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Licensing Regulation and the Supervisory Structure of Private Pensions

INTERNATIONAL EXPERIENCE AND IMPLICATIONS FOR CHINA

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LICENSING REGULATION AND THE SUPERVISORY STRUCTURE OF PRIVATE PENSIONS: INTERNATIONAL EXPERIENCE AND IMPLICATIONS FOR CHINA

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ABSTRACT/RÉSUMÉ

Licensing Regulation and the Supervisory Structure of Private Pensions: International Experience and Implications for China

China currently has a highly diversified structure of pension regulation and supervision. In this paper we first review the legal framework of private pension fund regulation and supervision in other economies, including Australia, Chile, Hong Kong China, Poland, Turkey, the United Kingdom and the United States. Then, based on international practices and experiences identified, and taking into account China's unique situation, we examine potential ways to improve the current private pension regulatory and supervisory structure in the country.

JEL codes: G23, J32
Key words: China, enterprise annuities, licensing, private pension, pension regulation, supervisory structure

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Réglementation des agréments et structure de contrôle des pensions privées : pratiques à l'échelle internationale et implications pour la Chine

La structure actuelle de réglementation et de contrôle des pensions en Chine est très hétérogène. Le présent rapport examine, dans un premier temps, le cadre juridique de la réglementation et du contrôle des pensions privées dans d'autres pays, comme l'Australie, le Chili, Hong Kong-Chine, la Pologne, la Turquie, le Royaume-Uni et les États-Unis. Ensuite, en s'appuyant sur les pratiques recensées à l'échelle internationale et sur la situation particulière de la Chine, il étudie les possibilités d'amélioration de la structure de réglementation et de contrôle des pensions privées actuellement en vigueur dans le pays.

Codes JEL : G23, J32
Mots clés : Chine, plans de pension professionnels, agrément, pensions privées, réglementation des pensions, structure de contrôle

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LICENSING REGULATION AND THE SUPERVISORY STRUCTURE OF PRIVATE PENSIONS: INTERNATIONAL EXPERIENCE AND IMPLICATIONS FOR CHINA

By Yu-Wei Hu and Fiona Stewart[2]

I. Background and introduction

Ageing populations and the un-sustainability of public pension arrangements have led governments around the world to rethink their pension systems. One solution is to increase the role of private pensions, either in the form of occupational or personal pension arrangements. As such private pensions increase globally, how to ensure they are effectively and efficiently regulated and supervised becomes an issue of significant importance.

China started to overhaul its old pay-as-you-go system in 1997, by implementing a multi-pillar model. Up until 2004 the government's efforts were mainly focused on reforming public pension arrangements. Since then, more attention has been paid to private pensions, which in China mainly take the form of voluntary occupational arrangements (known as Enterprise Annuities, or EA in short). This paper evaluates two aspects of the EA system, the licensing regime and the supervisory structure.

The current EA market adopts a licensing approach, i.e. a license issued by the Ministry of Human Resources and Social Security (MOHRSS) is required before financial institutions start their EA business in China. In this regard, four different pension licenses are relevant, those issued to trustees, custodians, administrators and asset managers, with different qualifying criteria applying to each type. All mainstream financial institutions can apply for the four licenses, although custodian and asset manager cannot be the same legal entity.

Such a licensing arrangement – requiring four separate approvals - is unique to China. International experience shows that in most OECD and non-OECD countries where licensing is applied to the pension system, only one license is required – i.e. the license granted to a dedicated, independent financial institution focused on trusteeship or equivalent business (the other financial institutions involved in the

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pension industry being covered by their main business regulation). The institutions in charge of pension funds are often specialised pension fund management companies, as in many Latin American and European countries. The complicated – and consequently sometimes opaque – licensing process may be one of the structural issues which are hampering the development of the EA market in China.

In terms of the supervisory structure, the main pension regulator and supervisor in China is the Ministry of Human Resources and Social Security (MOHRSS), which, in addition to issuing pension legislation and granting licenses, also conducts on-site and off-site supervision and inspection on an on-going basis, as well as overseeing the public pension system. Though similar arrangements can be found in other OECD countries, the mixing of such diverse functions in one institution may be causing confusion and overload. The international trend is towards an autonomous pensions supervisor, separate from the main regulatory ministry – though whether financial sector supervision should be integrated or separated along sectoral lines remains open to debate.

In addition, given the diversified financial regulatory structure in China three specialised financial authorities also play an important role in supervising pensions. The China Insurance Regulatory Commission (CIRC) oversees insurance companies acting as trustees, whilst the China Banking Regulatory Commission (CBRC) and China Securities Regulatory Commission (CSRC) oversee banks and securities companies with pension related licenses. Another two governmental agencies - the Ministry of Finance and the State Taxation Administration - are also involved, in that they set tax policies, which are of significant importance to the development of private pension markets. Though the sharing of supervisory responsibilities of the pension industry among authorities is not unique to China, a lack of coordination – or even competition – between agencies does seem to be posing a greater challenge than in other countries.

In this paper, we, firstly, conduct a detailed literature review with a focus on comparing private pension licensing regimes and supervisory structures in selected countries. Second, bearing in mind the specific conditions and circumstances in relation to the present pension supervisory structure and regulatory framework in China, practical policy recommendations are proposed concerning how to improve the current structure.

The remaining part of the paper is structured as follows. Section 2 presents the main arguments in favour of and against the integrated supervisory approach, which is largely drawn from current literature. In Section 3 a number of selected economies are examined to demonstrate how the pension supervisory structure and regulatory framework are arranged (i.e. Australia, Chile, Hong Kong China, Poland, Turkey, the United Kingdom and the United States). Section 4 provides a detailed and comprehensive overview of the pension supervisory structure in China, where issues and challenges associated with the current system are identified. Given the analysis and findings in the earlier sections, Section 5 focuses on the policy implications of international experiences for China. Section 6 concludes. The annex in Section 7 provides more detailed information about the regulatory and supervisory approach in the selected seven economies.

II. Licensing

The licensing of pension entities is widely observed in OECD and non-OECD countries. Comprehensive licensing requirements are particularly prevalent in mandatory pension systems, but some form of evaluation prior to start of operation is applied to pension funds in most systems (OECD 2008). The system of licensing plays an important role in ensuring an effective and efficient operation of the pension market, and in consequence is a useful and important mechanism to protect the best interest of plan members and other relevant beneficiaries.

According to Yermo and Tinga (2007) licensing is defined as the process by which an authority grants permission to a pension entity to operate and/or to have the right to benefit from specific tax treatment. It includes a range of actions, involving the assessment of compliance with specific requirements, prior to granting permission to operate or granting tax benefits, or it may be the status of compliance with such requirements.

In OECD and International Organisation of Pensions Supervisors (IOPS) member countries, different approaches have been adopted in line with the specific legal framework, maturity of the pension system, depth of financial markets, etc. At one extreme, licensing is only required for pension plans to qualify for tax relief. This is the case in the United Kingdom and the United States, where there are restrictions concerning the design of pension plans; however, if the tax benefit is sought, e.g. any one or a combination of pension contributions by employer and/or employee, investment income and pension payout are deductible before taxation, the said pension plan has to receive the appropriate approval from the tax authority and register with the pension authority.

At the other end of the spectrum, licensing related to pension related business is strictly regulated, with authorization typically only granted to the trustee or agency performing a similar role. In this case, trustee is either a 'purpose-built' agency, or an existing financial institution. Either way, a licence has to be granted before operation. For example, in Australia from mid-2006 all prudentially regulated trustee entities (i.e. those supervised by the Australian Prudential Regulation Authority APRA) must have applied for and been granted a licence to operate a fund, and must register with APRA the funds for which they act as a trustee. New entrants since mid-2004 must be licensed before commencing operations. Previously, only trustees of public offer (retail) funds, i.e. those open to the general public were subject to entry approval. The similar licensing arrangement is also observed in other economies, e.g. the Mandatory Provident Fund (MPF) system in Hong Kong and the mandatory private system in many Latin American countries.

For those countries where licensing is implemented, some common requirements are found, although at different magnitudes. For example, pension entities should have adequate risk control mechanisms in place to address investment, operational and governance risks, as well as well functioning internal reporting and auditing mechanisms. Meanwhile, in many cases, a business plan is required, which should included at least, a list of plans or funds that the pension entity will manage, the types of obligations that the pension entity proposes to incur (if any), and details regarding the risk control and auditing mechanisms. In Australia, for example, pension entities are requested to submit a business plan in order to provide a context for the analysis and review of the applying institution's risk management framework.

Another important requirement regarding licensing is related to the capital adequacy. This requirement is typically applicable to corporate trustees, rather than individual trustees, given the higher risk involved in the former. The main reason for this different treatment is that corporate trustees often operate on a for-profit basis, thus having the potential risk of conflicts of interest, i.e. fiduciary duties and commercial interest. Meanwhile, individual trustees are typically not financial institutions, therefore in reality lack the capital to meet this requirement.

In OECD countries, in addition to requirements on institutions who want to receive the license before operating pension business, the licensing system also specifies terms on what the role the pension authority/supervisor should play, and what requirements they need to meet. In most cases, they are the authority to grant licenses, supervise and oversee the market. However, in some cases the Government, advised by governmental departments, such as the Treasury in Australia, Department for Workers and Pensions in the UK, legislate the above-mentioned criteria, while in some countries, e.g. Chile, the supervisor at the same time is also the regulator, i.e. they also write the regulations on pension issues - including licensing.

In any case, there is a trend of promoting transparency and clarity of licensing on the part of the pension supervisor. For example, the legal provision should encourage a clear setting up of the license application process, including the timeframe in which the authority will decide an application, procedures for the licensing authority to seek further information from the applicant, and the actions that the licensing authority will take to confirm the information received as part of the licence application.

Meanwhile, it is also important to have an appropriate redress mechanism, in which case whenever the applicants feel they are treated unfairly or believe their applications are not evaluated rightly, they could raise their concerns and issues via a formal channel. It is of importance in ensuring confidence among the market participants, potentially benefiting development and growth of the pension markets in general.

Details about the licensing arrangements in OECD and selected non-OECD countries can be found in Yermo and Tinga (2007) and the OECD-IOPS Guidelines on the Licensing of Pension Entities (2008).

III. Conceptual arguments and theories of supervisory structures

Leaving aside considerations of regulatory and licensing responsibility, this section discusses the structure of pension supervisory oversight. There is an on-going debate internationally about the appropriateness of integrating financial supervisors into one single agency. In this section an overview is provided of the main theoretical arguments in the current literature for and against integrating the supervision of pension funds with that of other financial institutions.

3.1 Main arguments in favour of an integrated supervisor

As financial markets become more complex, traditional business lines between different financial sectors are becoming more blurred. One example is between the banking and insurance sectors - as highlighted by the new term “bancassurance” - where long-term banking products and long-term insurance products share similarities. Such similarities also exist between some insurance and pension products. Such overlapping products are increasingly offered by the same financial institutions, which are moving from their traditional spheres into new territories. Given this trend of conglomeration, it is argued that the supervisory structure should adapt to the changing market, and that similarly integrated supervisory authorities will ensure more efficient and effective oversight.

Another advantage of an integrated supervisor is the avoidance of regulatory arbitrage – i.e. where large financial conglomerates “game” existing rules to avoid, or at least reduce, their regulatory burden. Although regulatory arbitrage is not always inappropriate (e.g. it can reduce unnecessary or over-regulation), it runs the risk that financial conglomerates are not supervised appropriately, therefore exposing the market to potentially significant risk.

A unified supervisory agency can also help in alleviating regulatory capture, whereby a government agency, which is supposed to act in the best interest of public, is “captured” (or unduly influenced) by vested groups and the industry it supervises. This could be a risk for specialized regulators, partly due to the fact that they are typically funded by industry, and because specialized supervision staff and supervised entities may become so close that the impartiality of decisions risks being jeopardized (the risk being less in an integrated agency where staff are likely to move between divisions and industries).

Achieving economies of scale is frequently argued to be one of the main benefits of integrating the supervision of pensions with that of other financial products. The benefits can be realised by centralising various functions, such as general administration, information technology, and human resources.

Meanwhile, it is argued that integrated supervisors will help attract and retain talented employees, with the ability to offer more diverse and interesting career opportunities in the same institution.

It has also been suggested that transparency and accountability can be improved under an integrated supervisory regime. Where supervisory functions for different sectors are fully integrated in one single agency, a more harmonized supervisory approach is typically used (although some variation is justified given different types of institution). In addition, as different sectors of the financial industry face many of the same risks, consistency as well as economies of scale can be achieved in harmonizing the approach to risk management across the supervised sectors. Meanwhile, with all relevant sectors under the supervision of one agency, it is less likely that any areas or institutions are missed or overlooked, therefore improving supervisory responsibility and reducing the possibility of specialized agencies passing responsibility or blame between each other if problems were to occur.

Finally, moving to an integrated supervisory structure can also provide an opportunity to reform and strengthen the supervisory capacity, which is why such a move has taken place in some countries in response to financial sector problems.

3.2 Main arguments in favour of a specialised supervisor

Yet the case can also be made that the benefits of economies of scale are more theoretical than real. They may only be marginally achieved if different, specialised authorities are simply re-arranged into one institution, while at the same time there is no substantial or cohesive re-organisation of the new agency (Cihak and Podpiera 2006). The reason given is that whilst on the one hand the markets supervised by different authorities share some similarities, on the other there are significant differences between them in terms of lines of business, the nature of products, and the supervisors themselves (e.g. corporate culture, working style and supervisory approach).

Concerns have also been raised that a single, integrated, financial agency might be too big to function efficiently, leading to what has been termed a 'bureaucratic leviathan'. In contrast to the closeness of the specialised agency and its supervised industry, under the framework of integrated supervision, such a mega supervisor might be divorced from the markets it oversees (Madero and Lumpkin 2007), thus leading to slow responsiveness to new market developments. In addition, due to less competition between supervisory agencies, the integrated agency might become too powerful to function efficiently.

Moral hazard might arise if all supervisory activities are mingled under a single agency. Market participants may develop the false impression that different sectors are supervised by the same rules, and are therefore protected in the same way. For example, bank depositors might assume that they will receive the same level of protection if they purchase insurance products or securities (though in reality, given their different levels of potential impact of failure on market stability, different products normally receive different levels of protection and contain different inherent levels of risk). Such a false impression could lead to the belief that such 'safety nets' apply to the whole supervised market, potentially altering behaviour and therefore increasing systemic risk and market instability.

The above arguments generally relate to all sectors supervised. However, there is also an argument which is directly linked to pension funds. It might be claimed that pension funds are a distinct type of institution, and therefore more suited to oversight by a separate supervisory agency. Pension funds are different in that their investment horizon is much longer (potentially up to 40 years), such savings are mandatory in some countries (where as bank deposits or securities are typically voluntary savings or investment instruments). Meanwhile, although the beneficiaries of pension funds in most cases have limited investment and financial knowledge, pension funds play a vital role in funding post-retirement

income. Given the above unique features of pension funds, a specialised agency may be better suited to safeguarding such important financial assets.

Given this debate, is it possible to conclude that there is a best model which fits all cases? The answer is naturally 'no'. The benefits of both systems can be achieved in either structure. A focused pension division within an integrated agency may provide the specialization needed, whilst with adequate coordination the strengths of an integrated agency can be replicated where a 'stand alone' pension supervisor operates. Madero and Lumpkin (2007) conclude that no model is better than the other and that all depends on circumstances, e.g. nature of the pension system, stage of development of financial markets, supervisory capability, and budget.

3.3 Different supervisory approaches

Even supervisory agencies with the same organisational structure can have very different operational approaches. Despite the heterogeneity of pension fund systems in the world today, certain approaches to pension supervision have been identified. These are driven by factors including the nature of the pension system being supervised, the number of entities supervised, whether the system is mandatory or voluntary, whether it is a trust-based system or whether pensions are offered by employers or financial institutions etc., which all have an impact on the approach of the pension supervisory authority. External factors, such as the level of legal and financial market development, are also important (see Hinz and Mataoanu 2005; Madero and Lumpkin 2007). Rather than being a choice between discrete alternatives, these supervisory approaches should be considered to reflect a set of attributes that represent different positions along a spectrum. The two ends of the spectrum may be represented by the Latin American approach at one end (where supervisors engage in intensive supervision, interacting with funds on a daily basis) and an 'Anglo-Saxon' style at the other (whereby supervisors operate more by communication and deterrent). A third approach, part way along the spectrum, would be more usual in Continental Europe, for example. These various approaches naturally imply that some pension supervisors may use their powers and engage with pension funds more regularly than other supervisory authorities, whether integrated or specialized in terms of their organizational structure.

IV. Overview of International experiences

The specific pension supervisory structure and regulatory approach differs across countries, and largely depends on a country's unique characteristics, including the nature of the pension system, the external environment when the regulatory and supervisory structure was established or reformed, and the stage of development of financial markets etc.

This section provides a brief overview of how the regulatory and supervisory structure for private pensions is arranged in different countries around the world, focusing on seven selected economies, i.e. Australia, Chile, Hong Kong China, Poland, Turkey, the United Kingdom and the United States (Details can be found in the Annex in Section 8).

