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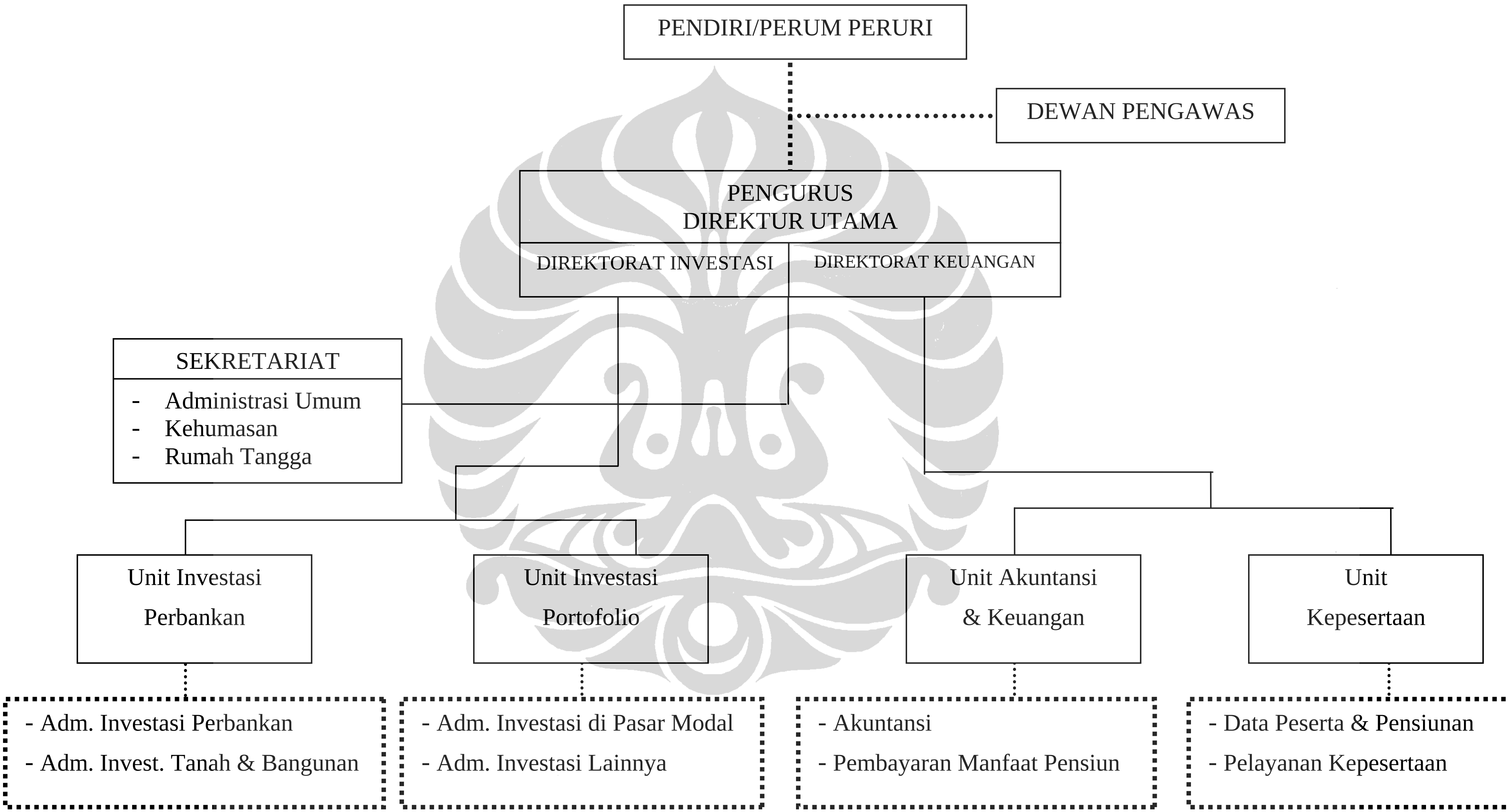

OECD OCDE

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS

OECD guidelines for pension fund governance

RECOMMENDATION OF THE COUNCIL

These guidelines, prepared by the OECD Insurance and Private Pensions Committee and Working Party on Private Pensions, were adopted by the OECD Council on 28 April 2005.

