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FMA MINIMUM STANDARDS

FOR PENSION FUNDS (*PENSIONSKASSEN*) FOR CONDUCTING DUE DILIGENCE

(MS PK for conducting Due Diligence)

DISCLAIMER: These minimum standards do not constitute a legal regulation. They serve as guidance and reflect the FMA's legal interpretation and the FMA's practical recommendations for conduct. No rights and obligations extending over and above the provisions of the law can be derived from them. The FMA reviews on a case-by-case basis whether legal provisions were also breached as a result of the non-observance of recommendations in minimum standards.

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PRELIMINARY REMARKS

These Minimum Standards are intended for all pension funds ("PKs"; *Pensionskassen*) as defined in Article 1 PKG.

These Minimum Standards do not constitute a Regulation, but are derived from market standards and form the FMA's legal view with regard to the performance of and documentation of due diligence procedures with business partners, in particular in relation to Articles 23, 25 to 26 PKG and Article 12 para. 3 no. 3 of the FMA's Risk Management Regulation for *Pensionskassen* (PK-RIMAV; Pensionskassen-Risikomanagementverordnung).

No rights and obligations beyond those stipulated in the legal provisions can be derived from these Minimum Standards. The FMA however expects in reference to the aforementioned provisions that *Pensionskassen* conform to these FMA Minimum Standards in conjunction with the investment of assets assigned to an investment and risk-sharing group (IRG) or to the *Pensionskasse*. Where specific items contained in these FMA Minimum Standards extend beyond the aforementioned listed conditions with regard to due diligence, these are to be considered as recommendations.

These FMA Minimum Standards shall not prevent higher standards from being set and applied by *Pensionskassen*. Other FMA Minimum Standards and FMA Circulars shall remain unaffected by these Minimum Standards.

For the purpose of ensuring the interests of the beneficiaries (both entitled and recipients) and in order to achieve the best possible results by making use of appropriate measures, when concluding transactions and agreements in relation to the assets under management of the IRG and the sub-investment group (Sub-IG) as well as for the assets of the *Pensionskasse* with business partners, an appropriate **assessment of the potential contractual parties** should be conducted commensurate to the nature, scope and complexity of the business relationship. Additionally **comparisons of offers and market-based comparisons** in relation to the specific delegation of tasks and procurement assignments should be undertaken, in order on the one hand to ensure that the risk of the beneficiaries (entitled and recipients) suffering financially as a result of a business partner is kept as low as possible, while also on the other hand ensuring that the definitive best possible offer is obtained. "best possible" should be understood in such a way in conjunction with the wording "appropriate measures" from the FMA's perspective, that **depending on the significance and value** of the respective assignment (i.e. on a case-by-case basis) adequate effort is to be taken for deciding on the best possible way of proceeding in accordance with the principles of due diligence of orderliness and meticulousness.

The FMA expressly believes that due diligence must also be undertaken in the case of **intragroup delegations or assignments** (e.g. as management company, custodian bank) and as applicable arms-length transactions arranged.

The purpose of undertaking due diligence is to identify a suitable business partner as well as to ensure the best possible mitigation of business risk. For this purpose, due diligence of the potential business partner must be undertaken on a case-by-case basis in either the normal amount of depth ("**Basic Due Diligence**") or in greater depth ("**Enhanced Due Diligence**"). A *Pensionskasse* may only decide once an appropriate due diligence has been conducted which entity is sufficiently suitable as a potential business partner to ensure the best interests of the beneficiaries (entitled and recipients) are respected. The decision making process shall be

required to be documented accordingly and a regular review conducted about the appointed business partner about its continuing suitability ("**Ongoing Due Diligence**") and is intended to reinforce the obligation to achieve the best possible outcome and to ensure that the interests of the beneficiaries (entitled and recipients) are guaranteed.

A. BUSINESS PARTNERS

The umbrella term "business partners" covers all kinds of contractual partners, facilities, service providers, advisors, management companies and custodian banks (cf. Article 26 PKG), lending partners etc. in conjunction with investment management, administrative activities, step-by-step transactions such as the buying and selling of securities, cash held at credit institutions, derivative contracts, outsourcing of risk management (cf. also Article 16 PK-RIMAV) and of investment activities, advisory services, custody services, validation, prime brokerage etc. This list is not to be considered as exhaustive.

B. INITIAL DUE DILIGENCE

1. BASIC DUE DILIGENCE

Basic due diligence of potential business partners must be carried out **prior to the commencement of a business relationship**. Relevant information must be collected about the business partner for risk assessment purposes and subsequently to reach a decision about the business partner's suitability, in particular with regard to the following **non-exhaustive** list of issues:

- personal reliability;
- professional competence, qualifications and authorisations;
- credit quality;
- capacities;
- the registered office of the contractual party or their head office (with regard to any other necessary legal enforcement);
- any supervision by another supervisory authority than the FMA;
- reputation;
- evaluation of previous experience with regard to satisfaction/problems/cooperation (using a scoring);
- media reports or similar.

