CHAPTER III

Supervision of pension funds

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1. Review of the first pension funds

2000 was marked by the approval of the first Luxembourg pension funds subject to the Law of 8 June 1999. Three pension funds were approved, one Assep and two Sepcavs[1]. The profiles of the fund promoters were varied:

– one multinational launching a fund for its expatriate staff worldwide;

– an insurance company of a country outside the EU creating a pension scheme for senior executives and to be offered to other companies in the Middle East;

– and an audit company creating a Sepcav initially intended for its Luxembourg partners and managers.

[1] *The* Sepcav *is based on a corporate structure in which affiliate members and beneficiaries are shareholders who receive a capital sum upon their retirement. The* Assep *is based on a partnership structure in which the rights of affiliate members and beneficiaries take the form of a right to future claims which are paid either in the form of a capital sum, or an annuity and where applicable, incidental benefits upon retirement.*

Table of pension funds subject to CSSF supervision

<u>Pension savings associations (Assep)</u>

THE UNILEVER INTERNATIONAL PENSION PLAN,
400, route d'Esch, L-1014 Luxembourg

<u>Pension savings companies with variable capital (Sepcav)</u>

APF INTERNATIONAL, c/o Barnett Waddingham SA,
16, avenue Grand-Duc Jean, L-1842 Howald

KPMG-LOMBARD INTERNATIONAL PENSION SCHEME,
Airport Center, 2, route de Trèves, L-2633 Senningerberg

At present, several applications for approval are being processed and a certain number of other applications are under preparation with service providers. Almost all these projects concern international groups with operating entities in Luxembourg. Starting out from their Luxembourg base, these groups intend to later expand their pension schemes to foreign entities and external companies. Contacts with companies reveal a clear need and heavy demand for new pension and savings products for businesses. While the multinationals are mainly interested in how to deploy Europe-wide instruments, SMEs are more attracted by a pension fund with defined contributions, very often multiple employer funds, offering the employer the benefit of a pre-defined contribution and the scheme member the prospect of a real return on his investment.

Since the law creating the Sepcav and Assep does not prescribe how these pension funds operate in terms of social and prudential structures, or in terms of the representation and running of the different bodies, it enables them to adjust to the foreign regulations of the contributor's country of origin: this is essential, at least in the current phase of harmonising European regulations, with a view to attracting foreign pension undertakings.

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Contacts between the CSSF and fund promoters concerned make it clear that the Sepcav's and Assep's appeal stems from the following combination of factors:

- regarding the management of pension fund assets, the absence of quantitative standards in investment policy and the possibility of providing multiple asset managers as well as the possibility to have access to "pooling" structures;
- the possibility of creating pension funds with several employers but not necessarily through an umbrella-type pension fund,
- the provision of the law on the working and composition of administrative bodies, particularly as regards the representation of contributors,
- the flexibility that the Assep provides in adjusting its commitment when the pension fund is created and during its life.

On the other hand, the law protects the rights of beneficiaries and safeguards future claims:

- Defined benefit schemes must be fully financed at all times. The provisions set aside for current and future benefits must be covered at all times by the value of the assets less any liabilities towards third parties.
- The pension rules must clearly define the rights of the beneficiaries and provide for regular information to be sent to the beneficiaries as to their rights.
- Prudential supervision by a supervisory authority with extensive experience in the financial sector is a further safeguard.

The prospect of receiving a European passport in the mid-term is an additional strength of Luxembourg pension funds.

Marc PAULY

Didier BERGAMO

2. Future developments: a European context marked by the recent draft pension funds directive

A new impetus is spreading within the European Union to tackle pensions, including company pensions. The European Council meeting in Lisbon made company pension institutions within the single market a priority objective.

In October 2000 the European Commission submitted a draft directive aimed at bringing about a minimum alignment between prudential standards, mutual recognition of supervisory authorities and the introduction of a European passport based on the principle of the freedom to provide services. The text of the draft directive reassures the CSSF that the Sepcavs and Asseps will be able to comply with future European legislation without too much difficulty. From a formal standpoint, the legislative amendments that would result from adopting the draft directive in its present form could be easily transferred into the Law of 8 June 1999, albeit partly through a Grand Ducal regulation or CSSF Circular. Such amendments would have no major impact on existing vehicles pending the completion of the single market.

