

## PENSION FUND GOVERNANCE

(Note by the OECD Secretariat)

### 1. Introduction

1. This report looks at governance issues raised by the structure and operations of autonomous pension funds in OECD countries. Autonomous pension funds are here defined as either independent legal entities or legally segregated pools of assets that are dedicated mainly to the provision of retirement and related benefits<sup>1</sup>. Autonomous pension funds exist in all OECD countries except the **Slovak Republic**, and **Turkey**, where the law does not recognise such entities<sup>2</sup>. Non-autonomous pension funds consist of reserves and other assets that are not legally separate from the plan sponsor or administrator (e.g. book reserves and other pension plan assets over which the plan sponsor has legal ownership). They are still popular in a few OECD countries, such as **Germany** and **Sweden**.

2. Autonomous pension funds hold the vast portion of pension plan assets in OECD countries. They have also experienced significant growth in recent years in the OECD. In **Hungary**, **Mexico**, and **Poland**, such pension funds have been established to support mandatory pension plans that replace partly the PAYG public pension systems. In other countries such as the **Czech Republic**, **Italy**, **Portugal**, and **Spain**, autonomous pension funds have been introduced as voluntary instruments for retirement provision.

3. Pension funds<sup>3</sup> are administered by one party (the administrator or governing body) for the benefit of the members and beneficiaries of a pension plan. In occupational pension plans, a third party (the plan sponsor) may be involved in the establishment and the operation of the pension fund. Such institutional arrangements create a role for governments to ensure that pension plan members and beneficiaries are adequately protected from conflicts of interest and related agency problems.

4. There are two instances, however, where the regulator's concerns over such problems would normally be abated:

- When the plan member and the fund administrator or governing body is the same person<sup>4</sup>: in such cases, there is no agency risk, because investment decisions are taken by the person that will receive the pension benefits.

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1. A more precise description of this and related terms can be found in the glossary in Annex 2.

2. The report does not cover pension funds in France and Greece either, due to lack of information. On the other hand, it covers the German *pensionskassen*, which are actually insurance undertakings. Despite not being pension funds under the OECD definition, their inclusion is deemed important for comparative purposes.

3. From now on, any reference to pension funds will refer to the autonomous type.

4. Individuals can set up their own funds in some OECD countries such as **Australia** (self-managed Superannuation Funds) and in the **United States** (pension funds of Keogh plans). The 401(k) plans in The

- When the pool of assets is invested exclusively in already regulated financial products (such as insurance contracts, collective investment schemes, or bank deposits): in such cases, the pension fund's pool of assets is not a different product from the underlying financial products in which the assets are invested. It can therefore be argued that existing regulations for the provider of the underlying products should already provide sufficient protection against agency risks in how that product is managed<sup>5</sup>.

5. On the other hand, to the extent that the governing body of the pension fund is different from the pension plan member and the pension fund's pool of assets is not invested only in already regulated financial products (that is to the extent that the pool of assets is really treated as a separate product), policymakers must design a regulatory framework, including a governance framework, for the management of those assets.

6. The key question policymakers must ask themselves is: how can the pension fund governance framework best protect the interest of pension plan members or beneficiaries? This document aims to answer this question and to describe the existing arrangements in OECD countries (in Annex 1). Annex 2 contains a glossary of terms related to pension fund governance. The focus of this document is on pension funds that are administered by persons other than plan members and which are not exclusively invested in already regulated financial products.

7. In order to protect the interest of plan members and beneficiaries, governance regulations should cover the functions and the decision-making process of pension funds and should offer pension plan members and beneficiaries channels to monitor those responsible for the management of pension funds<sup>6</sup>.

8. Effective regulation of the governance structure of pension funds includes the establishment of a transparent framework for the division of responsibilities in the operation and oversight of the pension fund, and the accountability and suitability of all parties involved in the pension fund process. Governance regulations must also define the mechanisms for internal control, communication, and redress for pension plan members and beneficiaries.

## 2. Corporate governance and pension plan management

9. Private pension plans function on the basis of agency relationships between plan members and beneficiaries, on the one hand, and the persons or entities involved in the administration or financing of the pension plan, such as the plan sponsor and the plan administrator, on the other. The plan statutes or

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**United States** also involve some degree of member responsibility over the investment of fund assets, but the plan sponsor also acts as governing body by limiting the extent of investment instruments in which pension contributions can be invested. Moreover, such plans are largely invested in already regulated financial products, such as mutual funds and guaranteed investment contracts underwritten by insurance companies. In some plans, however, company stock is also an investment option, which raises governance concerns.

5. Governance regulations would still be required to ensure that the choice of financial product is an adequate one given the members' characteristics or the plan's liabilities.
6. In complement to governance regulations, other aspects of the pension regulation, such as portability rules, can also function as disciplining mechanisms for the governing body of the pension fund. Portability, however, does not offer any compensation for lost benefits or mismanaged pension assets. Moreover, the ability to switch between pension funds may be costly for plan members, especially when benefit formulas are back-loaded or there are high administration charges.

contract specifies the schedule of contributions and possibly benefits which will be received as part of this plan.

10. The governance of these plans consists of all the relationships between the different entities and persons involved in the functioning of the pension plan. Governance also provides the structure through which the objectives of a pension plan are set, and the means of attaining those objectives and monitoring performance. It is the mirror image of the corporate governance of a public limited company, which consists of the set of relationships between the company's management, board, shareholders, and other stakeholders.

11. The OECD Principles for the Regulation of Private Occupational Pensions Schemes (see DAF/AS/PEN/WD(99)18/Rev3) cover various aspects of pension plan governance, based on the premise that the security of private pension plans is best served via funding. These regulatory guidelines have as their main aim the protection of beneficiaries' rights and ensuring the financial security of the schemes. The prohibition of unfunded or PAYG private pension plans is a basic pillar of this goal.

12. The principles also recommend that funding should take via a separate legal entity, which may be an autonomous pension fund (an independent legal entity), an insurance company, or another financial entity. In the case where the funds are not independent legal entities, that is when the pension assets are not legally separated from the plan sponsor (a non-autonomous pension fund as in the book reserve system), the pension plan liabilities should be properly insured.

13. The governance structure of a private, funded pension plan depends primarily on three factors:

- whether the plan is a defined contribution (DC), defined benefit (DB), or a hybrid plan,
- whether the plan is occupational or personal.
- whether the plan operates in a mandatory or voluntary pension system.

14. In most OECD countries, DB plans are (still) typical, in particular in the case of occupational pension plans. However, the importance of DC plans is increasing in many countries, while reforms to social security systems in several countries have led to the introduction of DC plans (see DAF/AS/PEN/WD(2001)1).

15. In DC plans, pension plan sponsors or/and administrators do not underwrite any of the financial or biometric risks that are concomitant to funded pension plans. Instead, the plan's benefits are determined purely on the basis of the interest earned on invested assets. Hence, the only governance issues that arise are over the timely payment of contributions and benefits, the management of the plan's assets (including performance measures and assessment), reporting to the supervisory authorities, and disclosure of relevant information to plan members.

16. In DB and hybrid plans, on the other hand, either the pension plan sponsor or the administrator insures beneficiaries against some form of financial or biometric risk. The plan may offer a guaranteed minimum rate of return on investments or annuitisation rate, or it may specify the formula through which benefits will be calculated, based on some measure of the employee's past earnings.

17. The presence of some form of guarantee raises additional governance issues. In particular, it creates an additional responsibility on the plan sponsor or/and the plan administrator to honour that promise. This added responsibility requires additional internal controls and monitoring to ensure that an adequate level of funding is kept at all times to ensure that these promises can be met.

18. In order to ensure that pension plan sponsors and administrators introduce such controls, regulations are put in place which specify various aspects of pension plan governance, such as the extent to which pension assets should be separated from the plan sponsor, the appointment of experts to evaluate the future liabilities of the pension plan and the schedule of contributions required to finance them, or the types of institutions that are permitted to manage pension assets.

19. Occupational and personal plans also raise different governance issues. In occupational plans, the employer normally acts as intermediary between the plan member and the institutions involved in the administration of the pension plan. Personal pension plans, on the other hand, are provided directly in the retail market by financial institutions. The only role of the employer in these plans may be to channel part of the worker's salary to these plans. Hence, regulations should focus on the governance of those financial companies and the pension plans they provide, as well as on the disclosure of information towards participants.

20. To the extent that pension regulators deem that personal plans can be products offered "on balance sheet" by standard financial intermediaries (insurance companies, banks, and collective investment scheme providers), there is little justification for introducing governance requirements on these institutions. Existing regulations should already ensure that these companies are solvent and that they honour their pension promises or manage pension assets prudently. Nonetheless, regulators may still require from these companies an adherence to specific pension plan governance requirements. For example, disclosure requirements may be more demanding. Regulators may also require more transparency in fee structures and net of fees performance than may be the case for other financial products.

21. The situation is completely different in the case of occupational and personal pension plans that are financed via autonomous pension funds. The segregation of a pool of assets for the provision of pension benefits raises the obvious question of how the funds are to be managed. Because of their nature, therefore, pension funds and their governing bodies require specific governance regulations that may not always be equivalent to those applied to other institutions involved in pension provision.

22. Finally, governance regulations of pension plans may vary depending on whether participation in these plans is mandatory or not. To the extent that participation is mandatory, the fiduciary responsibility of the state to ensure an adequate management of the pension plans and funds increases. Consequently, governance regulations of mandatory plans can be expected to be more onerous than those of voluntary plans.

### **3. Pension fund types and governance implications**

23. All autonomous pension funds have a governing body or administrator, which is the person(s) or entity(ies) responsible for the operation and oversight of the pension fund. The governing body may be internal or external to the pension fund, depending on the legal form of the fund. It may carry out operational tasks itself, or it may delegate these to other entities, including external service providers such as consultants, actuaries, and asset managers.

24. There are two types of autonomous pension funds, an institutional type, where the fund is an independent legal entity with legal personality and capacity, and a contractual type, where the pension fund consists of a segregated pool of assets without legal personality and capacity. Institutional funds have internal governing bodies. Contractual funds, on the other hand, are administered by external governing bodies, which may be a standard financial institution, or a specialised pension fund managing company,

and whose assets are legally separated from those of the pension fund. Furthermore, pension funds can be distinguished according to the nature of the legal title to ownership of pension fund assets.

25. Pension funds of the institutional type can take three main legal forms:

- In the corporate form, the plan members have legal title to the pension assets or capital. The governing body is internal, usually a board of directors. Examples of the corporate form include the *Pensionskassen* (normally set ups as mutual insurance associations) and the *Unterstützungskassen* (when set up as limited liability companies or associations) in **Germany**, the pension funds in **Hungary** (similar to mutual savings associations) that operate in both the mandatory and voluntary pension systems, the closed pension funds in **Belgium** (mutual assurance association) and **Italy** (associations), the pension funds in **Switzerland** set up as co-operative societies, the open pension funds in **Mexico** (investment societies)<sup>7</sup>, the pension funds in **Austria** (joint-stock companies, called *pensionskassen*), and the pension funds in the **Czech Republic** (joint-stock companies).
- In the foundation form, plan members do not have legal title to the pension fund assets, except, possibly, in some cases, such as bankruptcy of the plan sponsor or unwinding of the plan. Plan members are, on the other hand, the beneficiaries from the investment of those assets, and may hold legal rights over the plan benefits that the pension fund supports. The governing body is internal, usually a board of directors. Examples of pension funds operating as foundations include some close pension funds in **Belgium, Italy, Germany** (*Unterstützungskassen*), and **Switzerland**, and closed pension funds in **Denmark, Finland, the Netherlands, Norway, and Sweden**.
- In the trust form, the legal title to the pension fund assets in a trust are vested on trustees, who are the governing body of the fund<sup>8</sup>. Trustees must administer the trust assets in the sole interest of the plan participants, who are the beneficiaries from the investment of those assets according to the trust deed. The basic principle of trust law is that the assets of each trust must be segregated from the assets of all other trusts administered by the trustee and from its own assets. All Anglo-Saxon countries (**Australia, Canada, Ireland, New Zealand, United Kingdom, and United States**) recognise the trust as the main or only legal form for pension funds<sup>9</sup>.

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7. In Mexico, however, pension funds, must be managed by specialised pension fund managing companies dedicated exclusively to this purpose.

8. In the **United States**, however, it is possible for plan sponsors to set up pension funds where the trustee is devoid of any operational or governance responsibilities except holding the title to the assets. The governing body is then the plan sponsor or/and some third party, who act as the plan, and therefore the fund, fiduciaries. Where the pension funds are administered by third parties, the trust form is equivalent to the contractual form in everything but name.

9. The separate account of insurance companies in the United States could also be included under the trust form, since they are subject to the same legal standards as other pension assets.

26. Pension funds of the contractual type can take two main legal forms:

- In the individual contractual form, the plan members have a legal title to the pension fund assets. The closed and open pension funds of **Poland, Portugal, and Spain**, and the **Italian** open pension funds are established in this legal form. In **Poland and Portugal**, the funds are managed by pension fund managing companies, which are entities dedicated exclusively to the management of pension funds<sup>10</sup>. In **Italy and Spain**, the governing body can also be an existing financial company, such as a bank or insurance company.
- In the collective/group contractual form, the plan members are the beneficiaries of the investment of the pension fund assets. The pension funds that support the retirement allowance plans in **Korea** and the pension funds that support Tax Qualified Plans in **Japan** are of the collective contractual form. The pension funds that support the new DC plans in **Japan** will also be of this form, and they will be administered by pension fund managing companies. The *pensionsfonds* that will operate in **Germany** as of 2002 will also be of this form. However, their precise governance features are yet to be determined.

#### MAIN LEGAL FORMS FOR AUTONOMOUS PENSION FUNDS

	<b>Legal title to pension assets</b>	<b>No legal title to pension assets</b>
<b>Legal personality and capacity (institutional form)</b>	Corporate form	Foundation, trust
<b>No legal personality or capacity (contractual form)</b>	Individual contractual form	Collective / group contractual form

27. There is no a priori reason to prefer one legal form over another, the decision being based normally on the type of pension plan (occupational or personal), the legal tradition of the country, and tax considerations. However, the form chosen by a pension fund must be legally recognised in the home jurisdiction of the country where the pension fund is licensed or registered.

28. Another important classification of pension funds is based on the nature of membership:

- **Closed pension funds**: funds that support only pension plans that are limited to certain employees (e.g. those of an employer or group of employers)
- **Open pension funds**: funds that support at least one plan with no restriction on membership (collective membership may be possible, however).

29. Closed and open funds differ in the extent of portability and individual choice. Portability between closed funds is normally only limited to the case where an employer changes jobs and switches to the new company's pension plan. However, employers may establish several closed funds with different

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10 In Portugal, however, life insurance companies have been allowed since 1986 to manage directly pension funds.

risk-return characteristics and permit their employees to choose between these. In open funds, individuals normally can switch funds as frequently as they wish, though sometimes regulators may impose limits on the switching frequency in order to mitigate the adverse impact of fees on pension savings. Plan members therefore find it easier to "vote with their feet" in open pension funds and discipline the pension fund governing body by exiting the fund.

30. Closed pension funds, however, can have a significant cost advantage over open funds, since they have stable and in most cases guaranteed membership, as a result of automatic enrolment to the pension plan as part of the employment contract. Closed pension funds, therefore, do not require marketing and advertising expenses to attract membership. Open pension funds, on the other hand, must rely on costly distribution channels, such as agencies and sales agents as well as advertising campaigns to attract membership. Since expenses are to some extent passed on to plan members in the form of fees and commissions, the way the distribution channel is managed can impact significantly on retirement benefits.

