

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

CONSULTATION DOCUMENT

CONSULTATION ON AMENDMENTS TO THE PENSION RULES ISSUED UNDER THE RETIREMENT PENSIONS ACT

[MFSA REF: 09 - 2017]

6th December 2017

Closing Date: 12th January 2018

Note: The documents circulated by the MFSA for the purpose of consultation are in draft form and consist of proposals. Accordingly, these proposals are not binding and are subject to changes and revisions following representations received from Licence Holders and other involved parties. It is important that persons involved in the consultation bear these considerations in mind.

Note for Consultation

1. Purpose

- 1.1 The Retirement Pensions Act (“the RPA”), (Cap.514), Regulations and Pension Rules issued thereunder, came into force on the 1st January 2015. During the last three years, the MFSA received queries from the pensions market as well as representations from the Malta Association of Retirement Scheme Practitioners (*MARSP*). The MFSA is proposing various amendments to the Pension Rules for Personal Retirement Schemes issued under the RPA, which relate, in particular, to clarifications as to the applicability of the Pension Rules for Personal Retirement Schemes to member-directed Schemes, and to material changes proposed to the regime of member-directed Schemes.
- 1.2 The proposed Draft Pension Rules for Personal Retirement Schemes and Appendices 1 to 5 to the said Rules are being issued for consultation together with this Consultation Document.
- 1.3 Any comments and feedback in relation to this Consultation Document are to be addressed to the Insurance and Pensions Supervision Unit and submitted in writing on ipsu@mfsa.com.mt, by not later than the Friday **12th January 2018**.

2. Amendments to the Pensions Rules for Personal Retirement Schemes

The MFSA considered the issues relating to the practical application of certain requirements found in the Pension Rules with respect to personal retirement schemes, in particular member-directed schemes. The MFSA is proposing amendments in order to address issues observed during on-site and off-site supervisory work. Some of the issues which the Authority has identified are of concern, in particular, when considering that members, who are mostly retail members, contribute their life-time savings into a Personal Retirement Scheme with a view to obtaining a stream of income upon retirement.

Moreover, the proposed amendments to the Pension Rules for Personal Retirement Schemes also seek to address the queries raised as to the actual respective role and responsibilities of all the parties involved in the context of member-directed Schemes, as well as to enhance the practical implementation of the current provisions laid out in Part B.9 (Supplementary Conditions in the case of entirely Member Directed Schemes). Other amendments have been carried out to the said Pension Rules.

Member-Directed Schemes

2.1 The form of Member-Directed Schemes

The current Pension Rules are silent as to whether a Personal Retirement Scheme which provides for member-direction should be established as an entirely member directed Scheme or whether such a Scheme, in practice, may have individual accounts which are member directed and others which are non-member-directed (i.e. mixed accounts).

For the purposes of clarity, it is being proposed that a Personal Retirement Scheme which provides for member-direction under any of the grounds provided in SLC 9.2, shall be established solely as a member directed Scheme, and will thus not be permitted to operate as a “*mixed Scheme*.” This means that it is to be decided at the outset whether a Retirement Scheme is to be established as either a non-member directed Scheme or an entirely member-directed Scheme operating only member-directed accounts. In this respect, Retirement Schemes Administrators who currently operate Schemes with mixed accounts are expected to notify the MFSA accordingly, by Friday **12th January 2018**.

2.2 Entitlement to become a Member of a Member-Directed Scheme

The MFSA is proposing to review the current personal pensions regime for member-directed schemes, following on-site inspections carried out by the MFSA, whereby it transpired that members of member-directed Schemes are primarily retail individuals who are investing their life savings in these retirement schemes, and following complaints made to the MFSA in relation to member’s investments.

The MFSA is concerned that in some instances, members of member-directed Schemes (who are mostly retail investors and not necessarily high-net worth individuals) are being directed by their appointed investment advisor or investment manager to invest their life savings in risky and highly illiquid investments, without considering that these type of investments are not suited to the risk appetite or risk profile of the member concerned; and in a number of cases, the RSA would approve such investments, following instructions by the said advisor or manager.

Bearing the above considerations in mind, it is being proposed that, as from **2nd July 2018**, **only high net-worth individuals** will be entitled to enter into entirely member directed Schemes. This means that, as from that date, **no new retail customers** will be permitted to enter into such member-directed Schemes.

In this respect, it is proposed to introduce a new definition of “*high net-worth individuals*” defining who be eligible to join an entirely member-directed Scheme (*vide SLC 9.3 of Part B.9 of the Draft Pension Rules for Personal Retirement Schemes*):

“9.3 For the purposes of SLC 9.2, a Member may only be a person who, prior to entry into the member-directed Scheme, satisfies, as a minimum, throughout the financial year immediately preceding the entry into the Scheme, one of the following criteria:

- (a) has an annual income of €150,000 or more. Annual income for these purposes does not include money withdrawn from any pension savings (except where the withdrawals are used directly for income in retirement); or
- (b) holds net assets to the value of €500,000 or more. Net assets for these purposes do not include:
 - (i) the immovable property which is the person’s primary residence or any money raised through a loan secured on that immovable property; or
 - (ii) any rights of the person under a contract of insurance on human life or contracts to pay annuities on human life where the benefits are wholly or partly to be determined by reference to the value of, or the income from, property of any description (whether or not specified in the contracts) or by reference to fluctuations in, or in an index of, the value of property of any description (whether or not so specified); or
 - (iii) any benefits (in the form of pensions or otherwise) which are payable to the person on the termination of service or on death or retirement, and to which the said person or the person’s dependants are, or may be, entitled.