1. The OECD Ministers agreed in 2002 “that implementation of best practices in corporate and financial governance entails an appropriate mix of incentives, balanced between government regulation and self-regulation. [They] seek to improve such governance to enhance transparency and accountability and thereby strengthen investor confidence and the stability and resilience of financial markets”.

2. The emphasis on financial governance as well as broader corporate governance reflects both the essential role of financial markets in the economy and the distinct risks and responsibilities of the sector. The emphasis on governance is because, even in highly regulated sectors, regulation alone cannot achieve the good practice necessary for integrity and effectiveness. Companies themselves must develop internal rules and systems in order to reach these goals, but governments and international bodies can provide guidance on these rules and systems.

3. In this perspective, the work on pension funds governance undertaken by the Working Party on Private Pensions was intended to capture the specificities of the governance of pension funds and to complement the revised OECD Principles of Corporate Governance[1].

4. The Governance of pension funds must address sector specific issues related, for instance, to the responsibilities of fiduciaries, rights of beneficiaries/policyholders, risk management techniques or the non-corporate nature of numerous pension funds. Pension funds may be established as special purpose legal entities (pension entities), such as trusts, foundations, and corporate entities, that own and may also control the pension fund on behalf of the pension plan/fund members. Alternatively, they may consist of legally separate accounts managed by financial institutions and established under a contract between the plan sponsor and the financial institution that manages the fund.

5. The central figure in pension fund governance is the governing body that is the person, group of persons or legal entity responsible for the management and safeguarding of the pension fund. Where the pension fund is established as a pension entity, such entity's governing body will normally also be responsible for the management of the fund[2]. Where the fund consists of a separate account, the financial institution that manages the account is the governing body of the fund. In some countries, only dedicated financial institutions (pension fund managing companies) are permitted to manage pension funds.

6. The governing body is subject to various forms of external oversight. At one level, the governing body may be monitored by special committees set up especially for this purpose (e.g. a supervisory board or oversight committee), whose members may be elected by plan members and beneficiaries. At another level, regulations require independent professionals such as actuaries, auditors, and custodians to monitor and report on the compliance of the governing body with relevant legislation. Finally, the governing body is subject to the supervision of relevant authorities. The regularity and detail of the oversight exerted by the supervisory authorities will vary depending on the complexity of the pension system and the specific role of actuaries, auditors, and custodians.

7. Guidelines on Pension Fund Governance address several of the regulatory concerns that arise in the establishment and operation of pension funds. The guidelines aim *inter alia* to provide guidance to countries on the regulation of the governance of pension funds, which includes the legal form and structure of the pension entity as well as the interactions and relationship between the different parties involved in the management of the pension fund and the plan members.

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[1] See OECD website, http://www.oecd.org/daf/corporate/principles.

[2] In some countries, however, the governing body of the pension entity is required to delegate the management of the fund to financial institutions.

8. While the guidelines identify good practice in pension fund regulation, their implementation may be conducted through other means. In particular, it may be that some of the functions identified in the guidelines such as auditing and custody may be carried out by the same entity. The underlying objective in this case is that of identifying cases of non-compliance with regulations through an independent, external check on the decisions and activities of the governing body of the pension fund.

9. These guidelines apply to pension funds that support private occupational pension plans. In some countries, these principles may also be appropriate for pension funds established under personal pension arrangements. Individual pension funds[3] and insurance arrangements are excluded.

10. The development of these guidelines has been based on previous work on private pensions carried out by the Working Party on Private Pensions and the Insurance Committee in the area[4]. In particular, these guidelines complement the "Recommendation of the Council on Core Principles of Occupational Pension Regulation"[5]

11. The guidelines also benefited from the work and revision of the OECD Principles of Corporate Governance, which they complement. In this respect, the Working Party on Private Pensions considers that the revised OECD Principles of Corporate Governance provide some relevant insights for pension fund governance.

