

▶▶ Newsletter: **Governance and risk management at IORPs: (finally) a practical guide from the FSMA!**

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Dear reader,

On 19 January 2022, the FSMA published on its website the "Practical Guide for Institutions for Occupational Retirement Provision on the Implementation of IORP II and EIOPA's Opinions on Governance and Risk Management" ([link](#)).

By means of this document, the FSMA communicates to the pension fund sector its expectations and provides examples of good practices for the application of the governance rules imposed by the IORP Act (WIBP).

The Practical Guide is not a revolution but rather an evolution, as the FSMA is drawing on the experience gained since 2019, the year in which the IORP II Directive was transposed into Belgian law. It is a document that IORPs should take into account in their future practice.

We hope you enjoy the read!

1 Introduction

Following the transposition of the IORP II Directive into Belgian law – through the amendment of the Act of 27 October 2006 on the supervision of institutions for occupational retirement provision (IORP Act or WIBP) – the FSMA published for consultation in 2019 a draft circular on its prudential expectations regarding governance. In it, the FSMA sought to clarify its expectations in the context of the implementation and application of the governance rules contained in the IORP Act. However, the draft circular remained at the draft stage and was only a "shadow circular".

The IORP II Directive, however, obliges the FSMA to communicate transparently. The Practice Guide therefore enables the FSMA to comply with that obligation. It also contains references to the views of EIOPA (European Insurance and Occupational Pensions Authority) on the implementation of the IORP II Directive.

The Practical Guide is directly inspired by the 2019 draft circular, however with some – sometimes significant – changes. In addition to the main document, which explains the main principles and expectations, the Practice Guide also contains several annexes that provide further explanations and practical examples on the expectations of the FSMA. [Annex 1](#) contains the various definitions. [Annex 2](#) explains what is meant by 'key documents', 'policies' or 'procedures, technical notes and operating rules'. The purpose of this annex is to list all the documents that constitute the framework for the IORP's structure, policies and governance system. [Annex 3](#) is devoted to the evaluation of the IORP's system of governance: the need for an evaluation process, the themes to be covered by the evaluation and the evaluation of the key functions. In any event, the FSMA expects adequate documentation of the entire governance framework and its implementation. [Annex 4](#) is devoted to risk management, [Annex 5](#) to outsourcing, and [Annex 6](#) to integrity and remuneration.

In this *newsletter*, we go through this Practical Guide and highlight a number of elements that deserve special attention: novelties, differences with the 2019 draft circular and important practical issues. On this basis, we focus in the first part on the aspects related to the organisational structure, governance structure and management of the IORP, in the second part on risk management and in the third part on the increasing attention to ESG factors.

2 Aspects related to the organisational structure, governance and management of the IORP

The Practice Guide emphasises the importance of the proportionality principle, which means that implementation of the statutory open standards on governance must be proportionate to the nature, size and complexity of the IORP's organisation and activities and the pension schemes it manages. Guidelines are then provided on how this principle of proportionality should be assessed. When the FSMA formulates an expectation in its Practice Guide, it is merely explaining the way in which it believes an IORP 'may' (not 'should') apply an open standard of governance or risk management. In the event of an audit, the IORP will have to explain why it has applied the standard in a different way and how it complies with the legal rule ('comply or explain').

Unlike the draft circular, the Practical Guide does not go into detail about the legal policy structure and issues such as the composition, the powers or the decision-making process within the general meeting or the operational bodies (board of directors or other). For example, the difference between non-executive and executive directors in the draft circular is not included in the Practical Guide, while this distinction is still made in the forms concerning the (re-)appointment of members of an operational body.

The same applies to the principle of co-option of a director, although we are of the opinion that co-option remains possible within the limits set by the FSMA in the draft circular.

Like the Draft Circular, the Practice Guide focuses on the governance system, reiterating and describing the same principles: transparent and adequate organisational structure, effective internal control system, effective risk management system, measures to ensure business continuity and service delivery, written policies and independent key functions.

A crucial point for the FSMA is a clear separation between operational and control functions when assigning tasks and responsibilities (e.g., to an operational body). The Board of Directors also has an important role in the design and implementation of the governance system, as well as in the monitoring of the functioning of this governance system and the evaluation of its effectiveness. The FSMA also insists on effective cooperation between the IORP's employees, who should have sufficient time and resources to perform their duties.

With regard to outsourcing, the FSMA specifies that a function or task is essential if its termination or the defective or unsuccessful performance thereof would result in the IORP substantially impairing its continuing compliance with the conditions and obligations imposed by its authorisation or other obligations under the applicable legislation, or the soundness or continuity of its services or activities. The obligation to inform the FSMA is more important in the context of such an essential function or task.

The Practice Guide also explains that, for its integrity policy, an IORP can choose either to draw up one global document in which all aspects are dealt with, or to draw up different documents on the different sub-aspects (e.g., code of ethics, conflict of interest policy, remuneration policy).