The MFSA considered various ways in order to implement this new requirement in relation to existing Schemes under the RPA. In this respect, it is being proposed that:

- (a) current member-directed Schemes shall retain current retail members within the said Schemes, however, such Schemes will be crystallised so that no new retail members will be permitted to join such Schemes;
- (b) current member-directed Schemes may retain current members which fall within the proposed definition of “*high net-worth individuals*” in the current member-directed Scheme;
- (c) new members which fall within the proposed definition of “*high net-worth individuals*”, will be permitted to join the current member-directed Scheme;
- (d) new members which do not fall within the proposed definition of “*high net-worth individuals*” will only be permitted to join non-member-directed Schemes (pooled Schemes), as from 2nd July 2018.

It is to be pointed out that, the MFSA considers that the RSA remains responsible for the current retail members and the current member-directed Schemes and in particular, shall ensure that the investments made reflect the risk-profile of such members.

2.3 The Mandatory Functions (Investment Management Function and Custody Function at Scheme level)

In the context of member-directed Schemes, various Service Providers, in particular Investment Managers, have written to the MFSA asking for a clarification as to the role they should be performing, that is, the extent of the role of the Investment Management Function and the Custody Function within member-directed Schemes.

In terms of the Pension Rules, the Investment Manager at Scheme level is responsible for the investment management of the assets of the Scheme and is required to act in the best interests of the Members and Beneficiaries. However, in the context of a member-directed Scheme, each member usually invests its own funds as guided by its own investment manager and, or investment advisor appointed by the member in relation to the member's individual account, and such manager or advisor will then inform the Retirement Scheme Administrator ("*RSA*") as to the investments in which the member's assets are proposed to be invested. This means that, in the case of member-directed Schemes, the Investment Manager appointed by the Scheme is not being involved in any manner in the investment decision process or in the subsequent investment management of the investments made with respect to each member account.

To exemplify, the Investment Manager of the Scheme is required to prepare a report which is to be included in the Retirement Scheme's Half-Yearly Report or Annual Report. However, in practice, it appears that the Investment Manager of the Scheme is being informed by the RSA of the investments held by the Scheme, only for the purpose of preparation of the said Investment Manager report. In effect, the Investment Manager appointed at Scheme level is not performing the actual investment management of the assets of the Scheme, and thus, is not in a position to collate the required information.

In so far as custody function is concerned, currently the RSA has to either appoint a custodian to carry out the Custody Function or undertake the responsibility for such function himself. However, from on-sites conducted it appears that, in a member-directed Scheme, each member account may have its own custodian/s, leading to a situation whereby one Scheme may have several custodians for different members. Furthermore, there are instances whereby an investment manager or an investment house, makes use of its own custodians, and this is deemed to undermine the independence requirements currently required between the two mandatory functions at Scheme level i.e. the investment management function and the custody function.

Therefore, for the reasons outlined above, it is considered that in the context of entirely member directed-Schemes, there may be no scope in retaining the mandatory functions i.e. the Investment Management Function and the Custody Function, at Scheme level. Consequently, the MFSA is proposing that a Personal Retirement Scheme which is an

entirely member-directed will not be required to establish these two mandatory functions at Scheme level, since the investment manager and, or the custodian, where applicable, will be appointed or be present at each member account level.

In view of the above, it is being proposed to introduce certain safeguards in these type of set-ups by setting out the responsibility of the RSA in carrying out the appropriate due diligence on the investment advisor and the investment manager appointed by the member (*vide SLC 9.8 (a) and (b) and SLC 9.9 (a) and (b) in the proposed Part B.9 of the Draft Pension Rules for Personal Retirement Schemes*). As part of this due diligence, the RSA is to ensure that the investment advisor and, or the investment manager is qualified and competent to provide such investment advice and manage such investments in relation to the Member account, and that the relevant requirements laid down in the proposed SLC 9.8 and SLC 9.9 are satisfied by the said advisor or manager, **at all times**.

In the context of entirely member-directed Schemes, in so far as custody is concerned, it is proposed to insert a new SLC 9.11 in Part B.9 of the Pension Rules, which provides who may act as custodian as well as for the appropriate due diligence by the RSA.

2.4 The Independence Requirement between the Mandatory Functions

The current Pension Rules for Personal Retirement Schemes provide that the Investment Management Function is to be carried out independently from the Custody Function.

In the case of *member-directed Schemes*, the current SLC 9.6 allows the discretionary investment manager chosen by the member to appoint a custodian. However, in practice, the required independence requirements are not being applied at member level, since either no custodian is being appointed or else, where the member appoints an investment manager or makes use of an investment house, the latter have their own custodians.