12. The owners or beneficiaries of pension funds have characteristics that can identify them with both shareholders and the stakeholders. In particular the Principles require that both shareholders and stakeholders are granted the opportunity to obtain effective redress for violation of their rights and that they have access to relevant information. The revised OECD Principles of Corporate Governance also identify key responsibilities for the board of a corporation that have parallels with those of the pension fund governing body. In particular, the corporate governance framework, as defined in the "Principles", should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

13. In this respect, the Working Party on Private Pensions and the Insurance Committee decided that the work they were developing on both the Guidelines on Pension funds Governance and the Guidelines for Insurers' Governance needed to be conducted in close co-operation with the Steering Group in order to ensure full consistency with the revised OECD Principles of Corporate Governance, and that these guidelines should first be submitted to the Steering group before being sent to the Council.

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[3] Individual pension funds are excluded because the plan members manage the assets themselves and, in effect, act also as the governing body of the fund. Of course, individuals may invest such funds in existing financial products, such as banks deposits, collective investment schemes, or insurance policies, which involve delegation over the investment of those products in other assets.

[4] Among other sources, the guidelines also paid also attention to OECD and subsequent work by IOSCO on collective investment schemes. The requirements for a CIS have much in common with those for pension funds. However, it must be noted that collective investment instruments are based on the equivalent of a defined contribution principle. That is, they normally provide no insurance against financial or biometric risks. In September 2003, a directive of the European Parliament and of the European Council was also issued "on the co-ordination of laws, regulations and administrative provisions relating to institutions for occupational retirement provision" (2003/41/EC). The directive contains several rules on the governance requirement of occupational pension institutions, which include pension funds as defined in this document.

[5] Also available on the OECD website at: http://www.oecd.org/document/48/0,2340,en_2649_34853_33620272_1_1_1_1,00.html].

14. The guidelines for pension funds governance (which were first approved by the Working Party in 2002 and endorsed by the Insurance Committee in December 2003) were transmitted to the Steering Group after the revision of the OECD Principles of Corporate Governance, along with the new Guidelines on the Insurers' Governance. At its 19-20 October 2004 meeting, the Steering Group considered that both set of Guidelines are fully compatible and consistent with the revised OECD Principles of Corporate Governance.

15. The guidelines presented in the Appendix I fall into two main groups: guidelines for the governance structure, and guidelines for governance mechanisms. The Annotations set out in Appendix II provide additional information. Appendix II is not formally part of the draft Recommendation, and as such may be amended as necessary by the Insurance Committee and the Working Party on Private Pensions.

APPENDIX I

RECOMMENDATION ON GUIDELINES FOR PENSION FUNDS GOVERNANCE

THE COUNCIL,

Having regard to Article 5b) of the Convention on the Organisation for Economic Cooperation and Development of 14 December 1960;

Considering that the OECD Ministers agreed in 2002 “that implementation of best practices in corporate and financial governance entails an appropriate mix of incentives, balanced between government regulation and self-regulation. [They] seek to improve such governance to enhance transparency and accountability and thereby strengthen investor confidence and the stability and resilience of financial markets”;

Considering that the integrity of financial institutions depends not only on regulation and supervision, but also on the quality of governance practices within financial institutions;

Considering that the specificity of the risks and responsibilities faced by pension funds call for specific guidance on governance in addition to the more general standards provided by the revised OECD Principles of Corporate Governance;

Considering that the Guidelines for Pension funds Governance (hereinafter called “the Guidelines”) complement the revised OECD Principles of Corporate Governance and that the Steering Group on Corporate Governance in October 2004 expressed the view that the Guidelines for Pension Funds Governance are fully compatible and consistent with the revised Principles;

Considering that the guidelines address several of the regulatory concerns that arise in the establishment and operations of pension funds;

Considering that regulations on pension funds governance need to be guided under the overriding objective of pension funds which is to serve as a secure source of retirement incomes;

Noting that while the guidelines identify good practices in pension fund regulation, their implementation may be conducted through other means;

Considering that the guidelines are based on previous work carried out by the Working Party on private pensions in this area and complement the "Recommendation of the Council on Core Principles of Occupational Pension Regulation" which was endorsed by the Council in April 2004;

Considering in addition that the Guidelines have been elaborated on the basis of experiences of Member countries and relevant international institutions and organisations;

Recognising that evolutions of the pension funds structure or functioning or/and in the revised OECD Principles of Corporate Governance may call for further updating and adaptations of these guidelines;

On the proposal of the Working Party on Private Pensions and the Insurance Committee;

I. RECOMMENDS that Member Countries invite public authorities and pension entities to ensure an adequate and efficient governance framework for pension funds, having regard to the contents of the Annex to this Recommendation of which it forms an integral part.

