paragraph 3.1.3 of the Pension Rules, the Retirement Scheme Administrator is required to ensure that it also has an Internal Audit Policy. Paragraph 3.1.3 of the Pension Rules requires the Retirement Scheme Administrator to ensure that the policy is reviewed at least every three years and adapted whenever there are any significant changes in the system or area concerned.

The Internal Audit Policy is to cover *inter alia* the following areas:

a) the terms and conditions, according to which the Internal Audit Function can be called upon to give its opinion or assistance or to carry out other special tasks;
b) whether the policy provides for the internal rules setting out the procedures the person responsible for the internal audit function needs to follow before informing the competent authority; and
c) where appropriate, the criteria for the rotation of staff assignments.

It should be noted that the Internal Audit Policy should be readily available to the MFSA upon request.

2.7 Actuarial Function

Where a Retirement Scheme Administrator administers a Scheme/s which provide(s) cover against biometric risks or guarantees an investment performance or a given level of benefits, such Retirement Scheme Administrator is required to have an effective actuarial function. Article 13A(2)(b)(iii) of the Retirement Pensions Act requires a Retirement Scheme Administrator to have an effective Actuarial Function, where applicable. In this respect, a Retirement Scheme Administrator which are already in possession of a licence from the MFSA and which administers such Scheme/s is required to appoint a person who will be responsible to carry out the actuarial function of the Retirement Scheme Administrator and the Scheme/s and submit a Personal Questionnaire to the MFSA by the 30th June 2020. Retirement Scheme Administrators who already have a person performing the Actuarial Function are also required to submit a Personal Questionnaire to the MFSA of the natural or legal person who is carrying out the said function by the 30th June 2020.

The person proposed to perform the Actuarial Function should ideally be a fellow of the Institute and Faculty of Actuaries (UK) or actuarial qualifications of similar standing from a reputable institute.

2.8 Actuarial Policy

In order to ensure the Actuarial Function operates effectively and in line with the requirements of paragraph 3.1.3 of the Pension Rules, the Retirement Scheme Administrator which administers Scheme/s which provide(s) cover against biometric risks or guarantees an investment performance or a given level of benefits, is required to ensure that it also has an Actuarial Policy. The said paragraph also requires the Retirement Scheme Administrator to ensure that the policy is reviewed at least every three years and adapted whenever there are significant changes in the system or area concerned. The Actuarial Policy should be readily available to the MFSA upon request. When drafting the policy on actuarial activities, the Retirement Scheme Administrator is to take into account the Opinion on the practical implementation of the common framework for risk assessment and transparency of IORPs.

Underwriting Policy

A Retirement Scheme Administrator which administers a Scheme/s which provides cover against biometric risks or guarantees an investment performance or a given level of benefits is also required to have in place an Underwriting Policy. The said policy is to be reviewed by the Retirement Scheme Administrator every three years or immediately whenever there is a significant change. The Underwriting Policy should be readily available to the MFSA upon request.

2.9 Statement on Investment Policies and Procedures (SIPP)

The IORP I Directive already contained a requirement for a Retirement Scheme Administrator to have in place a Statement on Investment Policies and Procedures (hereinafter referred to as the "SIPP"). The said requirement was transposed in paragraph 1.2.4 of the Pension Rules, now paragraph 2.2.2 of the said Pension Rules. Under the current Pension Rules Retirement Scheme Administrators are required to include details on the SIPP in the Scheme Particulars. In fact, the detail as to the content of the SIPP is currently found in paragraph 3.5 of Appendix 3 of Part C of the Pension Rules, entitled Contents of the Scheme Particulars.

The IORP II Directive maintained the same requirements relating to the SIPP and introduced a new public disclosure requirement. The IORP II Directive requires a Retirement Scheme Administrator to ensure that the SIPP is disclosed in a manner that is easily accessible to members and beneficiaries. In this respect, the MFSA would like to clarify that in order to fulfil the said public disclosure requirement, Retirement Scheme Administrators shall upload the SIPP on the Retirement Scheme Administrator's website. Where the Retirement Scheme Administrator does not own and maintain a website but is a member of a pensions association which does own and maintain a website, and where permitted by that association, such information is disclosed on the website of that association

Retirement Scheme Administrators are required to draft the SIPP in a structured and logical manner, taking into account the nature and type of the Scheme/s. The SIPP is required to provide a clear membership structure and how such structure has been taken into account in the design of the investment policy. The objectives, principles (or beliefs) and risk appetite have to be clearly defined supported by explanations of how these are tailored to the current and changing characteristics. The Retirement Scheme Administrator is to ensure that as a minimum the SIPP contains the following information:

(a) scope of the investment policy;
(b) measurable objectives[4];
(c) constraints such as liquidity needs, funding, and regulation (for example, domestic investment rules);
(d) investment horizon, including the stages when the strategic asset allocation is set to change;

[4] Examples of measurable objective include but are not limited to measurable target investment return (e.g. rate of return exceeding by x percentage points a benchmark index over a specific number of years for a DC scheme); a target level of risk exposure or risk tolerance (e.g. a tolerance level that does not exceed a certain number of negative investment returns over a set period).