In the case of a *non-member directed Scheme*, it is being proposed that the mandatory functions (i.e. the Investment Management Function and the Custody Function), as well as the independence requirement between the two mandatory functions, should be retained so as to ensure an adequate and sufficient level of protection to the Members of a Personal Retirement Scheme. However, in the case of *entirely member-directed Schemes*, it is proposed that the independence requirements between the mandatory functions are not to remain applicable to such Schemes. This is in line with the proposed removal of the mandatory functions in entirely member-directed Schemes (*as further explained in section 2.3 of this Consultation Document*) due to the fact that the investment management and custody are actually being carried out at member account level.

2.5 Diversification at Member Level in entirely Member-Directed Schemes

The concept of diversification was already established under the Special Funds (Regulation) Act (now repealed). However, under the current Pension Rules issued under the RPA, the concept of diversification is now also applicable at member account level, in the case of member-directed Schemes.

In view that the concept of diversification is now also applicable at member account level, some market participants have expressed their view that it is difficult to reconcile the concept of member-direction with having the RSA held ultimately responsible for the retrospective compliance with the investment restrictions, in respect of diversification. It was also argued that the RSA's obligation is to be limited only in relation to placing the investment transactions directed by the Member and thus, it was questioned whether it is desirable to have the requirement of diversification applicable at member level, in the context of member-directed Schemes.

The pensions market also requested clarification as to the meaning of "*properly diversified*" in SLC 3.2.1(ii) of Part B of the Pension Rules for Personal Retirement Schemes and as to how the requirement of diversification is to be implemented at member account level (where members are entitled to appoint their own investment manager and, or investment advisor with respect to their individual member accounts), as required under the current SLC 9.3(d) of Part B. Furthermore, the industry queried as to whether, in the context of member-directed Schemes, diversification could be deemed satisfied in cases where a member invests in a single fund and then that fund has a number of underlying funds. It was also suggested that the concept of diversification is to be interpreted in relation to the whole personal wealth of the member, and not be limited only to the assets in the member account.

In view of complaints received from members of member-directed Schemes, who are considered to be retail customers, which were substantiated further from on-sites conducted, where it has been observed that the majority of members in member-directed Schemes are retail customers, the MFSA proposes that the principle of diversification at member level is retained in the best interests of the members, since the scope of having a pension pot in a personal Retirement Scheme is mainly to guarantee and safeguard the payments of retirement benefits upon retirement or death. Therefore, a member should not be allowed to take excessive risks by not diversifying his or her portfolio.

The MFSA would like to clarify that the diversification requirement should be limited to the assets held by the Member in the member-directed Scheme, and is not to be extended to take into account the whole personal wealth of the member. It follows that diversification is deemed to be satisfied only by taking into account the assets in the individual Member account, and not taking into consideration any other savings or free investable assets which that member may possess in his estate. In this respect, it is

proposed to amend the current SLC 9.3(d) (*vide draft SLC 9.7(c)(i)*) so that the investment restrictions (*Part B.3.2 of the Pension Rules for Personal Retirement Schemes*), including the requirement of diversification, are to be applied at the level of the member account, taking into account the risk profile of the Member *in relation to his individual member account*.

In relation to the meaning of diversification, it is being proposed that a look-through approach may be adopted, so that the diversification required at member level may be deemed to be satisfied in the cases where an individual member invests in a single fund and that fund has a number of underlying funds/investments, which are themselves diversified.

2.6 Proposals to the Investment Restrictions

From on-sites conducted the MFSA is concerned to note that, in a number of instances, the assets of members (who are mostly retail investors) are being placed in investments such as speculative derivatives, structured notes, and units in Professional Investor Funds ("PIFs"), on a regular basis. These type of investments are more apt and suitable for investors with higher risk appetite, such as professional investors.

In view of the above, in addition to the current investment restrictions found in Part B.3.2 of the Pension Rules for Personal Retirement Schemes, it is being proposed to introduce the following new investment restrictions which are applicable as follows:

- (a) all Personal Retirement Schemes shall also comply with the following new investment restriction proposed in *SLC 3.2.1(vii) of Part B of Draft Pension Rules* which provides that the RSA or the Investment Manager, as applicable, shall ensure that, with the exception of the embedded derivative component within structured notes, a Scheme shall not make use of derivative financial instruments for speculative purposes;
- (b) in the case of entirely member-directed Schemes (*vide SLC 9.7(c) of Part B of the Draft Pension Rules for Personal Retirement Schemes*), it is also being proposed that in addition to the investment restrictions laid down in the amended SLC 3.2, the RSA shall also ensure that:
 - (i) where structured notes are included in a Member's account, these will be permitted up to a maximum of 30% of the member's account total value, with no more than 20% of the Member's account to be subject to the same issuer default risk; and
 - (ii) a Member may only invest in a particular asset as long as the eligibility criteria of such an investment are met by that Member;

- (c) in the case of non-member-directed Schemes, the Retirement Scheme Administrator or the Investment Manager, as applicable, shall also ensure that:
- (i) where structured notes are included in the Scheme's assets, these will be permitted up to a maximum of 15% of the portfolio's total value, with no more than 10% of the Scheme's assets to be subject to the same issuer default risk, (*vide SLC 3.2.1(viii) of Part B of the Draft Pension Rules for Personal Retirement Schemes*); and
 - (ii) the Retirement Scheme Administrator or the Investment Manager, as applicable shall ensure that the assets of a Scheme shall be invested in order to ensure the security, quality, liquidity and profitability of the portfolio as a whole.