Table 1 Summary of pension system in selected economies

	Agency	License required	Main Legislative Authority	Supervisory structure	Structure of pension system	Stage of development of financial markets
Australia	APRA	Yes	Ministry / Government	Integrated	Mandatory (DC)[3]	Developed
Chile	SAFP	Yes	Supervisory Authority	Specialised	Mandatory (DC)	Developing
China	MOHRSS	Yes	Ministry / Government	Partial integrated	Mixed	Developing
Hong Kong China	MPFA	Yes	Ministry / Government	Specialised	Mandatory (DC)*	Developed
Poland	PFSA	Yes	Ministry / Government	Integrated	Mixed	Developing
Turkey	Treasury	Yes	Supervisory Authority within Ministry	Partial integrated	Voluntary (DC)	Developing
United Kingdom	TPR	No	Ministry / Government	Specialised	Voluntary (DB/DC)	Developed
United States	EBSA	No	Ministry / Government	Specialised	Voluntary (DB/DC)	Developed

Source: the authors.

* While all MPF schemes are DC, voluntary occupational retirement schemes (ORSO schemes), also supervised by the MPFA, can be either DC or DB.

4.1 Regulatory Structure

International practice usually shows the main legislative responsibility for the pension system lying with a government ministry (or ministries). In Australia the Department of the Treasury plays the main role in setting pension (superannuation) legislation, with the Department of Work and Pensions performing this function in the UK, and both the Ministry of Finance and the Ministry of Labour and Social Policy involved in Poland. In Hong Kong China the Financial Services and the Treasury Bureau undertake the legislative role. In Turkey the supervisory authority (the Undersecretariat of the Treasury) is housed in the Treasury with the ministry therefore having both legislative and supervisory functions. The similar structure is observed in the USA, where the Benefits Security Administration (EBSA) – located within the US Department of Labor and as a specialist agency is the main pension supervisor whist the federal pension laws are generally speaking written by the Department of Labour. Chile is the exception with the specialist pension supervisory authority also having primary legislative responsibility. The supervisory authorities in the other countries do, however, provide input into the drafting of pension legislation, and have the ability to issue secondary legislation or regulation themselves (such as guidance notes, codes of practice etc,).

The supervisory authority in most economies also issues any licenses required to operate pension related services (e.g. APRA in Australia, the MPFA in Hong Kong China, the Superintendency in Chile, the PFSA in Poland and the Undersecretariat of the Treasury in Turkey set and issue licenses).

4.2 Integrated supervisor

As discussed in the proceeding section, two of the major forms of private pension supervisory structure are the integrated and specialised models[4]. Under the integrated structure, the supervision of

[3] Whilst the vast majority of mandatory pensions in Australia go into DC funds, a small element goes into DB funds.

private pensions is integrated with that of other financial products within the same agency. One of the most prominent examples of such as model is the Australian Prudential Regulation Authority (APRA).

APRA is responsible for the supervision of financial services institutions, including banks, credit unions, insurance and superannuation funds, etc. Indeed APRA uses the same models (PAIRS and SOARS – see annex for further details) to derive a 'risk-score' and consequent supervisory response for all institutions overseen. When the Australian government was considering reforming the financial regulatory structure, the financial system and the overall economy were generally operating well, and significant weakness which needed to be addressed by changing the financial regulatory system were not the main driver for reform.[5] Instead the main catalyst was organisational efficiency and the need to resolve the mismatch between the large number of superannuation (pension) funds and limited supervisory resources (Thompson 2008). Australia currently operates a mandatory, largely defined contribution occupational pension system as shown in Table 1. Such an integrated supervisory structure could be argued to be appropriate in a country where many pension funds are offered by financial conglomerates, with Australia operating a 'twin peaks' model whereby APRA focuses on prudential regulation and ASIC (the Australian Securities & Investments Commission) deals with issues of market conduct. In addition to ASIC, APRA has close working relationship with the Australian Taxation Office (ATO), and Reserve Bank of Australia (RBA). Such relationship is underpinned by the formal signing of Memorandum of Understanding (MOU) and via a consultative group on specific issues which has been set up between the relevant agencies.

APRA's supervisory approach can be seen as coming from the 'Anglo-Saxon' model – i.e. operating more via communication and deterrent rather than intensive, daily interaction with supervised entities (as is the case with Latin American supervisory institutions). Such an approach can be seen to be suitable for a country such as Australia which has a developed economy and capital markets and a highly competitive pension system, with large numbers of supervised entities, operating under a trustee structure[6]. The regulatory approach in Australia is somewhat mixed. From mid-2006, institutions cannot conduct a trusteeship business without having applied for, and been granted, a license from APRA, and must meet certain requirements, such as capital adequacy, risk control mechanism etc. However, investment regulation is very liberal, operating on a prudent person basis.

In addition to APRA, integrated supervisory agencies also operate in many other countries, e.g. Denmark, Germany, Korea, Poland, and South Africa (see Table 2 for a more comprehensive list of countries). Poland recently introduced an integrated financial supervisory approach which combines supervisory activities relating to securities markets, banks, insurance and pensions under a single agency, i.e. Polish Financial Supervision Authority. The pension industry in South Africa is supervised by the Financial Services Board (FSB), a partially integrated supervisor with oversight responsibilities for all financial services except banking (Stewart 2007). They also implement risk-based supervisory approach, adapted from the APRA model. Korea in 1999 established the Financial Supervisory Service (FSS),

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[4] A third model – i.e. that of partial integration (with at least pensions and insurance products being handled by the same agency) – is not considered in detail in this paper for the sake of brevity and relevance to the Chinese situation.

[5] In other words, debate on reforming the Australian financial structure was undertaken in a relatively benign environment, unlike that in other countries (e.g. in the Asian region) which decided to reform or integrate their supervisory structure immediately after financial crisis with the view of strengthening financial authority's supervisory capabilities. The Australian debate was less influenced by period-specific considerations.

[6] For a discussion of the different approaches to pension supervision see Hinz and Mataoanu (2005), Madero and Lumpkin (2007).

following financial crisis which had a significant impact on the Korean economy and financial system. Therefore, the Korean government decided to merge the former specialised supervisory agencies (e.g. Banking Supervisory Authority, Non-Bank Supervisory Authority) into one single agency. The FSS is currently headed by a Governor and the organisation is structured into six areas by functions[7].

4.3 Specialised supervisor

Specialised pension supervisors exist in many countries, with the Pensions Regulator (TPR) of the United Kingdom being one example. TPR was established in 2005 under the Pension Act 2004 (which gave the authority additional, risk-orientated powers) and is responsible for supervising any work-based pension plans in the UK.

Given supervised entities are mainly employers and particularly trustees, a specialist supervisory agency could be argued to be more appropriate – due to the unique nature of the pension products covered[8]. Though operating as a specialized agency with different powers and goals, one similarity between the supervisory approach of the TPR and that of APRA in Australia is that communication and deterrent are the main supervisory tools used. Again this is consistent with the highly competitive and developed pensions and financial markets in the UK as shown in Table 1, especially considering the number of entities supervised (over 85,000) and the reliance of trustees within the system. Indeed TPR summarises their approach as ‘Enable, Educate and Enforce’, providing active support and education for trustees, notably via their on-line ‘Trustee Toolkit’. Regulatory requirements are relatively liberal, with more of a ‘registration’ than licensing requirement applied to providing institutions, and a prudent person approach to investment.

Though focusing specifically on pension supervision, the Employee Benefits Security Administration (EBSA) of the United States is unusual in that it operates on a regional basis, with nine offices across the country. The regional offices report to the Deputy Assistant Secretary directly and have considerable powers in terms of prioritizing national/regional projects and implementing enforcement powers. This largely reflects diversity and size of the US economy and the pension system in particular, (e.g. some urban areas have mainly large pension plans, whilst small pension plans are more common in some rural states). However, it should be noted that the Federal laws predominate and pension policy in the US is set at the national level.

The supervisory approach in the United States generally emphases two features, i.e. voluntary compliance and fiduciary responsibility, which is largely driven by specific and unique circumstances faced by the EBSA, i.e. voluntary nature of the US private pension system, the large number of retirement plans, the diversity of size and type of the plan and the limited resources available to the EBSA (the EBSA oversees more than 700,000 retirement plans, and assets under EBSA’s jurisdiction were around USD 5.6 trillion as of 2007). Against this background, the EBSA focuses on process rather than specific directives that fiduciaries need to follow. For example, trustees have considerable freedom in terms of allocating their pension assets, as long as they meet the general principle of fiduciary responsibilities. The highly developed and competitive financial markets in the United States facilitate such a supervisory approach, and allow for a liberal regulatory regime (with registration rather than licensing and a prudent person approach to investment).

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[7] See the link for more details. http://english.fss.or.kr/fsseng/eabu/int/est.jsp?menuName=Introduction&menuIndex=0

[8] It should be noted that personal pension arrangements, which are more like other financial products and offered by financial institutions, are supervised by the Financial Services Authority.

Both the Mandatory Provident Fund Schemes Authority (MPFA) of Hong Kong China and the Superintendency of Pension Fund Administrators (SAFP) of Chile – are specialized agencies which were established as part of the overall pension system overhaul. In other words, they both were set up to facilitate the functioning of a new mandatory defined contribution pension system and both oversee a limited number of pension entities. Given the mandatory nature of the systems, and more developing nature of the capital markets, (particularly in Latin America), both agencies apply a stricter regulatory regime than in 'Anglo-Saxon' jurisdictions, with stringent licensing requirements (e.g. on capital adequacy, human resources and risk control mechanism) and quantitative investment regulations.

The Mandatory Provident Fund Schemes Authority (MPFA) as the main regulator of the pension market in Hong Kong China adopts the risk-based supervisory approach, as APRA in Australia and TPR in the UK. However, the supervisory approach is more interactive (i.e. data is collected more regularly and inspections undertaken more frequently), largely driven by the fact that the MPFA has fewer entities to oversee, and the system being mandatory. All MPF schemes in Hong Kong China have to be established under a trust with trustees approved by the MPFA on meeting stringent legislative requirements.

The regulator of the Chilean private pension market is the Superintendency of Pension Fund Administrators (SAFP), which is a public agency in charge of supervising specialized professional pension fund administrators (i.e. AFPs). Since 2007, the SAFP has started to move towards a risk-based supervisory approach. In addition, given that currently only six AFPs are under supervision, SAFP conducts a more proactive supervisory strategy which features a greater level of supervisory oversight and daily reporting by AFPs to the supervisor. This approach can be seen as consistent with the mandatory nature of the private pension system and the less developed financial markets in the country.

Under the specialised pension supervisory system, collaboration between supervisors and regulators becomes more important, which is largely due to more potential overlaps between supervisory agencies' activities. In the UK, TPR and Financial Services Authority (FSA) – the integrated financial regulator - have signed a MoU and released relevant documents in order to define clearly the division of responsibilities between the two agencies. Similar arrangements also exist in Hong Kong China, where the MPFA has signed MoUs with the other specialised financial supervisors, i.e. the HK Monetary Authority (HKMA), the Insurance Authority (IA), and the Securities and Futures Commission (SFC). In the Unites States, although no MoU has been signed, procedures for collaboration between different agencies were formally written into the ERISA Law of 1974, which specifies different roles played by the Department of Labor (i.e. EBSA), the Internal Revenue Service (IRS) and the Pension Benefit Guaranty Corporation (PBGC). However, even in systems with a full control over the pension system is exerted by a pension specialist authority (such as in Chile), collaboration with other agencies will be required (e.g. with market authorities overseeing trading, conduct of business activities etc.) and suitably mechanisms should be put in place.

In addition to the four examples outlined, the specialised pension supervisory model is also found in other countries, including India, Italy, Kenya and Mexico etc. (see the Table 2 for a full list of countries). It is notable that specialist supervisory agencies tend to be more prevalent in countries with developing pension systems. Once the pension industry and financial markets become more advanced, financial agencies then tend to move to a more integrated model (as has been the case in some Central and Eastern European countries, such as the Czech Republic and Poland)[9]. As discussed, the supervisory approach depends very much on the country context, though a risk-based approach to pension supervision is increasingly being adopted around the world.

[9] See various IOPS documents – www.iopsweb.org

Table 2: Structure of pension supervision in selected OECD and IOPS member countries

Specialized Pensions Supervisor	Semi-integrated Supervision	Integrated Supervision
	At least pensions + insurance	*Pensions, insurance, securities and possibly banks*
Chile	Belgium	**Australia**
Costa Rica	Finland	Austria
Hong Kong China	France	Bulgaria
India	Jordan	Canada
Ireland	Luxembourg	Croatia
Italy	Portugal	Czech Republic
Japan	Spain	Denmark
Kenya	**Turkey**	Germany
Mexico	Zambia	Hungary
Nigeria		Iceland
United Kingdom		Israel
United States		Jamaica
		Kazakhstan
		Korea
		Mauritius
		Namibia
		Netherlands
		Norway
		Pakistan
		Poland
		Slovak Republic
		South Africa
		Thailand
		Trinidad + Tobago

Source: Madero and Lumpkin (2007). Countries highlighted in bold are reviewed in this paper.

V. Pension regulatory and supervisory structure in China

China currently operates under a diversified regulatory and supervisory structure in relation to the private pension system. In this context, the main regulator is the Ministry of Human Resources and Social Security (MOHRSS), which is in fact the principal regulator and supervisor of the country's social security system, i.e. including both public and private pensions. In addition, there are three specialised financial regulators and supervisors which, under the framework of separated financial regulation, are in charge of particular sections of the financial markets, i.e. banking, securities and insurance.

5.1 A short overview of China's pension system

China's pension system features a combination of participation and involvement from the state, companies and individuals. The overall structure and framework of the current system was first set up in 1997 when the central government in China decided to introduce a multi-tier pensions system, replacing the old pay-as-you-go system (PAYG).

The 1st tier is known as the basic pension which is comprised of two parts, i.e. Pillars 1A and 1B. Contribution to Pillar 1A is solely by employers and the contribution rate is 20% of payroll. Funds collected are used to pay pensioners of the current generation, i.e. it is operated on a PAYG basis. Pillar 1B consists of mandatory individual accounts which are in principle fully funded (although in reality funds accumulated are frequently used to meet deficits in Pillar 1A). The contribution is 8% of employees' salary and contributions are made by employees only. The expected total replacement rate is approximately 59%.

The 2nd tier consists of voluntary occupational pension accounts, i.e. a standard employment based occupational pension arrangement as exists in most OECD countries. Given the voluntary nature, there is no statutory contribution rate. However, for taxation purposes it is regulated that up to 4% of payroll could be deducted before taxable income (although this varies across provinces due to local adaption and modification). In addition, group insurance is another type of supplementary pension arrangement, purchased by sponsors from insurance companies on behalf of their employees. However, due to current legislation, such contributions are not subject to tax relief, although insurance companies which offer such life insurance products (to be approved by the State Taxation Administration) are allowed to deduct such contributions from business tax (but not corporate tax).

Currently occupational pensions are mainly established by large (particularly state-owned) enterprises, e.g. those in electricity, railway and petroleum. As of 2007 the total amount of assets was around RMB 152 billion (USD 22bn MOHRSS 2008) and is expected to grow fast in the coming years. Total members were approximately 9.3 million and the number of participating enterprises was around 32,000. Meanwhile, it is anticipated that if regulatory framework is favourable, small and medium sized enterprises could contribute at least another RMB 20 billion assets.

The final tier of China's pensions system consists of voluntary pensions which can be in the form of personal insurance contracts or other arrangements. This market has started to grow but is still in the early stages of development.

In addition to the above three tiers, the Chinese authorities in 2000 established the National Social Security Fund (NSSF). The NSSF, as the last resort of funding for public pensions, is a type of pension reserve fund, (such as the Future Fund in Australia and Norwegian Government Pension Fund – Global). Current assets as of 2007 by market value were approximately RMB 500 billion (USD 72bn), a rapid increase from less than RMB 100 billion in 2001.

5.2 Regulatory framework of China's private pension system

Occupational pensions, or Enterprise Annuities (EA), have been established for many years in China. However, the older schemes, set up before 2004, were not subject to proper regulation. In 2004 the former Ministry of Labour and Social Security (partly with CBRC, CIRC and CSRC[10]) issued two main regulations relating to the EA market, i.e. *Decree No. 20 Interim Measure for Enterprise Annuities*

[10] Chinese Banking Regulatory Commission, Chinese Insurance Regulatory Commission and Chinese Securities Regulatory Commission.

Schemes, and Decree *No. 23 Interim Measures for Management of Enterprise Annuities Fund* (hereinafter Decrees 20 and 23). New EAs set up from 2004 must comply with these regulations and old, 'legacy' EAs set up before this date will also be made compatible (for example, their assets, which were previously managed by local government authorities, are being transferred to private sector financial institutions). However, it should be noted that the EA system is founded on *decrees* and their basis as legislation is not clear. Hence they appear to be open to interpretation by provincial government and authorities other than the MOHRSS also appear to be able to issue pension related legislation (e.g. the CIRC's pension insurance related directives). International experience suggests that the fundamental basis of the EA system needs to be clarified and strengthened for the market to develop further.

The first decree, i.e. No 20 is mainly concerned on the overall framework and structure of the new EA system. In other words, it is specified that only firms meeting three criteria can offer voluntary EA pensions to their employees, i.e. having participated and paid social security contributions, being financially sound, and having a collective bargaining mechanism in place. In addition, new EA funds should be established on a trustee model, with either an external trustee (professional corporate entity) or an internal trustee (pension council). In the case of pension council model, at least one third of the council member should be represented by employees. In addition to trustees, three other institutions must be appointed, i.e. a custodian, an asset manager, and an account administrator.