(e) whether or not environmental, social and governance factors are incorporated;
(f) the date of approval/entry into force and the Board of Directors of the Retirement Scheme Administrator approving the investment policy;
(g) choice of asset management style;
(h) strategic asset allocation;
(i) investment risk measurement methods;
(j) implemented risk management processes;
(k) number of investment options for defined contribution schemes offering their members a choice;
(l) timeline for reviewing the investment policy including potential trigger events;
(m) the benefit structure (for example whether the Scheme is a defined benefit, a defined contribution or hybrid, single or multiple sponsors);
(n) whether the Scheme is only operating in the accumulation phase, or also in the pay-out phase including the coverage of biometric risk;
(o) specific requirements with regard to cross-border activities (for example applicable social and labour law of the host Member State).

Retirement Scheme Administrators are required to update their current SIPP and bring it in line with the requirements of the Retirement Pensions Act, Regulations and Pension Rules issued thereunder, including the guidance provided in this Circular, and then upload it on their website.

In accordance with paragraph 2.2.2 of the Pension Rules, a Retirement Scheme Administrator is to review the SIPP every three years or more frequently, where required, as per the triggers identified in the examples below. Where there is a significant change in the investment policy, the Retirement Scheme Administrator is required to review the Investment Policy immediately and publish the amended document at its earliest. The Retirement Scheme Administrator is to ensure that the SIPP contains a procedure for monitoring and reporting on the potential triggers. The following triggers are some examples which might require Retirement Scheme Administrators to review and consequently amend their SIPP:

(a) new regulatory requirements;
(b) change to the investment objectives;
(c) deviation from the strategic asset allocation;
(d) investment limits;
(e) risk tolerance thresholds as a result of revised market conditions;
(f) performance review (e.g. investment returns);
(g) changing market conditions;
(h) availability of new financial instruments;
(i) changes in the risk profile, for instance following completion of the Own Risk Assessment;
(j) change in the funding position based on the latest actuarial valuations report;
(k) organisational change;
(l) change in members' investment behaviour and investment option.

It is to be noted that the above list is not exhaustive. Furthermore, in line with paragraph 5.2.1(b) of the Pension Rules, a Retirement Scheme Administrator who is proposing to amend its Investment Policies is required to notify the MFSA in writing of such change. Where the Retirement Scheme Administrator amends the Investment Policies, such Retirement Scheme Administrator is required to obtain the MFSA's approval, in line with the requirements of paragraph 5.3.1 of the Pension Rules.

2.10 Remuneration Policy

In the Consultation Document dated 15th July 2019, the MFSA proposed to introduce Section 3.2 of Part B of the Pension Rules. Section 3.2 requires the Retirement Scheme Administrator to establish and apply a sound Remuneration Policy for all the persons who effectively run the activities, carry out key functions and other categories of staff whose professional activities have a material impact on the risk profile of the Retirement Scheme Administrator in a manner that is proportionate to their size and internal organisation, as well as the size, nature, scale and complexity of their activities. For clarification purposes, these persons may include but are not limited to the Chief Executive Officer, Chief Financial Officer, persons carrying out a mandatory function and committee members where applicable.

When establishing and applying the Remuneration Policy, a Retirement Scheme Administrator shall comply with the requirements set out in Section B.3.2 of the Pension Rules. The Remuneration Policy should also contain specific arrangements which take into account the tasks and performance of the persons identified. Furthermore, the said policy is to support the Retirement Scheme Administrator in overseeing the design of the remuneration policy and remuneration practices, their implementation and operation. The Remuneration Policy shall also take into consideration the long-term interests of members and beneficiaries of Schemes/s operated by the Retirement Scheme Administrator and be in line with the conflict of interest policy. The Remuneration Policy should be readily available to the MFSA upon request.

Moreover, where a Remuneration Policy includes both fixed and variable components, such components shall be balanced. The fixed or guaranteed component should represent a sufficiently high proportion of the total remuneration to avoid that all the persons who effectively run the activities, carry out key functions and other categories of staff whose professional activities have a material impact on the risk profile of the Retirement Scheme Administrator, are being overly dependent on the variable components. The Retirement Scheme Administrator should be allowed to operate a fully flexible bonus policy, including the possibility of paying no variable component.