2.7 Clarification of the Role and Responsibilities of the RSA

It is acknowledged that, in so far as the role of the RSA in the context of member-directed Schemes is concerned, the provisions found in Part B.9 of Part B of the Pension Rules need to be enhanced. The aim of the proposed amendments is to clarify the role and responsibilities of the RSA in the context of member-directed Schemes and to ensure more specific disclosures from the RSA to the member.

As specified in SLC 1.3.1 of Part B.1 (Pension Rules for Retirement Scheme Administrators) of the Pension Rules for Service Providers, the RSA, in carrying out his functions, shall act in the best interests of the Scheme members and beneficiaries. Therefore, the MFSA expects the RSA to be diligent and to take into account his fiduciary role towards the members and beneficiaries, at all times, and irrespective of the form in which the Scheme is established (*vide SLC 1.3.3 of Part B of the Draft Pension Rules for Personal Retirement Schemes*).

In carrying out his functions, a RSA of a Personal Retirement Scheme has a fiduciary duty to protect the interests of members and beneficiaries. It is to be noted that by virtue of Article 1124A of the Civil Code (*Chapter 16 of the Laws of Malta*), the RSA has certain **fiduciary obligations** to members or beneficiaries, which arise in virtue of law, contract, quasi-contract or trusts. In particular, the RSA shall act honestly, carry out his obligations with utmost good faith, as well as exercise the diligence of a *bonus pater familias* in the performance of his obligations.

In the case of Schemes established as a trust, even though, in terms of article 43(6)(c) of the Trusts and Trustees Act (*Chapter 331 of the Laws of Malta*), a person licensed as a RSA in terms of the RPA and acting as a trustee to Retirement Schemes is not required to be authorised in terms of the Trusts and Trustees Act, the Trusts and Trustees Act still

applies to such RSA, in terms of article 1(2) of the said Act. In order to expressly provide for clarification in respect of the above, it is proposed to insert a new SLC 8.5 in Part B.8 on the Supplementary Conditions for Schemes established as a trust.

In the case of member-directed Schemes (irrespective of the form in which the Scheme is established), the RSA is expected to have adequate knowledge of the risk profile of the member so as to ensure that the proposed investments are in line with the investment strategy and investment restrictions of the member-directed Scheme and with the risk-profile of the member, in order to approve proposed transactions in a member's account. In this respect, the RSA is expected to vet and approve the investment advice provided by the investment manager or the investment advisor, and raise certain queries, when necessary.

The RSA is expected to value the portfolio of the member, as well as to inform the member and its appointed advisor of any material information and of any material changes in the investments made (such as suspension of funds), in relation to the member's account. In this respect, it is being proposed to insert new provisions (*vide SLC 9.7(d) and (e) of Part B.9 of the Draft Pension Rules for Personal Retirement Schemes*), whereby a RSA is required to ensure that the member is kept updated and informed in relation to his account within the member-directed Scheme, by means of a statement of information which is to be provided to the member, at least every six months. In addition, the RSA is also required to immediately disclose to the member any material information as well as any material changes, relating to the member's account. It is to be noted that these new provisions shall apply in addition to the provisions relating to information for Scheme Members and Beneficiaries, as laid down in the amended Part B.5 of the Draft Pension Rules for Personal Retirement Schemes (outlined in point of this Consultation Document).

2.8 Clarification on the Role and Responsibilities of the investment advisor and the investment manager in the context of entirely Member-Directed Schemes

2.8.1 The RSA's approval of the investment manager and investment advisor

In the case of member-directed Schemes, a RSA needs to have the necessary controls in place, especially where the Scheme has a large number of members and such Administrator will inevitably have a relationship with a number of investment advisors and, or investment managers appointed at member account level.

In this respect, the current SLC 9.4 (b) in Part B of the Pension Rules for Personal Retirement Schemes provides that once a Scheme allows the member to appoint an investment advisor and, or investment manager in relation to his member account, then the RSA is to enter into an agreement with the investment advisor and, or investment

manager, on behalf of the Member, setting out the services, roles and responsibilities of such advisor or manager.

From on-sites conducted it was observed that, as between the RSA and the investment advisor, there is usually only an introducer agreement or a terms of business agreement. However, it was observed that, in the case of member-directed Schemes, in practice, a dual role may be carried out by an investment advisor (that is, acting as an introducer of business to the RSA and as an investment advisor to the member in relation to the member's account). The MFSA is of the view that these two different roles pertaining to such the investment advisor need to be distinguished to ensure the protection of the members and beneficiaries. Therefore, in terms of SLC 9.8(c) of the draft Pension Rules, it is being proposed that the agreement to be entered into between the RSA and the investment advisor is to include provisions clearly stating whether the investment advisor is acting as an introducer or is providing investment advice to the member. By way of contrast, in the case of the discretionary appointment of the investment manager, an agreement may usually be found between the RSA and the investment manager.