The second decree, i.e. No 23 is mainly related to investment issues of EA assets under the corporate trustee model. No 23 specifies in detail the requirements which are needed to be appointed to any of the above roles. For example, to be a trustee the institution has to be registered in China, and have capital of at least RMB 100 million. To be an account administrator, registered capital of RMB 50 million minimum is required as well as good internal risk control mechanisms. For a custodian, the net asset is minimum RMB 5 billion, and a separate department for custody business should be in place. For an asset manager, requirements on capital range from RMB 100 million and RMB 1 billion, depending on the type of company. Meanwhile, it is specified that one institution cannot serve as both asset manager and custodian at the same time (and should not even hold each other's shares).

To act in any of the above EA intermediary roles, the applicant institution must apply for a relevant license from MOHRSS before commencing operation. The license is renewable every three years subject to approval of MOHRSS, and can be revoked by MOHRSS at any time if it is believed that the institution is involved in any serious misconduct and misbehavior. The first EA licenses were handed out in 2005. In 2005, 37 institutions were granted various licenses to conduct businesses related to custody, trusteeship, asset management and record keeping. In 2007, 24 more licenses were granted. MOHRSS also has the punitive power to remove licenses - if serious misconduct occurs – in addition to being able to give direct administrative orders and impose fines. It should be noted that though the final decision regarding granting a license is made by MOHRSS, the assessment process is heavily assisted by a purpose-built advisory committee which currently consists of 51 experts and professionals. Specifically, members of the committee come from a wide background, including banking, investment, social welfare, accounting, auditing, and legal service, etc. The membership is made up of officials from both MOHRSS and other ministries, academics from universities and governmental think tanks, industry practitioners, industry associations and trade unions.

Table 3 below compares the licensing requirements in China and selected economies. Requirements differ across countries, with the United Kingdom and the United States having the most liberal regimes, while Australia and Hong Kong China imposing more requirements to be met by supervised entities before operation. For example, a statement of investment policy is not required for a license application in the UK and the US, while it is mandatory in the other economies including China).

The EA licensing requirements in China may be seen as relatively heavy in terms of capital obligations, and in addition government requirements are more burdensome for the financial institutions which are willing to or already operated in the EA market when compared with the licensing regimes of some other jurisdictions. For example, it is unique to China that a single institution[11] needs to receive four separate licenses by meeting four different requirements if it wants to provide a "one-stop shopping" service to customers. In many other economies, however, only one license – typically the one related to trusteeship - is issued by the pension regulator and/or supervisor, while leaving the responsibilities of granting permit of operating the other financial services to the (other) relevant agencies. For example, in Australia the Registrable Superannuation Entity (RSE) License is granted by APRA, while the Australian Financial Services Licence is granted by ASIC. After receiving the RSE license and registering its funds, an institution can conduct its business, e.g. selecting the existing asset managers and record keeper, so that APRA, for example, do not require the above-mentioned asset managers to receive an additional license in order to run superannuation related business. The same situation operates in Hong Kong China and Chile, whereby only a license of trusteeship is granted by the pension supervisor. This practice also emphases the important and pivotal role of trustee played in the whole private pension system, which China is also currently implementing. Meanwhile, licensing the trustee only reduces the regulatory and supervisory burden, not only for the supervised entities, but also the supervisor itself (an advantage which might be of particular relevance to the current situation in China).

The EA regulation in China is also not always consistent with the treatment of other, retirement related financial products. As mentioned earlier, many enterprises in China have purchased life insurance products, particularly group insurance, for their employees. Current legislation does not recognise contributions to these plans as tax deductible, despite the fact that they are made for the same purpose as contributions to EA plans (i.e. for retirement savings). From the perspectives of insurance companies and individuals, however, there is some favourable tax policy currently available. Specifically, insurance companies can be exempted from business tax (which is currently 5% in China) for the revenues generated from selling certain life related insurance products (which should be approved by the State Taxation Administration and Ministry of Finance). Meanwhile, dividends earned from the above insurance products are also exempt from personal income tax (which is currently 20% in China).

Nevertheless, the Chinese government has realised the above-mentioned problem of inconsistency of tax treatments on pension contributions by employers, and has been considering some solutions. For example, in early 2008 CIRC and the Tianjin Municipal City together introduced a new trial scheme in the Binhai New Area of Tianjin, in order to promote the development of the life insurance (private pension) market (CNPension 2008). Specifically, the new policy states that contributions by employers to buy relevant life insurance products are deductible up to 8% of payroll, while employees can contribute up to 30% of their salaries before the taxable income.

[11] It is noted that this single institution herein refers to a financial group which has separate subsidiaries with legal personality, since according to the current legislation a legal entity cannot apply for both licenses of custodian and asset manager.

Table 3 Comparison on Pension Licensing Requirements

	Agency	Is there a licensing process?	Statement of investment policy required?	"Fit and proper" requirements for pension entity management?	Reinsurance or guarantee fund required?	Licence application fee?	On-site inspection part of application assessment process?
Australia	APRA	Yes	Yes	Yes	No	Yes	Yes
Chile	SAFP	Yes	Yes	Yes	Yes	Yes	N.A.
China	MOHRSS	Yes	Yes	Yes	No	Yes	No
Hong Kong China	MPFA	Yes	Yes	Yes	Yes	Yes	Yes
Poland	PFSA	Yes	Yes	Yes	Yes	No	No
Turkey	Treasury	Yes	Yes	Yes	No	No	Yes
United Kingdom	TPR	No (tax purposes)	No	No	No	No	No
United States	EBSA	No (tax purposes)	No	No	No	No information available	No

Source: Yermo and Tinga (2007) and the authors.

Table 4 Comparison on Pension Licensing Requirements (continued)

	Agency	Type of license	License renewal	License withdrawal	Minimum capital requirement
Australia	APRA	Trustee	No	Yes	Yes, AUD 5m for public offer funds, not others
Chile	SAFP	• AFP	No	Yes	
China	MOHRSS	• Trustee • Custodian • Asset manager • Record keeper	Yes	Yes	• Trustee (RMB 100m) • Custodian (RMB 5bn) • Asset manager (RMB 1bn or 100m) • Record keeper (RMB 50m)
Hong Kong China	MPFA	• Trustee	No	Yes	Yes, HKD 150m
Poland	PFSA	• PTE	No	Yes	Yes, Euro 5m or 125,000
Turkey	Treasury	• Pension fund management company	No	Yes	Yes, YTL 20m
United Kingdom	TPR	N.A.	N.A.	N.A.	No
United States	EBSA	N.A.	N.A.	N.A.	Yes

Source: OECD (2008) and the authors. In Hong Kong China, pooled investment funds invested by the constituent funds of a registered MPF scheme should be approved and authorised products by the MPFA and SFC (Securities and Futures Commission).

5.3 Supervisory approach of China's private pension system

China's pension system is mainly supervised by the Ministry of Human Resources and Social Security (MOHRSS), which was established in early 2008 following the merger between the former Ministry of Labour and Social Security (MOLSS) and the Ministry of Personnel (MOP). The new ministry now is in charge of supervising pensions related to both the private and public sectors (including those of civil servants).

As briefly mentioned earlier, three specialised supervisors also play a role in supervising the private pension market, - particularly the China Insurance Regulatory Commission (CIRC) (which oversees insurance companies acting as trustees). The other two regulators the China Banking Regulatory Commission (CBRC) and China Securities Regulatory Commission (CSRC) oversee banks and securities companies with EA licenses. In addition, another two governmental agencies, i.e. Ministry of Finance and the State Taxation Administration are also involved, in that they are in charge of setting tax policies.

5.3.1 Ministry of Human Resources and Social Security (MOHRSS)

Organisational structure

MOHRSS is responsible for the regulation and supervision of both private and public pensions in China. Internally the supervisory responsibility lies within a specialised department, i.e. Department of Supervision of Social Insurance Fund, (known as the Department of Supervision for short). This

Department was established in 1998, and currently is organised into three divisions, i.e. Division 1, Division 2, and Division 3.

Division 1 is in charge of supervisory issues related to social insurance funds which have not been managed/administered in a commercial manner. The social insurance funds in China include pension funds under Pillar 1 and four other types of funds, i.e. medical insurance, unemployment insurance, labour injury insurance, and maternity insurance. As of 2007 the total amount of social insurance funds in China was approximately RMB 1,082 billion (MOHRSS 2008), of which RMB 739 billion belonged to pension funds, RMB 248 billion belonged to medical insurance, RMB 98 billion unemployment insurance, RMB 26 billion labour injury insurance, and RMB 13 billion maternity insurance.

Division 2 is in charge of supervisory issues relating to the social insurance funds which have been administered in a commercial manner. The funds included in this category are mainly EA assets and the NSSF assets[12]. As mentioned earlier, as of 2007 EA assets amounted to RMB 152 billion, while those for NSSF were approximately RMB 500 billion (at market values).

Division 3 is the General Division which is mainly responsible for assisting Divisions 1 and 2 on the issues which need collaboration between them as well as the general issues crossing the whole department (e.g. administrative issues).

As of 2007, as indicated in Table 3 there were 13 staff within the Department of Supervision, of which 3 were in Division 1, 3 in Division 2 and 4 in Division 3. Meanwhile, the Department is headed by Director-General who is assisted by two Deputy Director-Generals in charge of commercial and non-commercial social funds, respectively.

In addition to supervisory capabilities in Beijing, MOHRSS also has branches in local areas, i.e. at the provincial, city and country levels. It has been estimated that as of 2007 the total staff which were involved in supervision issues across the country was around 100. Of the 32 provinces in China, divisions specialising in supervision are only established within MOHRSS branches at the provincial level in 11 provinces. In all the other cases, supervision activities are mingled together with other activities. Meanwhile, officials in the MOHRSS branches are typically appointed by and therefore report to the local governments, rather than MOHRSS in Beijing. In consequence, there is always an issue in China on compliance of pension regulations and rules (which are issued by MOHRSS in Beijing) in the local regions; indeed, in China successful implementation of any laws across the country largely relies on the political willingness of head of the local governments, and pensions are not an exception.

Since MOHRSS is a ministerial agency it is fully funded by the fiscal budget. Although fees are charged to supervised entities in certain circumstances, they are far from covering the operational costs.

[12] Although under supervision of both MOHRSS and Ministry of Finance, NSSF answers directly to the State Council and is in fact a quasi-ministerial agency. Therefore, MOHRSS plays a limited supervisory role.

Table 5: International Comparison of Supervisory Structures

Country	*Supervisory Structure*	*No. of pension funds supervised*	*Pension Assets (2006 USD & % GDP)*	*Licensing Approach*	*Quantitative Investment Restrictions*	*No. of pension supervisory staff*	*Pension Supervisory Resources (USD million)*
China	Specialist	32,000	22bn (2007) 1%	Restrictive	Yes	12 (MOHRSS); 112 (including local MOHRSS offices	N.A.
Australia	Integrated	6821	858bn 94%	Open	No	608 (NB total APRA)	32
UK	Specialist	85,000	2tn 84%	Open	No	340	64
USA	Specialist	700,000	15tn 120%	Open	No	900	N.A.
Hong Kong	Specialist	326 MPF Constituent Funds & 7,315 ORSO Schemes (as at 30.6.2008)	65bn31% (MPF Constituent Funds & ORSO Registered Schemes (2007))	Restrictive	Yes	514 (Approved headcount of MPFA as a whole as at 31.3.2008)	36 (Total expenditure of MPFA for the year ended 31.3.2008)
Chile	Specialist	30	93bn 61%	Restrictive	Yes	149	9
Poland	Integrated	15	54bn 11%	Restrictive	Yes	49	N.A.
Turkey	Partially Integrated	103 funds (11 pension companies)	3.84 bn 1%	Restrictive	YES	5 (+ 20 Pension Monitoring Centre)	N.A.

Source: IOPS and the authors.

Supervisory approach

MOHRSS is responsible for issuing legislations and/or guidelines on pension related issues. Once issued, local offices of MOHRSS are meant to implement them in their region. However, given the diversity of circumstances and environments in China, local MOHRSS officials are allowed to adjust the above-mentioned guidelines in order to meet locality-specific and unique situations. For example, the contribution rate to Pillar 1 is specified as 28% of payroll in the relevant legislation. However, in practice the rate has been revised higher in some regions, where demographic structure is less favourable, while it is likely to be lower in other regions where there is a larger youth population.

MOHRSS's current supervisory approach combines both on-site and off-site supervision. So far on-site supervision has been the main method used by MOHRSS to monitor the pension system and market. On-site supervision includes routine supervision, ad-hoc supervision and the supervision of fund fraud. Ad-hoc supervision refers to the supervisory activities which are focused on cases of particular interest to MOHRSS. Supervision of fund fraud is also on an ad-hoc basis, but is singled out due to its potential important impact on the system. With on-site supervision, MOHRSS send staff (typically two together) to the supervised entities and investigate not only standard information, (such as annual reports), but also issues which are typically not easily identifiable via regular information and returns. Under off-site supervision investigators (mainly referring to those in Beijing and the provincial offices) analyse annual reports, financial accounts and other requested data, so as to monitor the market and identify any irregularities. In line with the efforts to strengthen supervisory efficiency through off-site supervision, the Chinese authorities started the "Jinbao Project" in 2003, which aims to introduce a networked system through three levels of government, e.g. national, provincial and city. Under the system, all information is stored in a centralised database to which local offices of MOHRSS input data regularly. This should allow MOHRSS to monitor the market in a more efficient manner. Meanwhile each member is supposed to be able to access their individual account and check their contribution history, balance, etc. However, as of 2007 such system was only partially established in 11 of 32 provinces.

Yet it should be noted that supervisory action in general has been relatively limited, with the ministry focusing on issuing legislation and granting licenses. Off-site supervision is constrained by the lack of data currently collected (the information which different supervised parties need to provide to the ministry has yet to be set out in detail), whilst on-site supervision has so far consisted of a restricted number of operational reviews. There have as yet been no publicly announced sanctions or corrective action which the ministry has required any pension funds or service providers to undertake (and again the enforcement and punitive powers of the supervisory authority have yet to be made clear).

5.3.2 Other regulators and supervisors

In addition to MOHRSS, three other financial regulators, i.e. CBRC, CIRC and CSRC also play an important role in supervising the private pension market. So far banks (subject to supervision by the CBRC) mainly serve as custodians and administrators, insurance companies (subject to supervision by the CIRC) as trustees, and securities firms (subject to supervision by the CSRC) as asset managers.

Although there is no regular collaboration mechanism between MOHRSS and the three regulators, cooperation between them in certain areas is already in place. On issues regarding the EA supervision, there is a general consensus which is that MOHRSS plays a leading role, while the other three regulators provide assistance if necessary. For example, Decree No 23 released in 2004 on the issue of pension fund investment was a product of the all four ministries, of which MOHRSS drafted the legislation and the three commissions checked the terms relative to their industry.

Regarding private pensions in the form of insurance products (group or individual), CIRC is the principal regulator and supervisor. The Insurance Commission is responsible for approving the establishment and closure of life insurance companies in China. Meanwhile, the senior management of life insurers also needs to be approved by CIRC. CIRC is organisationally divided into 15 functional departments, of which the Department of Life Insurance is mainly in charge of supervising life insurance companies.

As mentioned previously, the Ministry of Finance and State Taxation Administration also have influence over the private pensions market in China, which mainly stems from their power in setting tax policies and collecting pension contributions (in approximately half of China's 32 provinces and municipalities). In fact one of the arguments why the Chinese EA market is not growing as fast as expected is largely due to the current low level of tax relief.

5.4 Issues and challenges

The current supervision structure of the Chinese pension system is associated with some issues which need to be addressed in order to promote the EA market. For example, the current EA licensing system is overly complex, requiring four different licenses by financial institutions. This arrangement is not consistent with international experiences since the role of trustee can be carried out by any mainstream financial institutions rather than dedicated providers. A further, and indeed probably the single most important challenge, is the insufficient resources in terms of staff, expertise and budget among others in MOHRSS. Moreover, the practical implementation of the pension supervisory systems is highly fragmented in China, which features low compliance rate across the country due to frequently reluctant cooperation by the local governments.

Having a specialist pension supervisory structure can be argued to make sense in China at this stage of the development of the private pensions market. As in other developing countries, specialist institutions can oversee new pensions products at their vulnerable, early stages of development. A relatively strict licensing and investment approach is also consistent with the lack of developments and potential risks which are still associated with financial institutions and markets in the country. A relative intensive supervisory approach would therefore also seem necessary.

This section briefly lists the challenges associated with the current arrangements and the challenges facing the Chinese authorities – which will need to be overcome in order to further promote the development and growth of China's private pension market. The problems are arranged under two headings, i.e. licensing and supervision.

1. Licensing

1a Number of licenses

According to the current EA legislations, four different licenses are required in China in order to run a "one-stop shopping" business. This unique requirement not only does not help in clarifying the central role of the trustee in the whole pension system which China is trying to implement, but also complicates and overburdens both financial institutions and pension supervisors. International experiences indeed suggest that in most OECD and non-OECD countries where licensing is adopted, this requirement is typically only applicable to the trustee in the Anglo-Saxon systems, e.g. Australia and Hong Kong China, or the agency performing the similar fiduciary responsibilities, e.g. the pension fund management companies in Chile (where they are called ATPs) and other Latin American and European countries that have introduced similar DC pension fund systems and the pension management company in Spain. In other words, trusteeship or similar duties are typically served by dedicated institutions, rather than the mainstream

financial institutions, which is observed in both DB and DC environment. The other financial institutions participating in pension systems internationally are covered by existing regulation relating to their main business activity (e.g. as custodians) and do not need an addition, separate license to undertake specific pension related activity.