Depending on the nature, scale and complexity of the Retirement Scheme Administrator's business and the significance of the retirement Schemes in terms of size and internal organization, the MFSA strongly recommends that the Retirement Scheme Administrator considers the creation of an independent remuneration committee. The Retirement Scheme Administrator is to ensure that the composition of the remuneration committee enables it to exercise a competent and independent judgment on the remuneration policy and its oversight. Where no remuneration committee is established, the Board of Directors of the Retirement Scheme Administrator shall assume the tasks that would otherwise have been assigned to a remuneration committee in a way that avoids conflict of interest.

Paragraph 3.2.2 of the Pension Rules requires the Retirement Scheme Administrator to disclose publicly, relevant information regarding its remuneration policy. Retirement Scheme Administrators are required to disclose on their website once every three years and whenever there is a significant change, relevant information. Where the Retirement Scheme Administrator does not own and maintain a website but is a member of a pensions association which does own and maintain a website, and where permitted by that association, such information is disclosed on the website of that association.

For clarification purposes, relevant information is information that will enable the public to understand how the Retirement Scheme Administrator's remuneration policy takes into account at least the following:

(a) the activities, risk profile, objectives, and the long-term interest, financial stability and performance of the Retirement Scheme Administrator and the Scheme as a whole, and the sound, prudent and effective management of Retirement Scheme Administrator and the Scheme;

(b) the long-term interests of members and beneficiaries of Scheme;

(c) avoidance of conflicts of interest;

(d) the sound and effective risk management; not encourage risk-taking which is inconsistent with the risk profile of the Scheme, in terms of the Scheme Document and Scheme Particulars;

(e) the service providers of the Scheme and third party service providers to whom functions or activities of the Retirement Scheme Administrator have been outsourced; and

(f) clear, transparent and effective governance with regard to remuneration and its oversight.

It is to be noted that where a Retirement Scheme Administrator envisages to entrust a service provider to carry out key functions and other activities which have a material impact on the risk profile of the Scheme, the outsourcing contract shall also provide that the remuneration of the service provider's employees who perform those tasks, comply with the remuneration policy of the Retirement Scheme Administrator. Where the service provider is not able to make such a commitment, then such provider is not eligible to be entrusted with such outsourcing. Furthermore, this requirement does not apply to service providers which are covered by Directive 2009/65/EC, Directive 2009/138/EC, Directive 2011/61/EU, Directive 2013/36/EU and Directive 2014/65/EU in order to avoid duplication of requirements on the remuneration policy found in such Directives.

2.11 Conflict of Interest Policy

The Retirement Scheme Administrator of a Scheme/s is to ensure that it can analyse and identify any form of conflict of interest. In this respect, the Retirement Scheme Administrator is required to have in place a conflict of interest policy, which should describe how the Retirement Scheme Administrator will conduct such an analysis on the conflict of interest. The MFSA would like to note that the Retirement Scheme Administrator is required to avoid all conflicts of interest.

Where this is not possible, the Retirement Scheme Administrator is required to manage any conflict of interest that arises or can potentially arise, and document the actions taken to manage such conflicts. Retirement Scheme Administrators are required to have in place a Conflict of Interest Policy which should be readily available to the MFSA upon request.

2.12 Policy on Outsourced Activities

Paragraph 3.1.3 of the Pension Rules states that where the Retirement Scheme Administrator decides to outsource critical functions it is required to have in place, *inter alia*, an outsourcing activities policy.

The said paragraph also requires the Retirement Scheme Administrator to ensure that the policy is reviewed at least every three years and adapted in view of any significant change in the system or area concerned. It is to be noted that where the Retirement Scheme Administrator outsources any of its functions or activities, the Retirement Scheme Administrator shall remain fully responsible for discharging all of its obligations under the Act, Regulations and Pension Rules. The said policy should be readily available to the MFSA upon request by the MFSA.

The Policy on Outsourced Activities shall contain the processes identified in paragraph 3.8.4 of the Pension Rules. The Retirement Scheme Administration shall ensure that the outsourcing policy takes into account the impact of outsourcing on it and the Scheme/s and the reporting and monitoring arrangements which are to be implemented.

The Retirement Scheme Administrator is to ensure that the policy on outsourced activities contains *inter alia* the following:

(a) a record of the outsourced activities in terms of their criticality and importance;

(b) detailed procedures for the assessment and approval of the service provider's ability to provide the outsourced services ;

(c) specification for monitoring and managing each outsourcing arrangement, including the persons within the Retirement Scheme Administrator who will be responsible for the oversight of such outsourcing;

(d) contingency planning to ensure the service continuity of essential and core outsourced functions or activities.

Moreover, it is pertinent for the Retirement Scheme Administrator to notify the MFSA of any new outsourcing arrangements or significant changes in line with the requirements of Part 4.4 of the Pension Rules for Service Providers.