31. The type of plan also has important implications for pension fund governance. In the case of occupational plans, there are two parties involved in the administration of the pension fund, the employer or plan sponsor and the pension fund governing body. In the case of personal pension plans, on the other hand, there is only the governing body of the fund itself.

32. Whether the pension plan is of a defined benefit or defined contribution nature will also have implications for the legal form and governance structure of the pension fund. Actuaries and other insurance experts will be required in funds that support defined benefit plans in order to ensure their solvency.

#### **4. Agency risks**

33. To the extent that pension plans are financed through a pension fund, the question arises of what role governance mechanisms can play to ensure that the funds are used for their rightful purpose, which is to provide income for retirement purposes. Agency problems, or conflicts of interest, can arise because those who own the pension fund assets or benefit from their investment (the pension plan members and their beneficiaries) are not the same as those who exert control over the operation of the pension fund (the governing body of the pension fund and, in some cases, the plan sponsor). These conflicts of interest can be detrimental to the security of pension savings and benefit promises.

34. One risk in pension fund administration common to all pension funds is outright fraud and misappropriation of pension fund assets by the pension fund governing body or the plan sponsor. It could occur, for example, that a member of the governing body or the plan sponsor abuses its power to borrow money from the pension fund or simply appropriates some of its assets. In the Maxwell case in the United Kingdom, for example, the closed pension fund of the holding companies linked to the late Robert Maxwell was used to prop up the share price of insolvent companies that were part of this holding. Cases of fraud can equally arise in open funds: the members of the governing body may for example misrepresent the assets in the pension fund or the value of the individual accounts and misappropriate part of the pension fund. They may also use the pension fund assets to prop up the shares of the parent company that owns the pension fund governing body (e.g. the pension fund managing company).

35. In addition to fraud and misrepresentation, the abuse of agency relationships could occur in other ways. Asset managers of pension funds could use the fund to support issues of securities underwritten by the parent organisation. In extreme cases, these funds could be used to purchase assets that could not be placed in a public offering. Affiliated market intermediaries may be offered priority in trade execution, and

the pension fund may trade excessively in order to increase the commission income of these intermediaries or the parent company (churning of portfolios).

36. There is also a danger that the members of the governing body or other entities involved in the pension fund administration (e.g. asset manager) may improperly use the privileged or confidential information they have obtained through the administration of the pension fund. For example, a member of the governing body may sell off the shares of the company that sponsors the pension plan when a situation of underfunding is first revealed to the governing body.

37. Agency risks can also take more general forms, such as slack by employees, or failure to maximise the performance of a pension fund as a result of misunderstandings or other operational failures. Other, more specific conflicts of interest and agency risks can arise, which depend on:

- whether the pension fund is closed or open
- the legal form of the pension fund

38. In closed pension funds, employers may have an interest in using the pension fund as a source of internal financing or as a productivity-enhancing incentive mechanism for its employees by investing the pension fund in company assets.

39. Additional conflicts of interest can arise in the distribution and marketing side of open pension funds, because the personal pension plans that they support are sold in the retail sector. The remuneration structure for sales personnel, for example, may create incentives in these to convince individual consumers to join personal plans when it may not be in their best interest to do so. The United Kingdom's experience with the misselling of personal pension plans shows that uninformed consumers can suffer from personal plan providers that care only about their own interest.

40. The legal form of the pension fund also determines other types of conflict of interest that can arise between the governing body and plan sponsor of a pension fund, on the one hand, and the plan member on the other. In the case of pension funds established in the individual contractual form, ownership rights over the pension assets are clearly established. The plan members have a legal title to a specific portion of the pension fund. In the corporate form, on the other hand, there can be some confusion between the fund's own capital and the pension assets, especially when the fund supports a defined benefit plan or other plan with pension promises.

41. In pension funds set up as foundations, trusts, or in the collective contractual form, the plan members are the beneficiaries, not the owners of the pension fund's assets. Except in some special cases, such as termination of the plan, or bankruptcy of the plan sponsor, members of defined benefit and other plans with pension promises may not be able to claim legal title to the fund's assets. This relationship can be the source of conflicts of interest. Employers may have incentives to terminate a defined benefit plan in order to appropriate the fund's surplus, or they may take excessively long contribution holidays that may endanger the long-term solvency of the plan. When these funds support defined contribution plans, meanwhile, plan members should always have right to ownership of the fund's assets originating from their own contributions, but their right to the employer's contributions will depend on vesting rules.

## **5. Pension fund governance regulation**

42. In the broadest sense, the task of governance of a pension fund can be conceived as a set of arrangements, including a well-defined legal and regulatory framework for the protection of plan members' interest. A perfect system of governance would give all the parties involved in the operation and

oversight of the pension fund the right incentives to act in the best interest of the pension fund members and ensure the highest degree of retirement security.

43. The OECD Principles of Corporate Governance developed in relation to the corporation - transparency, accountability, fairness, and responsibility - provide a useful general framework for pension fund governance. These principles can be applied to two aspects of pension fund governance: the governance structure and governance mechanisms.

44. An effective pension fund governance structure requires identifying responsibilities in pension fund operation and oversight, ensuring the accountability of the parties involved, and requiring minimum suitability standards to ensure the professionalism of the responsible persons or entities and the absence of conflicts of interest. Good governance requires also the establishment of appropriate control, communication, and incentive mechanisms that encourage good decision making, proper and timely execution, transparency, and regular review and assessment.

45. While plan sponsors and providers may recognise themselves the need for effective governance structures and mechanisms, which may be incorporated in some Codes of Conduct for the industry and in the pension fund statutes, the general framework of pension fund governance should be addressed with relevant regulation.

46. The regulatory framework for pension fund governance should be based on the basic requirement for pension funds to be established under a legally recognised form in the home jurisdiction of the country where the pension fund is licensed or registered.

47. Governance regulations should cover the following aspects of the governance structure:

- the legal form that a pension fund can take
- whether the governing body or administrator will be internal or external to the pension fund, and whether employers or plan sponsors also play a role in it.
- the responsibilities of the governing body, its accountability, and the suitability requirements for being a member of the governing body or provide professional services to a pension fund.
- the extent of functional delegation required or possible for specific duties such as actuarial analysis, auditing, asset management, and benefit payment administration.

48. Regulations must also address various governance mechanisms:

- internal controls to address conflicts of interest, ensure adequate incentives through performance reviews and appropriate compensation, and ensure efficient communication channels within the pension fund.
- disclosure of relevant information to pension fund members on a timely and clear manner.
- redress mechanisms for pension plan members and beneficiaries to discipline mismanagement by those responsible for the operation and oversight of the pension fund.

49. Some of these regulations (e.g. division of responsibilities, suitability, and internal controls) aim at containing conflicts of interest by specifying certain requirements on the legal structure of the pension fund, its governing body (including the plan sponsor) and other parties involved in the pension fund

process, and the relationship between all these persons and entities. Regulations on accountability, disclosure, and redress mechanisms, on the other hand, aim at empowering individuals with monitoring, oversight, and disciplining powers over those responsible plan sponsor and the governing body.

50. The regulatory framework for pension fund governance must first of all distinguish between those entities that are already subject to an appropriate regulatory and supervisory framework and those that require regulations specific to institutions involved in the administration of pension funds.

51. Where pension funds are set up in the contractual form, the governing body may be a financial company that is engaged in another financial sector (such as insurance companies in Portugal and Spain). It is then clearly up to the respective regulatory bodies to impose adequate regulations on these institutions to ensure that pension funds are adequately managed. Similar regulations must be imposed on all financial companies that can offer asset management services to pension funds, irrespective of their legal form.

52. Where the governing body of a pension fund set up in the contractual form is a pension fund managing company exclusively dedicated to managing pension funds, one important question is whether the pension fund managing company should be subject to specific governance regulations or whether existing regulations applying to related institutions, such as insurance companies and collective investment instruments could be applied to them also.

53. The answer to this question depends partly on whether the pension plan that the pension fund supports is of a defined contribution or a defined benefit/hybrid nature. In the former case, it can be argued that the functions of the pension fund managing company are very similar to those of a collective investment scheme provider. In the case of defined benefit/hybrid schemes, where the pension fund managing company itself underwrites some risks, the functions of the entity are closer to those of an insurance company.

54. In the case of pension funds set up as trusts, trust law dictates some basic governance requirements, such as the separation of the assets of each trust and from the assets of the trustee. However, governance regulations need still specify certain aspects of the relationship of the plan sponsor vis-à-vis the trustees as well as the general responsibilities and duties of the trustees when they manage pension funds.

55. Specific pension fund governance regulations must also be designed for pension funds established in the corporate form (e.g. co-operatives, mutual assurance and savings associations), and as foundations. Regulations must also distinguish between pension funds that have only asset management responsibilities and those that have additional responsibilities, such as contribution collection, payment of benefits. In some cases (e.g. **Hungary**), the pension fund may also underwrite itself directly biometric or/and financial risks, without any backing from the plan sponsor. In such cases, they function like insurance companies and should be in principle subject to similar regulations.

56. Governance regulations have not always been present in all countries. Most often, they have been introduced as a response to cases of fraud or misappropriation of pension assets. In the **United Kingdom**, for example, the decision to enhance the responsibility of trustees over pension fund management and to increase their independence vis-à-vis employers was mainly a response to the Maxwell scandal, in which the Maxwell companies' main pension fund lost a large part of its assets as a result of lending to and investment in insolvent companies linked to the late Robert Maxwell. Similarly, the fiduciary standards introduced by the 1974 ERISA law in the **United States** were largely in response to various unhappy episodes of fraud in pension fund management and of plan insolvency caused by the bankruptcy of the plan sponsor.

### ***5.1 The governance structure of the pension fund***

57. Governance regulations should set out the general framework for the division of responsibilities, the accountability and the suitability of all parties involved in the administration of the pension fund. The governance structure and the responsibilities of the person(s) or entity(ies) party to it should be clearly stated in the fund statutes, regulations, by-laws, or contract. These documents should be made readily available to all plan members.

58. Regulations should require that every pension fund has a designated governing body or administrator that is responsible for the operation and oversight of the pension fund. This governing body may be a person or a committee of persons internal to the governance structure of the pension fund or it may be a separate legal entity (in the case of pension funds established in the contractual form). If the governing body is a specialised pension fund managing company, the general governance regulations described below should apply to this entity.

59. The overriding responsibility of the governing body of a pension fund should be to serve the interests of the members and beneficiaries of the pension plan, which the fund supports. The governing body should not be able to absolve itself of this responsibility by delegating certain functions to external service providers.

60. The functional roles and duties of the governing body should be defined in detail in one of the founding documents of the pension plan, the pension fund, or its managing company (e.g. the plan statutes, the pension fund by-laws, the trust deed, or the internal rules of the governing body, if this is a separate entity).

61. In general, it is good governance for the governing body to have only strategic and monitoring responsibilities, with operational tasks being handed over to an executive management team. This division of responsibilities between execution and governance is consistent with best practice of the corporate governance of publicly traded companies.

62. In addition, governance regulations may also require the establishment of an additional oversight committee to control the governing body ("to monitor the monitor"). This is all the more necessary when the governing body carries out operational tasks (as in the contractual form), since there is a need for an independent check on the suitability of key decisions, such as investment management.

63. As shown in Table 1, some examples of oversight committees include the pension funds in **Austria, Hungary, Poland, Spain, and Switzerland**, and the *Pensionskassen* and *Unterstützungskassen* in **Germany**. In these countries there is a board of supervisors or equivalent body (e.g. the pension fund control commission in **Spain**) whose function is to oversee the activities of the governing body. The purpose of this separation of responsibilities is to ensure that the decision taken by the governing body are in the best interest of the owners or beneficiaries of the pension fund.

64. Governance regulations should also require the appointment of certain persons or entities to carry out certain operational or oversight functions. These specialist functions include:

- Actuarial analysis
- Auditing
- Custody

65. An actuary should be appointed by the governing body where the pension fund itself or its governing body underwrites biometric or/and financial risks, though in general it is recommended to appoint an actuary whenever the fund supports a hybrid or defined benefit plan. As shown in Table 2, nearly all OECD countries require the appointment of an actuary. The only exceptions are **Mexico, Poland,** and **Sweden**. In the first two countries, however, pension funds can only support defined contribution pension plans, which do not require actuarial analysis.

66. A custodian should be appointed to hold the pension fund assets or be in a position to ensure their safekeeping. The custodian's assets should be legally separated from those of the pension fund. The custodian should not be able to absolve itself of its responsibility by entrusting to a third party all or some of the assets in its safekeeping. As shown in Table 2, the practice of appointing a custodian, different from the asset manager, is also widespread in OECD countries.

67. An auditor, independent of the pension fund, its governing body, and the asset manager, should carry out an audit with at least an annual frequency. The independent auditor should report directly to the pension fund supervisory authority, and, where appropriate, to the governing body. The audit should include at least an assessment of the financial position of the fund. The auditor should also be subject to a "whistleblowing" requirement. If in the course of his/her duties, he or she becomes aware of certain facts that are liable to impair the operation of the fund or have a serious effect on its financial situation, he or she should report this promptly to the competent authorities. As shown in Table 2, the requirement for appointing an auditor is applied throughout the OECD.

#### *5.1.1 The governing body*

##### Responsibilities

68. Governance regulations should require that the best interest of the plan members is clearly defined in the fund statutes. The best interest of plan members and beneficiaries is normally identified with their best financial interest. However, in the past plan members have voiced concerns that their interests extend to other objectives, which may not always coincide with the attainment of optimal financial results in the investments of the pension fund. Most recently, member's demands have focused in some countries such as the United Kingdom or the United States over the need to pay attention to ethical and environmental criteria in the investment of pension fund assets. Such demands have not materialised in regulations redefining beneficiaries' interest and it is unlikely that they will do so, especially in defined benefit plans where it is impossible to cater for each individual's special interests. However, it may be argued that plan members have at least a right to be informed of the extent to which their pension fund invests in a way that is consistent with their ultimate enjoyment of the income they will receive in old age.

69. The **United Kingdom** has set an example in this respect. With effect from 3 July 2000, private pension funds in this country have a statutory duty to disclose the extent to which they take ethical and social considerations into account in their investment policy. Similar regulations concerning public pension funds are being prepared.

70. Governance regulations define the general operational and oversight responsibilities of the governing body. The main responsibilities include ensuring:

- the cost-effectiveness of the administration of the pension fund;
- the maintenance of an adequate level of funding to meet pension promises and performance guarantees;

- the investment of pension assets in accordance with basic prudential principles, such as diversification, dispersion, currency and asset liability matching;
- the design, monitoring and review of internal risk control and operational systems, and the control of conflicts of interest situations and improper use of privileged information.
- the disclosure of relevant and timely information to pension plan members and beneficiaries, including their rights and obligations as pension plan members and beneficiaries;

71. The governing body also has a responsibility to seek expert advice and delegate functions where it is appropriate to do so. Some of the functions where the governing body may require external advice from consultants and other professional service providers include investment policy, asset-liability management, and benefit payment. The pension fund governing body may also delegate certain operational duties, such as asset management and benefit payment, to external professional service providers. It may also utilise the resources of the plan sponsor, though this may not always have qualified staff to carry out specific functions, such as actuarial analysis.

72. In most OECD countries, the governing body can delegate some of the pension fund's operational tasks, but it is not required to do so. As shown in Table 2, there are some exceptions, such as the pension fund managing companies in **Mexico** and **Poland**, which cannot delegate asset management to other financial intermediaries.