II. INVITES Member Countries to disseminate these guidelines among pension funds;

III. INVITES non Member economies to take account of the terms of this Recommendation and, if appropriate, to adhere to it under conditions to be determined by the Insurance Committee.

IV. INSTRUCTS the Insurance Committee and the Working Party on Private Pensions to exchange information on progress and experiences with respect to the implementation of this Recommendation, review that information and report to the Council within three years of its adoption, or sooner, and, as appropriate, thereafter.

ANNEX

GUIDELINES FOR PENSION FUND GOVERNANCE

The following guidelines are applicable to *autonomous, collective or group pension funds that support private occupational pension plans*. In some countries, they may also be appropriate for pension funds established under personal pension arrangements. Their practical implementation may vary from country to country, the aim being that the underlying objectives of the guidelines are met.

These guidelines are consistent and compatible with the revised Principles of Corporate Governance, which they complement.

- Regulations on pension funds governance need to be guided under the overriding objective that pension funds are set up to serve as a secure source of retirement incomes.

I. GOVERNANCE STRUCTURE

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

1. Identification of responsibilities

There should be a clear identification and assignment of operational and oversight responsibilities in the governance of a pension fund. To the extent that a pension entity is established that owns the pension fund on behalf of plan/fund members, the legal form of this entity, its internal governance structure, and its main objectives should be clearly stated in the pension entity's statutes, by-laws, contract or trust instrument, or in documents associated with any of these. If the pension fund is established as a separate account managed by financial institutions, the pension plan or contract between plan sponsors/members and the financial institution should clearly state the responsibilities of the latter with respect to the management of the pension fund.

2. Governing body

Every pension fund should have a governing body[6] vested with the power to administer the pension fund and who is ultimately responsible for ensuring the adherence to the terms of the arrangement and the protection of the best interest of plan members and beneficiaries. The responsibilities of the governing body should be consistent with the overriding objective of a pension fund which is to serve as a secure source of retirement income. The governing body should not be able to completely absolve itself of its responsibilities by delegating certain functions to external service providers. For instance, the governing body should retain the responsibility for monitoring and oversight of such external service providers.

[6] The governing body may also be an administrator.

3. Expert advice

Where it lacks sufficient expertise to make fully informed decisions and fulfil its responsibilities the governing body could be required by the regulator to seek expert advice or appoint professionals to carry out certain functions.

4. Auditor

An auditor, independent of the pension entity, the governing body, and the plan sponsor, should be appointed by the appropriate body or authority to carry out a periodic audit consistent with the needs of the arrangement. Depending on the general supervisory framework, the auditor should report promptly to the governing body and - if the governing body does not take any appropriate remedial action - to the competent authorities wherever he or she becomes aware, while carrying out his or her tasks, of certain facts which may have a significant negative effect on the financial situation or the administrative and accounting organisation of a pension fund.

5. Actuary

An actuary should be appointed by the governing body for all defined benefit plans financed via pension funds. As soon as the actuary realises, on performing his or her professional or legal duties, that the fund does not or is unlikely to comply with the appropriate statutory requirements and depending on the general supervisory framework, he or she shall inform the governing body and - if the governing body does not take any appropriate remedial action - the supervisory authority without delay.

6. Custodian

Custody of the pension fund assets may be carried out by the pension entity, the financial institution that manages the pension fund, or by an independent custodian. If an independent custodian is appointed by the governing body to hold the pension fund assets and to ensure their safekeeping, the pension fund assets should be legally separated from those of the custodian. 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.