2.13 Other Business Documents

The Retirement Scheme Administrator is also required to have an updated continuity strategy, contingency plan, a business plan, a management agreement between the Retirement Scheme Administrator and the sponsoring undertaking, documentation of the governance systems and an IT system policy.

The MFSA expects Retirement Scheme Administrators to review these documents as a minimum every three years and ensure that such documents are readily available to the MFSA upon request.

2.14 Own Risk Assessment Policy **(hereinafter referred to as the "ORA")**

Article 13A(2)(c) of the Retirement Pensions Act states that as part of its risk management system, the Retirement Scheme Administrator is required to conduct its own risk assessment and the risk assessment of the Scheme/s. Section 3.7 of the Pension Rules provides the detail as to what information the ORA is required to include.

The Retirement Scheme Administrator is required to have a stand-alone document for the ORA policy. The ORA policy shall set out the governance of the ORA process and clarify the roles and responsibilities within the ORA process and in relation to the Retirement Scheme Administrator's risk management system.

The ORA policy shall describe the processes and procedures for conducting the ORA and future reviews e.g. frequency and timing of the next ORA, the reasons for reviewing the ORA earlier or potential triggers to an early review. The policy is required to outline what significant factors and events may prompt a review within a three year period and shall include a description of the procedure used to identify potential events or changes in the Scheme's risk profile. The triggers which may lead to a review of the ORA are *inter alia* the following:

(a) new regulatory requirements;

(b) change in the risk objectives;

(c) change in the risk appetite or risk tolerance thresholds;

(d) change in the Retirement Scheme Administrator or the Schemes' risk profile;

(e) change in the Scheme's funding position;

(f) change in the risk profile of a specific pension scheme (where a Retirement Scheme Administrator administers multiple Schemes);

(g) organisational change;

(h) change in the Retirement Scheme Administrator or the Scheme's business plan;

(i) outsourcing of the Retirement Scheme Administrator's activities;

(j) cross-border transfers or activities;

(k) external factors or events such as changing interest rates, reputational damage, merger of service providers.

The Retirement Scheme Administrator is required to ensure that the ORA policy indicates the date of adoption of the ORA. The policy should identify all material risks to which the Retirement Scheme Administrator and the Scheme is or may be exposed to. The ORA policy should also highlight requirements on data quality, whilst the results report should explain the data quality issues encountered in the conduct of the ORA. These issues may include any deviations from data quality requirements and their potential impact on the interpretation of results. The ORA shall also include how the Retirement Scheme Administrator assesses ESG factors in the Risk Management Policy. The ORA Policy should be readily available to the MFSA upon request.

The Retirement Scheme Administrator shall ensure that the ORA policy indicates whether any part of the Retirement Scheme Administrator's functions have been outsourced. The policy should also be in line with other risk management documents. Any changes that are made in the Risk Management

Policy for instance the risk objectives, should be reflected in the ORA policy. To minimise duplication, the Retirement Scheme Administrator shall ensure that the ORA policy indicates where to find relevant information already contained in other documents such as the investment risk measurement methods and the investment risk tolerance, which are found in the SIPP. In this respect, attached to the Circular, Retirement Scheme Administrators can find an Annex I[5] providing guidance as to the contents and the structure of the ORA policy.

2.15 The ORA Results Report

Once the Retirement Scheme Administrator conducts an ORA, the Retirement Scheme Administrator is required to submit an ORA Results Report. The ORA results report should indicate the date of its adoption and the date of completion or reference period of the ORA.

The ORA results report should contain the assessment, including its outcome, for each material risk identified in the ORA policy, for instance market risk, counterparty risk, biometric risk, operational risk and any interdependencies. The envisaged valuation for these risk assessments, short-or long-term, should also be clearly reflected in the report. The ORA Report is expected to include stress tests, stress scenarios and reverse testing carried out by the RSA in order to evaluate its and the Scheme's resilience to negative events in the short, medium and long term. The RSA should also consider asset-liability management studies in order to evaluate further developments of the funding level, indexation and security mechanisms or in certain cases, back testing of assumptions and methodologies to provide useful insights for the ORA.

When assessing the frequency and severity of the operational risks which are difficult to quantify, the Retirement Scheme Administrator is to provide in their ORA results report, an assessment of the probability and expected losses of operational risks (e.g. using "high", "medium" and "low" scores) as well as an evaluation of the severity of operational risks (e.g. using the terms "critical" versus "non-critical" to indicate whether a particular risk threatens to interrupt essential operations).