73. In some OECD countries, the governing body is actually required to delegate certain operational tasks (e.g. asset management and benefit payment) to external entities. This is the case, for example of the closed pension funds in **Italy** and **Japan** (those established as foundations), where the board of directors must delegate asset management to banks, insurance companies, or professional asset managers. Benefit payment, meanwhile, must be delegated to life insurance companies. Pension fund managing companies in **Mexico** and **Poland** must also delegate the payment of benefits in the form of annuities to life insurance companies.

74. To the extent that the pension fund supports an occupational pension plan, regulations should clearly identify what the responsibilities of the plan sponsor are (e.g. timely payment of contributions). Regulations should also determine the other main responsibilities of the plan sponsor, such as the appointment of members to the governing body and the payment of contributions in a timely fashion to ensure an adequate level of funding.

75. The governing body is responsible for monitoring the extent to which assets are sufficient to meet pension liabilities in defined benefit and hybrid plans. It should review the actuarial evaluations and ensure that the funding and contribution policy followed is the desirable one. In the case of defined contribution plans with member choice, the governing body should ascertain that appropriate funding vehicles exist for members that permit adequate risk diversification.

76. Governing bodies also face a duty in most OECD countries to invest the pension fund assets in accordance with some basic investment principles, such as diversification, dispersion, currency and asset liability matching. This requirement is justified by the fact that investment management is the one key function of pension fund administration that the governing body may carry out on its own, without needing to delegate it to professional asset managers. It is equivalent to similar duties that are imposed by financial regulations on the management of assets of insurance companies and collective investment schemes.

77. In some countries these principles must be enshrined in a statement of investment policy that the governing body or the pension fund manager must disclose to the supervisory authorities, and which may

also demanded by the plan members. Countries that require the adoption and disclosure of a statement of investment policy (SIP) include **Mexico**, the **Netherlands**, and the **United Kingdom**. The provinces of Ontario and Quebec in **Canada** also require trustees to adopt a statement of investment policies and goals. In the **United States**, meanwhile, regulations do not require a SIP, but most pension funds, especially the larger ones, have developed them.

78. In Anglo-Saxon countries, trustees and other pension fund fiduciaries have a similar duty to act prudently in the exercise of their functions (the so-called "prudent expert rule"). The definition of the term prudence has been subject to some controversy and has evolved as a result of court rulings and decrees published by the relevant regulatory and supervisory bodies. Nowadays, prudence is identified in countries such as the **United Kingdom** or the **United States** with decision making processes that take into consideration all relevant information at their disposal, including the advice from professionals in the relevant function. Risk diversification of pension fund portfolios is also a basic principle that underlies the "prudent expert rule".

79. In the **United Kingdom**, for example, trustees are required to seek professional advice for some of the duties they carry out, such as the choice of investment manager. The need for external advice is critical in this country, since trustees have overall responsibility for the administration of all aspects of the pension plan. In the United States, on the other hand, the responsibility of trustees is limited to investment management, which greatly simplifies the decision-making process.

80. In the **United States**, the duty of prudence carries additional responsibilities for trustees. In the mid-80s, bulletins published by the Department of Labor urged trustees to exercise their voting rights attached to the equity investment of pension funds on "issues that may affect the value of the plans' investment". In 1994, the Department of Labor formalised this recommendation into a requirement, and confirmed that it applied to foreign as well as US equity holdings.

81. The governing body also has a responsibility to monitor and review governance mechanisms, including internal controls, reporting channels, disclosure policies, and redress channels for pension plan members and beneficiaries. These mechanisms are discussed in more detail below.

## Accountability

82. In order to be effective in protecting the interests of plan members as beneficiaries or owners, governance regulations must identify clearly those responsible for the administration of the pension fund with this exclusive aim and hold them accountable for their actions. Accountability over governance functions is particularly important in order to allow the supervisory authority and the plan members and beneficiaries to sanction or discipline the governing body in case of bad management. The legal basis of accountability is personal liability. Insurance of this liability can further ensure the ability of the pension fund to recover losses in case of mismanagement. Compulsory insurance of this liability, however, is rare among OECD countries, the **United States** being one special case. Most OECD countries, however, do hold the members of the governing body accountable under the law for their actions and decisions with regards to the operation of the pension fund.

83. The accountability of the governing body requires also:

- regular meetings;
- appropriate disclosure of the decisions reached in these meetings to plan members and beneficiaries;

- reporting of information about the operation of the pension fund to the supervisory authorities;
- diffused decision-making so that, for example, one member cannot take decisions on his/her own.
- transparent selection mechanisms and succession planning processes.

84. The selection and succession planning structure should deal with the term, appointment/election and removal of members of the governing body of the pension fund. Fair voting systems are particularly relevant for the representatives of pension plan members that sit in the governing body. Majority voting is used for the election of the members of the governing body in some OECD countries such as **Iceland**.

85. Accountability can be also greatly enhanced by requiring the appointment of representatives of plan members and beneficiaries to the governing body. Such representatives may be endowed only with oversight responsibilities, to ensure that the operational decisions taken are in the best interest of the pension plan members and beneficiaries. Member representation in the governing body may be most suitable when membership of the pension fund is compulsory or automatic as part of the employment contract (often the case for closed funds). In these cases, plan members cannot normally "vote with their feet" and choose a different pension fund (except if they leave their employer). Governance regulations should therefore envisage the possibility of appointing representatives of the plan members and beneficiaries to the pension fund governing body.

86. There are several countries where representation of employees in the governing bodies of closed pension funds is required by the regulations. In Italy, the general assembly, the board of directors, and the board of auditors of closed pension funds must each have an equal number of employer and employee representatives. A requirement for equal members of employee and employer representatives is also in place for the board of directors of the Employee Pension Funds (closed) in **Japan** and the closed pension funds in the **Netherlands, Norway, Sweden, and Switzerland**.

87. Member representation is also required in the two OECD countries where pension funds are set up as mutual assurance associations. In **Hungary**, both closed and open pension funds have the same governance structure, which includes a general assembly (which represents all plan members with equal voting and representation rights) or a delegate assembly (with representatives elected by the plan members), and a board of directors (chosen also by the assembly). In **Germany**, representation of plan members is required in the "supreme representation" of the *Pensionskassens*. For *Unterstützungskassen*, member representation is ensured through a regulatory feature of labour law called co-determination. This requires the representation of the employees in the governing body of the fund or an agreement with the plan sponsor over the responsibilities of the governing body.

88. Direct participation by plan members is also required in some countries where pension funds are organised as trusts. In the **United Kingdom**, the law requires funds to have at least one third of its trustees to be member-nominated, though employers can opt out of this requirement by submitting a proposal to the plan members. In **Australia** there is a legal requirement for closed pension funds to have an equal number of representatives of employees and employers in the trustee board. In Ireland, members of some occupational pension plans have a right to participate in the selection of a number of trustees of their plan. Finally, in the **United States**, the trustees of multi-employer plans must be appointed jointly by participating employers and employee organisations.

89. In the case of closed pension funds set up in the contractual form, employees may still carry out oversight through independent monitoring bodies. In Spain, for example, all closed pension funds are subject to the scrutiny of the so-called Control Commission, which must have a majority of representatives of the plan contributors. Representatives to the Control Commission are chosen by majority voting.

90. In open pension funds set up in the contractual form, member representation in the governing body is not normally feasible. Independent experts may nonetheless be called to oversee the operation of the pension fund administrators. These experts may form part of a separate governing body, such as a board of supervisors. This is the case of the open pension funds of the **Czech Republic** and **Poland**, where the supervisory board plays various monitoring functions, such as the evaluation of the investment strategy followed by the executive body and their choice of asset manager.

### Suitability

91. All the parties involved in the administration of the pension fund must have the necessary skills to carry out their tasks properly. To the extent that pension funds are externally managed by specialised managing companies, regulations may resemble those of other financial companies.

92. The suitability criteria for the governing body itself are difficult to determine because their activities vary significantly depending on the extent of delegation. However, some basic criteria may be identified for the members of the governing body, which are found in most OECD countries:

- they should not have been convicted of any criminal offence or have received significant civil penalties in relation to the administration of a pension body or its governing body;
- they must not have been insolvent under administration;
- they must have suitable qualifications and professional experience.

93. The first two requirements can be justified as a way to exclude persons who cannot be labelled as trustworthy in the exercise of their basic duty, to protect the interest of the owners or beneficiaries of the pension fund. The third requirement aims to ensure that the members of the governing body have the relevant competence in the functions that they carry out. For example, if the trustees or the board directors of a pension fund can manage the pension fund assets, they should be required to have the relevant qualifications or certificates authorising them to act as investment managers. To the extent that their responsibility is limited to setting out the investment strategy for the fund or the selection of investment managers, they may be exonerated from this requirement.

94. Regulations should also ensure that the members of the governing body are not exposed to conflicts of interest with respect to other functions they may perform. For example, the members of the governing body should not be allowed to carry out auditing tasks for the pension fund.

### 5.1.2 Other bodies

95. Governance regulations should set out the general responsibilities of actuaries, pension fund asset managers, auditors, and custodians. They should require appropriate suitability conditions for acting in these capacities.

96. In all OECD countries, solvency and funding evaluation and control of funds that support defined benefit plans must be left to actuaries and pensions consultants. The role of actuaries and pension consultants is to evaluate future pension liabilities and to estimate the financial solvency of the pension plan, according to both the on-going and winding-up approach. They set out a funding strategy for the pension plan, estimating the level of contributions required to ensure the sustainability of pension promises in both the short term and the longer term. Clearly, actuaries and pension consultants only play a role in the case of pension plans that offer some form of insurance against financial or biometric risks. Pension funds or pension fund managing companies that themselves underwrite financial or biometric risks should be required to appointment an actuary. Where the insurance is provided by the plan sponsor, as is the case in most occupational defined benefit plans, this will normally be required to appoint the actuary.

97. Most OECD countries also require investment management to be carried out only by persons or entities authorised to act as asset managers. In countries where pension funds are set up in the contractual form, investment management is always carried out by financial institutions. In most countries where pension funds are set up in the corporate form, as foundations or as trusts, the governing body is only permitted to carry out investment management if it has the relevant authorisation, but it can normally delegate this function to external investment managers. There are some special cases, however. In the United States, the plan sponsor may carry out the investment management function in-house (by the treasury department). In Italy, outsourcing of the tactical asset allocation function of closed pension funds to financial institutions is actually required by the law.

98. Delegation of investment management to financial companies can ensure that investment decisions are taken by persons with the relevant expertise and may also heighten protection from the influence of plan sponsors. At the same time, however, delegation can create new agency problems, since the financial company may run the pension fund in its own interest.

99. Two other functions that should be provided externally are auditing and custody. The financial activities of the pension fund and the pension fund managing entity (if there is one) are audited with at least an annual frequency in most OECD countries. The auditor may also be required to verify whether the pension fund complies with all the rules set out in the pension plans statutes concerning its structure and operation, as well as with all regulations emanating from the regulatory authorities. Auditors may be appointed by the pension fund governing body or the plan sponsor, depending on the type of fund.

100. The main function of the custodian is to carry out securities movement and control. They often provide additional services such as securities lending, cash management, investment accounting and reporting, and performance measurement. Swift, efficient clearance and settlement of transactions is vital since any delays in receipt of interest and dividends reduce the effectiveness of investment management decisions. The assignment of custody responsibility to a different entity from the asset manager can also be an efficient way to ensure the physical and legal integrity of the assets of a pension fund, and to oversee the transactions of the asset manager.

101. Given the lack of representation of pension plan members in the governing bodies of open pension funds set up in the contractual form, custodians can play a key role to ensure that all transactions carried out by the asset manager are in accordance with financial legislation as well as the plan and fund rules. Custodians in countries such as **Italy**, **Mexico**, **Poland**, and **Spain** have such monitoring responsibilities over the pension fund managing company.

## 5.2 Governance mechanisms

### *Internal control*

102. Governance regulations should require that pension funds have appropriate controls in place to ensure that all persons or entities with operational and oversight responsibilities act in the best interest of plan members and beneficiaries. Such controls include:

1. Regular assessment of the performance of the persons and entities involved in the operation and oversight of the pension fund
2. Appropriate compensation mechanisms, designed so as to provide the correct incentives for those responsible for the operation and oversight of the pension fund.
3. Identification, monitoring, and, where necessary, correction of conflicts of interest situations
4. Preventing the improper use of privileged information

103. An audit or control committee and chairperson may be established to oversee the activities of those providing consultancy, actuarial analysis, asset management, and other services for the pension fund. This committee should report to the governing body. An internal control mechanism is also necessary to monitor the activities of the governing body. This task may be carried out on a regular basis by the supervisory body.

104. Objective performance measures should be established for all the persons and entities involved in the administration of the pension fund. Performance should be regularly evaluated against the performance measures and results should be reported to the relevant decision maker, and, where appropriate, to the supervisory authority, and the pension fund members.

105. Compensation is a key determinant of the dedication to specific tasks. The duties of the members of the governing body can sometimes be arduous and time-consuming. Hence, appropriate compensation to ensure high levels of commitment and performance may be required. The establishment of a compensation committee and chairperson may optimise the process of evaluating the compensation of those responsible for the operation and oversight of the pension fund.

106. The compensation policy of sales forces of open pension funds may also warrant close scrutiny by the governing body, since these costs can reduce pension benefits significantly. There is a risk also that sales staff may not act in the best interest of plan members, offering products that are not suitable for certain individuals. The governing body should therefore ensure that the remuneration structure for sales staff does not create distorted incentives or and lead to ill-advised decisions by consumers.

107. Governance regulations should also aim at controlling the potential conflicts of interest that can arise between the entities involved in the administration of the pension fund, on the one hand, and the plan members and beneficiaries on the other. In general conflicts of interest can be corrected in a variety of ways. In certain cases, banning the concentration of functions in a single person or entity that would otherwise lead to a conflict of interests may be the preferred solution. For example, the members of the governing body may face a conflict of interest if they were permitted to act as auditors or custodians to the pension fund. Conflicts of interest can arise also for consultants, if they offer also asset management services to pension funds. Such conflicts of interest are often not addressed by pension regulations in OECD countries.

108. Other examples of governance regulations are those that prohibit or limit certain transactions (including investment) between the pension fund and the plan sponsor (in the case of closed funds) and between the pension fund and the asset manager or its parent company. Most OECD countries, for example, limit investment in the sponsoring employer or in companies related to the asset manager to less than 10% of the pension fund assets. The use of brokers and other market intermediaries associated to the pension fund manager or its parent company is also restricted in OECD countries.

109. The governing body should in any case establish a control mechanism to monitor conflicts of interest closely and to disclose these situations to the identified decisions makers, and, where appropriate, to the supervisory authority and the pension plan members and beneficiaries. These conflicts of interest should be reviewed and monitored by the governing body or members of it not conflicted. Where appropriate, the governing body may seek independent advice or guidance regarding the service or transaction. In the event of the governing body not being able to resolve a conflicts of interest situation, this should be reported to the supervisory authority, which will make a decision on whether they should be permitted, and if so under what conditions.

110. Governance regulations may extend to other types of conflict of interest arising in the distribution and marketing of personal pension plans, since pension savings and retirement income can be significantly reduced from excessive charges and commissions. In the case of open pension funds, for example, distribution methods can cause much consumer detriment, especially when intermediary remuneration is not based on a flat structure. The governing body of the pension fund may be assigned responsibility to endeavour that the remuneration structure for sales personnel does not create incentives in them that lead these to convince individual consumers to join personal plans when it may not be in their best interest to do so.

111. The governing body should also establish appropriate controls to prevent the improper use of privileged or confidential information. A code of conduct may be established, requiring employees to observe high standards of integrity, honesty, and fair dealing. Internal review mechanisms may be put in place to verify and sanction the compliance with the code of conduct.

