

CHAPTER IV

SUPERVISION OF PENSION FUNDS



1. Developments in the pension funds sector in 2003
2. Developments in the legal framework

1. Developments in the pension funds sector in 2003

1.1. Pension funds

During 2003, the CSSF authorised three pension funds subject to the law of 8 June 1999 as amended: two pension savings associations (assep) and one pension savings company with variable capital (sepcav):

- ERNST & YOUNG – LOMBARD INTERNATIONAL PENSION SCHEME, constituted in the legal form of a multiple compartment sepcav, was created on the initiative of Ernst & Young S.A., Ernst & Young Tax Advisory Services S.à r.l., Ernst & Young Business Advisory Services S.à r.l., Ernst & Young Resources S.à r.l., Ernst & Young Luxembourg S.A. and Monnet Professional Services S.à r.l.. Its purpose is to organise a pension fund for the employees of the Ernst & Young group in Luxembourg.
- FONDS DE PENSION DU GROUPE SIEMENS A LUXEMBOURG, constituted in the legal form of an assep, was created on the initiative of Groupe Siemens à Luxembourg with the purpose of organising a pension fund for its employees.
- LUXEMBOURG PENSION FUND, constituted in the legal form of a multiple compartment assep, has been created on the initiative of Banque de Luxembourg S.A. and its purpose is to organise a multi-employer pension fund.

The authorisation of these new pension funds raises the number of pension funds subject to the law of 8 June 1999 as amended to ten as at 31 December 2003.

It has to be noted that the growth rate of the pension fund sector is very slow. Half a dozen applications for approval are currently being processed, half of which being pension funds reserved for Luxembourg employers, the others being pension funds designed for international groups.

The impending creation of a single internal market for institutions for occupational retirement provision will hopefully facilitate the setting-up of pan-European pension funds in the medium term. The CSSF expects activities to continue their slow but ongoing pace in 2004.

1.2. Liability managers

Following the registration during 2003 of BÂLOISE VIE Luxembourg S.A., FORTIS LUXEMBOURG-VIE S.A. and HEWITT BACON & WOODROW LIMITED, United Kingdom, on the official list of professionals authorised to act as liability managers for pension funds subject to the law of 8 June 1999 as amended, the number of liability managers of pension funds approved by the CSSF amounted to eleven as at 31 December 2003.

2. Developments in the legal framework

In 2003, no changes have been made to the Luxembourg legal framework regarding sepcavs and asseps.

On an international level, the year 2003 was marked by the adoption of Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision, published in the Official Journal of the European Union of 23 September 2003 No. L 235.

The purpose of the Directive is to:

- create a harmonised prudential framework for the taking-up and pursuit of activities of institutions for occupational retirement provision;
- allow institutions for occupational retirement provision to freely provide their services to companies located in other Member States thanks to the mutual recognition of prudential standards and co-operation mechanisms between competent authorities of the home (where the institution is located) and host (where the company paying contributions is located) Member States.

While the original proposal of the European Commission dates back to October 2000, the Ecofin Council was able to reach an agreement on 13 May 2003 on the Directive on the activities and supervision of institutions for occupational retirement provision as it had been adopted on 12 March 2003 at second reading by the European Parliament. Indeed, the Council accepted all thirteen amendments voted by the European Parliament.

The amendments of the European Parliament notably aimed at emphasising the important role of the institutions for occupational retirement provision to ensure financial cover for retirement and to strengthen the requirements as regards information for members and beneficiaries. They also provide that the European Commission examines the opportuneness to extend the optional application of the Directive to occupational retirement activities performed by other regulated financial institutions. As regards prudential requirements applicable to institutions for occupational retirement provision, the amendments of the European Parliament left the provisions of the Council's common position unchanged.

As soon as the Directive was adopted in June 2003, the works to transpose the Directive into national law began in order to adapt the legal framework applicable to pension funds governed by the law of 8 June 1999 creating pension funds in the form of pension savings companies with variable capital (sepcav) or pension savings associations (assep) as amended to the provisions of Directive 2003/41/EC.