The assessment should be forward-looking, considering internal and external emerging developments likely to impact the Retirement Scheme Administrator and the Scheme's future risk profile, and may use relevant data and information from interim risk-related reports carried out during the three-year cycle. The ORA results report should also take into account the Retirement Scheme Administrator's assessment of ESG risks. The ORA should be conducted according to the method and procedures described in the ORA Policy. In this respect, attached to the Circular, Retirement Scheme Administrators can find an Annex II[6] providing guidance as to the contents and the structure of the ORA Results Report. The ORA Results Report should explain data quality issues the Retirement Scheme Administrator encountered in the conduct of the ORA, including any deviations from data quality requirements set in the ORA policy, and their potential impact on the interpretation of results.

3.0 Pension Benefit Statement

One of the main objectives of the IORP II Directive is to provide for adequate protection of members and beneficiaries of the Scheme and ensure transparency of such Schemes. In order to achieve these

[5] Annex I is a copy of Annex 4 to the [Opinion on the use of governance and risk assessment documents in the supervision of IORPs.]
[6] Annex II is a copy of Annex 4 to the [Opinion on the use of governance and risk assessment documents in the supervision of IORPs.]

objectives, the IORP II Directive has introduced a new requirement on the Retirement Scheme Administrator to provide its Members with a Pension Benefit Statement annually. Primarily the Retirement Scheme Administrator shall be required to draw up a concise document containing key information for each member taking into consideration the act, regulations and pension rules issued thereunder, and relevant social, labour and tax law, in relation to each Scheme.

The detailed requirements which are to be complied with when drafting the Pension Benefit Statement can be found in Section B.6.3 of the Pension Rules. It is to be noted that the European Insurance and Occupational Pensions Authority has issued draft templates which Retirement Scheme Administrators may refer to or use when drafting their Pension Benefit Statement. The templates can be found in Annex III and Annex IV of this Circular.

4.0 Way Forward

The MFSA expects Retirement Scheme Administrators to review their Constitutional Document, Scheme Document and Scheme Particulars to bring them in line with the requirements indicated in this Circular, the amendments to the Retirement Pensions Act, regulations and Pension Rules issued thereunder. The said documentation has to be submitted to the MFSA by the 30th June 2020.

4.1 Queries

Any queries or requests for clarifications in respect of the above should be sent by email on ipsu@mfsa.mt.

Annex I

ILLUSTRATIVE TEMPLATE OF THE ORA POLICY

Date of adoption / last revision of the ORA policy:

Anticipated date for re-conducting an ORA, if known and different from the 3- yearly regular update:

1. Background information relevant to the **Retirement Scheme Administrator's** risk profile

This section should provide a description of the Retirement Scheme Administrator's risk profile in relation to:

• risk objectives;

• risk tolerance limits;

• relevant elements concerning a partial assessment of a Scheme(s), if applicable;

• consideration of the membership structure in relation to the Retirement Scheme Administrator's risks;

• time horizon considered with respect to short, medium and long-term risks;

• funding requirements, if applicable including description of the recovery plan where relevant;

• other relevant information such as outsourcing of key functions and other activities and associated conflicts of interest, elements of ORA to be outsourced (for instance because the actuarial function is outsourced);

• reference to other relevant documents, which are necessary or useful to interpret this ORA: e.g. SIPP, Risk Management Policy

2. Description of the method(s) and risk measurement(s) used by the Retirement Scheme Administrator to conduct the ORA

Description of the method(s) used for conducting the risk assessment as required, making a distinction, if any, between the actuarial methods for determining the liabilities, the methods used for assessing the short term risks and the methods for assessing the risks in the long term.

Illustrative examples: common balance sheet, full standardised risk assessment (SRA), specific modules of the SRA, ALM, cash-flow analysis, stress testing, scenario analysis or corresponding national methods.

Description of any significant changes to the methods and/or parameters used for carrying out the ORA since the last assessment, including reasons for these changes and their expected impact on conducting the next ORA. Description of data quality standards / requirements.

3. Description of the ORA within the Retirement Scheme Administrator**'s management** system and decision making processes

Description of how the ORA is integrated into the management system and decision-making processes of the Retirement Scheme Administrator (i.e. risk culture) including reference to where further information on the Retirement Scheme Administrator's risk management system can be found.

Description of who is involved in the ORA within the Retirement Scheme Administrator's management and decision-making processes and their responsibilities in relation to the ORA.

4. Description of adjustment and security mechanisms and risk mitigating techniques available to the Retirement Scheme Administrator

Description covering all adjustment and security mechanisms, as well as any risk mitigating techniques (e.g. reinsurance) available to the Retirement Scheme Administrator. The description should cover the functioning of the mechanisms, including in which circumstances these mechanisms will intervene and may mitigate risks (which risks) for the Retirement Scheme Administrator, the retirement scheme and its members and beneficiaries. It should also describe the interactions between those mechanisms and the final expected result with regard to the risks and the funding needs of the Retirement Scheme Administrator and the retirement scheme.

