



# Recommendation of the Council on Guidelines on Funding and Benefit Security in Occupational Pension Plans

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## Background Information

The Recommendation on Guidelines on Funding and Benefit Security in Occupational Pension Plans was adopted by the OECD Council on 10 May 2007 on proposal of the Insurance and Private Pensions Committee and its Working Party on Private Pensions. The Guidelines, which formed an integral part of the Recommendation, set out good practices in the area of pension funding and benefit security. They covered regulatory issues, such as the valuation of pension liabilities, funding rules, the role of insolvency guarantee arrangements and creditor rights of pension plan beneficiaries in case of insolvency of the company that sponsors the pension plan. The Recommendation was abrogated on 28 June 2012 following the incorporation of the text of the Guidelines in the 2009 OECD Recommendation on the Core Principles of Occupational Pension [[OECD/LEGAL/0373](#)].

**THE COUNCIL,**

**HAVING REGARD** to Articles 1, 3 and 5 b) of the Convention on the Organisation for Economic Co-operation and Development of 14 December 1960;

**HAVING REGARD** to the Recommendation of the Council on Core Principles of Occupational Pension Regulation [C(2004)41], to which this Recommendation is complementary;

**CONSIDERING** that the funding of private pension plans is central for benefit security;

**CONSIDERING** that regulations should encourage prudent levels of funding so as to meet the retirement income objectives of the pension plan;

**CONSIDERING** that the Guidelines presented in the Annex to this Recommendation are based on previous work carried out in this area by the Insurance and Private Pensions Committee and its Working Party on Private Pensions and are complemented by the annotations set out in Appendix II, which may be reviewed as necessary from time to time by the Insurance and Private Pensions Committee;

**CONSIDERING** that the Guidelines address regulatory concerns that arise in the funding of occupational, private pension plans;

**NOTING** that these Guidelines are intended to apply to occupational, private pension plans;

**NOTING** that these Guidelines may also apply to funded, non-occupational plans and funds;

**NOTING** that the Guidelines identify good practices for the regulation of pension funds, where "regulation" is understood to include a broad variety of instruments, e.g. laws; tax requirements; standards set by supervisory authorities; codes of conduct developed by professional associations; collectively bargained agreements and plan documents;

**RECOGNISING** that evolutions of the structure and operation of private pension plans may call for further updating and adaptation of these Guidelines;

**On the proposal of the Insurance and Private Pensions Committee and its Working Party on Private Pensions;**

I. **RECOMMENDS** that Member Countries invite public authorities to ensure an adequate regulation of funding and benefit security in occupational pension plans, having regard to the contents of the Annex to this Recommendation, of which it forms an integral part.

II. **INVITES** Member Countries to disseminate these Guidelines among pension funds.

III. **INVITES** non-members to take account of the terms of this Recommendation and, if appropriate, to adhere to it under conditions to be determined by the Insurance and Private Pensions Committee.

IV. **INSTRUCTS** the Insurance and Private Pensions Committee and its Working Party on Private Pensions to exchange information on progress and experiences with respect to the implementation of this Recommendation, to review that information and to report to the Council not later than three years following its adoption and, as appropriate, thereafter.

## ANNEX

### GUIDELINES ON FUNDING AND BENEFIT SECURITY IN OCCUPATIONAL PENSION PLANS

#### I. Funding of Occupational Pension Plans

- 1.1. Occupational pension plans should be funded.
- 1.2. Occupational defined contribution plans should be funded through the establishment of pension funds, pension insurance contracts or the purchase of other authorised retirement savings products from financial institutions.
- 1.3. Occupational defined benefit plans should in general be funded through the establishment of a pension fund or through an insurance arrangement (or a combination of these mechanisms). Additional protection may be provided through the recognition of creditor rights to the pension fund or the plan members and beneficiaries and, in some cases, through insolvency guaranty schemes that protect pension benefits in the case of insolvency of the plan sponsor or the pension fund.
- 1.4. Private unfunded plans should generally be prohibited. The establishment of an insolvency guaranty scheme should in general be required for occupational defined benefit plans that are financed through the book reserve system.
- 1.5. Insolvency guaranty schemes should rely on appropriate pricing of the insurance provided in order to avoid unwarranted incentives for risk-taking (moral hazard). The level of benefits guaranteed should also be limited.

#### II. Measurement of Occupational Pension Plan Liabilities

- 2.1. Legal provisions<sup>i</sup> should be in place requiring the determination of occupational pension plan liabilities corresponding to the financial commitments or obligations which arise out of the pension arrangement. The ongoing liability is normally defined as the accrued benefit rights of pension plan members and beneficiaries excluding future service but taking into account the projected benefits to be received under estimated retirement, mortality, and early leaver (also known as membership termination or job separation) patterns. The termination liability takes into account the pension benefits accrued if the plan were to be terminated at the time of the valuation.
- 2.2. Any definitions of ongoing and termination liability should reflect any benefit indexation factors prescribed by law or plan terms (unconditional indexation) that apply from membership or plan termination to the annuity starting date and, if relevant, after the annuity starting date, provided that these factors are predictable. These definitions should also reflect benefits that become vested upon plan termination.
- 2.3. These legal provisions should require the use of appropriate calculation methods, including actuarial techniques and amortisation rules that are consistent with generally recognised actuarial standards and methods.
- 2.4. The legal provisions (referencing generally recognised actuarial standards and methods) should require the use of prudent actuarial assumptions which are considered appropriate for the calculation of the pension plan's liabilities. These assumptions would include, among others, the mortality table (representing the assumed level of mortality of plan members and beneficiaries as at the date at which the plan's liabilities are calculated), future trend in mortality (representing permanent changes in mortality that are assumed to occur after the date at which the liabilities are calculated) and retirement and early leaver patterns at different ages (taking into account the actual retirement and early leaver behaviour of those covered by the plan).
- 2.5. The legal provisions (referencing generally recognised actuarial standards and methods) should require the use of prudent discount rates for determining liabilities that are consistent with the methodologies used in the valuation of assets and other economic assumptions. These legal provisions (or the actuarial profession) should provide guidance as to the factors that may be considered in determining the discount rate for ongoing and termination liabilities.