The deadline for the transposition of the Directive into national law is set to 24 months from the date of its publication in the Official Journal of the European Union. Hence, the necessary legislative, regulatory and administrative provisions to comply with the Directive must come into effect on 23 September 2005 at the latest.

2.1. Prudential framework applicable to institutions for occupational retirement provision

The prudential framework introduced by the Directive is very similar to the approach adopted by the law of 8 June 1999 as amended. It imposes a permanent prudential supervision and requires that the institutions for occupational retirement provision hold sufficient assets to cover their commitments. The Directive introduces a certain number of mostly qualitative rules for the calculation of technical provisions, as well as for the definition of investment rules. It also introduces a requirement for additional assets where the institution itself, and not the sponsoring undertaking or a financial institution, covers the biometric risks or guarantees a performance or certain benefits.



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The approach of the Directive for the **calculation of technical provisions** is of a qualitative nature. Technical provisions should be calculated on the basis of recognised actuarial methods and certified by an actuary. The minimum amount of technical provisions should be sufficient for both ongoing benefits to continue to be paid to beneficiaries and to reflect the commitments that arise out of members' accrued pension rights. The economic and actuarial assumptions shall also be chosen prudently, taking account, if applicable, of an appropriate margin for adverse deviation. The interest rate shall be carefully determined by taking into account the return of the corresponding assets held by the institution, as well as the future investment return and/or the yields of high-quality or government bonds. The biometric tables shall be appropriately chosen with regard to the main characteristics of the pension scheme.

The Directive also adopts a mainly qualitative approach to the **investment rules** and which provides that the management of the assets must meet principles of security, quality, liquidity, profitability and diversification. The assets must be invested prudently and in accordance with the commitments made by each fund. The sole quantitative limit concerns the self-investment in the sponsoring undertaking (employer). The Directive sets a ceiling of 5% of the portfolio for investments in the sponsoring undertaking, as well as a ceiling of 10% of the portfolio for investments in the group to which this undertaking belongs, to avoid that the bankruptcy of the sponsoring undertaking has the double effect of depriving the employees of their jobs and jeopardising their pension rights.

The Member States have the possibility to submit the institutions for occupational retirement provision established within their jurisdiction to more detailed investment rules, but must allow these institutions in any case to invest at least 70% of their technical provisions or of their portfolio in shares and corporate bonds and at least 30% in assets denominated in currencies other than those in which the liabilities are expressed.

Finally, the Directive allows the host Member State to require the home Member State to apply certain quantitative rules to assets held by cross-border pension schemes, on the condition that the host Member State applies the same or more stringent rules to its own institutions for occupational retirement provision. These quantitative rules concern investments in assets that are not admitted to trading on a regulated market, investments in assets from the same undertaking or the same group of undertakings and assets denominated in currencies other than those in which the liabilities are expressed.

As regards **minimum funding requirements**, the Directive provides, as a general rule, that the technical provisions be fully covered at any moment by appropriate assets. However, as institutions for occupational retirement provision hold very long-term investments and have low liquidity risks, the Member States can authorise them, for a limited period of time, to depart from this obligation of full funding. Any deviation must be accompanied by a proper plan to restore full funding of the technical provisions. In case of cross-border activities on the territory of another Member State, the technical provisions must be fully funded at any time.

2.2. Freedom to provide services in other EU Member States

The Directive introduces the right for institutions for occupational retirement provision to freely provide their services to undertakings located in other Member States; it also obliges Member States to authorise their undertakings to sponsor institutions for occupational retirement provision set up in other Member States.

It provides a legal basis for notification and co-operation mechanisms between competent authorities regarding cross-border management of pension schemes by the institutions for occupational retirement provision.

Whereas the institutions for occupational retirement provision currently operate mainly in the Member State where they are established, an institution for occupational retirement provision can, following the implementation of the Directive, manage the schemes of companies established in other Member States by applying the prudential regulations of the Member State where it is established. The Directive provides that the social and labour legislation of the host Member States applicable to the relationship between the sponsoring undertaking that contributes to the institution for occupational retirement provision and the members will continue to apply.

Consequently, Luxembourg pension funds will be able to freely provide their services to sponsoring undertakings in other Member States in future and the other Member States must allow their undertakings to use sepcavs and asseps to manage their pension schemes.