The section should specifically describe the extent to which accrued retirement benefits can be reduced, under which conditions and by whom.

Possible benefit adjustment and security mechanisms:

- indexation/reduction of benefits;
- sponsor support;
- increase in employee contributions;
- Pension Protection Scheme.

Examples of risk mitigating techniques:

- Reinsurance;
- Derivatives.

This section should set out the context in which the Retirement Scheme Administrator operates. As part of the ORA, the Retirement Scheme Administrator will need to assess the effectiveness of the mechanisms. The results of this assessment is to be reported under section 12 of the results report.

5. Overview of the Retirement Scheme Administrator**'s risks to be assessed in the ORA**

As part of the description of the risk profile of the Retirement Scheme Administrator, this section should include a full overview of all risks that are assessed in the context of the ORA. This overview should include both quantifiable and non-quantifiable risks using relevant, existing information in other governance documents e.g. risk register.

Non-exhaustive list of possible risks:

- ALM risk, specifically the mismatching risk;
- market risks: equity risk, property risk, in particular derivatives; securitisations and similar commitments;
- pension liability risks: longevity risk;

- counterparty risk: lenders, sponsor;
- operational risk: outsourcing, cyber, etc;
- liquidity risk;
- concentration risk;
- strategy risk;
- compliance risk;
- expense risk;
- ESG risks in relation to traditional prudential risks (irrespective of whether ESG factors are being considered in the investment policy of the Retirement Scheme Administrator);
- other risks: for instance, scheme specific (e.g. cross-border activities), reputational risk, sponsor covenant, etc

6. Potential reasons / triggers for re-conducting an ORA before the anticipated time

Description of the possible reasons and conditions, which may trigger the Retirement Scheme Administrator to re-conduct the ORA earlier than anticipated within the three-year time limit, for instance as a result of an unexpected regulatory change.

ANNEX II

ILLUSTRATIVE TEMPLATE OF THE ORA RESULTS REPORT

Insert reference to where the ORA policy can be found if the two documents are separate

Date of completion or reference period of the ORA:

Date of adoption of the ORA results report:

Scope of the ORA: [full assessment], [partial assessment of specific retirement scheme(s): identification of the retirement schemes assessed]

1. Assessment of investment risks

This section provides an overview of the assessment of investment risks with supportive explanations for each category e.g. market risk and interpretation of the results.

2. Assessment of pension liability risks

This section provides an overview of the assessment of pension liabilities with supportive explanations and interpretation of the results in relation to overall funding needs of the retirement schemes administered by the Retirement Scheme Administrator.

3. Assessment of liquidity risk

This section provides an overview of the assessment of liquidity risks considering the investments and the liabilities, with supportive explanations and interpretation of the results.

4. Assessment of counterparty risk

This section provides an overview of the assessment on counterparty risks with supportive explanations and interpretation of the results.

5. Assessment of operational risks

This section provides results of the assessment of operational risks with supportive explanations for each relevant category (e.g. fraud) and interpretation of the results.

6. Assessment of concentration risk

This section provides results of the assessment of concentration risk, with supportive explanations for each relevant area (e.g. investment risk, outsourcing of activities) and interpretation of the results.

7. Assessment of strategy risk

This section provides results of the assessment regarding the Retirement Scheme Administrator's business strategy, if relevant, with supportive explanations and interpretation of the results stemming from potential losses from the strategic decisions or choices of the Retirement Scheme Administrator.

8. Assessment of ESG risks in relation to traditional prudential risks

This section provides results of the assessment of ESG risks with supportive explanations for each relevant area (e.g. market risk, operational risk) where ESG risks arise by type (e.g. transition risk, stranded assets risk) and interpretation of the results.

9. Assessment of compliance risk

This section provides results of the assessment regarding the Retirement Scheme Administrator's ability to comply with existing laws and forthcoming, new regulation, with explanations and interpretation of the results.

10. Assessment of expense risk

This section provides results of the assessment regarding the risk that the fees (included in or on top of the contributions) do not cover the (expected) expenses, considering future developments, with explanations and interpretation of the results.

11. Assessment of other risks

This section provides results of the assessment for other risks identified by the Retirement Scheme Administrator in the ORA policy and/or in the conduct of the ORA, with explanations and interpretation of the results.

12. Outcome of the ORA results

Relevant context to the interpretation of the ORA results

Assessment of the impact of any significant changes to the methods and/or parameters used for carrying out the ORA since the last assessment, if applicable and mentioned in the ORA policy.

Assessment of data quality issues, if applicable, encountered during the conduct of the ORA or if already mentioned in the ORA policy.