7. Accountability

The governing body should be accountable to the pension plan members and beneficiaries and the competent authorities. The governing body may also be accountable to the plan sponsor to an extent commensurate with its responsibility as benefit provider. In order to guarantee the accountability of the governing body, it should be legally liable for its actions.

8. Suitability

The governing body should be subject to minimum suitability standards in order to ensure a high level of integrity and professionalism in the administration of the pension fund.

II. GOVERNANCE MECHANISMS

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

9. Internal controls

There should be appropriate controls in place to ensure that all persons and entities with operational and oversight responsibilities act in accordance with the objectives set out in the pension entity's by-laws, statutes, contract, or trust instrument, or in documents associated with any of these, and that they comply with the law. Such controls should cover all basic organisational and administrative procedures; depending upon the scale and complexity of the plan, these controls will include performance assessment, compensation mechanisms, information systems and processes, and risk management procedures.

10. Reporting

Reporting channels between all the persons and entities involved in the administration of the pension fund should be established in order to ensure the effective and timely transmission of relevant and accurate information.

11. Disclosure

The governing body should disclose relevant information to all parties involved (notably pension plan members and beneficiaries, supervisory authorities, etc.) in a clear, accurate, and timely fashion.

12. Redress

Pension plan members and beneficiaries should be granted access to statutory redress mechanisms through at least the regulatory/supervisory authority or the courts that assure prompt redress.

APPENDIX II

ANNOTATIONS TO
GUIDELINES FOR PENSION FUNDS GOVERNANCE

The following guidelines are applicable to *autonomous, collective or group pension funds that support private occupational pension plans*. In some countries, they may also be appropriate for pension funds established under personal pension arrangements. Their practical implementation may vary from country to country, the aim being that the underlying objectives of the guidelines are met.

These guidelines are consistent and compatible with the Principles of Corporate Governance, which they complement.

- *Regulation on pension funds governance need to be guided under the overriding objective that pension funds are set up to serve as a secure source of retirement incomes.*

I. GOVERNANCE STRUCTURE

- *The governance structure should ensure an appropriate division of operational and oversight responsibilities, and the accountability and suitability of those with such responsibilities.*

1. Identification of responsibilities

There should be a clear identification and assignment of operational and oversight responsibilities in the governance of a pension fund. To the extent that a pension entity is established that owns the pension fund on behalf of plan/fund members, the legal form of this entity, its internal governance structure, and its main objectives should be clearly stated in the pension entity's statutes, by-laws, contract, or trust instrument, or in documents associated with any of these. If the pension fund is established as a separate account managed by financial institutions, the pension plan or contract between plan sponsors/members and the financial institution should clearly state the responsibilities of the latter with respect to the management of the pension fund.

Pension entities are established in accordance to statutes, by-laws, contract, or trust instrument. These documents, sometimes together with associated material, should define the legal form of the pension entity as well as its internal governance structure and main objectives. The main objectives of the pension entity will vary depending on the type of plan that they support. In defined contribution plans, the main objective of the pension entity may be to invest the pension assets in order to maximise risk-adjusted returns. In defined benefit plans, the pension entity may have several objectives, such as ensuring an adequate match between the pension plan assets and its liabilities and paying benefits upon the death or retirement of plan members.

Some of the operational functions of the pension entity that should be identified and assigned include collection of contributions, record-keeping, actuarial analysis, funding and contribution policy, asset-liability management (for defined benefit and hybrid plans), investment strategies (for both DB and DC schemes), asset management, disclosure to plan members, and regulatory compliance. These responsibilities and their assignment should be clearly stated in the pension entity's documents.

The role of the plan sponsor and the rights of the plan/fund members with respect to the governance of the fund should be also clearly documented. The plan sponsor normally chooses the governing body of a pension fund or appoints at least some of the members of the governing body. Where the pension fund is established as an independent legal entity, some of the professional staff of this entity, such as actuaries and asset managers, may also be employees of or external advisors to the plan sponsor. However, in general, it should be the governing body's responsibility to appoint the professional staff and the external service providers of the pension entity. Pension plan/fund members may also play a role in electing members of the governing body or the supervisory board of the pension fund. In some countries, trade unions elect the members of the governing body on behalf of plan/fund members.