Moreover, in China currently financial institutions which receive licenses should re-apply for their licences every three years, which may be too short a time for them to break even in a business area such as pensions. In contrast, in many other countries, the license is either granted for a (much) longer period, e.g. 10 years, or indefinitely.

The comparative information regarding types of licenses issued by the pension authority can be found in Table 3.

1b Lack of regulatory coherence

It has been argued (see Hinz 2007) that the pension system in China has been set up as a hybrid between an Anglo-Saxon, trust-based system (using a separate governing body/ trustee with an organisational/governance role and allocating operational functions to separate institutions on a contractual basis), and the specialised pension company model which exists in Latin America (with quantitative asset allocation and fee limits, and where a limited number of licenses are handed out – the difference being that in Latin America all functions are consolidated into one commercial entity). This hybrid structure will be very difficult to supervise, involving multiple parties with governance and operational roles, which need to cooperate closely. Given there is no accumulated body of trust law in China, the role and responsibilities of trustees, as currently laid out in the EA legislation, also lacks clarity. Furthermore, as mentioned, the fundamental legal basis of the EA decrees needs to be strengthened.

In addition, there are incoherent requirements on the financial institutions which want to conduct EA business in China. For example, regarding minimum capital requirement, the Chinese current regulation is rather strict compared to the other countries. In Australia, the requirement for public retail funds is AUD 5 million, while in China there are four different requirements corresponding type of license the applicant is applying for. If it is a trusteeship license, the minimum capital required is RMB 100 million, while it is RMB 5 billion for the license of custodian business. Largely due to the latter requirements, so far the custodians are mostly served by the largest state-owned banks. See Table 3 for detailed comparative information.

As indicated in Decrees 20 and 23 - the two major EA regulations in China, the entry hurdles for applying for the four licenses are rather vague on the side of the qualitative requirements. For example, in Decree 23 it is stated that in order to be a qualified trustee, the internal governance structure must be sound. This requirement sounds right, but is indeed too vague to be meaningful. This kind of requirement is very likely to create confusion to the applicants.

Furthermore, given the similarities of the requirements on financial institutions for the all four licenses, in fact most mainstream institutions meet the requirements specified in the legislation. In consequence, the question of how to allocate the limited number of licenses among many applicants becomes very relevant. Unfortunately, public information regarding the procedure of granting licenses is limited to the extent that they are selected by an advisory board consisting of 51 members who come from a range of different background as noted earlier. Therefore, the selection process could be discretionary, rather than clearly criteria defined and rules-based, thus leading to a less transparent supervisory and licensing system.

2. Supervision

2a Overlap of public/private pension supervision

Supervisory activities related to China's public and private pensions are conducted by one department within MOHRSS. This is not common in many other countries. For example, for the economies reviewed in this paper, specialised pension supervisors exist in Hong Kong China, Chile, and the UK, while in other countries, i.e. Australia and the US, supervisory activities related to public pensions are conducted separately from those related to private pensions. Separate supervision may be more appropriate for the current system in China for two reasons. First, the public and private pension systems have different goals (public pensions mainly aiming at providing basic pension needs, whilst private pensions are more concerned with additional pension provision), and are increasingly provided by different institutions (as EA assets in China are being transferred to private sector financial institutions). Second, private pensions are likely to be invested based on market rules, while public pensions are typically invested in a more conservative manner. Hence the supervisory agency and approach relating to the two types of pension would be better distinguished and separated, which would allow for the different elements of the system to be better targeted and supervisory resources to be directed with more clarity and precision. Third, confusion could be created to some extent concerning what role the MOHRSS plays, in that MOHRSS is currently in charge of regulation and supervision of both private and public pensions as well as licensing.

2b Lack of coordination within financial sector supervision as a whole

As discussed, a specialist pension supervisory agency can be desirable, but to operate efficiently, it needs to coordinate closely with other financial sector oversight bodies. This is particularly the case in China, given the challenging structure of different authorities overseeing different EA license holders. EA assets in China are now mainly managed by private financial institutions, which are subject to supervision of three different financial regulators. In this regard, it is important to ensure a working collaboration mechanism between the authorities. However, such mechanisms are not really in place at the moment. Indeed in fact, a lack of cooperation between ministries and authorities has been observed to be actually hindering the development of the EA market. For example, the question of how small and medium sized enterprises (SMEs) set up EA plans has been debated, with different types of financial institutions favoring different models/products, contributing to the delay of releasing the draft legislation on the SMEs pension plan in China.

2c Lack of geographical coordination

China also faces an additional, geographical coordination challenge. MOHRSS is in charge of supervising national EA pension plans, while local offices of MOHRSS are responsible for supervising local pension plans. Although currently the majority of EA plans are established by large/national companies (and therefore subject to supervision of MOHRSS), it is likely that more and more small and medium sized enterprises will set up their own plans in future, particularly given increasing awareness of EA plans and encouragement by the authorities to develop the EA market among SMEs. If this is case, the number of supervised entities will be potentially very large, therefore compounding the challenges already being encountered, i.e. the lack of expertise and number of supervisory staff. This is especially an issue for local MOHRSS offices, which will face the additional challenge of being largely under the control of local governors (as opposed to central MOHRSS), making collaboration between the MOHRSS in Beijing and at the provincial offices particularly challenging, particularly when it comes to solving local issues.

2d Insufficient supervisory staff and powers

Given that the private pension system in China is in its infancy, and that financial institutions and markets are still developing, a relatively intensive supervisory approach would seem justified, e.g. strict requirements on granting licenses to financial institutions. Yet the single most difficult challenge facing the MOHRSS is the current low staffing positions. As noted earlier, the Department of Supervision of MOHRSS is in charge of various types of responsibilities related to supervision, including drafting relative legislation, and conducting both on-site and off-site supervision. Meanwhile, the workload is (significantly) exaggerated given that MOHRSS need check and assess application for the four separate types of licenses. This licensing structure is unique, in that in other countries the supervisors are typically in charge of granting one type of licensing, e.g. trustee in Australia and AFPs in Chile. In any case, the current staff numbers only 13, with only 3 directly responsible for EA supervision. Though the current supervisory staff are experienced and highly dedicated – and indeed are doing a remarkable job considering their limited resources - by international comparison, such a low staffing level is far from sufficient, with the other authorities reviewed numbering in the hundreds.

As discussed, pension funds can be argued to be a distinctive type of financial product, involving low risk tolerance, long-term investment horizons and requiring a steady income stream to be delivered in the pay-out phase. Supervising pensions is therefore a complex task, with a range of different professional expertises needed, notably investment, finance, actuarial, accounting, legal service, etc. However, given the current extremely limited human resources in MOHRSS, it is not clear that the staff collectively have the above-mentioned skills and expertise. In contrast, with the other international authorities reviewed in the paper, supervisory staff include investment professionals, lawyers, actuaries, etc, which effectively facilitates the establishment of a sound and reliable supervisory regime[13]. Again it should be stressed that the current MOHRSS team are highly dedicated to their huge task, they need such expert backup and support.

As discussed, the powers of the MOHRSS, as the main supervisory authority, are not always apparent. As mentioned, the information and data which they can demand from supervised entities has not been fully set out and their enforcement role and punitive powers are not specified. In addition to investigation, enforcement is a vital element in an effective supervisory regime. Yet, it is currently not clear to pension funds and related parties what it expected of them by their supervisors, how they should stay in compliance with regulations, and, importantly, what happens to them if they do not. MOHRSS needs more transparent punitive and enforcement powers, and to explain to supervised entities how and when these will be applied.

Meanwhile, the current pension supervisory approach (theoretically) features relatively pro-active supervision, involving both on-site and off-site investigation, either on a routine or ad-hoc basis. Yet a risk profile for the supervised entities is not quantitatively analyzed and assessed. This makes it difficult to target the supervisor's extremely limited resources to where the most risks lie. In contrast, in most of the cases reviewed (e.g. PAIRS/SOARS model in APRA and the Triage approach in the UK), a risk-based approach to supervision is adopted, which defines supervisory priorities according to risk profiles of each entity. By doing so, supervisory resources are allocated to the most needed areas, therefore achieving optimal supervisory effectiveness particularly given resource constraint. To achieve such as efficient allocation of resources, data collection is of crucial importance, in order to facilitate analysis and assessment of risk profiles. Although MOHRSS has started to establish a centralized network system at the national level, this project is only partially completed across the country, making it difficult to establish a truly efficient supervisory approach.

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[13] See various IOPS documents, including 2008 Newsletter, 'Pension Supervision in Focus', due to be published 2008 – www.iopsweb.org

VI. Policy implications for China

EA assets in China are currently at the level of RMB 152 billion, which is a sizable amount. It is expected, however, that this will increase rapidly in the coming years, partly due to increasing awareness of the important supplementary role played by EAs, and reflecting efforts by the government to promote the market. Admittedly, some aspects of the current supervisory approach match current situations and conditions, therefore they are justifiable. However, from the long-term perspective and particularly in view of promoting and encouraging development of the EA market in China, both supervisory approach and structure need to be modified to adapt to the changing environments. This section consequently proposes a range of practical policy recommendations for improving the current supervisory structure and supervisory approach. It should be noted that the recommendations come from both a short-term and a long-term perspectives so as to allow for flexibility, which will be needed when reforming the supervisory system in China.

1. Recommendations to improve licensing system

1a Simplify the licensing regime

The trustee is the central agent of a trust-based private pension system. Therefore, given that China is implementing the trust—based EA system, the supervisory arrangements should be also consistent with it by focusing on its activities, particularly given MOHRSS's limited resources on supervision and the continuous growth and sophistication of financial markets in general in China. This could be achieved, for example, by issuing only one licence, i.e. the trusteeship license, while leaving supervisory responsibilities over asset managers, administrators and custodians to the relevant financial supervisors in China. MOHRSS's supervisory responsibilities would extend also to the monitoring of the contractual agreements between trustees and the various service providers but it would focus most of its resources on supervising trustees. This would require the centralisation of reporting on the different activities carried out by service providers at the level of the trustee. With a single license scarce supervisory resources can be allocated to the most needed areas, thus potentially greatly increasing supervisory and regulatory efficiency and effectiveness.

Furthermore, MOHRSS could consider introducing a requirement to establish corporate pension trustees as special purpose institutions or dedicated independent providers which have pension trusteeship as their sole business purpose, like the AFPs in Chile and other countries. This proposal would clarify fiduciary responsibilities, reduce the scope for conflicts of interest, and facilitate supervision. In addition, MOHRSS could consider lengthening the period of validity of the license from the current three years to a longer period, e.g. 10 years, even indefinitely, in order to facilitate the development of the pension business. Such reform would also bring the EA system in line with international experience. Finally, greater transparency needs to be sought on the criteria for granting licenses.

1b Improve regulatory clarity

Before the supervisory structure and approach can be tackled, the Chinese authorities also need to introduce greater clarity to their pensions regulation. It needs to be made clear that directives issued by the MOHRSS are the fundamental (and only source) of legislation governing the EA market. The roles and responsibilities of the varies parties to the EA system need to be more clearly laid out, and indeed the ministry may need to undertake an educative approach to ensure that the position of trustee is truly understood within the market. If a trust based approach is to be fully adopted, the supervisor will need to lay out secondary legislation, for example, providing guidance on expected behaviour, codes of conduct, risk management requirements etc., which will allow them to focus on the quality of decisions which such a system is based upon, rather than acting as a compliance based supervisor, checking conformity with

strict quantitative rules. In addition, regulation clarifying acceptable investments and standardizing the tax code relating to pensions will also be required for the EA market to flourish.

2. Recommendations based on the current supervisory structure

Several policy recommendations are proposed below which can be relatively easily translated into action, largely due to the fact that they do not necessarily involve (significant) changes of the current supervisory structure. As discussed, a specialized supervisory structure and relatively intensive supervisory approach is not inconsistent with this stage of development in China's private pension market. The proposals aim for a reasonable balance between the urgent need for an improved supervisory structure and difficulties typically encountered when reforming a political institution in China. The recommendations can be considered as short-term/or and medium-term solutions, but they also have considerable long-term relevance.

2a Closer collaboration with other regulators

The current supervisory structure in China involves a number of institutions. MOHRSS is the main EA market regulator and supervisor, whilst financial institutions are also supervised by the three specialised financial regulators. This is not unique in China, as such structure is also observed in other economies, e.g. Hong Kong China and the United States. The difference, however, is that in other economies, a close collaborative relationship between the pension supervisor and other financial sector supervisory authorities is in place, which is either highlighted by a formal signing of MoU, though legislation, or through the formation of a task force to solve particular issues concerning the relevant parties, or indeed a combination of the above. In China, such collaborative mechanisms have yet to be established. Therefore, in order to promote the development of the EA market (which is closely linked to the financial markets in general), it is necessary to establish a closer working relation between MOHRSS and the other three supervisors, i.e. CBRC, CIRC and CSRC. This could be done via formal or informal agreements between the relevant agencies, which should be achievable, particularly in light of the recent signing of MoU between CBRC and CIRC on insurance and banking issues. If a similar agreement could be struck in China, it would not only indicate the agencies' efforts to cooperate, but also (most importantly) would serve as a pro-market message to the industry, therefore encouraging development of the EA market.

2b Strengthen supervisory capabilities and powers

Based on the current level of staffing within MOHRSS, it is very difficult to achieve a fully developed supervisory regime. There are two dimensions in this context, i.e. number of staff and the level of expertise. As noted, the number of staff in the Department of Supervision of MOHRSS in charge of supervising the EA market at the national level is extremely low by international standards, with the current, dedicated team highly stretched. The Chinese authorities should therefore seek to increase the number of staff overseeing private pension supervision to a level which is consistent with the market needs (which will mean increasing staff levels considerably, indeed by multiples). Meanwhile, pension fund supervision is a complex task, involving knowledge and understanding on a range of fields. Therefore, if a properly supervised pension industry is the goal, the current pension supervision team been supported by relevant experts (in finance, investment, law etc.).

The powers of the supervisor to collect data and enforce action also need to be clarified and strengthened. In order to ensure an efficient and effective supervision pension funds and related parties need to know what is expected of them, what will happen if they do not comply with requirements, who has the power to impose punitive measures (and how and when these will apply).

2c Move towards risk-based supervisory approach

Currently MOHRSS implements a supervisory strategy with a focus on on-site supervision, which is consistent with the existing supervisory framework (i.e. compliance-based rather than risk-based based), more developing nature of the capital markets, and also reflects the lack of reliable data and information, therefore disallowing MOHRSS to conduct efficient off-site analysis and supervision. On-site supervision per se is not a problem, since it permits supervisory staff to conduct detailed investigation based on information which otherwise is not accessible. However, this approach cannot currently be efficiently implemented given the limited number of supervisory staff in MOHRSS. A solution to this issue is to introduce risk-based supervisory structure as in other countries, e.g. Australia, Chile and the United Kingdom. Based on this new approach, a risk profile for supervisory entities can be derived using a pre-specified model (which typically incorporates both level of risk and likelihood that the risk will incur in the near future). Supervisory resources can then be prioritised and allocated to the entities which impose the most immediate and significant risk to the pension market and system. Likewise, the entities with less risky profiles will receive secondary supervisory attention. This system allows limited supervisory resources to be assigned to the most needed areas, thus optimising supervisory efficiency and effectiveness.

3. Recommendations involving changes of the current supervisory structure

The above proposals do not necessarily involve changing the existing supervisory structure, which therefore are considered to be practically straight forward to implement. However, from a long-term perspective some aspects of the current system may need to be altered to address more fundamental issues relating to the Chinese pension supervisory system and to further ensure the sustainability and flexibility needed to implement efficient and effective supervision of the growing pensions market.

3a Separate supervision of private pensions from that of public pensions and clarify central authority

Public and private pensions are distinctive institutions. Public pensions in China aim to provide basic needs for retirees, i.e. ensuring basic living conditions are met, as before-retirement. Private pensions, (i.e. EAs) in China are supplementary to the public pensions, and arranged in a different manner, with voluntary contributions limited to the level of tax relief. Meanwhile, EA assets are managed in more a liberalised manner, i.e. according to the market rules, while public pensions are still subject to strict regulations and government control. Given the different objectives and operational functions, the approach to supervising the two pillars should not be the same, and therefore it is advisable to separate the supervision of private pensions from that of public retirement provisioning. Currently the public and private pensions markets have to compete for limited resources within the same department of MOHRSS, placing a major constraint on supervisory efficiency. Therefore, with the development of the EA market, the function and supervisory capability of EA supervision should be strengthened and ideally be conducted by a separate department in MOHRSS, or a stronger division with the Department of Supervision, which should feature more staff resources and an increased budget under its direct control.

The role of the central ministry vs. regional offices also needs to be enforced. As Hinz (2007) states, "There is no other voluntary occupational pension system that has been able to effectively operate without clarity of regulatory and supervisory oversight."