Interpretation of the ORA results vis-à-vis the Retirement Scheme Administrator and the retirement scheme's funding policy and from the perspective of members and beneficiaries

This section should include an overview of all quantifiable results of the ORA, with supportive explanations for each of the figures, allowing full comprehension and a proper interpretation of the results. Part of this explanation should cover any differences between the results of the ORA compared to the national regulatory standards with respect to valuation and funding. Such comparison can also be done where the Retirement Scheme Administrator uses the common framework in the context of the ORA, in which case the quantifiable results for the assessment can be extracted from the excel tool.

Description of whether the ORA results will lead to a review and change of the Retirement Scheme Administrator's funding policy and, where applicable the recovery plan.

Description of what the ORA results mean in relation to the risks from the perspective of members and beneficiaries.

<u>Current and future material changes to the risk profile of the Retirement Scheme Administrator</u>

Description of any material changes in the Retirement Scheme Administrator and the retirement scheme's risk profile since the adoption of the ORA policy. This would include the identification of specific risks accountable for material change in the Retirement Scheme Administrator and the retirement scheme's risk profile and a forward-looking perspective on material change in the future.

Assessment of the impact of material changes in the Retirement Scheme Administrator and the retirement scheme's risk profile on sponsor(s), members and beneficiaries (also distinguishing between short-, medium- and long-term risks).

Effectiveness of security mechanisms and risk mitigating techniques

Qualitative assessment of the reliance on and effectiveness of the security mechanisms, and any other risk mitigating techniques (e.g. reinsurance, derivatives hedging) available to the Retirement Scheme Administrator , distinguishing between short-term and long-term risks.

This assessment should also include, where relevant, an analysis of the financial health of the sponsor, the maximum sponsor support, the value and effectiveness of the sponsor covenants.

13. Remedial actions and decisions of the Retirement Scheme Administrator following completion of the ORA

The Retirement Scheme Administrator should provide an overall conclusion of its ORA, including a statement on the effectiveness of the risk-management system. The conclusions should be forward-looking and include lessons learned collected during the exercise.

Possible elements to be included in this conclusion, including a conclusion on the need for updating/modifying:

- adequacy of the parameters used for calculating the technical provisions and/or the risk assessment;
- adequacy of the actuarial methods used to determine the technical provisions;
- adequacy of the methods used to assess the short term risks/funding needs;
- adequacy of the methods used to assess the long term risks/funding needs.

Action plan following the ORA

Description of how the Retirement Scheme Administrator plans to take forward actions on the results of the ORA in its governance process to inform future strategic decisions. For instance *"As a result of this ORA the Retirement Scheme Administrator will modify …"* (policies - e.g. SIPP, documents - e.g. recovery plan, methods, parameters, procedures - e.g. internal control system that will be modified and foreseen timing for modifying documents, procedures etc). When will the ORA need to be reviewed? Increased frequency of monitoring specific risks?

ANNEX III

PENSION BENEFIT STATEMENT TEMPLATE

PENSION BENEFIT STATEMENT

For the period 01 January 2019 – 31 December 2019

1. YOUR DETAILS

Pension plan number:
123456789

Name:
Jane Smith

Date of birth:
12 January 1980

Address:
123 Road, City,
COUNTRY

Date you joined the scheme:
1 March 2009

Expected date of retirement:
12 January 2045

2. HOW MUCH MONEY DO YOU ALREADY HAVE IN YOUR PENSION POT?

FROM THE DATE YOU JOINED UNTIL 31 DECEMBER 2019

EUR 6 000
Total amount you have paid in

\+

EUR 9 000
Total amount your employer has added

\+

EUR 2 710
Total return on your investment minus costs

=

EUR 17 710
The total value of your pension pot

3. WHAT COULD YOU RECEIVE WHEN YOU RETIRE?

DEPENDING ON HOW THE MARKET AND YOUR INVESTMENTS PERFORM, IF YOU CONTINUE TO CONTRIBUTE AS YOU DO TODAY

Bad weather scenario	EUR 63 000	**EUR 300/month***
Best estimation scenario	EUR 75 000	**EUR 350/month***
Good weather scenario	EUR 83 000	**EUR 400/month***

Be careful: These amounts are projections only. The amount you receive at retirement will be different and could be subject to tax.