2. ENHANCED DUE DILIGENCE

Enhanced due diligence shall be conducted in the case of there being **an increased business risk or an increased significance of transactions**. Enhanced due diligence should be understood as a more **in-depth review of the potential business partner** than a mere estimation on the basis of the information gathered ("basic due diligence"), e.g. where the business relationship affects material duties in relation to asset management by the *Pensionskasse*, or where other relevant justification exists that confirms the necessity of performing more detailed due diligence. Where it is necessary to conduct Enhanced Due Diligence, depending on the nature, scope and complexity of the business relationship conducted, in addition to Basic Due Diligence an on-site visit as well as, in particular in the

case of a business relationship being initiated for the first time, detailed research about the potential business partner are to be conducted, and more in-depth information collected. Furthermore all measures that appear to be necessary in the specific case in hand must be taken to ensure the orderly, careful and conscientious conducting of business.

Enhanced Due Diligence shall in any case be required to be conducted in the following cases, although the list below merely **contains a number of examples**, and is not to be considered exhaustive:

- where the volume of the assignment is large;
- where particularly risky transactions are involved;
- where the length of the contract is particularly long without the possibility of early termination, or where early termination is only possible with considerable difficulty;
- when choosing a fund manager, to managing a substantial proportion of the IRG assets;
- when choosing a custodian bank;
- when choosing a valuer;
- when entrusting someone to execute orders;
- where risk management and investment activities are outsourced;
- where supervision and checking the orderly performance of duties or assignments (e.g. due to compatibility issues for PC systems; or the registered office of the business partner being located abroad) is only partially possible, or only possible with considerable difficulty;
- where assets are to be deposited, e.g. margins at brokers; physical custody of assets, sight deposits (except at credit institutions pursuant to Article 72 InvFG 2011);
- where the registered office of the potential business partner is located outside the European Union, due to the increased difficulty with regard to legal enforcement in the event of breaches of contracts;
- where negative information is currently in the public domain about the contractual partner, although in such cases Enhanced Due Diligence is to be performed in advance.

In all such cases where Enhanced Due Diligence has to be conducted, appropriate **representative arms-length comparisons** should be made by obtaining bids from business partners that are classified as being suitable when transferring duties or awarding contracts.

The quantity and scope of the bids to be collected (and whether to merely collect market prices, or to request specific, detailed and comparable contractual bids, putting bids out to tender etc.) shall be determined based on the volume of the contract, the risks existing in relation to default and liquidity, the significance of intended contract, the planned duration of the contract, the number of the potentially available business partners for the contract in question, and should be considered on a case-by-case basis. From the bids received, once they have been reviewed for comparability with one another, **the best bid** (not necessarily the lowest offer in terms of price) is to be selected based on criteria applicable to the case in hand, taking into consideration the declaration on the investment policy principles pursuant to Article 25a PKG.

C. ONGOING DUE DILIGENCE

Ongoing or ad hoc due diligence is to be undertaken in **ongoing business relationships** at regular intervals, as well as whenever problems occur or where current negative media reports exist in relation to the business partner. *Pensionskassen* must remain convinced on an ongoing basis about the suitability of the business partner by reviewing the information gathered during the initial Due Diligence. The business relationship must also be subjected to a **regular re-evaluation**. If Enhanced Due Diligence is necessary as a result of a change in circumstances, then either ad hoc or regular on-site visits must be undertaken. The decision about the extent of the collected information and as applicable the conducting of an on-site visit is the responsibility of the *Pensionskasse*.

D. DOCUMENTATION AND REQUIREMENT OF THE WRITTEN FORM

The documentation should **reflect the factual decision making process as clearly and plausibly as possible**, in particular also in relation with the counterbids received or the comparability checks conducted regarding market prices etc. The reasons for the decision in favour of or against commencing or continuing business relationships must be documented **in writing** in a justifiable manner, and must be retained along with the collected information for documentation purposes. The FMA recommends as a best practice that initial information is collected directly from potential business partners by means of questionnaires.

Any problems or irregularities during the business relationship or the performance of an assignment as well as how such issues are handled and any follow-up measures should also be documented. It should also be stated whether a further business relationship should be avoided or why the business relationship should be continued. The document should also contain details about the reasons for undertaking a basic or enhanced due diligence.

Any kinds of delegations and **contractual agreements** should in any case also be made by *Pensionskassen* **in written form**.

E. PROCESSES

Pensionskassen shall establish corresponding **internal processes**, in accordance with which due diligence shall be performed, and where business partners are to be selected following due diligence having been conducted. These processes must be documented in the internal guidelines pursuant to Article 11 PK-RIMAV. Depending on the category of business, business partners that have been checked and established to be suitable are to be communicated internally to the responsible persons (e.g. those authorised to conclude the transaction). Furthermore processes are to be drawn up and responsibilities assigned regarding the conducting of (initial and ongoing) due diligence, approval of business partners etc.

F. EXISTING BUSINESS RELATIONSHIPS

In such cases, where the business arrangement was **already concluded before 01 June 2016**, these Minimum Standards shall apply to the extent that **ongoing due diligence** shall be required to be performed.

CONCLUDING REMARKS

In conclusion, the FMA advises that the assessment regarding the depth and scope in which due diligence as well as arm's length comparisons are to be undertaken, depends on the individual case in hand, and must therefore be decided upon by the competent *Pensionskasse*, and that the measures to be taken should also be applied for existing contracts.