3b Establish a separate supervisory agency

A step further from the previous recommendation would be to establish a separate supervisory agency, independently from MOHRSS and other regulators, such as the Administradoras de Fondos de Pensiones (AFPs) in Chile and TPR in the United Kingdom. The separate supervisor should be granted more compliance power and implementation capability, which can be achieved by more staff (with broader

expertise) and a greater control of resources at both the national and local levels. The key benefit of having a separate supervisor is to enable the agency to focus on its main responsibility at the arm's length from the government. In other words, the proposed separate agency is solely responsible for supervising and monitoring the pension market, whilst regulatory responsibilities (drafting legislation etc.) would rest with the MOHRSS. The clear division of responsibilities between supervisor and regulator could potentially enhance supervisory efficiency gains. Meanwhile, a separate and more specialised agency is consistent with marketisation of the Chinese EA system. EA assets are managed based on market rules in China, and this is expected to become a large market in future. Such an agency would be more able to react to new market developments. Finally, enhancing the staffing situation and compliance power across the country could strength supervisory capability, which indeed is one of the main weaknesses associated with the current structure.

This new system would allow the supervisory authority to focus on providing licenses to trustees and overseeing their operations and the stability of the pension system as a whole. The licensing of the other financial institutions, which are contracted to provide services by the trustees, could then be left to the appropriate industry authorities, thereby reducing the workload and increasing the focus on the pension supervisor. At a minimum, a separate, clearly distinct unit for private pension supervision within the MOHRSS should be set up (as with the Undersecretariat operating within the Treasury in Turkey).

Meanwhile, given that it is likely to have more resources in terms of number of supervisory staff and expertise, licensing process should be more transparent, and less discretionary. In this regard, this process could be advised or assisted by an external expert committee, like what MOHRSS is doing; however, the final decision should be made independently by the supervisors, rather than others.

3c Integrate with other financial supervisors

As discussed, though pension funds have special characteristics, they do share similarities with other financial products, particularly when provided by financial institutions. The dividing line between financial sectors is becoming increasingly blurred internationally, and such trend is likely to develop in China as well, particularly the case between insurance products and pension products, which are closely inter-linked. In addition, as the securities market develops they will become an important component in the pension fund investment process. In future it may therefore be advisable to integrate supervision of pension funds with that of other parts of the financial markets, as has been the case in other countries (for example in Central and Eastern Europe). In China, this would involve integrating the pension supervisor with CBRC, CIRC and CSRC. However, if the consolidation to such a super-agency would be politically difficult to achieve in one step, such an integration process could start with the pension supervisor with CIRC merging – i.e. the two agencies which are directly involved in supervising private pensions in China, and where regulatory and supervisory responsibilities do to some extent overlap, with detrimental effects on the development of the market.

VII. Conclusion

China's pension system features a combination of participation and involvement from the state, companies and individuals. One important component of the system is occupational pensions (or enterprise annuities EA in China). The market has recently witnessed rapid growth particularly since 2004 and is expected to continue its expansion in the near future. The main regulator and supervisor is the Ministry of Human Resources and Social Security of China (MOHRSS), which is in charge of supervising the overall pension system (including EA) in China, with three other financial regulators, i.e. CBRC, CIRC and CSRC also playing an important role. Though a specialized supervisory agency with a relatively intensive supervisory approach can be argued to be appropriate given the current level of development of the private

pensions market in China, the current complex regulatory and supervisory structure presents practical challenges which may limit the further growth of the EA market.

Given the problems identified with the current pension regulatory and supervisory structure in China and international experiences reviewed, the following policy recommendations - involves both relying on the current system and making more radical changes – are recommended:

Reforming the current supervisory system

- Clarify the legislative structure, particularly the role of trustees
- Increase the staffing levels and expertise of the pension supervisory authority and supervisory powers, in line with international standards
- Introduce a more risk-based approach to pension supervision, in order to utilize limited resources more effectively
- Improve the collaboration between the MOHRSS and other financial sector supervisors - particularly between the MOHRSS and the insurance regulator CIRC- via the signing of a MoU between the relevant agencies

Changing the supervisory system

- Issue the single license for the special purpose institutions, i.e. those which perform the trustee function, and extend the length of the license duration
- Separate the supervision of public and private pensions to avoid competition for scarce supervisory resources and improve clarity
- Establish a separate EA supervisor, separating supervisory and regulatory functions, again increasing transparency and clarity by focusing on the (independent) licensing process and oversight of trustees
- Eventually aim for the establishment of an integrated supervisory authority, possible with an interim step integrating pension and insurance supervision, thereby eliminating the most harmful areas of overlap.

ANNEX - CASE STUDIES

A. Australia

The Australian retirement system is one of the most sophisticated and developed ones in the world. Earnings related superannuation (pension) schemes are mandatory in Australia, and five main types of schemes exist, i.e. 1) Industry funds: occupational pension plan established by enterprises within a single industry, or related industries; 2) Corporate funds: occupational pension fund set up by a single enterprise or companies within the same group; 3) Retail funds: occupational or individual pension fund, normally provided by financial institutions; 4) Public sector fund: the scheme covering public sector employees; 5) Small superannuation funds: the scheme with less than five members, including small APRA funds and, self-managed superannuation fund (SMSF). Most funds are defined contribution (DC) in nature. As of 2005 there were approximately 1,000 pension funds with more than 4 members (Bruner et al 2008), with total assets amounting to AUD 857 billion in 2007 (approximately USD 700 billion). Total pension fund assets (including assets of funds with 4 or fewer members) recently reached 100% of GDP.

The private pension system in Australia is subject to regulation and supervision by three main authorities, i.e. the Australian Prudential Regulation Authority (APRA), the Australian Securities and Investments Commission (ASIC), and the Australian Taxation Office (ATO). The Australian financial supervisory structure adopts the so called "twin peaks" model, with APRA, the prudential regulator, mainly covering issues which affect the financial health of supervised financial services institutions, while ASIC, as the conduct and disclosure regulator, is mainly concerned with market integrity and business conduct issues. The ATO also plays an important role in the Australian pension system in that it is the main regulator of the self-managed superannuation funds (SMSF).

The Australian Prudential Regulation Authority (APRA)

As the main regulator of the private pension system, APRA was established in July 1998 as part of the government's efforts to restructure the Australian financial system. APRA is responsible for supervision of the financial services institutions, including banks, credit unions, building societies, insurance, friendly societies and superannuation funds, etc. – i.e. it is an example of an integrated supervisory authority.

a) Organisational structure

The headquarters of APRA are in Sydney, while it has five other regional offices across the country. As of 2007 APRA staff numbers were 582 (APRA 2007) while APRA supervises financial institutions holding assets approximately around AUD 3 trillion. APRA is organised into five divisions:

a) Specialised Institutions Division responsible for the supervision of licensed entities in Australia. The specialised institutions include regional banks, credit unions, building societies, insurance companies, friendly societies and superannuation funds.

b) Diversified Institutions Division responsible for the supervision of functionally diversified financial institutions, including large financial conglomerates, banks, insurance and superannuation funds.

c) Policy, Research and Statistics Division responsible for providing APRA supervisors and other staff with sufficient information and tools to conduct risk analyses and fulfil supervisory responsibilities, mainly through policy studies, statistics, etc.

d) Supervisory Support Division providing advice and support to assist APRA supervisory staff on a number of areas, e.g. actuarial services, assessment of credit, market, insurance, IT and operational risks.

e) Corporate Services Division in charge of APRA's administration-related issues, e.g. human resources, IT, finance and auditing.

APRA's governance structure consists of a full-time Executive Group which currently has three members, (according to legislation the Executive Group should have at least three but less than five members in order to ensure efficient running of the organisation). The members are appointed by the Australian Treasury. The Executive Group as the executive board is responsible for the overall operation and performance of APRA.

In addition, APRA has a Risk Management and Audit Committee which consists of an external chairperson (with casting vote), one external member, one member of APRA's Executive Group and one Executive General Manager. The main purpose of this Committee is to provide Executive Group members with independent evaluation of the performance of the organisation.

APRA is largely financed by industry through fees charged to the supervised entities. The amount of charges is approved by the Australian Treasurer annually.

b) Regulatory Functions and Licensing Approach

The Parliament of Australia makes laws relating to superannuation, advised by the Department of Treasury. APRA administers the legislative requirements in respect of the funds it supervises and develops the manner in which supervision is carried out. APRA provides regular input to Treasury on matters relating to regulation.

In addition APRA develops and publishes guidance in the form of Circulars, Prudential Practice Guides & Guidance Notes; these documents provide information on APRA's interpretation of legislation and examples of best practice. Under the SIS legislation, APRA has some limited discretionary powers and the power (subject to review) to modify certain parts of the legislation as it affects individual entities and classes of entity.

The Australian authorities in 2004 introduced mandatory licensing for APRA regulated trustees, also requiring all existing trustees (except those of self-managed superannuation fund with no more than four members) to receive a license before 2006 if they intended to continue their business. After being granted a license, trustees must register their fund or funds with APRA before commencing operation. APRA will grant a license if it has no reason to believe that the applicant would fail to comply with relevant law or any condition imposed, and is satisfied that the applicant meets requirements relating to fitness and propriety, adequacy of resources, outsourced service provider agreements, and has an adequate risk management framework in place. If the applicant intends to operate a public offer fund (i.e. retail funds open to the general public) certain capital conditions should also be met.

Successful applicants are issued one of three Registrable Supperannuation Entity (RSE) licence classes:

- Public offer entity licence (typically retail and/or industry funds that accept contributions from the public)

- Non public offer entity licence (typically corporate funds or industry funds which only accept contributions from particular employers)

- Extended public offer entity licence (typically a trustee operating one or more non public offer entity funds in addition to one or more public offer entity funds)

According to the current legislation, there is no requirement for periodic renewal of the trustee license or the entity registration. There is, however, provision for variation of the class of license and for variation of license conditions. The licensee may apply for a variation or revocation of a license condition, or APRA may unilaterally vary or revoke a condition. A licensee may voluntarily request APRA to cancel its RSE license. APRA may also cancel a license if the trustee is a body corporate and is a disqualified person. In certain other circumstances APRA may cancel an RSE license (e.g. where the licensee has breached a condition of licence, and where the licensee has failed to comply with a direction given by APRA to comply with a licence condition). These powers are intended for use only as an ultimate sanction, and as such are subject to review.

In terms of investment regulation, APRA adopt an open, prudent person approach rather than imposing quantitative investment limits. For example, pension funds in Australia may freely invest in shares, bonds and foreign assets as long as the trustees believe the investments are to the benefit of members and beneficiaries. However, some regulatory restrictions do still exist, one of which the Australian government relaxed slightly. The latest OECD survey (OECD 2008) of investment regulations of pension funds shows that changes to the existing Australian regulations in 2007 allowed superannuation fund trustees to invest in limited recourse instalment warrants over any asset a fund could invest indirectly (e.g. real property or listed securities).

c) Supervisory approach

The core mission of APRA is “to establish and enforce prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by institutions APRA supervises are met with a stable, efficient and competitive financial system”.

APRA’s supervisory approach aims to be forward-looking, primarily risk-based, consultative, consistent and in line with international best practice. It is forward looking in that APRA actively monitors and assesses the performance and situation of the supervised entities against pre-specified standards and requirements on an on-going process, then forms an opinion on the likelihood of the entity defaulting on its promises made to superannuation members, and what actions APRA needs to take. APRA’s approach also recognizes that management and boards of supervised institutions are primarily responsible for financial soundness.

APRA’s supervisory approach can be seen as coming from the ‘Anglo-Saxon’ model –i.e. operating more via communication and deterrent rather than intensive, daily interaction with supervised entities (as is the case with Latin American supervisory institutions). Such an approach is consistent with a country such as Australia which has a developed economy and capital markets and a highly competitive pension system operating under a trustee structure[14].

[14] For a discussion of the different approaches to pension supervision see Hinz and Mataoanu (2005), Madero and Lumpkin (2007).

APRA has its in-house risk-based supervisory tools, i.e. the Probability and Impact Rating System (PAIRS) and the Supervisory Oversight and Response System (SOARS)[15]. The PAIRS system is used to assess the likelihood that a particular supervised entity (e.g. pension trustee) will fail to honour its promises (probability rating), and the extent to which such potential failure will impact on the financial system (impact rating). APRA's PAIRS assessment begins with the overall risk level of the entity, and then the entity's ability to control or reduce the risk. The two assessments then lead to a net risk level, which ranges from "low", to "medium", "high", and further to "extreme".

Chart 1: Summary of PAIRS Scoring

PAIRS Category	Inherent Risk	Management and Control	Net Risk	Significance Weight
Board			(0-4)	%
Management			(0-4)	%
Risk Governance			(0-4)	%
Strategy and Planning	(0-4)	(0-4)	(0-4)	%
Liquidity Risk	(0-4)	(0-4)	(0-4)	%
Operational Risk	(0-4)	(0-4)	(0-4)	%
Credit Risk	(0-4)	(0-4)	(0-4)	%
Market and Investment Risk	(0-4)	(0-4)	(0-4)	%
Insurance Risk	(0-4)	(0-4)	(0-4)	%
Net Risk Total			(0-4)	100%
Coverage/ Surplus			(0-4)	%
Earnings			(0-4)	%
Access to Additional Capital			(0-4)	%
Capital Support Total			(0-4)	100%
Overall Risk of Failure			(0-4)	

Source: APRA(2008a)

Chart 2: PAIRS OFR and Probability Index against Indicative External Ratings

Overall Risk of Failure		Probability Index	Indicative External Rating
Very Low	0.25	1	AAA
	0.5	1	AA+
Low	0.75	1	AA
	1.0	1	AA-
Lower Medium	1.17	2	A+
	1.33	3	A
	1.5	5	A-
Upper Medium	1.67	8	BBB+
	1.83	11	BBB
	2.0	16	BBB-
High	2.25	26	BB+
	2.5	39	BB
	2.75	57	BB-
	3.0	81	B+
Extreme	3.33	123	B
	3.67	181	B-
	4.0	256	CCC

Source: APRA(2008a)

[15] For detailed descriptions of the PAIRS and SOARS systems see APRA's 2008 papers:
http://www.apra.gov.au/PAIRS/upload/PAIRS_Final_May_2008_External_Version.pdf
http://www.apra.gov.au/PAIRS/upload/SOARS_Final_May_2008_External_Version.pdf

APRA then employs the SOARS tool to assist in responding the above-mentioned risk assessments. Depending on the risk level, supervisory stances vary. SOARS results in supervised entities being allocated one of four supervisory stances (Normal, Oversight, Mandated Improvement or Restructure).

Entities grouped into the "normal" stance are not expected to fail in reasonable foreseeable circumstances, no special treatment is needed, and they are subject to routine supervision. The "oversight" entities are not expected to fail, but have some level of risk which needs to be further examined. The "mandated improvement" entities are institutions where operations are being conducted in a way that potentially puts beneficiaries at risk, resulting in APRA requiring the institution to take immediate measures to correct problems and thus strengthen risk profile. The last supervisory stance is ""restructure". These are entities in which APRA has lost confidence that financial promises to beneficiaries will be met in the absence of vigorous intervention. Usually APRA has formed the view that the entities do not have the ability or willingness to rectify problems and are at material risk of failure, and APRA therefore needs to consider transferring assets to a healthier institution, closing businesses, etc.

Chart 3 below illustrates how APRA uses both PAIRS and SOARS tools to conduct supervisory activities. For example, when an entity receives a "low" score for its PAIRS probability rating, even if its score for PAIRS impact rating is "extreme", it is still considered a "normal" entity. For entities with "high" impact rating and "medium" probability rating, they will be grouped into the "oversight" stance, i.e. subject to more investigation.

As of June 2007, around 66% of risk-rated entities were in the "normal" stance, 32% in "oversight", 1% in "mandated improvement", and the remaining 1% in "restructure" (APRA 2007).

Chart 3: SAI Grid

Impact rating	Impact index	Supervisory Attention Index				
No Limit	500	22	50	89	201	358
	250	16	35	63	142	253
Extreme	125	11	25	45	101	79
High	12.5	4	8	14	32	57
Medium	1.25	1	3	4	10	18
Low	0.25	1	1	2	5	8
Probability rating		Low	Lower Medium	Upper Medium	High	Extreme
Probability index		1	5	16	81	256

Source: APRA(2008a)

d) Collaboration between authorities

With the aim of reducing regulatory overlaps and arbitraging, regular liaison mechanism between pension regulators is in place in Australia, underpinned by the signing of the Memorandum of Understanding (MOU) between APRA and ASIC. Meanwhile, APRA and ASIC have set up a working group to review their respective administrative practices. The recent conclusion was that the two organizations have followed their own distinctive and complementary missions, and the issue of regulatory duplication is minor. In addition, APRA also has a close working relationship with the Reserve Bank of Australia and the Australian Treasury, which involves regular meetings and contacts at both senior and operational levels.

B. United States

The US private pension system is governed by the Employee Retirement Income Security Act (ERISA) which was passed in 1974. According to the ERISA, the main supervisory authority is the Employee Benefits Security Administration (EBSA) of the US Department of Labor, which is mainly responsible for issues related to information reporting, disclosure, fiduciary conduct and civil enforcement etc. In addition, the US Internal Revenue Service (IRS) is also one of the key pension regulators, which reflects and stems from its role as the national tax agency. Meanwhile, given the decentralized financial regulatory framework in the US, the financial service providers which relate to pension provisions, e.g. banks, securities firms and insurance companies, are supervised largely by the relevant regulators at both the federal and state levels. For example, the US Securities and Exchange Commission (SEC) as a federal agency, is in charge of supervising securities exchanges, securities brokers and investment funds etc., while insurance companies are subject to supervision of the state-level agencies. The total amount of autonomous pension funds was approximately USD 9.7 trillion in 2006, which accounted for 74% of GDP.