To find out how these amounts are calculated, go to: link here

Are you on track for retirement?
Use our pension calculator to find out:
www.europensionscheme.eu/calculator

* Paid every month for life

4. HOW YOUR PENSION POT HAS CHANGED IN 2019

Value at the beginning of 2019			**(+) EUR 16 138**
Contributions by you		(+) EUR 600	
Contribution by your employer		(+) EUR 900	
Return on your investment		(+) EUR 204	
Total costs, of which:		(-) EUR 132	
• Administrative costs	(–) EUR 38		
• Investment and transaction fee	(–) EUR 20		
• Taxes	(–) EUR 44		
• Death coverage premium	(–) EUR 30		
TOTAL SUM in 2019		**(+) EUR1 572**	
Your pension pot on 31/12/2019			**(=) EUR 17 710**

5. YOUR PENSION AT A GLANCE

Your pension is a defined contribution pension plan

Your pension pot is currently invested in two funds. If you want to find out more, please go to: *link*

You pay in

EUR 50/month

NOTE: Your pension income is not guaranteed and your investment could go up or down.

Your employer contributes

EUR 75/month

BENEFICIARIES:
If you die before you retire, your beneficiaries will receive

EUR 2 000/year

6. WHAT CAN YOU DO TO PLAN BETTER FOR RETIREMENT?

- See if you can save more
- Review your other savings, investments and debts
- Visit www.Mypension.eu to find more information about your state pension and other pension plans
- Find your pension in Europe at: https://www.find-yourpension.eu

HOW TO INCREASE THE MONEY YOU RECEIVE AT RETIREMENT?
Depending on your personal situation, you may be able to:

- Increase your contribution
- Choose a higher retirement age
- Consider a different investment strategy
- Keep your pot invested after retirement

Contact us to discuss any of these options.

OTHER IMPORTANT INFORMATION:

- Check your pension plan options and choices here: add link here
- Call us or e-mail us to find out about your benefits if you stop working or change employer
- Access our Annual Accounts, Annual Report and Investment Policy here: add link here

ANNEX IV

PENSION BENEFIT STATEMENT TEMPLATE II

PENSION BENEFIT STATEMENT

FROM 1 JANUARY TO 31 DECEMBER 2019

YOUR DATA

Jane Smith
123 Street Name Road
1234 City, Country
jane.smith@email.com

born 12 January 1980
Expected date of retirement: 12 January 2045
You joined on 1 March 2009

YOUR PENSION COMPANY

European Intercontinental Pension Funds
123 Pension Fund Road
1234 Pension City

CONTACT

info@europensionfund.eu
tel +123 123 456 789

1. How much money do you already have in your pension pot?

From the date you joined until 31 DECEMBER 2019

€ 6,000 This is how much you have paid until now

€ 9,000 This is how much your employer(s) have added until now

€ 2,710 This is the results of your investments minus related cost

€ 17,710 Total amount of your pension pot on 31/12/2019

2. How much money could you get when you retire?

Depending on how the markets and your investment perform, if you continue to contribute as you do today

Unfavourable scenario	Best estimation scenario	Favourable scenario
€ 63,000	€ 75,000	€ 83,000
300 €/month*	350 €/month*	400 €/month*

* Paid every month for life

Be careful: these amounts are estimates only. The amount you receive at retirement will be different and could be subject to tax.

To find out how these amounts are calculated, go to *add link*

Are you on track for retirement? Use our pension calculator to find out www.europensionfund.eu/calculator

3. How your pension pot has changed over the past year

01/01/ 2019

Contributions

Contributed by you:
+ €600

Contributed by your employer:
+ €900

Return on investment:
+ €204

Costs

Withheld from contributions:
- €59

Withheld from assets in your pension account:
- €73

31/12/ 2019

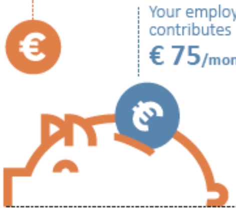
€ 16,138 → +1704 → -132 → € 17,710

4. Your pension plan at a glance

Your pension plan is a defined contribution pension plan

You pay in
€ 50/month

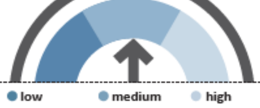
Your employer contributes
€ 75/month



Your pension is currently invested in 3 funds*

34 % in Fund A | 33 % in Fund B | 33 % in Fund C

You are in a medium risk profile**



Your beneficiaries

If you die before you retire, your beneficiaries will receive:

€ 2,000/year

Partial/full guarantee is provided by Company/insurer XYZ

For more details go to: *Link*

* For more information go to: link

**Based on how your pension pot is invested and your expected date of retirement

5. What can you do to plan better your retirement

- Take a look at your spending to see if you can save more
- Take the opportunity to review your other savings, investments and debts
- Find more information about your state pension and other pension plans on the pension dashboard www.Mypension.eu
- Find your pensions in Europe at: https://findyourpension.eu

To increase your income in retirement, depending on your personal situation, you may be able to:

Contact us to discuss any of these options

Other important information

- Check your pension plan options and choices here: ***add link***
- Call us or e-mail us to find out about your benefits if you stop working or change employer
- Access our Annual Accounts, Annual Report and Investment Policy here: ***add link***