112. In addition to internal controls, pension funds require efficient reporting channels to ensure the effective and timely transmission of information between all the persons and entities involved in the administration of the pension fund.

### *Disclosure*

113. The duty of disclosure of accurate and relevant information to pension plan members and beneficiaries in a clear and timely manner is a basic responsibility of the governing body, irrespective of the type of fund. This duty is also part of the regulatory policies in DAFPE/AS/PEN/WD(99)18/Rev3.

114. All pension plan members should receive, on joining the plan, the fund by-laws, statutes, or rules and related documents. These documents should state clearly the objectives of the pension fund (including a simplified, easy to understand description of the investment policy of the fund) and the rights of plan members and beneficiaries. Material changes in these objectives or rights should be reported to pension plan members and beneficiaries in a timely manner.

115. Pension funds should be required to inform plan members on a clear and timely basis of all relevant aspects related to the operation of the pension fund. Relevant aspects include the level of fees charged in personal pension plans, the investment strategy followed by the pension fund, the type of plan supported, and the contribution rates and benefits scheduled.

116. In defined benefit and hybrid plans, plan members should be able to demand information on the level of funding backing pension promises and other relevant aspects of the financial accounts of the pension fund. Most OECD countries conform with this requirement, though most pension plan members are not aware of this right.

117. Disclosure requirements should be even more exigent in defined contribution plans, where plan members may exert some degree of individual choice over the investment of the pension fund. Such individual choice may be in the form of choice of investment portfolios in defined contribution schemes of closed funds, or in the form of actual choice over fund manager and asset allocation, in the case of open pension funds. Participants in these schemes should receive periodic statements, at least annually, showing their account balances, and the investment regime and performance of the pension fund. Pension funds should also be required to disclose certain information about their operations and performance on a more regular basis. For example, information on investment performance and commissions may be disclosed publicly through the local financial press.

### *Redress*

118. Redress mechanisms are particularly important where there are no alternative devices, such as member representation in the governing body or, in the case of collectively bargained schemes, the right to industrial action to discipline those responsible for the operation and oversight of the pension fund. Nonetheless, in closed pension funds, membership is often mandatory as a result of automatic enrolment. Hence, individual fund members may need channels for specific complaints handling and dispute resolution, for example in the case of unfair treatment.

119. In open pension funds set up in the contractual form, members have no representation in the governing body and cannot therefore exert any pressure directly on it. Discontent fund members can always use the exit option and switch to a different pension fund. However, switching is usually a costly option, since open pension funds often charge exit or entry fees. Moreover, consumers may be exposed to unscrupulous plan providers or their sales forces who may mislead led with inaccurate or distorted information. Hence redress mechanisms should also be required for open funds.

120. Consumer redress may take place through informal, independent arbitration, regulatory/supervisory bodies, or through the courts. The first two channels offer many advantages, in particular the cheaper cost to consumers. Independent arbitration also provides a route to self-regulation by pension fund administrators. An arbitrator may be set up by the industry itself in order to encourage public confidence and maintain efficient business practice. Litigation, while potentially highly effective in sanctioning bad management, can be excessively costly for individual consumers, though it may be appropriate in the case where a common group (e.g. and employment association) is affected.

121. The specific duties of the pension fund governing bodies may be stated in the legislation, the plan rules, and the fund statutes. The governing body must therefore act both within the framework of the law, and in accordance with the pension plan and the fund rules and statutes. The oversight or monitoring body of the pension fund, auditors, custodians, as well as the supervisory authority may be required to verify that these functional duties are adequately executed.

## **6. Conclusion**

122. Pension fund governance regulations vary significantly across OECD countries. In general, the basic principles of good governance (responsibility, accountability, suitability, control, disclosure, and redress) are obeyed, but some potential conflicts of interest and other agency risks are still unattended to in some countries. One problem identified is suitability requirements for the governing body, which in some cases are insufficient to ensure a high degree of professionalism in the administration of pension funds. Another problem is the lack of a clear separation of operational or administrative tasks from strategic and monitoring responsibilities, which is the basis of sound governance. More generally, clarity over the responsibilities of the governing body is still needed in some countries.

123. Regulations also play an important role in defining governance mechanisms. The work of the governing body can be eased by having precise rules on transactions and ownership structures that are the source of damaging conflicts of interest. In general, however, governance mechanisms that are self-managed, such as internal review and performance mechanisms, codes of conduct, and informal redress channels have the benefit of being more flexible than regulations and adapting better to the circumstances of each pension fund. Striking the right balance between internal rules and external regulations is no easy matter. It is, nonetheless, necessary, if pension funds are to succeed in their important social and economic function.

**Table 1: Basic governance structure of pension funds in selected OECD countries**

	<b>Type</b>	<b>Legal form</b>	<b>Governing and Supervisory bodies</b>	<b>Representation of members/beneficiaries</b>	<b>Suitability requirements</b>
<i>Australia</i>	Open, closed	Trust form  Contractual form (only Retirement Saving Accounts)	Trustee	Standard employer-sponsor funds are required to have equal numbers of employers and employees on the trustee board	Trustees - must not have been convicted of dishonest conduct, - must not have been subject to a civil penalty order under SIS, - must not be insolvent or under administration
<i>Austria</i>	Closed	Contractual / Corporate form	General assembly Board of directors Board of supervisors	Members and shareholders must be represented in the board of supervisors	Members of the board of directors - must have a professional training, - must have at least three years of management experience in a financial institution or in the (single) employer - must not have been convicted for a criminal offence - must not have been declared bankrupt
<i>Canada</i>	Closed	Trust form	Trustees (at least three) Pension plan administrator (must be a pension committee in Quebec)	In Quebec the pension committee must include plan members	At least three of trustees must be resident in Canada, one of whom is independent of the sponsoring company.
<i>Czech Republic</i>	Open	Contractual form	Meeting of shareholders Board of Directors	None	Minimum age of 18 Legal capacity

	Type	Legal form	Governing and Supervisory bodies	Representation of members/beneficiaries	Suitability requirements
			Supervisory Board		Professional qualification Lack of criminal antecedents + several “conflicts of interest” rules
<b>Germany</b>	Closed	Corporate form (mutual assurance association)	Board of directors	Member representatives do not have to account for 50% of the votes, but there must be institutional safeguards which prevent them from being overruled.	Only qualified insurance professionals may be managing directors of <i>pensionskassen</i> .
<b>Hungary</b>	Open, closed	Corporate form (mutual saving association)	General assembly / General delegate assembly Board of directors (BD) Supervisory board (SB) Consultants/experts (in MF): <ul style="list-style-type: none"> <li>• executive director</li> <li>• investment consultant</li> <li>• lawyer</li> <li>• actuary</li> </ul>	Voluntary funds: only members  Mandatory funds: in the BD members must be represented, in the SB more than 50%	Unblemished professional and civil antecedents for the members of the Boards  Additional suitability requirements are imposed for the consultants and experts: adequate professional qualification and work experience
<b>Iceland</b>	Open, closed	Foundation form	Board of directors Managing director / Managing company Internal control General assembly	Open funds: Members elect their representatives in the board of directors  Closed funds: Labour unions and the employer’s unions choose their representatives in the board of directors	The board members and the manager - must be of legal age, control their own finances and have an unblemished reputation, - must not have been convicted in the last five years of an offence related with a commercial activity punishable by the criminal

	Type	Legal form	Governing and Supervisory bodies	Representation of members/beneficiaries	Suitability requirements
					code, acts on limited companies, private limited companies, accounting, financial statements, bankruptcy or public levies,  Board members must be resident of Iceland or another EEA member state  The manager must have adequate education and work experiences
<i>Ireland</i>	Closed	Trust form	Trustee (individual or corporate)	Members of occupational pension plans have the right to elect an equivalent number of trustees as the employer	There are no specific suitability requirements
<i>Italy</i>	Closed	Foundation or corporate (association) form	General assembly Board of directors Board of auditors	The general assembly, the board of directors and the board of auditors must each have an equal number of employer and employee representatives	The members of the general assembly and the boards must possess the necessary requisites of professional standing and experience as laid down by a special-purpose statutory provision.
	Open	Contractual form	Financial institution that manages the pension fund This must have a General manager/supervisor (“ <i>responsabile del fondo</i> ”)	None	The members of the “ <i>responsabile del fondo</i> ” must possess the necessary requisites of professional standing and experience as laid down by a special-purpose statutory provision.
<i>Japan</i>	Closed, Employee	Foundation (EPF)	EPF:	EPF: Half of the	EPF:

	<b>Type</b>	<b>Legal form</b>	<b>Governing and Supervisory bodies</b>	<b>Representation of members/beneficiaries</b>	<b>Suitability requirements</b>
	pension funds (EPF) Tax qualified pension plans (TQP)	Contractual (TQP)	Board of representative Board of directors Auditors  TQP: Financial institution authorised to administer pension funds	representatives are elected by the employer, and the other half by the subscribers of the pension fund. Half of the directors and the auditors are elected by the representatives nominated by the employer and the other half of them are elected by the representatives of the subscribers.  TQP: None	There are no suitability requirements.  TQP: Standard requirements for financial institutions
<b><i>Korea</i></b>	Closed, open	Contractual form (Retirement insurance and Retirement trust)	Financial institution authorised to administer pension funds	None	Standard requirements for financial institutions
<b><i>Mexico</i></b>	Open	Corporate form	Pension fund ( <i>Siefores</i> ): Board of Management Shareholders' General Assembly  Pension fund managing company ( <i>Afores</i> ): Board of Management: - Independent advisors (at least 2) - Compliance officer Shareholders' General Assembly	None	Independent advisors and compliance officer: expertise in the relevant field. Proven technical and management skills.
<b><i>Netherlands</i></b>	Closed	Foundation form	Foundation board	Boards must be composed of an equal number of employee and employer representatives	There is no suitability requirement, however, the supervisor is able to test the

	Type	Legal form	Governing and Supervisory bodies	Representation of members/beneficiaries	Suitability requirements
					qualification of the members and disqualify people.
<i>Norway</i>	Closed	Foundation form	Board of directors Chief executive (appointed by the board)	The board must have at least 4 members, at least 2 of whom must be elected by the employees.	No specific requirements
<i>Poland</i>	Open	Contractual form	Pension fund managing company (Universal pension society): <ul style="list-style-type: none"> <li>• General meeting of the shareholders</li> <li>• Board of management</li> <li>• Supervisory board</li> <li>• Board of auditors (optional)</li> </ul>	None	<ul style="list-style-type: none"> <li>• full legal capacities</li> <li>• no convictions for offences against property, document credibility, economic trading in money and securities</li> <li>• professional certificate (economics, law: 1/3) and work experience (minimum of 7 years: 2/3 of the members) )</li> </ul>
	Closed	Contractual form	Pension fund managing company (Occupational pension society): <ul style="list-style-type: none"> <li>• General meeting of the shareholders</li> <li>• Board of management</li> <li>• Supervisory board</li> <li>• Board of auditors (optional)</li> </ul>	Not less than half of the members of the supervisory board of the occupational pension society should be nominated by the members of the fund.	<ul style="list-style-type: none"> <li>• full legal capacities</li> <li>• no convictions for offences against property, document credibility, economic trading in money and securities</li> <li>• professional certificate (economics, law: 1/3) and work experience (minimum of 7 years: 2/3 of the members) )</li> </ul>
<i>Portugal</i>	Closed, open	Contractual form	Pension fund management company or life insurance company:	Obligatory in case of funds funding contributory schemes. Optional for the	Professional qualifications Work experience Lack of criminal antecedents

	<b>Type</b>	<b>Legal form</b>	<b>Governing and Supervisory bodies</b>	<b>Representation of members/beneficiaries</b>	<b>Suitability requirements</b>
			<ul style="list-style-type: none"> <li>• General assembly</li> <li>• Board of directors</li> </ul>	remainder but not relevant in practice.	lack of history of insolvency
<i>Spain</i>	Closed, open	Contractual form	Pension fund management company or other authorised financial institutions ( <i>Gestora</i> ). Pension plan control commission Pension fund control commission	In the control commissions, the majority of the participants and beneficiaries is necessary	The general requirements for financial institutions are applied
<i>Sweden</i>	Closed	Foundation form	Board of foundation Supervisor	Equal representation of employees and employers is required	No specific requirements
<i>Switzerland</i>	Open, closed	Foundation form (most of them)  Corporate form (co-operative society)	Supreme council (foundation board) Board of directors Supervisory board Experts: pension and investment expert	50-50% of the council represent the employer and the employees	No suitability requirements for the members of the governing bodies
<i>UK</i>	Closed	Trust form	Trustee	Minimum 33% member-nominated trustees	Lack of conviction of an offence of dishonesty and deception Lack of bankruptcy and disqualification as director
<i>US</i>	Closed	Trust form	Trustee	Not relevant	

**Table 2: Specialist bodies**

	<b>Actuary</b>	<b>Asset manager</b>	<b>Auditor</b>	<b>Custodian</b>	<b>Benefit provider</b>
<i>Australia</i>	Obligatory (in case of DB plans)	Optional	Obligatory	Optional, except in limited circumstances	Optional
<i>Austria</i>	Obligatory	Optional	Obligatory	No requirement	No provision
<i>Canada</i>	Obligatory	Optional	Obligatory	Obligatory	Optional
<i>Czech Republic</i>	Optional	Optional	Obligatory	Obligatory	No, only pension funds are allowed to provide the benefits
<i>Germany</i>	Obligatory	Optional	Obligatory	Obligatory	Optional
<i>Hungary</i>	Obligatory in mandatory funds, but may be replaced by external expert	Optional	Obligatory	Obligatory	VF: no MF: fund itself or insurance company
<i>Iceland</i>	Obligatory	Optional	Obligatory	No requirement	No provision
<i>Ireland</i>	Obligatory	Optional	Obligatory	Optional	Optional
<i>Italy</i>	Optional	Obligatory (closed funds), Optional (open funds)	Optional (closed funds) Obligatory (open funds)	Obligatory	Obligatory
<i>Japan (EPF)</i>	Obligatory	Obligatory	Internal	Internal	Optional
<i>Korea</i>		Optional: Financial institutions that manage pension funds can delegate asset management	Obligatory	Obligatory	External
<i>Mexico</i>	Not required	Pension fund managing company cannot delegate asset management	Obligatory		Obligatory: insurance companies
<i>Netherlands</i>	Obligatory	Optional	Obligatory		
<i>Norway</i>	Obligatory	Optional	Obligatory	Optional	Optional

	<b>Actuary</b>	<b>Asset manager</b>	<b>Auditor</b>	<b>Custodian</b>	<b>Benefit provider</b>
<b><i>Poland</i></b>	Not required	Pension fund managing company cannot delegate asset management	Obligatory	Obligatory	Special annuity company (regulation to be defined)
<b><i>Portugal</i></b>	Obligatory	Optional: pension fund managing company or life insurance company may delegate asset management to credit institutions and investment companies authorised to carry out asset management in OECD countries.	Obligatory	Obligatory	Optional: Pension fund management company, but also may be delegated
<b><i>Spain</i></b>	Obligatory	Optional: Pension fund managing company or authorised financial institution ( <i>Gestora</i> ) may delegate asset management	Obligatory	Obligatory	Obligatory: pension management entity
<b><i>Sweden</i></b>	Not required	Optional	Obligatory	Not required	Obligatory
<b><i>Switzerland</i></b>	Internal expert is obligatory	Optional	Obligatory	No obligation for independent custodian	Optional
<b><i>United Kingdom</i></b>	Obligatory (may be internal)	Optional	Obligatory	No obligation for independent custodian	Optional
<b><i>United States</i></b>	Obligatory for DB plans (may be internal)	Optional	Obligatory (for plans with over 100 employees)	Obligatory, independent of asset manager	Optional

## ANNEX 1: PENSION FUND GOVERNANCE IN OECD COUNTRIES

### Australia

1. In Australia closed - private or public sector employer sponsor - pension funds must be set up in the trust form, and industry-wide schemes are common. Open funds operate in both the mandatory and voluntary pension system (superannuation). They may operate also in the trust form, where the trustees are a financial company, but they make take also the contractual form (Retirement Saving Accounts).