The Employee Benefits Security Administration (EBSA)

The Employee Benefits Security Administration (EBSA), (previously known as the Pension and Welfare Benefits Program until 1984 and the Pensions and Welfare Benefits Administration until 2003), was established under the ERISA of 1974. As a federal agency, it administers Title I of ERISA, i.e. with a focus on administration and enforcement of the fiduciary, reporting and disclosure provisions of the Act.

a) Organizational structure

Following the name change of EBSA, this agency was upgraded to a sub-cabinet level, which was reflected by new position creation for the agency, i.e. Assistant Secretary and Deputy Assistant Secretary (previously private pensions supervision was effectively covered by a sub-cabinet agency dealing with union related employment contracts etc.). The Assistant Secretary as the head of the agency is appointed by the US President, and responsible for the overall policy design and direction of the EBSA. In addition, there are currently two Deputy Assistant Secretaries who are in charge of the daily running and management of the agency; one is responsible for the policy, legislative and research functions of EBSA, while the other is responsible for EBSA's regulatory, enforcement and reporting activities.

The EBSA is comprised of nine headquarter-based offices in addition to 10 regional offices. The nine headquarter-based offices are arranged by function – i.e. Office of Exemptions Determinations, Office of Enforcement, Office of Policy and Research, Office of Health Plan Standards and Compliance Assistance, Office of Regulations and interpretations, Office of the Chief Accountant, Office of Technology and Information Services, Office of Participant Assistance, and Office of Program Planning Evaluation and Management. Responsibilities differ between these groups, for example, the Office of Exemption Determinations is responsible for dealing with requests for individual and class exemptions from ERISA's prohibited transaction provisions, e.g. analyzing individual exemption applications against the existing rules., while the Office of Enforcement, which promotes the protection and security of pension and welfare benefits under ERISA by ensuring a strong and effective national and field office enforcement program, and the Office of Policy and Research, which provides leadership and coordination of employee benefit plan policy analysis, long-term policy development, and legislative analysis.

In addition, 10 regional offices operate geographically across the country, which are mainly responsible for enforcement and participant assistance activities. The regional offices are accountable to the Deputy Assistant Secretary, (i.e. the other headquarter offices do not have direct line authority over the regional offices). Meanwhile, regional offices are granted some flexibility to carry out activities which are best suitable for the local specific conditions and situations, although within the overall national regulatory

framework and guidance. It should, however, be noted that the central authorities have overall control of the pension system and that federal pension law has a strong provision stipulating that ***federal law preempts any and all state laws*** that are even related to providing private pension benefits through employers (i.e. the so called preemption clause, Section 514 in ERISA).

According to ERISA provisions, the ERISA Advisory Council was established to advise the EBSA on particular issues. The council consists of 15 members representing different groups of the US population, including three members representing employee organizations (at least one of whom should represent the multiemployer plan participants), whilst another three members are representatives of employers (at least one of whom should represent the employers sponsoring multiemployer plans). Meanwhile, three members represent the general public. The remaining fixed members represent each of the specialist sectors, i.e. insurance, corporate trust, actuarial counseling, investment counseling, investment management, and accounting.

The EBSA oversees more than 700,000 retirement plans, approximately 2.5 million covered health plans, and similar numbers of other welfare benefit plans. Asset under EBSA's jurisdiction were around USD 5.6 trillion as of 2007, and approximately 150 million Americans were covered. As of 2003 there were around 900 employees in EBSA.

b) Regulatory Functions and Licensing Approach

The pension or financial sector supervisory authorities in the United States do not operate a formal licensing process for pension plans or pension funds, nor is advance approval required as is the case in some other countries. There are no "fit and proper" requirements for pension entity managers nor requirements for reinsurance or guarantees of pension fund.

Most occupational pension plans, however, must file public annual information returns with the pension supervisors (i.e. the US Department of Labor (DoL) and the Internal Revenue Service (IRS). Plans must meet certain requirements in order to qualify for tax deferral and typically choose to file with the IRS for a determination that the plan document meets the tax requirements. The latter is akin to a licensing process, but focuses primarily on the consistency of plan terms with the tax requirements, including non-discriminating in favour of highly compensated employees. The plan's assets must be held in trust by individual or corporate trustees or in an annuity contract.

As with the Australian pension regulatory regime, the US also adopts an open, prudent person approach rather than imposing quantitative limits on investments in certain asset classes. Nevertheless, some residual regulatory restrictions still exist. For example, according to the latest OECD survey on pension fund investment regulations (OECD 2008), as of December 2007 there were still some limits on employer securities, and some limits on real estate leased to employers. Meanwhile, pension assets are not allowed to be lent to employers.

c) Supervisory approach

The mission of EBSA is as follows:

- Assist workers in getting the information they need to exercise their benefit rights
- Assist plan officials to understand the requirements of the relevant statutes in order to meet their legal responsibilities
- Develop policies and regulations that encourage the growth of employment-based benefits

- Deter and correct violations of the relevant statutes through strong administrative, civil and criminal enforcement efforts to ensure workers receive promised benefits

The supervisory approach in the US generally emphases two points, i.e. voluntary compliance and fiduciary responsibility. This is largely driven by specific and unique circumstances faced by the EBSA, i.e. the voluntary nature of the US private pension system, the large number of retirement plans, the diversity of size and type of the plan and the limited resources available to the EBSA. Against this background, the EBSA focuses on process rather than specific directives that fiduciaries need to follow. For example, trustees have considerable freedom in terms of allocating their pension assets, as long as they meet the general principle of fiduciary responsibilities, (i.e. actions are undertaken with due diligence and for the best interests of plan members). Meanwhile, voluntary compliance to the rules and principles is considered important by EBSA, in that limited resources (e.g. staff and finance) are available within the EBSA, which constrains its ability to undertake large numbers of investigation and monitor the market very intensively. Mechanism is in place to encourage such voluntary compliance, e.g. a large financial penalty for violation behavior and even criminal law penalties for more serious misconduct, e.g. fraud and embezzlement. Given the highly developed markets in the United States, the supervisory authority is able to operate on a more reactive basis, relying heavily on information disclosure (see Hinz etc. (2005)).

In order to utilize scarce administrative resources efficiently, supervised entities are monitored under three broad risk-based strategies/categories:

- *Effective targeting:* for entities within this category, there is some indication that an EBSA violation has occurred or about to occur. Therefore, further investigation needs to be established in order to find out more details and take actions as appropriate.

- *Protecting at-risk populations*: for entities falling in this category, interests of plan members are in significant risk, because of the EBSA violations. Therefore, EBSA needs to take immediate action to address the issue and solve the problem as quickly as possible so as to minimize the losses of plan members.

- *Deterring violations:* the EBSA seeks to deter rules-violation behavior through a range of means, e.g. increasing awareness of EBSA rules and principles among the public, publication of violated cases.

Each year, EBSA launches "national plans" – i.e. projects which the EBSA believes are the most important and relevant for the year, typically compliance issues. In principle "national projects" apply to the whole country, however given the diversity in terms of size and type of pension plans in the US and the local specific conditions, regional offices of EBSA are allowed to adjust the "national plans" and have their own "regional plans", (which are submitted to the EBSA's headquarters for approval). Such flexibility is mainly due to the consideration of different characteristics observed in different regions, e.g. the New York region features many large retirement plans, while the Kansas City region has many small plans, which justifies necessary modification of the "national projects" in order to better meet the local needs. It is noted that some "national plans" may originate from the "regional plans", i.e. as a large expansion of a successful regional project.

d) Collaboration between authorities

Although EBSA is the main regulator and supervisor of the private pension market in the US, several other governmental agencies also play an important role in their respective jurisdictions.

The Internal Revenue Service (IRS) as the national tax agency is also a major supervisor of the US private pension market, e.g. the 401(k) plans. Its role largely arises from the fact that qualified retirement plans in the US are entitled to significant tax relief. Indeed it has been argued that retirement plans are the largest legal tax shelter in the country. The Office of Employee Plan (EP) established within IRS is in charge of supervision and enforcement of relative tax laws and the Internal Revenue Code. A formal monitoring mechanism is in place to facilitate supervision, known as the "LUQ" - that is returns are scrutinized to determine if an item is Large, Unusual or Questionable. Any item indentified as a potential LUQ will be subject to further investigation and actions are undertaken if necessary.

Financial regulators: Financial market players, e.g. banks, insurance companies are essential in ensuring an efficient running of the private pension system, given their different functions as financial service providers. Regulatory framework of the US financial markets features de-centralization at both sectoral and geographical levels. For example, the Securities and Exchange Commission (SEC) is the national securities regulator, supervising securities companies, investment funds. However, securities companies are also subject to state securities regulators at the same time. Concerning the insurance industry, there is no federal regulator, as the supervision activities are achieved and conducted at the state level.

Procedures for collaboration between different agencies in the context of private pension market supervision are formally written down in the ERISA Law of 1974, which specifies the different roles played by the Department of Labor (i.e. EBSA), the IRS and the Pension Benefit Guaranty Corporation (PBGC). The EBSA is mainly responsible for the supervision of retirement plans in terms of fiduciary responsibility, information disclosure and reporting, while the IRA is largely concerned with tax related issues (e.g. whether tax claims have been valid). The PBGC, as the guarantee scheme of last resort, for is in charge of continuing pension payments to those DB plan members whose sponsors went bankrupt whilst the pension plan was underfunded.

C. The United Kingdom

The private pension system in the UK has become an important component of the overall pension system. The typical form is the occupational pension plan, but personal pension arrangements have also witnessed rapid growth in recent years. As of 2006, the number of pension funds was around 86,000, of which 87% members were in large DB plans (i.e. more than 1000 members). Total assets of autonomous pension funds were approximately GBP 994 billion in 2006 (US$1942bn), which accounted for 77% of GDP.

In general, the private pension system in the UK is subject to regulation of two authorities, i.e. The Pensions Regulator (TPR) and the Financial Services Authorities (FSA). TPR is mainly responsible for the supervision of work-based pension schemes, with a focus on employers and trustees, while FSA's supervision is mainly focused on the financial services providers related to both occupational and individual pensions. As a fully integrated financial regulator, the FSA is responsible for regulation and supervision of the UK financial markets, including banks, asset managers, insurance companies, etc.

The Pensions Regulator (TPR)

The UK occupational pension supervisory structure features a specialized regulator, i.e. The Pensions Regulator (TPR). TPR was established under the Pensions Act 2004 and replaces the previous regulator, i.e. Occupational Pensions Regulatory Authority (Opra). Upon its foundation, TPR was given extended powers to allow it adopt a specifically risk-based supervisory approach. Meanwhile, the pension protection fund (PPF) was launched at the same year as an insurance fund of last resort in the case of the failure of

plan sponsors with underfunded pension schemes. The PPF is funded by a risk-based levy paid by the participating pension schemes.

a) Organisational structure

According to the Pensions Act 2004, TPR Board comprises a chairperson, the Chief Executive, and at least five other persons. The chairperson and the five other members are appointed by the Secretary of State for Work and Pensions. The Board currently consists of the chairperson, five non-executive members, the Chief Executive and three executive directors.

TPR is organized into three functional areas. Function 1 is business delivery, which comprises corporate risk management, customer support and project implementation, etc., Function 2 relates to strategic development, comprising DB schemes, research, determinations panel support and DC schemes, etc., while Function 3 concerns business support, e.g. finance, human resources, information management.

TPR is funded by the Department for Work and Pensions (DWP) through grant-in-aid, and its running costs are recovered by a general levy imposed on pension schemes.

b) Regulatory Functions and Licensing Approach

In the UK the Department of Work and Pensions (DWP) is primarily responsible for setting pension regulation. The Pensions Regulator does not have the power to make secondary legislation but does issue codes of practice and publishes the DWP's legislation online. In addition guidance or updated/amended information is sometimes published alongside a code of practice, if it is felt this would help to explain TPR's approach further.

Licensing is not required for pension schemes in the United Kingdom. However, certain types of pension schemes need to register with The Pensions Regulator (TPR) and HM Revenue & Customs (HMRC) in order to receive tax benefits. Governing documents, (such as the trust deed, the scheme rules or in the case of contract-based schemes, the contract between the employee and the pension provider), need not be submitted as part of the registration process. Information on risk management, modeling techniques or internal control mechanisms can appear in the submitted document but it is dependent upon the scheme type, the contracts that have been put in place and whether the scheme has been set up under trust or by contract. A funding policy must be in place at the outset of the scheme, but it is not examined by the Pensions Regulator as part of the registration process.

Although trustees in the UK do not need to receive formal approval from TPR to start operations, the Pensions Act 2004 includes terms which require trustees to have knowledge and understanding of the Act in relation to pensions and trusts, as well as the principles concerning the funding of pension schemes and the investment of scheme assets. In addition the Act also requires trustees to be familiar with certain important scheme related documents, e.g. the trust deed and rules, the statement of investment principles (it should be noted, however, that the above requirements do not apply to the trustees of schemes with less than 12 members). In order to assist trustees to understand better the above issues, TPR designed an online learning tool, i.e. trustee toolkit, which has been considered highly useful by the trustees who used this material.

De-registering a pension scheme is not allowable from the Pensions Registry, which houses all pension schemes for whom a levy[16] is payable and also acts as a source of information for members

[16] This levy refers to the general TPR levy and the PPF administration levy, while PPF is in charge of the Pension Protection Levy.

making enquiries and seeking to trace the whereabouts of their pension entitlement. As a consequence, once a pension scheme has been registered it remains on the register and amendments to the original registration occur as and when required. Regarding registration with HMRC, a scheme may be de-registered only when HMRC believe that the scheme administrator has failed to pay a substantial amount of tax or, interest on tax, for which they are liable, or the scheme has made "scheme chargeable payments" and the total of these in any 12 month period exceeds the "de-registration threshold", among other reasons.

As in other the other 'Anglo-Saxon countries', the UK adopts an open, prudent person approach to investment regulation rather than imposing quantitative investment limits. Pension trustees in the UK can invest pension assets in almost all asset classes and financial instruments as long as they believe such investment is conducted in the best interest of scheme members and beneficiaries. In this regard, it is the decision making process or investment procedure which is more important than investment outcomes.

c) Supervisory approach

The main objectives of the Regulator in exercising its functions are:

a) to protect the benefits under occupational pension schemes of, or in respect of, members of such schemes;

b) to protect the benefits under personal pension schemes of, or in respect of, members of such schemes;

c) to reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund; and

d) to promote, and to improve understanding of, the good administration of work-based pension schemes.

Though operating as a specialized agency, the supervisory approach of the TPR is similar to that of APRA in Australia, in that communication and deterrent are the main supervisory tools used. Again this is consistent with the highly competitive and developed pensions market in the UK, which also relies heavily on trustees[17].

TPR have implemented the risk-based supervisory approach since its inception in 2005. The approach is designed along two dimensions, i.e. level of risk and scheme size. According to the current 'risk and intervention' model, schemes are considered as "small" if there are less than 1,000 participating members, while they are considered as "large" if the number of members is greater than 1,000. Meanwhile, "risk" is defined as the negative impact of the failure of a scheme on the member and the market.

As shown in the chart below, an intervention matrix is presented, which comprises four scenarios (of three different levels of risk intensity). It is used by TPR to prioritize and allocate resources according to risk.

Intelligence-based action refers to the scenario where risk is high but the scheme size is small. The corresponding overall level of risk is "medium intensity". Under this category, small schemes face high risk, (such as inaccurate financial reports or misconduct of a member of the top management). This kind of malpractices can be revealed by the supervisor's own intelligence-gathering activities, or communication

[17] Again for a discussion of the different approaches to pension supervision see Hinz and Mataoanu (2005), Madero and Lumpkin (2007).

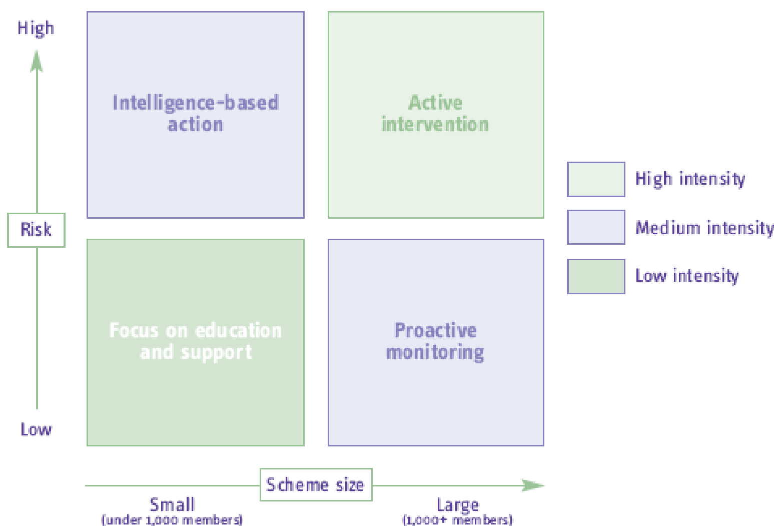
between supervisors and employees/employers. In this case, TPR normally will raise the concerns to the relevant schemes directly and ask them to address the issues immediately and properly. In addition, if necessary, before allocating more sources and taking specific actions, TPR may conduct further investigation in order to get a clearer picture regarding what is happing with the particular schemes.