The proposed amendments to Part B.9 of the Draft Pension Rules for Personal Retirement Schemes provide for separate requirements applicable to the investment manager and the investment advisor. The RSA is required to carry out the appropriate due diligence on the investment advisor and, or investment manager appointed by the Member, at all times, and shall also keep the relevant records and documentation as a proof of the due diligence performed. As part of this due diligence, the RSA is also to ensure that the investment advisor and the investment manager appointed in relation to the member account is qualified and competent to provide such investment advice or to manage such investments (*vide new SLC 9.8(a) and (b) and SLC 9.9 (a) and (b) of Part B.9 of the Draft Pension Rules for Personal Retirement Schemes*).

In so far as the agreement between the RSA and investment advisor is concerned, it is being proposed to retain in place such a requirement (*vide SLC 9.8(c) of Part B.9 of the Draft Pension Rules for Personal Retirement Schemes*), in particular since, the RSA will be required to have a relationship with the investments advisor of the member.

2.8.2 *The Tripartite Agreement between the RSA, custodian and investment manager*

The current SLC 9.6 of Part B.9 of the Pension Rules for Personal Retirement Schemes provides that where the member appoints an investment manager on a discretionary basis over his/her investments, the appointment of a custodian by the investment manager is permissible, provided that there is a direct link between the RSA and the custodian so that the RSA can effectively monitor the Scheme in aggregate and as a whole and retain overall control. In addition, the said provision also requires that an arrangement is entered

into between the three parties i.e. the RSA, investment manager and custodian, setting out the services, roles and responsibilities of the investment manager and the custodian.

However, during on-sites, it was observed that the current market practice is that an agreement is entered into only between the RSA and the investment manager and such an agreement usually mentions the custodian but would not include direct access or communication by the RSA with the custodian or any regular reporting by the custodian to the RSA. Moreover, some market participants are of the view that the requirements for custodians laid down in the current SLC 9.6 are incompatible with current practices. It was suggested that the requirement to have a tripartite arrangement in place is to be removed, especially since there is no need to have a direct contractual relationship with a custodian who is holding custody of a member's assets, where such custodian is not engaged directly by the RSA.

Therefore, it is being proposed to remove the requirement to have a tripartite agreement or arrangement between the RSA, the investment manager and custodian, currently found in SLC 9.6. However, the MFSA is of the view that certain safeguards need to be retained in place and in this respect it is being proposed that the back to back agreement between the RSA and the Investment Manager, required under the current SLC 9.4(b), is to include a clause that the investment manager is to provide the RSA with any necessary information as the RSA may require in the carrying out of his duties (*vide SLC 9.9(c) of Part B.9 of the Draft Pension Rules for Personal Retirement Schemes*).

In addition, in so far as the custodian is concerned, it is proposed to insert a new SLC 9.11 in Part B.9 which provides that the RSA is to carry out due diligence on the custodian, where appointed, similarly to the exercise carried out on the investment advisor and investment manager (*as proposed in the new SLC 9.8 and 9.9 of Part B.9 of the Draft Pension Rules*).

2.9 The provisions in the Pension Rules for Personal Retirement Schemes which are deemed to be applicable/not applicable, in the case of Member-Directed Schemes

Part B.9 of the Pension Rules for Personal Retirement Schemes contains supplementary conditions applicable in the case of member-directed Schemes, which are considered to be additional to all the other requirements laid down in the said Pension Rules.

Therefore, for the purposes of consistent interpretation and for the avoidance of doubt, the proposed new SLC 9.12 of Part B.9 of the Draft Pension Rules contains a list of provisions which are considered not to be applicable to the operation of member-directed Schemes, as well as provisions which require a modified application in the context of member-directed Schemes.

The proposed SLC 9.12 provides that the Pension Rules for Personal Retirement Schemes shall apply to a member directed Scheme, in the same manner and to the same extent, unless specified otherwise, as they apply to a Retirement Scheme which is not a member-directed Scheme, subject to the following:

- (a) paragraphs 1.4.2 and 1.5.1 (*mandatory functions*) of Part A of the Pension Rules shall not apply;
- (b) SLC 1.3.5 to SLC 1.3.11 of Part B of the Pension Rules (*Investment Manager, Custodian, Investment Advisor*) shall not apply;
- (c) SLC 1.3.12 to SLC 1.3.16 of Part B of the Pension Rules (*Introducers, Independence Requirements*) shall not apply;
- (d) SLC 3.1.3 of Part B of the Pension Rules shall apply as if for the words “*the Scheme’s investment allocation*”, there shall be substituted the words “*the Member Account investment allocation*”;
- (e) in SLC 4.2.1(f), (h) and (m) of Part B of the Pension Rules the term “*Service Provider*” shall apply only to the Retirement Scheme Administrator;
- (f) in addition to the information listed in SLC 5.1.3 of Part B of the Pension Rules, the Member shall also be provided with information on the investments made in relation to the Member account;
- (g) SLC 5.1.3(c) of Part B of the Pension Rules shall also include the contact details of the investment advisor and or the investment manager appointed in relation to a member’s account;
- (h) SLC 5.1.3(e) of Part B of the Pension Rules shall apply as if for the words “*received within the Scheme*”, there shall be substituted the words “*received within the member account*”;
- (i) SLC 5.1.4 and SLC 5.1.5 of Part B of the Pension Rules shall not apply.