The Practice Guide also places a strong emphasis on risk management in these chapters.

3 Practical implementation of the risk management system

Although the FSMA already provided some clarification on risk management and *own risk assessment (ORA)* in its draft circular, it goes a step further in the Practice Guide by providing extensive explanations of the risk management system.

3.1 Risk management system

Besides the general provisions on the purpose of the risk management system, the risk management policy and the embedding of risk management in the organisational structure (which were already included in the draft circular), the FSMA now also gives recommendations and examples of good practice concerning the practical implementation of the risk management system. This section provides a great deal of detail and may help the IORP to further shape its risk management system. These provisions do not constitute binding legislation either, but merely set out the expectations of the FSMA (which, as explained above, is subject to the comply-or-explain principle) and examples of good practice.

The FSMA identifies the risk management system as a cyclical activity consisting of various steps. An important cornerstone in this respect is the determination of the IORP's risk appetite or risk tolerance. The FSMA therefore expects the IORP to establish risk tolerance limits per risk category and to define these clearly. In this regard, the FSMA emphasises that the financial health of the contributing companies plays an important role. In this context, the FSMA sent a letter to many IORPs in December 2021, stating that the financial health of the sponsoring undertakings must be taken into account in the ORA exercise. The inclusion of this passage in the Practical Guide once again emphasises that the IORP must take this element into account in its risk management system.

The risk management cycle consists of the following steps, in accordance with the Practice Guide:

1. Identifying the risks and classifying them into the various categories. In [Annex 4](#) to the Practical Guide, the FSMA includes a comprehensive list of the different risks and risk categories;
2. Risk measurement based on the relevance of the risk, its impact and its likelihood of realisation. Again, this is developed in much more detail in [Annex 4](#), where the FSMA mentions tools and methods for assessing risk, such as stress tests, stochastic projections, cash flow analyses, ALM studies, etc;
3. Risk management, whereby the FSMA identifies various strategies such as risk avoidance, risk reduction, risk transfer and risk acceptance on the basis of the cost and the desired outcome in relation to the risk appetite. Here too, the FSMA provides detailed explanations of these various strategies in [Annex 4](#);
4. Finally, the reporting and follow-up of risks: the FSMA highlights the risk register and the risk matrix as examples of good practice.

3.2 Own risk assessment

A second component of risk management is the IORP's own risk assessment or ORA, which must be carried out every three years or earlier in the event of a significant change in the IORP's risk profile. Of course, the information mentioned above about the different steps of the risk management cycle is also relevant for the ORA. However, the Practical Guide is less extensive about the ORA itself, and the additions to the draft circular are rather limited. Additional input on the ORA is expected from the FSMA, now that IORPs had to submit their first ORA report to the FSMA before 13 January 2022. The ORA is a new exercise for IORPs, which will take further shape in the coming years. However, in [Annex 4](#), the FSMA already provides a number of additional points of interest in the assessment of the effectiveness of the risk management system, on the one hand, and in the ORA assessment of the financing requirements, on the other. Both parts include a questionnaire that can help IORPs with the assessment in the context of the ORA exercise.

4 Increasing importance of ESG factors

Finally, we note that ESG (environmental, social and governance) factors are given significant focus in the Practice Guide, particularly in the context of risk management. Also, the IORP Act as amended following IORP II already placed additional emphasis on ESG, and this is further reinforced by the FSMA.

For instance, in the risk management system, the FSMA identifies ESG risks as a separate risk category from actuarial risks, investment risks and operational risks. Also in the ORA exercise, the FSMA considers the assessment of ESG aspects as a separate item. The FSMA therefore expects ESG factors or risks to occupy an important place within the risk management system of an IORP.

In this context, the FSMA expects the IORP to consider the impact that ESG risks have on other risks, such as reputational, strategic and political/regulatory risks of the IORP, but also on the continuity and actuarial risks, whereby the FSMA considers the financial capacity of sponsoring undertakings, which may themselves also be subject to ESG risks, and the impact on mortality and disability resulting from natural disasters to be examples. Generally speaking, the FSMA requires the close monitoring of ESG risks, whereby it indicates that this monitoring may be part of the ORA exercise.

Therefore, although there is no obligation for IORPs to invest sustainably, ESG is also gaining in importance for IORPs and will increasingly have to be taken into account in the future. At the very least, this should be included in the next ORA exercise.

5 Conclusion

The Practical Guide is a welcome help to IORPs, as it gives an insight into the expectations of the FSMA regarding governance and risk management and thus into the way in which the FSMA will carry out its supervision of compliance with the governance obligations. Governance and risk management must be a constant concern of IORPs, which must be constantly assessed and fine-tuned where necessary. The IORPs may from now on take into account the expectations and concerns of the FSMA in these evaluations and controls. The guidelines contained in the Practical Guide will also be useful during the next ORA exercises (within three years at the latest).

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