2. All superannuation funds regulated under the SIS must be managed by a trustee that can be a committee of natural persons or a corporate body with its own board of directors. Trustees may outsource functions to third parties, including asset management. However, the responsibility for the management of a fund remains with the trustee. They must also appoint an external auditor and an independent custodian. Defined benefit funds are also required to have an actuary.

3. Pension fund trustees have responsibility over all aspects of the operation of the pension plan, including the collection of contributions, the investment of the fund assets, the engagement of the custodian, asset managers, and consultants and the provision of benefits. Trustees are the single responsible entity in terms of fiduciary obligations to members and regulatory responsibilities more generally. They bear personal liability for all these functions.

4. With respect to the asset management function, trustees are charged with managing members' moneys with competence, diligence, prudence, and honesty, and always acting in the members' best interest.

5. Once a superannuation fund is regulated under the SIS Act the trustee must comply with a range of standards designed to ensure that the fund's assets are managed with suitable care (the prudential aspect) and are used for genuine retirement income purposes (the sole purpose test). The standards also cover issues such as reporting requirements (to members and to the regulator), payment requirements, and other operational issues.

6. These include:

- the trustee developing and implementing an investment strategy having regard to risk, diversity, liquidity and return, which must be appropriate given the membership of the fund ;
- members being fully informed about the fund and its performance;
- the keeping of accurate accounts and proper record keeping;
- extensive member reporting rules when members join the fund, annually and on exit;
- corporate funds having equal employer and member representation on the trustee board;

- approval processes for professional trustees of public offer (retail) superannuation funds;
- the lodgement of annual returns with APRA including certification that the fund's accounts have been audited by an external 'approved auditor';
- internal inquiry and complaints handling mechanisms and compliance with any determination of the external, statutory-based Superannuation Complaints Tribunal; and
- restrictions on in-house investments. (Part 8 of the SIS Act).

7. Trustees are also subject to extensive reporting rules towards members (when members join the fund, annually and on exit, and when the fund encounters adverse conditions which could potentially threaten member interests). Disclosure towards the supervisory authorities includes Risk Management Statements (RMS) since 1995, which contain the risk management practices and controls adopted for investment in derivative instruments.

8. Suitability requirements for superannuation trustees include the following rules:

- they must not have been convicted of dishonest conduct;
- they must not have been subject to a civil penalty order under the SIS Act; and
- they must not be insolvent or under administration.

9. Further, recent legislative amendments provide APRA with the power to disqualify certain persons from acting as Trustees where those persons:

- have contravened the SIS Act on one or more occasions and APRA is satisfied that the seriousness or frequency, or both, of the contraventions warrants the making of a disqualification order; or
- are otherwise not a fit and proper person to be a trustee.

10. Regarding the right to redress, Australia has a statutory disputes authority, the Superannuation Complaints Tribunal. It is one of two free redress avenues available to those with a complaint. The other is the Life Insurance Complaints Service (LICS) which serves those with a complaint on open pension funds managed by life insurance companies. LICS are bound by terms of reference guidelines which state that common law damages cannot be awarded, only the loss on a policy can be recovered and that commercial decisions, such as fees, charges, premiums or risk loading cannot be examined unless they relate to an issue such as deceptive conduct.

## **Austria**

11. In Austria, the legal structure for pension funds (*Pensionskassen*) is a joint-stock company that may be identified with the corporate form. Employers and employees are the only shareholders of a pension fund company covering a single employer. For other pension fund companies there are no specific provisions as to shareholding. The pension assets and liabilities must be kept separate from those of the pension fund company. Unlike in Germany, in Austria *pensionskassen* are regarded as a special kind of - *sui generis* - financial institution and are subject to specific supervision, different from that of banks and insurance companies. Pension funds can only be set up for the exclusive purpose of managing pension plan

assets and liabilities and must have a minimum of 1000 members, except for the two years following the establishment of the company.

12. The governance structure of pension funds consists of the general assembly, the board of directors and the board of supervisors. The establishment of an advisory committee may also be required by the statutes of the pension fund. The general assembly makes the decision on the approval of the reports of the board of directors and board of supervisors and on other issues that are explicitly stated in the statute. It may only decide on issues of the management of the fund if the board of directors explicitly request it.

13. Participation in the general assembly is open to shareholders, the sponsoring employer(s) and all beneficiaries. The general assembly must meet at least once a year. Decisions are taken by simple majority vote unless the statute provides otherwise.

14. The board of directors is in charge of the actual management and administration of the pension fund and is responsible for compliance with the regulation and internal rules. They are required by law to conduct their business in the interest of the pension fund members and must follow the principles of security, profitability, liquidity, and adequate diversification and dispersion of assets. The directors are further obliged to act with due diligence and, in case of contravention, can be held liable by the pension fund company.

15. The board of directors must consist of at least two members, one of which must be resident in Austria. In addition to the general requirements laid down in the law for all professions (e.g. full legal capacity, good repute, etc), directors must have relevant professional training and experience. They are deemed to be qualified if they have worked for at least three years in a management position in a financial company or have had a leading position in the personnel or financial management of the employer sponsoring the plan. A person convicted of a criminal offence to detention longer than three months or who has been declared bankrupt in the past is not eligible to the post of director. Directors are appointed by the board of supervisors for a period not exceeding five years. The decisions of the board may not be taken by a single person. Unless the statutes provide otherwise, the person who is appointed chairman of the board, in case of parity of votes, enjoys the casting vote.

16. The pension fund also has to establish an internal control system that is directly responsible to the board of directors. The board of supervisors is responsible for the control of the management and is entitled to demand reports - at any time - and to examine the books and documents of the fund. Specific transactions and documents must be subject to the consent of the board of supervisors particularly with regard to general business policy, acquisition of real estate, and major investments and loans. The Pension Funds Companies Act also requires the approval by the board of supervisors of the investment of pension assets in credits and loans to the sponsoring employer.

17. The board of supervisors of a fund covering the pension plans of several employers must consist of a minimum of 6 and a maximum of 12 persons representing the shareholders and at least the same number of persons minus two representing the beneficiaries of the fund. The number of members of the board is laid down in the statutes. The representatives of the shareholders are elected by the general assembly. In pension funds covering the pension plans of one employer or employers belonging to a single group, the number of representatives of beneficiaries must be one less than that of the representatives of the shareholders. There are no specific suitability requirements for supervisors. They are elected by the general assembly for a period no longer than four years. The board of supervisors must meet at least four times a year. Decisions are taken by simple majority vote unless the statute provides otherwise.

18. Pension funds are required to employ two actuaries. One of them is an independent actuary appointed by the board of supervisors. In order to ensure independence, this person may not receive an annual salary from the pension fund exceeding 30 percent of his total income from equivalent professional activities. His duties with respect to the pension fund are also restricted to control. He or she must submit an annual report to the board of directors, the board of supervisors, and the Ministry of Finance. The control auditor examines whether the business plan is complied with and that necessary modifications to contribution schedules are made to ensure the solvency of the fund.

19. The annual accounts must be examined and approved by an auditor. He has to assess and certify the compliance of the annual account with legal requirements and, in particular, the accurate valuation of the assets of the fund, the compliance with provisions concerning own funds, investments and separate accounts to be set up for the individual beneficiaries. Any infractions must be reported to the Ministry of Finance.

20. Pension funds may employ external asset manager companies but they are not required to do so. There is no provision in the regulation regarding the employment of external benefit providers.

## **Belgium**

21. In Belgium, closed pension funds may operate either in the form of a foundation or a mutual insurance association (corporate form).

22. An actuary must be appointed. The actuary's duties include reporting to the Insurance Supervisory Body on the operating reserves and advising the pension fund managers in relation to financing, operating reserves and reinsurance.

23. An agreed auditor is *inter alia* responsible for reporting to the Supervisory Body on the financial and managerial situation of the pension fund. Pension funds are subject to specific accounting rules.

## **Canada**

24. In Canada, closed pension funds must be set up in the trust form and are typically established at the employer level.

25. Pension plan fiduciary administrators decide whether to establish and operate a pension fund. However, it is usual for the administrator to delegate the investment management to a trust company, an insurance company, or investment counsel. Ontario and Quebec have recently moved to require the administrator to adopt a Statement of Investment Policies and Goals, setting out in considerable detail how the pension fund will be managed. The statement must be reviewed annually and any changes reported to the pension authorities.

26. Special rules apply in the case in which corporate trustees or individual trustees are called upon to hold and manage the funds. There must be at least three trustees resident in Canada, one of whom is independent of the company. The trustees are required to exercise prudence in dealing with the investments. They are also required to appoint an external auditor, a custodian and an actuary.

27. Pension fund trustees are subject to the same fiduciary rules as pension plan administrators.

28. The law does not envisage limits on fees or commissions paid by employees for the management of a pension plan.

### **Czech Republic**

29. Open pension funds work as joint-stock companies.

30. Pension funds must have a Statute and a Pension Plan, which must be accessible to the participants. The statutes contain the scope of the activities, the aim and objectives of the pension fund's investment policy, the method of distribution of profit, information on the depository bank and the method of disclosure. The pension plan specifies the internal regulation on benefits and contribution.

31. Pension funds must be contracted with a depository bank that has to be approved by the Ministry of Finance in agreement with the Securities Commission. The appointment of an external actuary is optional, but pension funds are obliged to have an independent external auditor. Pension funds may delegate investment management to an external asset manager. However, only the pension funds are allowed to provide retirement income.

32. The pension fund manager must manage the assets expertly and carefully with the aim of securing dependable revenues, and in accordance to the interests of the beneficiaries. They hold personal liability for the management of the pension fund, but they are not required to insure themselves against this liability.

33. The pension fund's board of directors and the supervisory board must have at least five members and must meet at least four times a year. Special suitability regulation is applied for the directors and supervisors of the pension funds. Only individuals over 18 years of age, professionally qualified and unimpeachable are eligible to serve on the board of directors and supervisory board. These are completed with detailed conflicts-of-interest rules excluding certain individuals, e.g. members of boards of another pension fund, an insurance company, or an investment fund, persons involved in securities trading and members of the custodian (depository) institution. Employees of the pension fund are also excluded from being members of the supervisory board.

34. Pension funds are obliged to publish a report on their financial results semi-annually containing also an overview of placement, the deposit and the amount of the pension fund's assets. Pension funds, which exist for more than three years must also include the financial results for the past three years. In addition, funds are obliged to provide the Ministry of Finance (MOF) and the Security Commission annually and in case of changing with the list of shareholders and the required relating data, which information are kept by the MOF and available for the public. Funds are further obliged to provide annually their participants with a statement containing the accumulated balances and investment earnings.

### **Denmark**

35. In Denmark, closed pension funds operate in the mandatory pension system. Closed pension funds are set up as foundations for the exclusive purpose of providing retirement and related benefits. Collective bargaining at the industry level is common, hence pension funds are tied to a specific collectively bargained scheme. Some company pension funds exist also. These must have a minimum of 50 members.

36. Both company and nation-wide pension funds must have a board of directors and a general assembly. Nation wide pension funds must also have a Chief Executive Officer. Some funds also have an assembly of delegates.

37. The Company Pension Funds Act require that the board of directors act in the best interest of the pension funds, i.e. make sure that the fund is organised and administrated properly. Furthermore, the management is obliged to invest the capital in a way that is in the best interest of the pension fund members. The board of directors sets out the investment policy and has responsibility for the general administration of the fund. They are required to match assets and liabilities but are not required to approve or apply a statement of investment policy. The board is also responsible for ensuring disclosure of information regarding the plan and changes in it to the members. Members must also be informed annually of contributions paid and bonus received. Important decisions (e.g. changes in the articles of association) are taken by qualified majority voting.

38. The board of directors of nation wide pension funds must have at least 3 members (as under normal company legislation). The board of company pension funds, on the other hand, do not have to have a minimum number of members, but half of them must be appointed by the members of the fund. The articles of association of the fund determine how the members are chosen. There are no specific rules concerning the compensation of the members of the board.

39. The members of the board must be over 18, should not have a criminal record that would influence their work, and must have suitable qualifications. The specific conditions for appointing an administrator or trustees and the roles and powers of these are set in the articles of association of the pension fund.

40. The board of nation wide pension funds must employ an actuary approved by the Financial Supervisory Authority (FSA). The role of the actuary is to ensure that the pension fund establishes appropriate technical provisions, review the actuarial content of the pension fund's activities and secure that the technical provisions are at all times in accordance with the requirements laid down by the law. Furthermore, the actuary is responsible for any contact to the Financial Supervisory Authority including annual reports and requests of information from the Authority. The actuary is entitled to request from the board of management all such information necessary for the performance of his functions. Company pension funds must also have an actuary that is approved by the FSA.

41. From 1 July 1995 large companies/funds have been under an obligation to introduce internal auditors who are directly accountable to the board. The auditors of pension funds have the same role and powers as auditors of insurance companies. Auditors are elected at the general assembly in nation wide pension funds. The articles of association determine how auditors are elected in company pension funds.

42. Pension funds are not required to have a custodian. They may have one or more external asset managers. Banks, investment companies, and investment trusts are authorised to act as asset managers. There are no constraints on the remuneration and duration of mandates of pension assets managers.

43. Pension funds may also have external benefit administrators, but they usually administer themselves the provision of retirement income. There are no constraints on the remuneration and duration of mandates of these external service providers.

## **Finland**

44. In Finland closed pension funds operate as foundations and most pension funds are actually established at the employer level, as in Anglo-Saxon countries.

45. A pension insurance company must have a supervisory board which is responsible for the plan administration, including drafting an investment plan for the company assets.

46. No specific fees and commissions are charged to plan members, hence the legislation does not contemplate any limits.

## Germany

47. In Germany, employers can use two types of independent legal entities to manage pension plan assets. *Pensionskassen* are usually set up as mutual associations, which corresponds to the corporate form of the pension fund. *Pensionskassen* are, however, insurance undertakings and not a special institution as is the case in most OECD countries where pension funds have legal personality and capacity. They therefore fall outside the OECD definition of autonomous pension funds.

48. *Pensionskassen* are subject to the same regulatory and supervisory framework, including the same governance regulations, as other insurance companies. However, the fact that they are set up as mutual associations means they are subject to specific requirements. Large mutual associations in Germany must have the following governing bodies: a managing board, "supreme representation", and a supervisory board. Small associations are not required to have a supervisory board.

49. The managing board is responsible for the management of the institution. The supervisory board's main role is to supervise the managing board. The "supreme representation" allows plan members to exercise their rights in all matters of the institution. A *Pensionskassen* that has the legal form of a larger mutual must have at least managing board members. There are no specific requirements for the managing board of smaller funds or for the supervisory board.

50. As insurance undertakings, *Pensionskassen* are obliged to employ an actuary, who is appointed by the managing board. They must also comply with regulations on investment management, and disclosure towards members.

51. *Unterstützungskassen* are pension funds set up as independent legal entities different from insurance companies. The funds can take either the corporate form (association or limited liability company) or the form of a foundation. Most *Unterstützungskassen* are established in the association form. The governing bodies of an association are the committee and the general assembly.