Amendments applicable to all Personal Retirement Schemes

2.10 The Equivalence test – An Equivalent level of Regulatory Supervision

In the case of non-member-directed Schemes, the Investment Manager, the Custodian and where appointed, the Investment Advisor of the Scheme may be an entity located in a country which is not a Member State or EEA State, which the MFSA considers to be subject to *an equivalent level of regulatory supervision* in the jurisdiction where its operations take place, for it to undertake the relevant activities (*vide SLC 1.3.6(e), SLC*

1.3.9(f) and SLC 1.3.11(c) of Part B of the Draft Pension Rules for Personal Retirement Schemes).

Moreover, in the context of member-directed Schemes, the RSA shall ensure (*as part of the due diligence which it needs to carry out in terms of SLC 9.8, 9.9 and 9.11 of Part B.9 of the Draft Pension Rules for Personal Retirement Schemes*) that in the case of a person established in a non-Member State or non-EEA State, the investment advisor, investment manager and the custodian, at member account level, is a person who is considered by the RSA to be subject to an *equivalent level of regulatory supervision* in the jurisdiction where its operations take place, for it to undertake the relevant activities.

It was pointed out by the market that there is uncertainty as to the elements which are to be taken into account for the equivalence test to be satisfied, and therefore requested some guidance in this respect. Therefore, as a form of guidance, it is to be noted that in the case of an investment manager, investment advisor or custodian from a non-Member State or non-EEA State, the MFSA regards the following jurisdictions as having *an equivalent level of regulatory supervision*:

- (a) a country that is a signatory of the International Organisation of Securities Commissions (IOSCO) Multilateral Memorandum of Understanding; and, or
- (b) any other jurisdiction with which the MFSA has a Memorandum of Understanding with the country in which the entity operates, in relation to Investments and Pensions,

and in all cases, the entity established in such jurisdictions, is to be subject to a full regulatory regime that is, subject to authorisation, supervision and enforcement requirements.

2.11 Introducing an oversight and monitoring role for the Custodian Function at Scheme level

In terms of the Part A of the current Pension Rules for Personal Retirement Schemes, the custody function is a mandatory function. Moreover, a Custodian is responsible for the safekeeping of the assets of a Retirement Scheme for which it acts as Custodian. Therefore, the MFSA is proposing that, in the case of Personal Retirement schemes (non-member directed), the entities responsible for carrying out the custody function, besides being responsible for the safe-keeping of assets, are also to be made responsible for carrying an oversight function over the investment management function. In this respect the Pension Rules for Personal Retirement Schemes are proposed to be amended to reflect the oversight function.

2.12 The Scheme's Half-Yearly Report

In so far as the Scheme's half-yearly report (*Appendix 5 to the Pension Rules for Personal Retirement Schemes*) is concerned, market participants suggested a possible extension of the deadline for submission of the half-yearly report from two months (*vide current SLC 2.3.5 of Part B*) to a period of three months. Therefore, the MFSA proposes to amend the above-mentioned time-frame to three months.

2.13 The Statement of Investment Policy

The Statement of Investment Policy forms part of the matters which shall be contained in the Scheme Particulars (*Appendix 3 in Part C of these Pension Rules*). It is proposed to amend the current SLC 2.2.2 which requires that the Statement of Investment Policy is to be revised at least every three years or more frequently where appropriate, so as to add the requirement that the Statement of Investment Policy is to be revised, without delay, after any significant change in the investment policy, to reflect the requirements of Article 12 (Statement of investment policy principles) 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, ("IORP Directive").

2.14 Schemes which qualify as Recognised Overseas Pension Schemes ("ROPS")

The pensions market made a number of representations on SLC 4.6.8 of Part B of the current Pension Rules for Personal Retirement Schemes, dealing with programmed withdrawals, and requested clarification. In particular, it was pointed out that the main issue which requires clarification relates to the fact that, within a ROPS, scheme assets may come from a source which is different from that recognized as a "*relevant transfer*" in terms of UK law, and that such a source should not fall within the ROPS rules when withdrawals are considered. At the moment, in terms of the current SLC 4.6.8, all drawdowns from ROPS Schemes are to follow HMRC Rules, and does not distinguish between UK tax relieved funds or otherwise. Therefore, it was suggested that SLC 4.6.8 is to be amended in order to be made applicable only to UK tax relieved funds belonging to transfer Members within a Maltese ROPS. Hence, it is proposed to redraft the current SLC 4.6.8. In relation to SLC 4.6.8, industry participants also requested clarification as to the meaning of the undefined term "*UK HMRC Rules*" and which UK rules apply in the case of ROPS and to what extent.