3. Fine-tuning the Luxembourg legal framework

At the beginning of 2000 Grand Ducal regulations were enacted regulating access to the profession of foreign asset manager and foreign liability manager. The main import of these Grand Ducal regulations dated 4 February 2000 was described in the previous CSSF annual report.

In October 2000 the Luxembourg government tabled bill n° 4703 amending certain provisions of the Law of 8 June 1999 to explain and clarify them. The amendments mainly concern the criteria and procedures for approving asset and liability managers and provisions on the publication of the articles of association and rules of pension funds and respective amendments thereto. They also introduce in the text of the bill a definition of the legal mission performed by the liability manager. Other changes are more technical such as allowing for an initial outlay of assets by contributors to enable adequate risk spreading once the fund is formed. Moreover, certain changes are aimed at laying a legal basis for the subsequent adoption of the European directive – currently under review in the Council of Ministers – under national law.

Finally, for the sake of consistency, it is proposed to align certain legal provisions with those of the Law of 30 March 1988 on Undertakings for Collective Investment. These provisions concern the qualifications of independent auditors, the separation of assets within umbrella-type pension funds and the procedure to be followed in the event of liquidation.

4. Principles underlying the prudential approach

The flexibility written into the Law of 8 June 1999 gives the CSSF considerable leeway in the way it conducts its prudential supervisory mission. The CSSF has decided to apply this flexibility in so far as it does not clash with the concern for security, which must prevail over any other consideration. The absence of uniformly applicable rules requires the CSSF to monitor each pension fund almost on an individual basis. Security, financial solvency, profitability and liquidity are objectives that all pension funds must pursue. The attainment of these objectives mainly depends on several key factors: a prudent investment policy and financing plan, and the employer's sound financial status.

Based on the above principles, the approach and requirements of the CSSF are as follows:

a) investment policy

The law does not lay down constraints or quantitative limits in respect of the investment policy and refers to the "collective investment of assets in accordance with the risk spreading principle". However, it has made allowance for the possibility of introducing restrictions on investment identical to those applicable to UCITS under a Grand Ducal regulation. Pending the outcome of the work of the European Commission, the CSSF applies what is commonly called the "prudent man principle". This entails determining on a case by case basis whether the proposed investment policy meets the prudence and risk spreading principles and whether it takes sufficient account of the type and maturity structure of the pension fund commitments.

Pension funds differ fundamentally from investment funds in that they can take a long-term perspective since the possibilities of early withdrawal of funds are strictly limited by the law and the articles of association, and in so far as cash flows on the liabilities side can be planned long in advance. The law enables a pension fund to invest all its assets in an asset-accumulation vehicle (such as a UCITS) provided the latter meets the investment policy that the pension fund

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has set. In practice, the CSSF observes that pension fund promoters tend to align the framing of their investment policy to what is generally applicable in the UCITS sector.

b) financing plan

The calibre of the financing plan is crucial to ensure that the defined benefit scheme (Assep) is able to honour the commitments it has undertaken. In contrast under defined contribution schemes, the financing plan consists of the method used to calculate the contributions together with a forecast of their probable volume and a forecast of the net assets of the pension fund over a five-year period. In simple terms, under defined benefit schemes, the financing plan involves determining the amount of contributions needed using actuarial computations to finance current and future benefits within the pension fund. The law requires that pension fund commitments are fully covered at all times. In other words the provisions for present and future benefits must be covered at all times by the value of the net assets in the pension fund. This constraint has been included in its present form in the draft directive.

c) solvency of the contributing employer

The primary aim of a compound financing scheme such as a pension fund is to protect the acquired rights of the scheme member from the employer's insolvency. However, the employer's solvency remains a necessary condition for the continuous accumulation of rights until retirement, and often essential to sustain the instrument. The CSSF therefore attaches great importance to the quality and financial soundness of the contributing employer.