52. There are no specific regulations with respect to the responsibilities of the governing body or suitability requirements for pension funds set up as associations or foundations. In the case of pension funds set up as limited liability companies, criminal offences in the field of bankruptcy law disqualify a person from being a managing director for a period of five years. The members of the governing bodies are legally liable for any damage to the pension fund under the general provisions of the German civil law. IN dealing with the affairs of the limited liability company, the managing directors have to exercise the care of a prudent businessperson.

53. There are no requirements either to appoint an actuary, custodian, or auditor. *Unterstützungskassen* are not required to appoint an asset manager.

54. The members of the committee are appointed by decision of the general assembly. There is no requirement for employee's representatives to participate in these governing bodies. For tax reasons, however, it is mandatory that employees or members of work councils participate in the decisions of the support funds. The works council is entitled to co-determination with respect to the form, the organisation, and the management of *Unterstützungskassen*. Co-determination by the works council can be enforced in a

dual way: first, it is possible for the council to be present in the governing bodies at a equal footing with the representatives of the employer. Alternatively, the employer and works council can lay down beforehand standards for the governing bodies. The latter approach is the more popular one.

55. A law passed in 2001 will introduce a new, contractual, form of pension funds, the so-called *Pensionsfonds*. These funds will be administered by existing financial intermediaries (mainly insurance companies since at retirement, they have to guarantee the capital contributed to the plan), and will be set up through a contract between this and the plan sponsor. Further details on the governance structure of these funds are still to be decided.

## **Hungary**

56. In Hungary, closed and open pension funds are a form of mutual saving association that are identified with the corporate form, where the plan members are the owners of the institution operating the plan, but the entities are subject to specific regulation, separate from that of insurance companies. The members of the fund are also owners of the mutual, but all persons have the same voting and representation rights, independent of their level of ownership of the mutual.

57. Workers can transfer their balance from closed funds to open funds. Members, however, can only switch between mandatory closed and open funds once every six months. Further, in the case of mandatory pension funds workers need to buy an annuity from the mandatory closed pension fund but may contract directly with an insurance company. There are no portability restrictions or annuity conversion regulations for voluntary pension funds.

58. The main decision-making body is the assembly of all the members, or the general delegate assembly of their representatives. The funds must be operated by members of a board of directors, who are chosen by the assembly and audited by an elected auditing committee. In mandatory pension funds, the Board must appoint certain experts, such as an executive director, actuary, accountant, and lawyer. It is also required (in MPF and VPF) to appoint an external custodian. Similarly to other countries, the board may engage third party companies and outsource the investment of the fund's assets to financial institutions, the administration and record keeping, and – in case of mandatory funds – the annuity service (to insurance companies only). Only pension funds with assets above HUF 100 million may manage their own assets or provide benefits.

59. The board of directors has responsibility over all functions related to the pension plan, which are set up on a defined contribution basis, but must still attain a minimum return relative to a market benchmark. The board of directors, however, does not have personal liability for ensuring that returns do not fall below this level. Individual members have responsibility to determine whether to transform the accumulated balance at retirement into an annuity, and whether to buy the annuity from an insurance company of their own choice. In VPF only the funds themselves are allowed to provide annuities, however, in this case members may also choose lump-sum. In the case where pension funds offer annuities, it is the pension fund itself that is responsible for ensuring that adequate reserves are maintained to ensure that the liabilities can be met. Plan sponsors bear no liability.

60. The main responsibility of the board of directors is the adequate management of the fund according to the respective regulation, the statute of the fund and the decisions of the general assembly. In this framework, the board must prepare the main documents of the fund such as the by-laws, the financial plan and once the general assembly passed, take care of their execution. In addition, the board is required to prepare and approve the internal regulation of the asset management and asset valuation as well as the regulation on the service of the benefits.

61. The board is also responsible for the reporting and disclosure towards the supervisory agency as well as the members. The pension funds must publish the annual financial report and the balance sheet in at least one countrywide newspaper. In addition, the following information must be disclosed – in case of mandatory funds - annually: the starting date of the fund, the names and titles of the fund officials, the number of the members, revenues from contributions and other sources and their division among reserves, the value of benefits provided by the fund, the operational costs, the main indicators of the investment performance, the name of the asset manager (in case of contracting out), the penalties imposed by the supervisory agency and the use of the Guarantee fund. The members of the fund has to be informed once a year and at any time on request about the balance of their individual account.

62. There are no professional and special legal requirements for the board of directors partly related to the fact that they are elected by the members of the general assembly. However, several rules are imposed requiring unblemished professional and civil antecedents. At the same time, the regulation impose professional requirement – in additional to the rules describe above – for the management of the fund, such as the adequate specialised qualification and work experience for the executive director, the manager in charge with the investments or the actuary.

63. The governance structure, the responsibilities of the governing body and the suitability standards for the managers of open funds are exactly the same as those of the closed funds.

## **Iceland**

64. In Iceland open and closed pension funds operate as foundations (non-profit, self-owned) in the mandatory occupational pension system. Pension funds can also operate in the voluntary pension system. Collective bargaining at the industry level is common. Hence pension funds are tied to a specific collectively bargained scheme.

65. The governance structure of pension funds consists of the board of directors, the managing director or a managing company, the internal control department, and the general assembly. The general objective of the board of directors is to ensure that the operation of the fund is in accordance with the regulation and the statutes of the fund. Further, the board is responsible for the preparation and the enforcement of investment policy. The functional duties of the board are as follows:

- To conduct general supervision of the operation, bookkeeping and allocation of the assets;
- To modify the fund's statutes and suggest changes to the statute to the general assembly;
- To exercise the employer's rights over the managing director and the manager of the auditing departments, or negotiate and sign the contract with a management company and an independent auditor;
- To formulate an investment policy, set rules regarding the security transactions of the pension fund, it's board members and employees;
- To decide on the representation of the fund on the board of an institution or a company
- To carry out an actuarial assessment;
- To draw up along with the managing director the annual account for each accounting year.

66. In the case of open funds, the board members are elected partly by the general assembly and partly by the financial company that manages the fund. Generally the proportion is equal, though in some cases the fund managing company selects one additional member. In closed funds and are appointed by employer and employee associations in the case of closed funds. Still, there are some closed funds that have their boards elected at the annual meeting by the fund members. There are no legal requirements on the composition of the board. There are no particular rules concerning compensation systems.

67. Board members should be of legal age, shall control their own finance and should have an unblemished reputation. They must not have been convicted - during the last five years - for an offence related to a commercial activity punishable by the criminal code, or any limited companies' Acts, accounting, financial statements, bankruptcy or public levies. They shall be residents of Iceland or another EEA member state. The manager must also have adequate education and work experience.

68. The managing director or managing company (it may be integrated or external) is principally responsible for the daily operation of the fund in compliance with the instructions and policies from the board. The same suitability criteria as for board members are applied.

69. The internal control department of the fund

- Supervises the registration of contributions and pension rights;
- Ensures that pension rights are calculated according to law and the statutes of the fund;
- Makes proposals to the board about the organisation of internal controls and carries out special assessments of the effectiveness of the internal control;
- Supervises the enforcement of investment policy and ensures that the return is reasonable;
- Ensures that the contributions and other disposable funds are allocated according to the regulations and the statutes.

70. The manager of the internal control department must be a certified public accountant or person who has been authorised by the Financial Supervisory Authority.

71. The general assembly must approve the report of the board, the annual accounts, the actuarial report, the investment policy and amendments to the fund's statutes. The assembly must meet by the end of June of each year. In open funds, members of the general assembly elect their representatives in the board of directors and vote for changes in the fund's statutes at the general annual meeting. In closed funds, on the other hand, employer and employee associations appoint the members of the board of directors and vote for changes in statutes.

72. Pension funds must appoint an actuary and an independent auditor. There are no rules concerning the remuneration or duration of mandates of these persons. The actuary must carry out a study of the fund once a year and must report immediately to the board if there is a funding shortfall. The auditing must be carried out by a certified public accountant who cannot be a member of the board, an employee, and work in any other function for the fund other than auditing and internal control. The auditor endorses the annual accounts of the fund and must report immediately to the FSA in case of any failures in internal controls.

73. The employment of an external asset manager is optional, and there is no provision in the regulation regarding external benefit administration.

## Ireland

74. In Ireland closed (occupational) pension funds must be set up in the trust form. Trustee arrangements can vary from scheme to scheme but generally come under the category of either individual trusteeship, corporate trusteeship or a combination of individual and corporate trustees acting together. Individual trusteeship includes trustees selected and appointed directly by the employer from the company's management, outside professionals (such as solicitors, accountants, actuaries) and those selected for appointment by scheme members or after consultation with scheme members (could include current employees, retired employees and/or trade union officials). Corporate trusteeship means that a company acts as the trustee and could include the following:

- where the employer as a corporate body acts as trustee (this is fairly common in small schemes),
- where a corporate body other than an employer acts as trustee (e.g. a specialist firm providing trusteeship services),
- where a separate trustee company is set up in lieu of individual trustees, the directors of which could include those selected by the employer and by the scheme members.

75. Members of certain occupational pension plans have a right to participate in the selection of a number of trustees of their plan. In order to have this right, a person must be a qualified member of a plan which has 50 or more qualified members. Arrangements for member participation will usually be made following discussions between the employer and representatives of members. The discussions will cover such matters as the overall number of trustees and the arrangements for the selection of a proportion of this number by members. Specific rules on all these matters are set down in the Act and its underlying Regulations.

76. Pension plan trustees have duties under trust law. These have been reinforced and added to by the Pensions Act, and include the following:

- to be familiar with the trust document;
- to carry out the terms of the trust document to the letter;
- to see that the contributions due to the plan are received;
- to see that the trust fund is properly invested;
- to keep the fund separate from their own property and from the property and assets of the employer;
- to make arrangements to pay the beneficiaries in accordance with the rules;
- to ensure that accounts and records are kept;
- not to make a profit from the office of trusteeship;
- to be prudent and diligent, to exercise care and to act in the utmost good faith in carrying out their duties;
- to seek professional advice as necessary; and

- to supervise those to whom functions have been properly delegated.

77. Investment of the pension fund assets is probably the most important trustee duty. The Pensions Act requires trustees to provide for the proper investment of the assets in accordance with the “prudent man principle”.

78. A trustee who is negligent, does not act in good faith or does something which is contrary to the rules of the trust, can be sued by the beneficiaries. The trustee can be held to be personally liable for the whole amount of any loss which occurs. In addition, criminal penalties apply to trustees who are in breach of the Pensions Act.

79. The trustee is required to appoint an actuary and an auditor, however, it is not a legal obligation that pension funds have an appointed custodian. Many of the administrative functions may be undertaken on behalf of the trustee by the scheme administrator, however the ultimate responsibility remains with the trustee.

## Italy

80. In Italy closed pension funds can be set up only as foundations or associations. Asset management and benefit payment, however, must be delegated to authorised institutions. Closed pension funds are endowed with corporate governing bodies such as the general assembly, the board of directors and the board of auditors. All of these governing bodies must include employee and employer representatives in equal number.

81. Open pension funds operate in the contractual form. Banks, insurance companies, and collective investment scheme providers are authorised to manage open pension funds. The managing company of an open pension fund is required to appoint a “*responsabile del fondo*” who is usually a manager or director of this company. He or she acts as a general manager/supervisor of all activities of the managing company related to the pension fund.

82. The members of the boards and the general assembly of closed pension funds as well as the “*responsabile del fondo*” of open pension funds must meet specific requirements regarding professional qualification, work experience, lack of criminal antecedents and lack of history of insolvency.

83. In closed pension funds, the board of directors’ main responsibilities include the selection of a financial institution for the management of the pension fund assets, as well as the selection of a life insurance company for the administration of pension benefits.

84. The appointment of an independent custodian is obligatory for both closed and open pension funds. Only open pension funds are required to appoint external, independent auditors. Pension funds also must appoint an insurance company for the administration of annuities.

85. There are limitations on the fees that asset managers can be paid for acting as pension fund managers.

## Japan

86. Employees (closed) pension funds in Japan operate as foundations. Each EPF is a public juridical entity as provided for under the EPIA, and is legally independent from the sponsoring employer or employers. Administration and record-keeping services of EPFs can be sub-contracted to the Pension

Funds Association, a non-profit, private-sector organisation that is also in charge of providing benefit insurance and ensuring the portability of pension benefits in the system (see below).

87. The main decision-making body of an EPF is the board of representatives, which consists of an equal number of representatives nominated by the employer and those elected by and among the subscribers of the pension fund. This body is responsible for the modification of the by-law, the annual budget, the financial report and the settlement of accounts. The members of the board of directors as well as the auditors are elected by and among the representatives so that the equal representation of the employer and the subscribers is ensured. The chief director is responsible for the administration of the fund and also represents the fund in relation to third parties. The directors are obliged to obey the relevant regulations, administrative measures taken by the Minister of Health, Labour and Welfare based on the relevant regulations, the by-law of the fund and decisions made by the board of representatives, and to carry out their duties for the benefit of the fund. There are no suitability requirements imposed on the members of the governing bodies.

88. The functions of the custodian and the auditor are carried out within the pension funds, It is obligatory to appoint a custodian among the directors and auditors among the representatives. Pension funds are required to have their actuarial duties confirmed by actuaries, but it is not mandatory to appoint an actuary. However, the appointment of an external asset manager is obligatory. This might be a trust company, a life insurance company or an investment advisor. Pension funds may have external benefit administrators but this is not a requirement.

89. There is another type of closed pension fund that can be established in Japan, that support the so-called Tax Qualified Plans. These funds take the collective/group contractual form. TQPs are eligible contracts between employers and outside financial institutions, based upon the retirement pension provision rules, which in turn are based on collective agreements by the employer and employees. These agreements designate employees as the beneficiaries, and entrust the management and operation of the plans to the financial institutions as a fiduciary. TQPs are set to be abolished in 2002 and should be replaced by pension funds similar to the EPFs. New defined contribution schemes will also be permitted.

## **Korea**

90. In Korea, both closed and open pension funds that operate in the retirement allowance (severance) system must cover at least 5 plan members. They must be set up in the collective/group contractual form (Retirement Trust or (Retirement Insurance). Funds are required to appoint a custodian, however only banks are allowed to provide this service, as well as external auditors. Pension fund assets may be managed by banks, insurance companies and investment management companies. There is no specific regulation applied to these contracts.

## **Luxembourg**

91. In Luxembourg, closed pension funds may operate either in the form of a foundation or a mutual association and also co-operative societies (corporate form).

92. The pension funds managers must meet certain conditions with regard to competence and integrity. Appointment of an actuary is mandatory. The actuary must certify the operating reserves.

93. The auditors are not subject to any particular rules, and special requirements only apply to pension funds with limited liability company status.

## Mexico

94. In Mexico, open pension funds that operate as part of the mandatory defined contribution pension system are based in the corporate form. Open pension funds can also operate as part of the voluntary system, but the funds must be different from the mandatory ones. Voluntary savings can be withdrawn every six months. Open pension fund assets must be managed by pension fund managing companies (called *Afores*) that must be specialised financial institutions dedicated exclusively to this purpose. *Afores* must own by law at least 99% of the fixed equity of the *Siefore* under management. In addition to managing *Siefore*'s pension assets, *Afores* manage and operate individual accounts and maintain record-keeping. However, they are not allowed themselves to pay benefits in the form of annuities.

95. The governing body of both *Siefores* and *Afores* is the Board of Management, which must be composed of the same members. Both *Afores* and *Siefores* must also have a General Assembly of shareholders. Since *Afores* own the private equity of *Siefores*, the General Assemblies are also composed of the same members.

96. The General Assembly of the *Afores* must appoint two independent advisors, as well as a compliance officer as part of the Board of Management. They must be experts in the financial, economic, legal and/or social security areas and they should not have any business or working relation with the *Afores*'s shareholders or senior management. Exclusively *Afores* are allowed to manage pension fund assets.