When the pension fund is established as a separate account managed by financial institutions, their responsibilities should be clearly stated in the plan or contract documents. In occupational plans, plan sponsors should sign a contract with the financial institutions responsible for the management of the pension fund, where the objectives of the fund are also clearly stated. In personal plans, the contract is signed directly between the plan member and the financial institution.

2. Governing body

Every pension fund should have a governing body vested with the power to administer the pension fund and who is ultimately responsible for ensuring the adherence to the terms of the arrangement and the protection of the best interest of plan members and beneficiaries. The responsibilities of the governing body should be consistent with the overriding objective of a pension fund which is to serve as a secure source of retirement income. The governing body should not be able to completely absolve itself of its responsibilities by delegating certain functions to external service providers. For instance, the governing body should retain the responsibility for monitoring and oversight of such external service providers.

Pension funds are controlled by a governing body or administrator that is responsible for the operation and oversight of the pension fund. The governing body may also be responsible for other (or indeed all) aspects of the administration of a pension plan. This governing body or administrator may be a person, a committee or committees of persons, or a legal entity. In some cases, it may be appropriate to split the operational and oversight responsibilities between different committees. Hence, a separate supervisory board or oversight committee may be established whose main functions are the selection and oversight of the executive board. The supervisory board may have other responsibilities, and may for example appoint the external monitors (auditor) of the pension fund. The supervisory board may form part of the internal governance structure of the pension entity or it may be established externally. Its members may be elected by the plan sponsor and plan/fund members. In pension funds established in the corporate form, the general meeting of plan/fund members also exerts some oversight functions.

Though the governing body may delegate operational duties to the pension entity's internal staff or external service providers, it remains ultimately responsible for ensuring that pension funds fulfil their overriding objective which is to serve as the sources of funds for retirement benefits. In particular, the governing body should retain the responsibility for monitoring and oversight of those service providers. Core functions, such as formulating the investment policy and risk monitoring should also normally rest with the governing body, though external advice may of course be requested.

The governing body's main responsibilities should include at least:

- monitoring the administration of the pension fund in order to ensure that the objectives set out in the fund by-laws, statutes, contract or trust instrument, or in documents associated with any of these, are attained (e.g. diversified asset allocation, cost-effectiveness of administration, etc);
- selecting, compensating, monitoring, and, where necessary replacing staff with operational responsibilities as well as external service providers (e.g. asset managers, actuaries, custodians, auditors, etc);
- ensuring the compliance of the activities of the entity with the pensions law (e.g. investment regulations, reporting and disclosure requirements, control of conflicts of interest situations, improper use of privileged information, etc);

While the governing body should best serve the interest of the pension plan members, he may also be required to cater for some of the interests of the plan sponsor. In particular, the pension plan/entity documents may require the governing body to carry out its activities in a way that does not impose an unnecessary financial burden on the plan sponsor (i.e. where the interest of plan members and beneficiaries could be equally best served through other means, which are more beneficial for plan sponsors). For example, where the expenses of administering the pension fund are borne exclusively by the plan sponsor, the governing body may be required to ensure that these are managed efficiently in order to minimise the cost to employers.

3. Expert advice

Where it lacks sufficient expertise to make fully informed decisions and fulfil its responsibilities the governing body could be required by the regulator to seek expert advice or appoint professionals to carry out certain functions.

Where it is appropriate to do so, the governing body should seek expert advice and may delegate functions externally. 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 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.

The governing body should ensure that all its professional staff and, where appropriate, the external service providers have the relevant qualifications and experience required to carry out their functions in accordance with the objectives of the pension entity and the pension plan.

4. Auditor

An auditor, independent of the pension entity, the governing body, and the plan sponsor should be appointed by the appropriate body or authority to carry out a periodic audit consistent with the needs of the arrangement. Depending on the general supervisory framework, the auditor should report promptly to the governing body and - if the governing body does not take any appropriate remedial action - to the competent authorities wherever he or she becomes aware, while carrying out his or her tasks, of certain facts which may have a significant negative effect on the financial situation or the administrative and accounting organisation of a pension fund.