Furthermore, it was also suggested that SLC 4.6.8 is to be amended so that Part B.4.6 relating to Retirement Benefits is disapplied for ROPS, with the exception of SLC 4.6.2 relating to the initial cash lump sum, which provides that on the retirement date, a Member may elect to take up to 30% of his assets in the Retirement Scheme. Finally, in

so far as the age limit of seventy-five found in SLC 1.2.5, which provides that the payment of Retirement Benefits is not to commence later than the date on which the Member attains the age of seventy-five (75), it was argued that this should not be applicable to ROPS.

The MFSA acknowledges that SLC 4.6.8 needs to be amended so as to be made applicable only to UK tax relieved funds belonging to transfer Members. Moreover, in so far as the term “UK HMRC Rules” is concerned, there is no identifiable set of rules which apply in relation to overseas pension schemes and the MFSA is not in a position to determine the specific UK legislation which applies to Retirement Schemes licensed under the RPA which qualify as ROPS. Thus, it is being proposed to substitute the words “UK HMRC Rules” with the term “the applicable UK legislation relating to the withdrawal of retirement benefits”. Therefore, in order to address the said concerns, it is proposed to amend the current SLC 4.6.8 of part B of the Pension Rules, as follows:

“4.6.8 The rules referred to under Part B.4.6 relating to Retirement Benefits for a Defined Contribution Retirement Scheme shall not apply to pension funds transferred from Pension Schemes registered in the United Kingdom (‘UK’) to Retirement Schemes licensed under the Act which qualify as Recognised Overseas Pension Schemes under rules issued by Her Majesty’s Revenue and Customs (‘UK HMRC’). Members of these Schemes shall be subject to the applicable UK legislation relating to the withdrawal of retirement benefits.”

However, in so far as the initial cash lump sum of 30% of the member’s assets in the Scheme in terms of the Pension Rules, the MFSA is of the view that this is not to apply with respect to ROPS, since by virtue of SLC 4.6.8, as amended, ROPS are to be subject to the applicable UK legislation relating to retirement benefits. In addition, in so far as the market suggestion in relation to the age limit applicable to ROPS, the MFSA is of the view that the payment of retirement benefits to the member is to commence by age 75.

2.15 Amendments to Part B.5 on Conditions relating to information for Scheme Members and Beneficiaries

2.15.1 The issue of the Signature of the Scheme Document / Scheme Particulars

The current SLC 2.1.4 in Part B of the Pension Rules for Personal Retirement Schemes provides that the Scheme Document shall be signed by the persons who are bound by the terms of its provisions.

Some market participants are of the opinion that SLC 2.1.4 is not compatible with the way personal pension schemes operate and is more akin to occupational pension plans whereby the contributor, usually being the employer, is central to the whole Scheme. Therefore, it was suggested to remove the signature requirement in the case of Personal

Pension Schemes, so that if a member receives a copy of the Scheme Document and confirms its receipt, or else if the Scheme Document and Scheme Particulars are made available upon request from the RSA, the signature of the member is not necessarily required.

Moreover, it was highlighted that there appears to be a conflict between the requirement relating to signature found in SLC 2.1.4 and the provisions of SLC 5.2.4 of Part B of the current Pension Rules for Personal Retirement Schemes which provides that persons who are *bound by the acceptance* of the Constitutional Document, the Scheme Document and the Scheme Particulars shall be provided with a copy of these documents and *must accept these documents* in writing, *if they have not signed them in any other capacity*, and must send their statement to the RSA of the Scheme.

From the industry comments raised above, as well as from on-sites conducted, it transpires that it is not the current market practice that the Scheme Document is actually signed by the member. Therefore, it is proposed that the signature requirement is to be removed so that if the RSA provides the member, upon joining the Scheme, with a copy of the Scheme Document and Scheme Particulars, it is considered as sufficient for the protection of the prospective member or member.

Therefore, in this respect, it is being proposed to redraft the current Part B.5 of the Pension Rules for Personal Retirement Schemes so as to ensure that every Scheme Member shall be notified by the RSA of the entry in the Scheme, as well as provided with a copy of the Scheme Document and Scheme Particulars, upon joining the Scheme. The notification is to include the information listed in the proposed draft SLC 5.1.3. Moreover, the RSA shall also keep evidence of its compliance with the requirement of providing the members with the necessary documentation (*vide SLC 5.1.1 of Part B.5 of the Draft Pension Rules for Personal Retirement Schemes*).

2.15.2 Right of Withdrawal

The MFSA is proposing that a member is given a period of 30 days to withdraw from the contract entered into with the Scheme. Pursuant to regulation 7 of the Distance Selling (Retail Financial Services) Regulations (S.L. 330.07), the member is given a period of thirty (30) calendar days to withdraw from the distance contract relating to personal pension arrangements, without incurring any penalty and without having to give any reason.

