



Pension Fund Governance: Challenge and Potential Solutions

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Private Pension Governance

- ***Involves:*** managerial control and organization, including the regulation, supervision and accountability of management boards
- ***Goal:*** minimize potential agency problems or conflicts of interest between fund members and the fund administrator which can adversely affect the security of pension savings and promises
- ***Benefits:*** may improve the performance of the fund and creates trust amongst stakeholders

Good pension fund governance is a vital element for the efficient functioning of private pension systems

Legal Forms of Pension Fund + Governance Implications

- ***Institutional***: fund is an independent entity, with a legal personality and its own internal governing board (sometimes 2 tier).
Denmark, Hungary, Italy, Japan, Netherlands
- ***Contractual***: fund is a segregated pool of assets without legal personality governed by a separate entity, typically a financial institution such as a bank, insurance company or pension fund management company.
Czech Republic, Portugal, Mexico, Turkey
- ***Trust***: pension fund assets owned by trust, but administered in the interests of beneficiaries. Trustees are the governing board of the fund – can have corporate trustees.
UK, Ireland, Australia, South Africa
- ***Closed vs. Open***: funds which do or do not restrict membership. Market discipline aids governance but costs are an issue.
- ***Occupational vs. Personal***: plans sponsor vs. individual vacuum



OECD Work on Private Pension Governance

- **OECD has been the leading international body in the field of pension fund governance – building on the standard setting work on corporate governance**
 - **2000 started work**
 - **2002 published ‘Guidelines on Pension Fund Governance’**
 - **2005 approved by the OECD Council - 30 member countries**
 - **2008 revised guidelines (now with Council for approval)**

OECD reports available on www.oecd.org

Guidelines on Pension Fund Governance

I. Governance Structure

“ The governance structure should ensure an appropriate division of operation and oversight responsibilities, and the accountability and suitability of those with such responsibilities.”

- ✓ Identification of responsibilities
- ✓ Governing body
- ✓ Delegation / Expert Advice
- ✓ Auditor / Actuary / Custodian
- ✓ Accountability
- ✓ Suitability

Guidelines on Pension Fund Governance

II. Governance Mechanisms

“Pension funds should have appropriate control, communication and incentive mechanisms that encourage good decision making, proper and timely execution, transparency and regular review and assessment.”

- ✓ Risk-based Internal Controls
- ✓ Reporting
- ✓ Disclosure

Recent Developments

- **The topic has been rising up the policy agenda**
 - *Lessons learnt from corporate governance*
 - *Link between governance and performance*
 - *Important for protecting beneficiaries*
 - *Move to risk-based supervision*
 - *Macro impact*
- **Public authorities + national institutions have issued regulation and guidance**
 - *Netherlands / Brazil/ South Africa*
 - *Associations in UK/ Canada*

BUT SURVEYS STILL SHOW CONSIDERABLE WEAKNESS

Main Challenges Still Outstanding

- **Quality and structure of Board**
 - *Operational weakness stemming from poorly defined responsibilities*
 - *Weakness in composition and suitability of the Board*
 - *Lack of trustee / fiduciary knowledge + training*
 - *Inability to understand the advice of experts*
- **Conflicts of interest within boards + with commercial trustees**
- **Governance vacuum within DC funds**

Surveyed international experience + suggest some possible solutions

Problems and Solutions

Define the Board's Responsibilities

- *Ensure legislation defines main duties of pension fund boards (setting investment policy, selection + monitoring of executives + external service providers, monitor performance)*
- *Statutes of pension fund should also clearly define the roles + set out measurable objectives*
- *Encourage Board members to restate annually that they know and have fulfilled their obligations*
- *Use subcommittees to ensure key issues are covered + appoint a top executive responsible for investment management*

Problems and Solutions

Composition + Suitability of Board

- *Encourage employee/ member nominated representatives*
- *Provide templates for ideal board mix*
- *Describe fit + proper more accurately (including collective knowledge of the Board + requiring sufficient training)*
- *Consider the costs + benefits of licensing trustees*
- *Allow + encourage the use of independent, professional trustees*

Problems and Solutions

Ensure regular self-assessment + training

- *Encourage self-assessment by Boards*
- *Allow third-party monitoring*
- *Provide guidance on level + types of knowledge required of trustees*
- *Encourage trustee training – ongoing basis*
- *Provide free training (e.g. on-line)*
- *Advise trustees where training can be obtained*
- *Approve training courses*
- *Allow fund to pay for training of trustees*
- *Encourage use of experts to provide technical support (though stress trustees should not rely on one source + require knowledge to assess such advise adequately)*

Problems and Solutions

Handling Conflicts of Interest

- *Require a policy for identifying potential conflicts of interest and for dealing with them + require Board members to notify compliance on an annual basis*
- *Disclose conflicts (in minutes of Board meetings)*
- *Conflicted trustees abstain from voting (resign as last resort)*
- *Authority should have the ability to appoint independent trustees*
- *Appoint an independent trustee where the sponsor is the sole trustee + sponsoring firm is in liquidation*

Problems and Solutions

Governance Vacuum DC funds

Members govern themselves

- Improve disclosure (e.g. provide comparative performance + fees table)
- Improve communication to members (e.g. personal statements with est. income, peer comparisons)

DC Governance Structure

- Ensure governance for DC scheme is in place
- Encourage boards to pay sufficient attention to DC
- Encourage boards to ensure that individual choice + default options are structured properly
- Where members assume risk should have say in key appointments
- Ensure ongoing monitoring of investments (plan sponsor –with safe-harbour – or committee)
- Safe-harbour rules allow pension providers fulfil duties

Supervisory authority

- Strengthen monitoring role

Ongoing OECD Work

- Suggestions support the proposed amendments to the OECD Pension Fund Governance Guidelines
- Please provide examples/ good practices in your countries
- Case studies of pension funds with strong governance structures also welcome

Your input is most welcome!