The auditor is responsible for reviewing the financial accounts for the pension plans and the pension fund with an appropriate periodicity. The extent and frequency of the audit will vary depending on the nature, complexity, and size of the pension plan/fund.

Auditors should also play also a "whistle-blowing" function. If, in the course of the exercise of their duties, they become aware of any significant threat to the financial position of a pension fund or its administrative and accounting organisation, they should promptly report to the governing body. If appropriate remedial action is not taken by the governing body, the auditor should report to the competent authorities. The authorities or relevant professional bodies should issue guidance for auditors on the significance of actions of non-compliance with the pension fund statutes and/or current legislation. In some countries, some of the functions normally carried out by auditors may be carried out by other entities, such as the custodians.

The independence of the auditor from the pension entity, the governing body, and the plan sponsor is important to ensure the impartiality of the audit. Normally, the auditor should be appointed by the governing body of the pension entity. In some instances, the supervisory authority may appoint the auditor directly.

5. Actuary

An actuary should be appointed by the governing body for all defined benefit plans financed via pension funds. As soon as the actuary realises, on performing his or her professional or legal duties, that the fund does not or is unlikely to comply with the appropriate statutory requirements and depending on the general supervisory framework, he or she shall inform the governing body and - if the governing body does not take any appropriate remedial action - the supervisory authority without delay.

The governing body should appoint an actuary for all pension funds that support plans where the plan sponsor insures the plan member against investment or/and biometric risk. Even in defined contribution plans, however, an actuary with a limited role may be advisable, since investments should be made with the objective of providing an adequate income at retirement.

The actuary may not always be an employed member of the staff of the pension entity or the financial institution managing the fund. For example, the actuary may be employed directly by the employer or plan sponsor or he/she may be an external service provider (e.g. a professional actuary or a benefits consultant firm). Members of the governing body should not normally be appointed as pension plan/fund actuaries.

The role of the actuary should include at least the evaluation of the fund's present and future pension liabilities in order to determine the financial solvency of the pension plan following recognised actuarial and accounting methods. The actuary should also identify the funding needs for the pension plan, and estimate the level of contributions taking account of the nature of the liabilities of the pension plan. The actuary should also play a "whistle-blowing" function, and report to the governing body immediately when he or she realises that the fund does not or is unlikely to comply with the appropriate statutory requirements (e.g. minimum funding requirement). If the governing body does not take appropriate remedial action, the actuary should report to the competent authorities. The authorities or relevant professional bodies should issue guidance on the significance of actions of non-compliance with the pension fund statutes and/or current legislation.

6. Custodian

Custody of the pension fund assets may be carried out by the pension entity, the financial institution that manages the pension fund, or by an independent custodian. If an independent custodian is appointed by the governing body to hold the pension fund assets and to ensure their safekeeping, the pension fund assets should be legally separated from those of the custodian. 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.

Where appropriate, it may be required that a custodian, different from the pension entity or the financial company that manages the pension fund, is appointed by the governing body of the pension fund. The appointment of an independent custodian is an effective way to safeguard the physical and legal integrity of the assets of a pension fund.

The custodian holds the pension fund assets and should be in a position to ensure their safekeeping. They may also provide additional services such as securities lending, cash management, investment accounting and reporting, and performance measurement. In some cases, the custodian may also play an external whistleblowing function similar to that of the auditor with respect to, for example, the investment of pension assets.

7. Accountability

The governing body should be accountable to the pension plan members and beneficiaries and the competent authorities. The governing body may also be accountable to the plan sponsor to an extent commensurate with its responsibility as benefit provider. In order to guarantee the accountability of the governing body, it should be liable for its actions.

Accountability over governance functions is particularly important in order to allow the supervisory authority and the plan members and beneficiaries to discipline the governing body or seek other means of redress in case of mismanagement. The governing body may also be accountable to the plan sponsor to an extent commensurate with its responsibilities as a benefit provider.