In this respect, the MFSA proposes to extend this right of withdrawal also to *non-distance contracts*, in order to enable the members to make an informed decision. Therefore, it is being proposed that the RSA shall inform the member of his/her right to opt out of the Scheme within 30 days of the member receiving a welcome letter, together with a copy of the Scheme Document and Scheme Particulars. The member is also to be provided with a cancellation notice on a durable medium (which if not provided the contract remains

cancellable), which shall include information on the conditions for exercising the right of cancellation, the consequences of not exercising the cancellation period and the practical instructions for exercising the cancellation period indicating the address to which the notification of cancellation or withdrawal is to be sent, (*vide SLC 5.1.2 and SLC 5.1.3(h) of Part B of the Pension Rules for Personal Retirement Schemes*).

For that period of thirty days, the funds would not be invested, however, the member will be given the choice to waive the cancellation period. When a member exercises the right of withdrawal from the personal pension scheme, his/her membership within the Scheme would be terminated. However, it needs to be emphasised that such member is not to incur any penalty, fees or charges and need not give any reasons for such withdrawal. The RSA shall, without undue delay and no later than within 30 calendar days from when a notification of cancellation is received, return to the member the funds contained in his member account or return the funds to the retirement scheme.

2.15.3 Clarification of Information Disclosures to the Members and Beneficiaries

It is proposed to amend the current Part B.5 of the current Pension Rules on Personal Retirement Schemes for the purposes of clarifying the conditions relating to information for Scheme Members and Beneficiaries. It is being proposed to introduce a new SLC 5.1.3 in Part B.5, which specifies the information to be included in the notification submitted by the RSA to the Member, upon joining the Scheme.

Moreover, it is proposed to insert a new SLC 5.1.4, so that in the case of non-member directed Schemes, the RSA shall provide a statement to the Member noting his individual entitlements, at least every six months. In terms of the new SLC 5.1.5, the RSA will also be required to immediately disclose any material information as well as any material changes to the Member. In the case of member-directed Schemes, similar provisions are found in the proposed Part B.9 of the Draft Pension Rules for Personal Retirement Schemes.

In addition, in terms of the new SLC 5.1.9, a member who opts to transfer the assets out of the Scheme shall, as a minimum, be notified with the information about the applicable fees and charges relating to the transfer, details of the new RSA, as well as details of the new Retirement Scheme.

2.16 Back-Office Administration

Part C.1 (Standard Licence Conditions for Back-Office administrators) of the current Pension Rules for Service Providers, lays down the requirements for recognition and provides for a list of which activities constitute back-office administrative activities. From on-sites carried out, it emerged that some of the activities carried out by current back-office administrators recognised, or otherwise exempted, in Malta (for instance, compliance reporting and member beneficiaries' enquiries) went beyond back-office

administrative activities, to the extent that, some back-office administrators are, in practice, carrying out functions compatible to those of a RSA. Therefore, the MFSA proposes that the concept of back-office administration is to be removed from the RPA and any Pension Rules issued thereunder.

In view of the proposed amendment, the RSAs and back-office administrators currently recognised under the Act, as well as exempted back-office administrators, are required to carry out the necessary arrangements to comply with the removal of back-office administrative activities (for instance current back-office administrators may take the necessary steps to come in line with all the requirements applicable to a RSA, or the RSA may opt to enter into any outsourcing arrangements). Any necessary measures are to be taken until the end of June 2018. Following the proposed removal of the back-office administrator recognised under the RPA, the RSA will be permitted to outsource certain activities which the MFSA considers to be of an administrative nature.

Following the proposal of the removal of the back-office administrator recognised under the RPA, the RSA will be permitted to outsource certain activities which the MFSA considers to be of an administrative nature. These shall include the following activities:

1. *Receive application packs (including application forms and relevant documentation) and checking for completion and requesting outstanding documentation;*
2. *Inputting of member details into the Retirement Scheme Administrator's system or database;*
3. *Administrative tasks with respect to ceding schemes in relation to pension transfers;*
4. *Preparation of member statements;*
5. *Finance services, such as:*
 - *Payment of expenses*
 - *Billing (such as issuing invoices)*
 - *Time sheets postings*
 - *Processing payroll*
 - *Open bank accounts for members*
 - *Book-keeping*
 - *Checking market prices with relevant valuation (valuations produced by the investment house).*

4. Way Forward

The MFSA proposes that the new regime shall come into force on the **2nd July 2018**. In this respect, the RSA is expected to act in a prudent manner, taking into consideration these new envisaged requirements as outlined in this Consultation document, and ensuring that member's rights and expectations are not to be prejudiced, in any manner. The MFSA will host applications in line with the envisaged regime, as from **1st March 2018**, for RSAs to apply with the Authority to set-up a non-member directed Scheme where new retail members can join as from **2nd July 2018**.

It is to be noted that the amendments proposed in this Consultation Document, particularly in relation to member directed Schemes and to the removal of back-office administration, may necessitate further consequential amendments to the RPA, any regulations issued thereunder, the Pension Rules for Occupational Retirement Schemes and Pension Rules for Service Providers.

Moreover, it is to be noted that in the near future, the RPA or any regulations or Pension Rules issued thereunder, will be subject to amendments in view of the upcoming transposition exercise of Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs) (recast).

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