"Proactive monitoring" is the opposite quadrant along the diagonal to the "intelligence-based action". In terms of the two dimensions, "risk" is low, while "the scheme size" is large. Although the overall level of risk is the same as the above category, i.e. both are of "medium intensity", with schemes failing in this category potentially needing more proactive responses from TPR, as the size of the schemes implies a bigger potential impact. In this context, TPR may require concerned schemes to submit more specific (unpublished) information, conduct detailed investigation via on-site visit, etc.

To the left side of "proactive monitoring" is the "focus on education and support" quadrant. For schemes failing in the category, minimal scheme specific actions are needed. In other words, the main responsibility of TPR is to educate trustees and scheme sponsors, and provide necessary assistance in running the schemes, e.g. by providing codes of practices, necessary training courses, and policy advices. Nevertheless, TPR still needs to maintain regulator contact with the schemes, and keep them updated of new developments concerning regulatory environment.

The last category is "active intervention", which is located at the top right corner of the matrix. Schemes within this scheme face significant risk which requires TPR to take immediate actions, e.g. direct communication with employers and trustees, freezing assets. Failure of the schemes poses considerable risk not only because of severity of the risk, but also because of the large number of members involved.

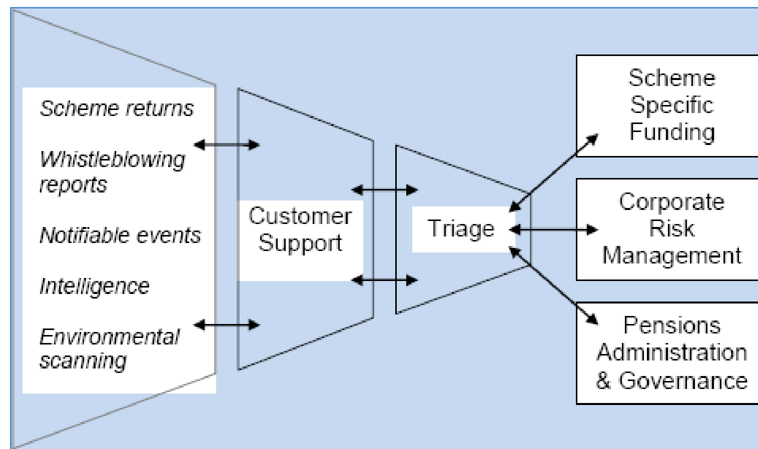
Chart 4 TPR's "risk and intervention" model



Source: TPR (2007a)

TPR adopts a 'triage' approach to organize its workflow and identify the appropriate supervisory response. High risk work is channeled into one of three regulatory practices, with the role of triage being to manage the flow of work between these practices.

Chart 5: TRP Triage System



Source: Stewart (2007)

d) Collaboration between authorities

The Financial Services Authority (FSA). FSA as the integrated financial section regulator is in charge of both prudential and conduct supervision of the UK financial services industry. In this regard the FSA plays an important role in the pension market in that it is the main regulator of the financial institutions that provide pension related services, therefore implying a regulatory overlap between FSA and TPR. This is particularly the case when group personal pensions are involved (group personal pensions are offered by employers who in turn make regulator contributions, though the contractual relation is between member and service provider). In view of this issue, TPR and FSA set up a formal mechanism to collaborate and liaise, which is underpinned by the signing of a MoU (2007b) and the releasing of "a guide on the regulation of work place contract-based pensions" (2007c), which clearly sets up the division of responsibilities between the two supervisors. According to this guide, for group personal pensions both the FSA and TPR have regulatory and supervisory responsibility, although with different focuses. In other words, FSA supervises the market with focus on service providers, while TPR with focus on employers. Therefore, when a particular issue emerges, either FSA or TPR takes a lead depending on the nature of the problem.

Department of Work and Pensions (DWP) and the Pension Protection Fund (PPF). DWP provides the overarching regulatory and legal framework that governs the operation of TPR and PPF, while PPF is established an insurance fund of last resort when a plan sponsor with an underfunded pension schemes goes into bankruptcy. In order to facilitate better understanding about regulatory responsibilities between them, a trilateral MOU was signed in 2008.

D. Hong Kong China

HK China's mandatory DC occupational pension system (i.e. mandatory provident fund system) started operating in 2000. Three types of pension schemes currently exist, i.e. employer-sponsored schemes (i.e. occupational mandatory provident fund schemes sponsored by a single employer and/or its associated companies), industry schemes (i.e. schemes established for particular industries), and master trust schemes (i.e. schemes which more than one employer can join). As of April 2008 there were 35 master trust schemes, two industry schemes and two employer sponsored schemes in HK China. The MPF assets under

management were just under HKD 250 billion as of March 2008. Some voluntary occupational retirement schemes (ORSO) which were set up before the MPF reforms also continue to operate.

The Mandatory Provident Fund Schemes Authority

The HK private pension supervisory structure features a separate agency, i.e. the HK Mandatory Provident Fund Schemes Authority (MPFA), which is responsible for regulating and supervising the mandatory provident fund system and the occupational retirement schemes (ORSO schemes) in HK. However, the MPFA also maintains close working relationship with other HK financial regulators, e.g. HK Monetary Authority, Insurance Authority, and Securities and Futures Commission, on cross industry issues.

a) Organizational structure

The MPFA was established in 1998 under the Mandatory Provident Fund Schemes Ordinance (MPFSO), forming an important component of the late 90s pension system reforms. The MPFA is directly overseen by the Government of the HK Special Administrative Region (HKSAR).

The governing body of the MPFA is the Management Board which currently comprises 11 non-executive directors (one of whom is appointed as the Chairperson of the Management Board), and five executive director (one acting as the Managing Director and vice Chairperson). All board members are appointed by the Chief Executive of the HKSAR. According to current legislation, the MPFA should consist of at least 10 directors, of which not fewer than four are executive directors, and a majority should be non-executive directors.

There are five divisions with the MPFA which are organized by function: supervision division, enforcement division, regulation and policy division, external affairs division, and corporate services division. The supervision division, for example, is responsible for the approval/registration and supervision of trustees, service providers and investment products, whilst the regulation and policy division is mainly concerned with policy development and legislative issues.

In addition, several committees have been set up to support certain functions of the MPFA, e.g. finance, auditing. Meanwhile, statutory advisory committees and statutory appeal boards were established to assist in advising the MPFA on issues such as strategic planning and daily operation, and in case of appeals against the decisions made by the MPFA, respectively.

Currently the total number of staff in the MPFA is more than 500. When the MPFA was created, it was financed by the HK government through a one-off grant of HKD 5 billion to meet the setting-up and running costs. However, it is expected that over the long-term, the authority will become self-financing, for example by fees and charges paid by the supervised entities and investment returns on the initial grant.

b) Regulatory Functions and Licensing Approach

The Financial Services and the Treasury Bureau is primarily responsible for setting pension regulation in HK. In line with the MPF legislation, the MPFA does have some regulatory discretions (such as setting credit ratings or approving stock exchanges for investment purposes) and may issue guidelines for the guidance of approved trustees, service providers, participating employers and their employees, self-employed persons and other persons concerned. A guideline may consist of a code, standard, rule, specification or provision relating to the provident fund scheme or a class of such schemes.

All MPF schemes in HK China have to be established under a trust with trustees approved by the MPFA. In this context, trustees can be corporate trustees or individual trustees (although no individuals

have sought approval to date). In order to be granted approval, applicants must meet strict requirements in terms of capital adequacy, governance structure and internal risk control mechanism etc. For example, a registered trust company incorporated in HK and a company incorporated outside HK must have a paid-up share capital of at least HKD 150 Million, own net assets of at least the same amount, and own assets held in HK to the value of at least HKD 15 Million. Meanwhile, in order to meet the potential losses suffered by the beneficiaries (e.g. due to misfeasance or illegal conduct of the trustees or their service providers) 0.03% of the MPF assets are deducted from the scheme assets as a compensation fund levy.

In addition to the licensing of the trustees, MPF schemes and funds are also subject to registration or approval from MPFA. When conducting its assessment, the MPFA takes into account a range of factors, including scheme rules, operation procedures, investment policies and strategies.

In terms of investment regulation, quantitative investment regulations apply to mandatory provident funds in HK China. For example, the total amount invested in securities and permissible investment products issued by any one company should not exceed 10% of the total assets of an MPF fund. Meanwhile, the funds of an MPF scheme may be deposited with eligible banks subject to the spread of investments as specified in the relevant legislation, and the total assets of an MPF scheme must maintain at least 30% Hong Kong dollar currency exposure.

c) Supervisory approach

As the regulator of the MPF system and the Registrar of ORSO schemes, the MPFA's main responsibilities are to approve applications from MPF trustees and to supervise these trustees, to oversee MPF products and MPF intermediaries to ensure efficient and effective operation of the MPF system by working with other financial regulators, and to supervise the operation of ORSO schemes.

The MPFA adopts a risk-based approach when supervising the pension trustees. Given this supervisory framework, the MPFA allocates its resources (e.g. finance, staff) appropriate to the risk imposed by trustees to the scheme members and the market in general. In other words, schemes which have demonstrated the most significant risks will receive greatest attention from the MPFA, e.g. via more information gathering and analysis, frequent communication between the authorities and trustees, employees and employers.

In general, the MPFA undertakes proactive inspection of trustees, which is achieved either through on-site visits or off-site monitoring. In this regard, data collection is of crucial importance in assisting the MPFA to assess the performance of trustees, who are required to submit important financial information, e.g. returns, audited financial statements regularly, i.e. monthly, quarterly and annually. In addition, the MPFA staff visits trustees on a regular basis. The main purpose is to review the performance and situation of the trustees, with an aim to ensure compliance with relevant regulations and address issues and developments of interest. The supervisory approach is more interactive than some countries (i.e. data is collected more regularly and inspections undertaken more frequently), largely driven by the fact that the MPFA has less entities to oversee, and the system being mandatory[18]. As of April 2008 there were 19 approved trustees.

d) Collaboration between authorities

The HK financial markets are subject to regulation and supervision of three separate agencies, which reflects the decentralized financial regulation approach adopted in HK. The three agencies are:

[18] For a comparison of supervisory approaches, see IOPS (2008).

a) HK Monetary Authority (HKMA), as the de facto central bank in HK, responsible for maintaining general monetary stability and effective working of the banking system;

b) Office of the Commissioner of Insurance (OCI), responsible for supervising the HK insurance market; The Office is headed by the Commissioner of Insurance who has been appointed as the Insurance Authority (IA);

c) Securities and Futures Commission (SFC), as the independent non-governmental agency, responsible for regulating the securities and futures markets in HK.

Given the fact that most service providers of the MPF scheme are from the banking, insurance or securities industry, it is of crucial importance to have a proper collaboration mechanism in place. Therefore, in June 1999, a Memorandum of Understanding Concerning the Regulation of Mandatory Provident Fund Products was entered into by the MPFA and the SFC to set out in broad terms their respective responsibilities regarding the regulation of MPF products and their operators. The Memorandum of Understanding was updated in April 2003 mainly to reflect the changes in the Securities and Futures legislation. In October 1999, a Memorandum of Understanding Concerning the Regulation of MPF Intermediaries was entered into by the MPFA, HKMA, IA and SFC to set out in broad terms their respective responsibilities in the regulation of MPF intermediaries.

In April 2004, a Memorandum of Understanding between the MPFA and the IA was signed to strengthen the co-ordination of supervisory efforts between the two authorities concerning financial entities with insurance and MPF businesses.

E. Chile

The Chilean pension system was radically reformed in the 1980s, when the authorities decided to privatize the system by introducing a mandatory personal account for each member. The reform has been argued to be a success, with many other countries in both Latin American and in other regions following suit with privatization of their respective systems.

The current private pension market in Chile is served by specialized professional pension fund administrators (i.e. AFPs). The AFP is separate from the funds it administers, and solely responsible for collecting pension contributions, managing investment of the assets and paying out pensions to retired members, etc. Each AFP is allowed to offer five types of pension fund from which pension members can choose. These pension funds are mainly differentiated by its risk-return profiles in order to meet demands of members of different risk preferences.

In addition, the Chilean securities and insurance market is subject to supervision of the Superintendencia de Valores y Seguros – SVS, which as an autonomous agency is accountable for the Chilean Ministry of Finance.

Administradoras de Fondos de Pensiones (AFPs)

The regulator of the Chilean private pension market is the Superintendency of Pension Fund Administrators (SAFP), which as a public agency is in charge of supervising AFPs, e.g. granting licenses, issuing directives, and levying fines for any misconduct.

a) Organizational structure

The SAFP was established in 1980 as an important part of the overall pension reform package. As an autonomous agency, it is answerable to the Ministry of Labour and Social Provision, and financed by the

fiscal budget rather than charging a levy to industry as in other countries. The SAFP is headed by the Superintendent who is appointed by the President and responsible for leadership and overall performance and operation of the organization. Currently a board structure, which is common in other countries, does not operate in Chile. However, when dealing with the daily operational issues, the Superintendent is supported by the Management coordinators and Communications officers, which are directly under the Superintendent Office.

The SAFP is divided into seven departments by function, i.e. collection and transfers, investments, payment of benefits, legal, studies, medical commissions, and support. The first three departments correspond to the three typical stages relating to the life cycle of a pensioner, while another four departments are mainly concerned about other activities which are of importance and support efficient and effective supervision. The SAFP employs more than 100 employees, including professionals (e.g. lawyers, auditors) as well as investigators.

Along with the process of moving towards risk-based supervisory approach, the SAFP is considering reorganizing its internal structure in order to better meet higher demands for efficient supervision (Jáuregui 2008). Considerations include a reduction in the number of lines of business, the establishment of an investment advisory board and the creation of several high-level positions, etc.

b) Regulatory Functions and Licensing Approach

Unlike the other countries surveyed in this report, it is the Supervisory authority in Chile which is primarily responsible for setting pension legislation. Administrative norms, called circulars, are published by the Superintendence. The Superintendence also writes Secondary Regulation ("Reglamento"), but these have to be approved and signed by the Labor Ministry.

Strict licensing requirements apply in Chile when financial institutions intend to operate as an AFP, i.e. to serve as professional pension fund managers. Among others, such requirements include capitalization, insurance protection and fit and proper tests for management personnel. Any merger and acquisition of existing AFPs need to be approved by the SAFP. Meanwhile, if a SAFP notices any irregularities occurring in an AFP, which it believes is not of compliance with the relevant legislations, the SAFP is empowered to request the AFP to undertake corrective actions. If the severity of the problem is significant, the SAFP is also authorized to revoke the license, thus stopping further operation of this entity in the Chilean pension market.

In terms of investment regulation, quantitative investment regulations still apply to mandatory provident funds in Chile. For example, according to the latest pension law passed in 2002, AFPs are allowed to operate four different pension funds, which are differentiated by the proportion of their portfolio invested in equities and fixed income securities, i.e. funds B (up to 60% in equities), C (up to 40% in equities), D (up to 20% in equities), and E (equities are not allowed). AFPs may also offer an additional fund A (up to 80% in equities). Meanwhile, pension funds in Chile should not invest more than 40% of their assets in foreign assets, and there are also detailed and strict rules on investment in single issuer and/or issue and self investment (OECD 2008). However, the regulatory regime in Chile has been subject to gradual liberalization since inception of the new pension system in 1980. For example, investment in foreign assets was initially not allowed, but now as stated earlier, the limit has been increased to 40%. It is understood that this limit is likely to be raised in the future when external environments and conditions are ready.

c) Supervisory approach

As a specialized pension supervisor, the central mission of the SAFP is to monitor and oversee the Chilean private pension system, and particularly is responsible for ensuring a smooth running and reliable operation of the AFPs.

Generally speaking the Chilean pension market is subject to relatively strict regulation. In this regard the SAFP closely monitors the operation and performance of each AFP, in order to ensure compliance with the existing rules and regulations. For example, SAFP collects information and data related to AFPs on both a regular basis (including daily) and on ad hoc basis – which typically becomes necessary when the SAFP notices a market irregular behavior related to an AFP. Moreover, the SAFP is even directly involved with investment issues relating to each AFP, for example is in charge of approving what types of investment products can be included in the pension portfolio, and what is the investment limit, particularly related to the high risk asset classes (e.g. foreign assets and real estate).

It has been argued that such a level of intensity of supervision is feasible for the Chilean system, given that there are only a few supervised entities (currently six AFPs are operated in Chile). For countries where there are hundreds (even more) market participants, such intensive supervision is not practically workable, largely due to constraints on administrative and supervisory capabilities. The Chilean system is also mandatory, requiring greater protection and the less developed capital and financial markets in the country (certainly when the pension system started to operate) also imply a greater level of supervisory oversight (see Hinz etc. (2005)).

Before undertaking business AFPs apply to the SATP and are only licensed after meeting strict requirements. Due to the intensive reporting and supervisory involvement, communication between the SATP and AFPs is typically less intensive than in other countries. In other words, AFPs submit their requested information regularly. Afterwards, SATP will send a directive if necessary. The SATP is empowered with more enforcement and punitative powers than authorities in some other countries (such as in the United States – see Hinz etc. (2005)). For example, for any non compliance behavior, actions the SATP is authorized to take include imposing a fine (which is done more regularly than in other counties – see IOPS(2008)) and disallowing the operations of an AFP.