2.6. The calculation of pension liabilities should take place at least once every three years, while a certification or report of the adjusted development of the liabilities and changes in risks covered should be required for the intervening years. All actuarial valuations should be carried out by an actuary, or by another equivalent specialist, who has had appropriate training and experience in the field of pensions.

2.7. As part of the process of defining its funding policy, the governing body of the pension fund should seek the advice of the actuary or other relevant specialist regarding the assumptions and methods to be used in calculating pension liabilities and funding levels. This advice should be provided in a clear and timely fashion.

### **III. Funding Rules for Occupational Pension Plans/Funds**

3.1. The legal provisions require the identification and maintenance of a level of assets that would be at least sufficient to meet accrued benefit payments. The targeted funding level may be based on the termination or the ongoing liability. It should also take account of the plan sponsor's ability and commitment to increase contributions to the pension plan in situations of underfunding, the possibility of benefit adjustments or changes in retirement ages, as well as the link between the pension fund's assets and its liabilities.

3.2. Approved funding methods (also known as actuarial cost methods) for the ongoing liability should attempt to prevent sharply rising cost curves over time by spreading the actuarial (or accrued) liability over the expected career path of plan members. In order to ensure adequate funding levels over time, ongoing funding methods should take into account factors such as future salary growth, mortality, disability, early leaver (separation) and other relevant events.

3.3. In addition to normal costs (the present value of benefits that have accrued on behalf of the members during the valuation period), contributions should reflect other factors, including, to the extent appropriate to the accrual of benefits under the plan, work before a plan's inception, plan amendments that increase liability attributable to past service, deviations of actual results from assumptions (experience gains and losses), and the effects of changes in assumptions (actuarial gains and losses). These supplemental costs should be amortised as even currency units or at a minimum as even percentages of payroll. Amortisation periods should in general not be longer than the expected future period of service of active plan participants.

3.4. The legal provisions should not prevent funding methods that seek to dampen the short term volatility in firms' funding contributions. Prudent amortisation of supplemental costs over time might help achieve a smoother contribution schedule and more stable funding levels.

3.5. These legal provisions set out the different mechanisms and the recovery period for correcting a situation of underfunding, taking into account the sources of underfunding and the type of underfunding (ongoing or termination basis). Funding rules may grant some reprieve on contribution obligations only under restricted circumstances and to defined limits. Temporary reductions of contribution obligations may be considered with a clear waiver procedure managed by the pension regulator.

3.6. Funding rules should aim to be countercyclical, providing incentives to build reserves against market downturns. They should also take market volatility into account when limiting contributions (or their tax deductibility) as a certain funding level is reached. Tax regulations should not discourage the build-up of sufficient reserves to withstand adverse market conditions and should avoid restricting the full funding of the ongoing or termination liability. Temporary suspension of contribution obligations may be appropriate in circumstances of significant overfunding (calculated on an on-going basis).

3.7. Funding rules should take into account the extent to which the autonomous pension fund itself as opposed to the plan sponsor or the plan members is directly responsible partly or wholly for the commitments represented by the pension liabilities. Where the pension fund itself underwrites the pension liability without any guarantee from the plan sponsor or members, it should be required to hold additional assets over and above those necessary to fully fund the pension liabilities on a plan termination basis. This capital requirement or solvency margin should be determined taking into account the nature and size of assets held and liabilities due that are the responsibility of the pension fund and the extent to which benefits may be reduced.

#### **IV. Winding-Up**

4.1. The allocation of plan assets and the responsibility for underfunding in the event of plan termination should be clearly established. In the event that assets exceed promised benefits on a termination basis, there should be rules in place as to the allocation of the funding excess or surplus. In the event that assets are insufficient to cover promised benefits, there should be rules concerning the benefit payment allocation.

4.2. Whenever plan benefits are guaranteed by sponsoring employers, the creditor rights of pension plan members and beneficiaries (either directly, via the pension fund, or, where relevant, via insolvency guarantee schemes) should be recognised in the case of bankruptcy of the plan sponsor. Priority rights relative to other creditors should be required for at least due and unpaid contributions.

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<sup>i</sup> Throughout this document, legal provisions are defined in a broad sense. They may include the main body of the pension law, related laws (e.g. trust law), tax requirements, standards set by pension and financial sector supervisory authorities, codes of conduct developed by professional associations (e.g. a pension fund association), collectively bargained agreements, or plan documents (e.g. trust documents).

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