97. Workers can choose freely between the different open pension funds available, but in mandatory pension system they can only switch every six months.

98. On joining a pension fund, a member must receive an information package, including the statement of investment policy and details of commissions that will be charged. All pension fund managing companies must also send an annual statement to the fund member showing his/her account balance, the contributions and yield earned over the course of the year, as well as the fees charged.

99. Affiliates can present a complaint to the Financial Services Users Defense Commission (CONDUSEF). This institution conducts any legal action against the *Afore*.

## Netherlands

100. In the Netherlands, closed pension funds are not required to take a specific legal form. However, almost all pension funds operate in the foundation form ("Stichting"). A few very small funds operate in the corporate form. The rest of the information provided concerns the "Stichting". Collective bargaining at the industry level is common. Hence pension funds are tied to a specific collectively bargained scheme. Some pension funds support mandatory industry-wide pension schemes.

101. The governing body of the pension fund is the board of the foundation, an internal body regulated by the Pensions and Savings Act (PSW) and by common civil law. Pension funds usually have a board of executive directors or similar internal administration units, to which the managing board delegates day-to-day decisions. Operational tasks can instead be delegated to an external entity, including a pension fund managing company set up by the plan sponsor or third parties. The board can only delegate asset management to institutions licensed by the Dutch Securities Board ("Stichting Toezicht Effectenverkeer").

102. There is no legislation prohibiting the ownership of pension fund managing companies by pension funds. Nonetheless, some pension funds are taking steps to improve transparency and reduce potential conflicts of interests. For example, one of the largest Dutch pension funds is operated by a

pension fund managing company created through the disentangling of the administration unit of the pension fund. The pension funds then sold its stake in the managing company to the plan sponsor.

103. If requested by at least plan members, pension funds must also have a council of members. The pension fund board is also required to appoint an actuary and an independent auditor (unless the benefits are externally insured). The auditor certifies the supervisory returns prepared on an annual basis, including a balance sheet, a profit and loss account, details of investments and returns on these. Pension funds that manage the pension scheme themselves (without recurring to external insurance) must also appoint an external actuary who approves an actuarial report submitted annually by the pension fund to the supervisory authority. There is no requirement to appoint a custodian.

104. In its decisions, the board has to take the interests of all parties involved into account (including the plan sponsor) in a well balanced way. The PSW also requires that assets are sufficient to cover pension promises, and that assets are invested in a sound way. The pension fund board is responsible for all aspects of the operation of the pension plan, including:

- Decide on the fund's articles of association;
- Decide on the pension scheme (in accordance with the propositions of the social partners);
- Decide on the investment policy (investment goals - passive versus active management -, strategic and tactical asset mix, the way investment activities are organised, how the risks involved are measured, how the performance is evaluated, which benchmarks are used, valuation bases used on the balance sheet).
- Establish an Actuarial and Business Memorandum (including the contribution/funding and investment policies), which must be reviewed and submitted directly to the supervisor whenever any major change of policy is introduced;
- Contribution collection and transfer, asset-liability management, and benefit payment;
- Control of compliance with regulations and internal fund rules (e.g. fulfilment of funding, investment, performance evaluation, disclosure requirements, corporate governance, and other requirements).

105. The pension fund board also has various responsibilities over disclosure. The board has the obligation to inform plan members about the statutes, the pension plan, and about any changes to it. If request by the plan members, it must also provide them with a yearly statement of accrued rights (obligatory if leaving the plan). In Dc plans, members must receive an annual report with their account balance.

106. The board must also report to the members' council on the actuarial valuation of the pension fund, asset-liability management, the asset allocation and performance, and the auditing and actuarial reports.

107. The members of the board have personal liability, but are not required to insure it. Individual members can therefore put a civil claim on board members. The members' council can also lodge a complaint with the supervisor or with a specific court of law (the "Ondernemingskamer") if it concerns items over which they have an advisory role.

108. The board of industry-wide funds must be composed of an equal number of employee and employer representatives. In the case of company pension funds, there must be at least as many members representing employees as representing the employer. Pensioners are not directly represented in the board, although recommendations have been made to permit also their representation.

109. In industry-wide funds, board members are appointed by the organisations of employers and employees (trade unions). In company pension funds, board members are elected by the participants or appointed by the employer. There is no legal regulation concerning the duration of the mandate or the compensation of board members.

110. The board must meet with the members' council at least twice a year. There are no specific requirements on the frequency of its own internal meetings. Decisions always have to be taken by at least two persons of the board. Decisions should be taken by majority voting (regulation of "Stichting").

111. Board members must have no criminal history or have been insolvent. At least two of the members of the board must have managerial experience. The board as a whole must show sufficient knowledge to carry out its responsibilities. It must lay down its education policy in a report that is submitted to the supervisory authority (PVK). From 1999 on, the law makes it possible for the supervisor to test the qualifications of the members. The supervisor is able to disqualify people.

112. The members' council has a purely advisory function on all decisions taken by the board, amendments to the articles of association, changes in benefit promises, and decisions about the winding down of the pension fund. There are no regulations on the size of the members' council, only that members (both active and retired) are represented in proportion to their numbers. There are no regulations either on the decision-making process of the council, nor on the term and compensation of the members of the council. There are no suitability requirements for the members of the council.

113. A pension ombudsman was introduced in 1995. No legislation was needed and decisions are enforced by goodwill and industry ethics.

## **New Zealand**

114. In New Zealand, closed pension funds must be set up in the trust form. Trustees are the legal custodians of superannuation schemes. Even when trustees employ an agent to administer their scheme or to manage its investments, they cannot delegate their responsibilities to these administrators. Trustees may be groups of individuals, or a corporate body which acts as sole trustee. In the latter case, it is usually the board of directors of the company who are appointed trustees, with the company secretary and/or a senior executive undertaking day-to-day administrative duties. Individual trustees are almost always appointed by the sponsoring company for the task. However a handful of schemes allow trustees to be elected by contributing members and beneficiaries. Because appointment rather than election is the norm, trustees are often executives of the sponsoring company but rarely union delegates or other employee representatives except in a union-sponsored scheme. A few schemes do have "worker trustees".

115. General trustee duties include the drawing up of a trust deed, keeping membership records, providing information and advice to members and potential members and preparing an annual report. In addition, there are financial duties including the maintenance of accounts, the arrangement of group life cover, actuarial review, development of a long-term investment policy and short-term investment strategies, and portfolio management. The Trustee Amendment Act 1988 and the Superannuation Schemes Act 1989 gave trustees more freedom to administer schemes and wider powers of investment, but these new powers were accompanied by improved incentives towards the responsible management of schemes. The thrust of the legislation was to encourage trustees to be fully accountable for both the administration of

schemes and the investment of funds. While trustees were supposed to be fully accountable under the previous legislation, many were not aware of the full extent of their responsibilities. Accountability is encouraged through requirements governing the provision of information to the Government Actuary and to scheme members.

## **Norway**

116. In Norway, closed pension funds operate as foundations. Most pension funds are actually established at the employer level. Independent pension funds must be administered separately from both the employer and the unions, in an institution separated as an independent judicial entity.

117. The governing body of a pension fund is the board of directors. The board of directors has responsibility over all aspects of pension fund administration, including the establishment of the by-laws of the pension fund.

118. The board of directors must have at least 4 members, at least 2 of whom must be elected by and among the pension plan members (employees). The remaining board members are appointed by the employer. The funds must also have a chief executive, appointed by the board of directors. The board of directors must meet at least four times a year. There are no specific suitability requirements for the members of the board and the chief executive.

119. The governing body must appoint an actuary and an external auditor, but, on the other hand, they are not required to appoint an external custodian. The board of directors may also engage an external asset manager and an external benefit administrator, but it is not required to do so. Only life insurance companies that are licensed for the management of group pension funds and specialised companies licensed for carrying out so-called “active capital management” are allowed to manage pension funds’ assets.

## **Poland**

120. Employees (closed) pension funds are voluntary. Open pension funds, on the other hand, are compulsory and operate as part of the social security system. Both types of funds are based in the individual contractual form. Closed pension funds are managed by an occupational pension society, a non-for-profit company created by employers and fully owned by them. Open pension funds, on the other hand, are managed by universal pension societies, which are a specialised financial institution, *sui generis*, exclusively dedicated to this purpose. These companies manage pension assets and maintain account management. Benefits in closed pension funds must be in the form of as lump-sum or gradual withdrawal. In open pension funds benefits must be in the form of an annuity purchased from a special annuity company (regulation to be developed).

121. The governing bodies of the pension fund management companies are the board of management, the supervisory board and the general meeting of the shareholders. The company may also set up a board of auditors.

122. The investment of the pension fund’s assets is determined by the board of management. The board has legal responsibility to guard the interest of the fund members. Occupational pension companies may delegate asset management to financial institutions. Investment management should ensure the maximum security of the assets and maximise the overall return on investment. These companies are obliged to inform both the supervisory agency and the participants of the fund about their activities.

123. All members must receive a prospectus containing the internal regulations of the fund and their rights as fund members. They have to be informed also of the changes in the prospectus and the financial results of the fund. Annually and at any time on request participants must be given a statement of account containing the number of credited units and their total value.

124. Ethical and conflict-of-interest requirements are imposed to individual shareholders and individuals serving on the supervisory boards of legal entity shareholders of pension fund companies. The members of the board of management and the supervisory board are appointed by the general meeting of the shareholders. Members of the board of management of a pension fund manager company shall be a person who:

- has legal capacity,
- has not been convicted for offences against property, document credibility, economic trading in money and securities,
- has professional certificate (economist, lawyer: minimum of 1/3 of the members) and work experience (7 years for a minimum of 2/3 of the members).

125. The appointment of an independent custodian is obligatory.

126. Participants of open pension funds can choose freely between the different pension funds available.

127. An open pension fund is obliged to publish its information prospectus once a year in a daily newspaper circulating generally in Poland. A fund is also obliged to make its information prospectus available for inspection by any person who applies for membership and shall provide it also upon request to any member.

128. A pension fund shall at regular intervals, and at least every year, provide each member with written information containing details of its operations, and detailed information on each member's account, including contribution, yield on investment, and fees paid. Upon request, a member can also demand a statement of its account value.

## **Portugal**

129. In Portugal, pension funds can be set up only in the contractual form. The (external) governing body/administrator can be either a pension fund management company dedicated exclusively to that purpose or an insurance undertaking which legally pursues the business of life assurance in Portugal. Pension fund managing companies themselves must have a specific governance structure: they must have a general assembly and a board of directors. The general assembly must meet at least once a year, while the board of directors must meet at least once a month. Decisions are taken by majority voting, though in some cases (e.g. transformation and dissolution of the managing company) they must be taken by qualified majority voting.

130. The members of the board of directors of a pension fund managing company must meet the following suitability criteria:

- suitable education or qualification,

- work experience,
- lack of criminal antecedents,
- lack of history of insolvency.

131. The pension fund governing body (the pension fund management company or life insurance company authorised to administer pension funds) shall perform all its acts in the name of and on behalf of the sponsors, members, contributors and beneficiaries. As the fund's administrator and legal representative, the pension fund manager may deal with assets and real estate, make bank deposits in the fund's name and exercise all rights or perform all acts directly or indirectly related to the fund's assets.

132. The governing body may not transfer, in whole or in part, the pension fund management powers granted them by the law to third parties, although they may employ the services of third parties where it is convenient to the exercise of their duties, namely the provision of specialist advice on actuarial and investment matters and the execution, under the pension fund managers' supervision and responsibility, of acts and operations with which they are charged.

133. Notwithstanding their liability towards the pension funds, sponsors, members and beneficiaries, the governing body may only delegate management of part or all of a pension fund's assets to credit institutions and investment companies legally authorised to manage assets in OECD member countries. A written contract shall be signed between the governing body and the asset manager. The contract shall ensure the assets are employed to the fund's ends under the terms to be defined by Instituto de Seguros de Portugal regulations. There are not any constraints on commission and duration of mandate of the pension fund asset managers.

134. The financial instruments and other documents representing the assets making up a pension fund shall be deposited with one or more credit institutions, external to the pension fund, established in Portugal, referred to as asset custodians. The governing body of the pension fund appoints the asset custodian and the relationship between them shall be the subject to a written contract, which shall include commission payable to the asset custodian. A copy of the aforesaid contract, as well as of any subsequent amendments, shall be sent to the ISP. There are not any constraints on commission and duration of mandate of the asset custodian.

135. The governing body shall appoint a responsible actuary for each defined benefit or mixed pension scheme funded by a pension fund it manages. This appointment shall be submitted to Instituto de Seguros de Portugal at the same time as submitting an application to incorporate a closed pension fund or sending a collective membership to an open pension fund. In addition to preparing the annual actuarial report the responsible actuary is required to verify the actuarial valuations, the pension fund's funding level, the suitability of the technical and actuarial plan, the present value of the total liabilities for the purpose of determining whether there is surplus funding and the suitability of the nature of the assets making up the pension fund in the light of its liabilities, from the time and under the terms laid down for that purpose in the Instituto de Seguros de Portugal regulations. There are no constraints on commission and duration of mandate of the responsible actuary.

136. The pension fund governing body shall provide the Instituto de Seguros de Portugal with the year-end documents relating to the pension fund activities duly certified by an official auditor or audited by an external auditor. Also, pension fund management companies shall provide the Instituto de Seguros de Portugal with copies of their management report, balance sheet, profit and loss account, and other financial statements certified by an official auditor or audited by an external auditor.

137. The governing body has the liability for the management of the pension fund, but it is not required to subscribe an insurance policy against this liability. Pension fund investments shall take into account the type of liabilities the fund assumes so as to guarantee safety, profitability, and liquidity. Such investments shall be suitably different and spread, and investments in assets that by their value or by the quality of the issuer carry a high risk premium shall be kept within prudent limits.

138. Pension fund members have access to the incorporation contract (in the case of closed pension funds), or to the management regulations (in the case of open pension funds). The sponsor must also inform the members about the pension scheme and any subsequent amendments within the same.

139. In the case of open funds, the value of each unit, the allocation of the fund's assets, and the number of units in circulation shall be calculated and published in "Boletim da Bolsa de Valores" at least once a month.

140. In the case of pension funds that finance contributory pension schemes, contributors and members have the right to receive, at least once a year, from the pension fund managers, information about the amount of contributions made by them or on their behalf, and in their favour, by their employer, and about the value of their share of the fund.

## **Spain**

141. In Spain, pension funds can be set up only in the contractual form. The (external) governing body is an authorised financial institution (*Gestora*). Banks, insurance companies, and other financial companies can act as the governing body, but employers can also set up companies exclusively dedicated to this purpose (pension fund managing companies). One of the largest pension fund managing companies was actually established by the largest telecoms operator in the country.

142. The governing body of the pension fund is appointed by a Pension Plan Control Commission, which must meet at least once a year. Participation of employers in this Commission is permitted, but not required. There must be a minimum of 5 and a maximum of 9 members, where a majority of the members of the Commission must be plan members, and not the plan sponsor or the beneficiaries (retired people, widows, and the disabled). Persons who own over 5% of the capital of a pension fund managing entity are not eligible to become members of the control commission. Meanwhile, members of the Control Commission will be disqualified in their role if they acquire rights or shares of the entity that manages their pension fund.