Since 2007, the SATP has been working to introduce a risk-based system with risk scoring features. The main motivations include the agency's desire to be forward looking, to investigate the root as well as the consequence of problems, and to adapt to the increasing complexity of the financial markets (Jáuregui 2008).

d) Collaboration between authorities

The SATP as the specialized pension supervisor in Chile is exclusively responsible for supervision of the ATPs. Meanwhile, the Superintendencia de Valores y Seguros – SVS (i.e. the Chilean securities and insurance regulator) also plays a role in that both securities and insurance markets are heavily involved in pension fund management. Therefore the health of the securities and insurance markets is important for ATPs and the private pension market in general. Currently there is no formal collaboration agreement between the SAFP and SVS regarding supervision of the private pension market.

F. Poland

Poland started to reform its pension system in 1999, largely influenced by the Chilean pension reform in early 1980s. The new system features a multi-tier structure. The first tier comprises notional accounts in a state run pay-as-you-go system. The second tier consists of mandatory individual accounts or Open Pension Funds (OFEs), whilst the third tier is made up of voluntary employee's pension accounts, i.e.

Employee Pension Plans (PPEs). In addition voluntary personal pensions (i.e. IKEs) were introduced in 2004. OPFs are managed by professional pension management companies, known as PTEs in Poland, while PPEs and IKEs are managed by a wider range of financial institutions, including banks and insurance companies. PPEs established for big companies or a group of companies can also be structured as Employee Pension Funds managed by a designated manager.

Initially, the private pension market in Poland was supervised by a specialized agency, i.e. The Superintendency of Pension Funds (UNFE), which was merged with the insurance supervisor to form the Insurance and Pension Fund Supervision (Knife) in 2002. However, in 2006 the Polish government decided to transfer supervisory responsibilities of Knife to the integrated financial regulator, i.e. Polish Financial Supervision Authority (PFSA).

Polish Financial Supervision Authority

PFSA was created under the Act of July 21st 2006 on Financial Market Supervision, and is in charge of supervision of the whole financial market in Poland, including securities, investment fund, pensions and insurance markets, etc. In January 2008, supervisory responsibility for banking supervision was also transferred to FSA from the former banking supervisor, i.e. the Banking Supervisory Commission.

a) Organizational structure

According to the 2006 Act on Financial Market Supervision, the PFSA board consists of a Chairperson, two Vice-Chairpersons and four members (one representative of the finance ministry, one representative of the ministry in charge of labour and social policy issues, the Governor/Deputy Governor of the National Bank of Poland, and a representative of the President of Poland). The Chairperson of PFSA is appointed by the President of the Polish Council of Ministers, while the two Vice-Chairpersons are also appointed by the President but under request from the Chairperson. As head of the organization, the Chairperson is responsible for the overall running and operation of the PFSA.

The PFSA is structured into seven directorates largely arranged by sector. Specifically, four directorates are dedicated to insurance, pension, banking, and capital markets, respectively. Within each of these four directorates, separate supervision and investigation departments exit. For example, the activities of the Directorate of Pension Supervision are served by three departments, i.e. Pension Legal Supervision Department, Pension Investments Supervision Department and Occupational Pension Plans Department. In addition three other directorates with general functions also operate – i.e. law and legislation, administration, and financial market development and cross-sector policy.

Operational expenses of PFSA are fully financed by fees charged to the supervised entities, although they are included in the annual state budget.

b) Regulatory Functions and Licensing Approach

As with other Central and Eastern European supervisory authorities overseeing mandatory, individual account systems, the PFSA has a relatively intensive approach to pension regulation and supervision. Some quantitative investment restrictions are still in place and the licensing procedures are strict. Information is provided to the supervisory authority on a daily basis and all pension entities are inspected regularly.

Parliament, the Council of Ministers, the Ministry of Finance, and the Ministry of Labour and Social Policy are primarily responsible for setting pension legislation in Poland. Meanwhile, the supervisory authority can issue regulations at the ministerial level. Nevertheless, the Polish Law on Financial Market Supervision states that PFSA's responsibilities comprise, inter alia, "participating in the preparation of drafts of legal acts related to financial market supervision". In addition, the same law also envisages that

"Within the scope of its competence the PFSA shall adopt resolutions and issue administrative decisions and rulings defined in other laws". This applies to the pension regulations as well. Therefore, PFSA plays a role in drafting fundamental laws and in their implementation through lower level regulations and administrative decisions.

Both OFEs and PPEs organized in the form of a pension fund must be licensed by the PFSA to start operation. In order to receive a license, applicants must meet certain requirements set by the authorities. For example, the submission of a business plan is required, and this document plays an important role in helping the PFSA in their decision of whether to issue a license or not. In addition, a minimum capital requirement is Euro 5 million for OFESs and Euro 125,000 for PPEs (in the form of an Employee Pension Fund) applies. For the managing companies of OFEs or PPEs (in the form of an Employee Pension Fund) the following bodies should exist: a management board, a supervisory board and a general meeting. Regarding the management board, for OFEs managing companies, members are appointed and recalled by the general meeting, while, where PPEs are concerned, they are appointed and recalled by the Supervisory Board. Meanwhile, the all board members should meet "fit and proper" requirements on expertise, experience, etc.

A license is required to start pension operation in Poland. A license will be issued to the applicants unless the authority believes that a) the application and related documents fail to satisfy the requirements specified in the law, b) they fail to protect the fund members' interests, and c) they do not warrant proper discharge of their duties (KNF 1997). Consequently, there are no specific license renewal procedures. Upon obtaining the license, the institution should then file with the registration court an application requesting that the fund will be entered in the register of funds.

c) Supervisory approach

The key responsibilities of the PFSA on the pension issues included oversee of funds' performances, supervision of employee pension plans, increasing public knowledge and awareness of pension funds, collaboration with other stakeholders to protect member interests. When implementing the relevant legislation, the PFSA has a range of supervisory powers. For example, they could instruct the pension fund managers to make available copies of documents concerning the business of the fund, or call on members of the management board of the funds to supply information needed and explain certain issues upon request. They also have power to enter the premises of pension fund managers and related institutions (e.g. service providers) to access books, documents and other relevant information.

The PFSA adopts a compliance based supervision approach over pension fund issues. The above mentioned law on organization and operation of pension funds regulates in a quite detailed way not only investment rules, but also fees and reporting requirements, which intends to minimize the risks faced by the plan members.

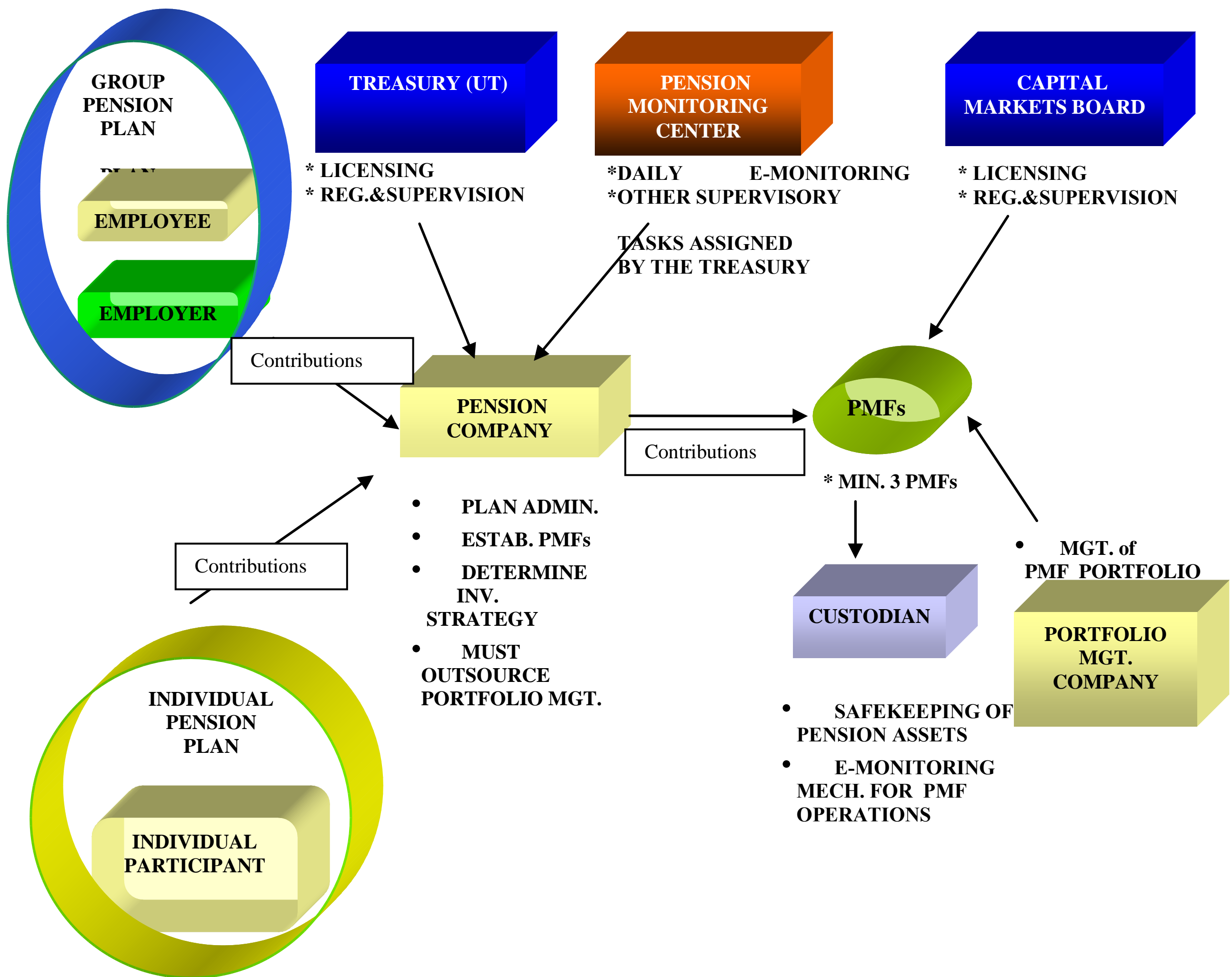
d) Collaboration between authorities

Given that Poland is implementing a fully integrated pension (and financial) supervisory structure, the risk of lack of collaboration between sectoral supervisors previously observed is expected to be minimized. Meanwhile, as noted earlier, the board of PFSA includes, by legislation, representatives from other relevant ministries, (e.g. labour and finance ministries as well as the central bank), which should be helpful in strengthening both the formulation and implementation of relevant pension policy in Poland. Meanwhile, the representative of the President of Poland on the board should be able to play an important mediating role when disputes occur between governmental agencies.

G. Turkey

Reform of the Turkish pension system started in 2001, when it was decided to introduce voluntary and defined contribution based private pensions under the Individual Retirement Law. This personal private pension system is aimed to complement the state run pay as you go public pensions which were viewed as unsustainable in the long run. In this regard, pension companies were created to administer private pension assets. The main regulator of private pensions in Turkey is the Undersecretariat of Treasury (UT), which covers the regulation and supervision of both insurance and private pensions, in addition to other relevant regulatory responsibilities. Meanwhile, the Capital Markets Board (CMB) of Turkey also plays an important role in supervising private pension funds, in that as the regulator of securities markets and banking sector, CMB oversees the operation of pension mutual funds to which pension assets are required to be contributed, (a feature of the 2001 pension reform). As of end of 2006 there were 11 pension companies, and 103 pension mutual funds operating in Turkey (Olgac 2006).

The following illustration provides an overview of the functioning and the supervisory structure of the Turkish personal private pension system.



Source: Undersecretariat of Treasury

Undersecretariate of Treasury (UT)

The Undersecretariat of Treasury (UT) was founded after a governmental restructuring in 1994, and is mainly in charge of public financing (e.g. debt management), economic development, as well as the regulation and supervision of the financial sector in Turkey.

a) Organizational structure

The UT is currently headed by an Undersecretary who is responsible for the daily running and operation of the organization, while the Minister of State, as the most senior politician in this field, is a Cabinet member and also directly reports to the Prime Minister of Turkey. The Undersecretary is assisted by three Deputy Undersecretaries who oversee in total 8 General Directorates, which include the General Directorate of Public Finance, the General Directorate of Insurance etc. Meanwhile, 9 other separate departments (which report directly to the Undersecretary) exist with responsibilities for different activities, including the Internal Audit Department, the Insurance Supervisory Board, etc.

In terms of private pension supervision, General Directorate of Insurance (GDI), and the Pensions Monitoring Center (in Turkish Emeklilik Gözetim Merkezi; in short EGM) are relevant bodies. Loosely speaking, GDI is in charge of both the regulation and supervision of pensions (and insurance) market although with a focus on regulation, while EGM as a purpose-built agency is specifically responsible for supervision and particularly monitoring the operation of the system. The initial setting up costs of the EGM were financed by both UT and its eleven pension companies which received licenses from UT to conduct pensions business. The eleven companies are entitled to equal share ownership of EGM.

b) Regulatory Functions and Licensing Approach

Given the supervisory authority is part of the Ministry, it also has regulatory responsibility in Turkey. The Undersecretariat of Treasury is allowed to publish circulars and rulings. Additionally, the publication of communiqués and regulations are subject to approval by the Minister of State who is the head of the Treasury as a whole.

In order to start operations relating to pensions, two types of licenses are required from the UT. The first is an authorization which is needed for an applicant to become a pension company, while the second is an operating license, which is needed for the pension company to commence operation in Turkey. In both cases, applicants should submit relevant documents and meet certain requirements in order to receive approval. For example, the governing plan document must be submitted with the application for an establishment permit. This must state the business purpose, areas of operation and capital structure of the firm. After receiving licenses from the UT, pension companies should also apply for establishment permit from the CMB for the operation of pension mutual funds.

It is specified that the pension company must have a board of directors and a supervisory board, as these are incorporated as joint stock companies. The pension company should have at least one person (or a committee) responsible for internal control and supervision, and there should also be an investment committee, which deals with the investment strategies and operations of the pension mutual funds established by that pension company. Concerning capital adequacy requirement, pension companies should have a paid-in capital of at least 10,000,000 YTL with an additional 10,000,000 YTL to be paid within 3 years. Proof that these requirements have been met must be shown during the application for the operating license.

The authorization becomes invalid if the pension company does not apply for the operating license within 1 year following the issuance of the authorization. The Minister of State (whom the Treasury reports to) has the authority to call for the liquidation of the pension company in case of continuity of financial troubles of the Company.

Pension investment used to be subject to stricter quantitative restrictions in Turkey. However, the key restrictions have been gradually removed and nowadays the pension fund investment regime is quite liberal compared to some other OECD countries. In particular, in 2007 the cap of 15 % on the foreign investment instruments and the floor of 24% on government bonds were removed. Two of the few restrictions which are currently in place are the 10% cap for bank deposits and the 10% cap for loans borrowed by plan members or others.

c) Supervisory approach

General Directorate of Insurance (GDI)

GDI is empowered with both regulatory and supervisory responsibilities in terms of the private pension market. In this regard, one of their most important supervisory activities is to approve the establishment of and grant licenses to pension companies, which are the only eligible institutions to operate private pension businesses after the 2001 reform. Currently, there are 11 pension companies in Turkey. In order to receive a license in Turkey, pension companies are required to meet strict criteria, including capital adequacy, staff capability, and internal auditing&risk management mechanisms, etc. Meanwhile, each pension company has to offer at least three different types of pension mutual funds to their pension plan participants. The pension mutual funds should be designed in a way which reflects different risk and return profiles in order to meet varying risk preferences of participants. The GDI, assisted by inspection reports carried out and submitted by the Insurance Supervisory Board, conducts off-site supervision as well as on-site visits. The main purpose of on-site visits are to ensure the company meets the requirements stipulated in the relevant legislation, has sufficient capital and resources to cover its liabilities, directors and managers are fit and proper, etc.

To enforce implementation of the relevant legislation, UT is authorized to issue directives, to change the composition of the Board of the pension fund companies, and to issue fines, etc.

Pension Monitoring Center (in Turkish Emeklilik Gözetim Merkezi; in short EGM)

The EGM is a purpose built supervisory and monitoring agency. It is de facto a central database which stores all relevant and standardized pension information in a national and centralized system. Given the availability of electronic information, the EGM conducts daily monitoring of all pension companies and the entire private pension system. Whenever market irregularities occur, they will either report to GDI or intervene themselves, subject to delegated supervisory authorities.

The legislative and supervisory approach in Turkey can therefore be seen as fairly intensive, given the strict licensing requirements and daily monitoring. Some quantitative investment restrictions are also still in place. Though not overseeing mandatory arrangements, this would seem consistent with the development of a new pension system in a country with developing pension markets.

d) Collaboration between authorities

Capital Markets Board of Turkey (CMB)

CMB is the one of the main financial regulators and supervisors in Turkey, which oversees securities markets and mutual funds (including pension mutual funds). In this regard, CMB is mainly concerned with

compliance and information disclosure issues relating to pension mutual funds offered by pension companies, e.g. whether investment in a certain asset category exceeds the allowable limit and whether the funds are properly organized.

So far there is no formal agreement between CMB and the UT regarding the potential supervisory overlap between the two agencies.

On the other hand, for some cases, the private pension law requires the mutual consent of both institutions. Also, in order to increase supervisory efficiency and coordination between different governmental agencies, an advisory board was set up. The board is composed of high level representatives from Ministry of Finance, Ministry of Labour and Social Security, the Undersecretariat of Treasury and Capital Markets Board. This board is headed by the Undersecretary of Treasury and according to the law the board should meet every 3 months.

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