143. The aim of the Control Commission is to ensure that occupational pension plans operate correctly. Among other functions, it supervises the application of the plan's rules, selects the actuaries who must certify the situation of the plan, nominates the representatives of the plan's Control Commission in the Fund's Control Commission, represents the interests of participants vis-à-vis the management company, approves the financial statements of the fund presented by the management company, and makes recommendations with regards to the contributions, benefits and other plan variables. The Control Commission must also appoint the fund manager, the auditor, the custodian, and the plan actuary (for defined benefit and hybrid plans). However, the Commission can delegate the responsibility of appointing the actuary to the pension fund managing company.

144. The pension fund managing company acts as the governing body of the pension fund. It keeps the books of the fund, determines the amount of the different pension plan assets, and controls the depository of the fund. Investment policy is determined directly by the managing company in personal plans. In occupational plans, on the other hand, it is dictated by the Pension Plan's Control Commission. Only when instructed by the Control Commission will the managing company determine the investment policy. The

managing company also has disclosure responsibilities towards the supervisory agency, beneficiaries, the Pension Fund Control Commission, and, in the case of occupational plans, towards the Pension Plan Control Commission. Fees charged by pension fund managing companies are limited to 2% of the pension fund assets.

145. All pension funds must be supervised by a Control Commission. Only in the case where the pension fund finances a single pension plan, can the Pension Plan Control Commission exercise the functions of Pension Fund Control Commission. Otherwise, the Pension Fund Control Commission is formed with representatives from all the Pension Plan Commissions.

146. The functions of the Pension Fund Control Commission include choosing the managing and the depository entities, ensuring the adequate functioning of the fund according to its prescribed rules, examination and approval of the managing entity's activities, and demanding retribution for the damage caused by any failure to fulfil its obligations.

147. The custodian, in addition to being the depositor of the fund's assets, plays a monitoring role over the pension fund managing entity, in that it is required to ensure the funds are managed in an adequate way, and adequate disclosure is made to the supervisory authorities. It can charge a maximum of 0.6% of the pension fund assets. The custodian must be different from the pension fund managing entity.

148. Both the pension fund and the pension fund management entity must be audited on a yearly basis.

149. Specific regulations are established on the suitability of the board of directors of the pension fund managing entities. These are similar to those of other financial companies, such as the requirement for adequate qualifications and professional experience, and the lack of criminal or insolvency antecedents.

150. Pension funds can support defined contribution schemes, but the funds are collectively managed by a financial institution chosen by the employer and the worker cannot transfer its funds unless it leaves the company.

## **Sweden**

151. In Sweden, closed pension funds operate as foundations. A pension fund is founded by one or more employers, and it has its own board of directors with equal representation of employers and employees. The board members choose the chairman of the board. If the board members cannot agree, the chairman is appointed by the supervisor. There is no fixed limit on the number of board members. Board members must receive fair compensation in addition to costs incurred. There are no suitability criteria for board membership.

152. No general objectives are set out for the board, except the purpose of securing the pension commitments of the employer. The articles of association and changes of them must be approved by the supervisor, who also receives the annual accounts and may react on them. The board of the fund monitors the administration, mainly the investments, and the compliance with the articles of association.

153. The employer must appoint an external auditor. The auditors perform the auditing tasks and are responsible for checking the evaluation of the pension provisions and the sufficiency of assets. The employer is responsible for valuing the pension liabilities and keeping the fund at a corresponding level. There is no requirement to appoint an external actuary. The evaluation of the technical provisions of the pension foundations are performed by Finansinspektionen (the Swedish Financial Supervisory Authority).

154. There is no regulation on delegation of investment management functions, on the liability of the governing body, or on disclosure to plan members.

## **Switzerland**

155. In Switzerland, closed pension funds may operate either in the form of a foundation or a mutual association, and also co-operative societies (corporate form).

156. The governing bodies of the pension fund are the board of directors and the investment committee. The board of directors of closed pension funds must be composed of an equal number of employee and employer representatives. The law further stipulates also that employer representatives should not include any senior managers. The board of directors must meet at least once a year. Investment management can also be carried out in-house (by the board and the investment committee) or delegated to third parties. Pension funds can in particular delegate asset management to collective investment trusts, which are established to cater exclusively for these institutions.

157. The board of directors makes decisions on the main activities such as the benefits and the funding of the plan, the strategic asset allocation of the fund's assets, it supervises the whole functioning of the fund, and provides information to the supervisory agency and the participants. The investment committee executes the investment policy dictated by the board of directors (carries out the tactical asset allocation).

158. The board of directors is required to appoint independent auditors, and pension experts or actuaries, but, on the other hand, it is not required to appoint an external custodian. Each pension fund must be audited at least once every three years. The role of the actuary can be substituted by so-called pension experts, who can be lawyers, accountants and others with a federal diploma of experts in pension insurance. The board of directors may also appoint investment consultants who may be internal or external to the pension fund. The appointment of such experts is mandatory when the pension fund surpasses investment limits set out by the regulation.

159. Persons involved in the management and auditing of the foundation are personally responsible for any losses or damages caused wilfully. Investment must be carried out according to basic principles such as security, diversification, and liquidity. Pension funds are required to carry out an asset liability modelling exercise when they surpass investment limits.

160. Fund members must receive on at least an annual basis the pension fund report, which includes information on:

- the amount insured
- the amount and the formula for calculating employee contributions
- the amount of benefits in case of invalidity or death of the insured employee

161. Additional information may be obtained on request, such as the legal form and governance structure of the pension fund, the risks underwritten by the pension fund, and the annual financial accounts of the pension fund.

162. There are no specific managerial requirements of the board members. Pension experts, on the other hand, must have a federal diploma of experts in pension insurance.

## **United Kingdom**

163. In the United Kingdom, closed pension funds must be set up in the trust form. There is no requirement for a minimum number of members. Trustees hold the title to the pension fund assets for the exclusive benefit of plan members and their beneficiaries.

164. The Act introduced the possibility of appointing member-nominated trustees. Trustees normally include representatives of the employer, members and beneficiaries. The Pension Act of 1995 provides that 1/3 of trustees should be nominated by employee representatives. Schemes with over 100 members must have a minimum of two employee trustees, under 100 they must have one. A person convicted of an offence of dishonesty and deception, who has been bankrupt, or disqualified as a director, may not be a trustee. Actuaries and auditors of the scheme in question may not be trustees of it.

165. Trustees have responsibility for all the functions of the pension plan. They have responsibility over the investment strategy, but investment management must be executed by an authorised asset manager. Trustees may seek authorisation to act as asset managers, but most trustees delegate the work to an authorised asset manager. Trustees must ensure that the manager is a suitable person to carry out the investment business of the scheme on their behalf. Trustees must also appoint the auditor and actuary to the scheme (in the case of DB and hybrid plans). The appointment of a custodian is not obligatory, but most pension funds in fact conform to this requirement, via industry standards set by the National Association of Pension Funds.

166. The 1995 Pensions Act assigned various additional responsibilities to trustees, including:

- the right benefits are paid at the right name,
- accurate records of past and present members are maintained,
- full and proper accounts are kept,
- proper actuarial advice is taken,
- the level of contribution is sufficient to meet the liabilities,
- suitable professional advisers are appointed,
- members and others are told about the scheme and about their personal benefits.

167. Among the various reports that trustees must submit to the supervisory body (and to plan members on request) is a statement of investment principles. These statements constitute the basis of the investment activity and the composition of the portfolio. The statements can be submitted and passed by different governing bodies of the fund, must be revised over a certain frequency and published to the members in an adequate method. Trustees must also state in the investment of investment principles the

extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments. They must also state their policy (if any) in relation to the exercise of the rights (including voting rights) attaching to investments.

168. Trustees must also send an annual report to members in the case of DC plans. This report must include the value of the DC account, the contributions made, and the yield earned over the year.

169. The specific responsibilities of auditors and actuaries are also defined in the 1995 Pensions Act. The duties of actuaries include the annual verification of compliance with the law and its implementing regulations and the legality of pension fund operations (including the receipt of contributions and payment of benefits as well as the management of assets). Auditors are also required to examine the annual accounts of the pension institution and to submit a written report to the board of trustees on the findings of their audit.

170. Actuaries are required to determine periodically that pension institutions are able to meet their obligations and that the terms and conditions of their pension plan comply with legal provisions.

171. Both auditors and pension experts are required to report to the competent supervisory authority any infractions of rules by pension funds as well as any problems that would require immediate intervention. They must also notify to the competent supervisory authority the termination of the contract.

172. Employees are able to leave a closed pension fund, but they are not guaranteed employer contributions, as they would if they contributed to the closed pension fund. Indeed, few employers choose to contribute to their employees' personal pension plans.

173. Trustees hold personal liability for their decisions. They are not required to insure themselves against this liability, but often do so. They must act prudently, conscientiously, honestly, and with the utmost good faith.

174. Individuals may turn to the Pensions Ombudsman, a figure that was introduced by the 1995 Pensions Act, for infractions to plan rules and to regulations. Cases of fraud and misappropriation are dealt by the courts.

## **United States**

175. In the United States, plan fiduciaries bear responsibility for all aspects of the plans' operation, including the management of the plans' assets. Plan fiduciaries include the staff of the plan sponsor, the trustees of pension assets, and asset managers. These plan fiduciaries constitute the governing body of the pension fund.

176. Closed pension funds must be set up in the trust form. A trustee or trustees must be named in the plan or trust documents or must be appointed by the plan fiduciary to hold the legal title to the pension fund assets. Trustees also have exclusive authority and discretion to manage the assets of a pension fund unless (1) the plan document or trust instrument expressly provides that the trustee or trustees are subject to the direction of a named fiduciary who is not the trustee, or (2) the authority to manage, acquire, and dispose of assets of the plan is delegated to one or more asset managers. The trustee retains the title to these assets when the authority to manage the assets is delegated.

177. Member representation as trustee is not required. In single employer plans, the sponsoring employer nearly always retains the authority to appoint the trustees of a pension fund. In multi-employer

plans, on the other hand, trustees are jointly appointed by participating employers and employee organisations in equal proportion.

178. Asset management can be carried out in-house (by the financial staff of the plan sponsor) or, at the discretion of the plan sponsor, this responsibility may be delegated to a collective investment trust, an investment adviser registered under the Investment Advisers Act of 1940, a bank, or an insurance company qualified under the laws of two or more states to provide investment management services. To be qualified, an asset manager must acknowledge in writing that it is a plan fiduciary, as defined by ERISA.

179. All other professionals that provide services to the pension fund are appointed directly by the plan fiduciary. ERISA requires closed pension funds to have custodians independent of the asset manager. Custodians are appointed by the plan fiduciary. Sponsors of plans with over 100 employees must also appoint an independent auditor.

180. The plan fiduciaries, as the governing body of the pension fund, are subject to various governance regulations. The ERISA law of 1974 contains three basic duties for fiduciaries:

- Fiduciaries are required to make decisions for the exclusive purpose of providing benefits to participants in the plan, often described as a duty of loyalty. This is generally viewed as prohibiting consideration of factors such as stimulating demand for a sponsor's products or even in enhancing the job security of the sponsor's employees.
- Fiduciaries are required to undertake their activities in a "prudent" manner. In particular, fiduciary law requires the plan fiduciary to exercise "the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims". This has come to be interpreted to require expertise in the matters for which the fiduciaries are responsible, skill in undertaking these actions and diligence appropriate to the circumstances relevant to the action. As a result of court rulings and of Department of Labour regulations, evidence of prudence requires evidencing that (i) there has been a thorough consideration of the issues; (ii) there has not been "blind" reliance on experts; (iii) the fiduciary did not ignore or fail to investigate any relevant facts that would be altered the decision taken.
- Investments are required to be diversified in order to minimise the chance of losses.

181. To the extent that trustees are granted responsibility for asset management, they also bear personal liability for the prudent investment of pension assets. They are generally obliged to secure a bond to ensure the ability of the pension fund to recover losses.

182. Other functional duties of trustees enshrined in the regulation are to ensure that the fund does not engage in any prohibited transactions and to disclose certain information to the supervisory authority and the fund members.

183. Prohibited transactions include a limit on self-investment of pension assets in the plan sponsor of 10% and a list of parties disqualified from engaging in transactions with the pension fund, including, among others, the sponsor of the plan, its employees, related entities that meet certain common ownership tests, relatives of fiduciaries and any of the beneficiaries of the plan. However, the law also provides several means to obtain exemptions from these prohibitions, specifically in the case where such prohibitions may impose significant disadvantages to pension funds.

184. Disclosure requirements include the submitting of the annual pension funds accounts to the supervisory authorities, and the provision of information to plan members about the investment allocation of the pension fund.

185. The right to redress can be exercised through individual action in the federal courts to enforce the right to benefits under the terms of the plan or by referring to the Department of Labour for any offence that affects the pension fund as a whole.

## ANNEX 2: PENSION FUND GLOSSARY

The *(pension fund) asset manager* is the individual(s) or entity(ies) endowed with the responsibility to physically invest the pension fund assets. Asset managers may also set out the investment strategy for a pension fund.

The *actuary* is the person or entity whose responsibility, as a minimum, is to evaluate present and future pension liabilities in order to determine the financial solvency of the pension plan, following recognised actuarial and accounting methods.

*Autonomous pension funds* are pension funds that constitute either (i) independent and self-administered legal entities (with legal capacity and personality), different from other institutions providing pension funding services such as banks, collective investment scheme managers, and insurance companies, that are dedicated primarily to the provision of retirement and related benefits of a funded pension plan or (ii) pools of pension assets that are legally separate from the assets of the plan sponsor, provider, and administrator (such funds have no legal capacity and personality) and which are either the legal property of pension plan members or must be used only to fund the pension plan benefits and distributions. Autonomous pension funds with legal capacity and personality are able to engage in financial transactions in the market on their own account. Autonomous pension funds that do not have legal capacity and personality are administered by separate institutions (specialised pension fund managing companies or other financial institutions), whose assets are legally separated from those of the pension fund.

*Biometric risk* is a risk related to human life conditions, such as life expectancy/longevity, disability, and sickness.

*Closed pension funds* are funds that support only pension plans that are limited to certain employees (e.g. those of an employer or group of employers)

The *custodian* is the entity responsible, as a minimum, for holding the pension fund assets and for ensuring their safekeeping.

The *governing body* or *administrator* of a pension fund is(are) the individual(s) or entity(ies) ultimately responsible for the operation and oversight of the pension fund. Depending on the legal form of the pension fund, the governing body or administrator may be internal or external to the pension fund.

*Non-autonomous pension funds* are funds whose assets are not legally separated from those of the plan sponsor. An example of such funds is the book reserve system.

*Open pension funds* are funds that support at least one plan with no restriction on membership (collective membership may be possible, however).

The *oversight committee* of a pension fund is(are) the individual(s) or entity(ies) responsible for monitoring the governing body of a pension fund. The oversight committee may be, for example, a board of supervisors or a control commission.

*Pension funds* are pools of assets consisting exclusively of the contributions to a pension plan and the income earned on them.

A ***pension fund managing company*** is a type of pension fund governing body or administrator in the form of a company whose exclusive activity is the administration of pension funds. The pension fund's assets are legally separated from the managing company. By definition, the pension fund managing company is also the asset manager of the pension fund.

A ***pension plan beneficiary*** is an individual, other than a plan member, entitled to a benefit (e.g. survivors' benefit).

A ***pension plan member*** is an individual that is an active (working or contributing, and hence actively accruing benefit) or passive (retired, and hence receiving benefits, or holding deferred benefits) participant in a pension plan.

A ***pension plan sponsor*** is an institution (e.g. company, industry/employment association) that designs, negotiates, and normally helps to administer an occupational pension plan for its employees or members.

***Pension fund administration*** is the operation and oversight of a pension fund. The governing body is responsible for administration, but may employ other specialist entities, such as actuaries, consultants, and asset managers to carry out specific operational tasks.