In order to guarantee the accountability of the governing body, this should be liable for its actions. Such liability may include in some instances personal financial responsibility. In such cases, insurance of this liability can strengthen the ability of the pension fund to recover losses in case of mismanagement.

The accountability of the governing body also requires:

- regular meetings of the governing body;
- diffusion of decision-making power in the governing body (for example, a requirement for decisions to be taken on a majority basis);
- 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;
- transparent selection mechanisms for the members of the governing body (including the possibility of appointments of representatives of plan members and beneficiaries through a fair selection system);
- appropriate succession planning processes.

Disclosure to plan members and beneficiaries may be required for decisions that could have a material impact on future pension benefits, such as a change in the investment policy. In order to reduce the administrative burden on the governing body, disclosure could be made on a regular basis, for example, once a year, rather than after every meeting of the governing body.

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. The term of appointment of the members of the governing body may vary depending on the type and context of particular plans.

Accountability can be also enhanced by requiring that certain members of the governing body are elected by plan members and beneficiaries. These members of the governing body 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. The election by plan members and beneficiaries of representatives in the governing body may be most suitable when membership of the pension plan/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).

Election through a fair voting system (e.g. majority voting) is recommended in cases where plan members and beneficiaries can elect some of the members of the governing body. Biographical information on the member of the governing body seeking election should be provided to those involved in the selection process. The information should be provided in a timely manner and should be sufficient including age, length of time he/she has been associated with the pension fund, qualifications and experience. Having said this, existing associations of employees (e.g. trade unions) already have internal electoral systems in place which may make these additional elections redundant.

8. Suitability

The governing body should be subject to minimum suitability standards in order to ensure a high level of integrity and professionalism in the administration of the pension fund.

Members of the governing body should be subject to minimum suitability standards. Causes of automatic disqualification could include conviction for fraud or other criminal offences, gross mismanagement of a pension fund or other fund that led to significant civil penalties, and personal bankruptcy.

The qualifications and experience required of the members of the governing body will depend on their responsibilities. Specific qualifications and experience will generally be required for those members of the governing body with operational duties, such as those involved in the design of the investment strategy, or asset liability modelling. On the other hand, members who have only oversight responsibilities, such as those selected by pension plan members, may not always be subject to such requirements, though it would be desirable that they have sufficient knowledge and experience to be able to understand the decisions of the professionals that operate the fund. Where the governing body includes a general assembly of the plan members (as is sometimes the case in pension funds set up in the corporate form), these would evidently not be subject to a fit and proper criteria.

II. GOVERNANCE MECHANISMS

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

9. Internal controls

There should be appropriate controls in place to ensure that all persons or entities with operational and oversight responsibilities act in accordance with the objectives set out in the pension entity's by-laws, statutes, contract, or trust instrument, or in documents associated with any of these, and that they comply with the law. Such controls should cover all basic organisational and administrative procedures; depending upon the scale and complexity of the plan, these controls will include performance assessment, compensation mechanisms, information systems and processes, and risk management procedures.

The scope and complexity of internal control measures will vary according to the type and size of pension plan, fund and entity. However, there are certain basic organisational and administrative procedures that are central to risk management and control and sound business practice:

1. Regular assessment of the performance of the persons and entities involved in the operation and oversight of the pension fund;

2. Regular review of compensation mechanisms, in order to ensure that they provide the correct incentives for those responsible for the operation and oversight of the pension fund;

3. Regular review of information processes, operational software systems, and accounting and financial reporting systems;

4. Identification, monitoring, and, where necessary, correction of conflicts of interest situations;

5. Mechanisms to sanction the improper use of privileged information;

6. Implementation of an adequate risk measurement and management system including effective internal audit

7. Regular assessment of regulatory compliance systems

Mechanisms are needed to assess regularly the performance of the pension entity's internal staff as well as the external service providers (e.g. those providing consultancy, actuarial analysis, asset management, and other services for the pension entity). It is also good practice for the governing body to undertake self-analysis and for an independent, external person/organisations to undertake a review of the internal controls of the pension entity. Where the governing body consists of an executive and a supervisory board the latter may be assigned with the task of assessing the performance of the executive board.

Objective performance measures should be established for all the persons and entities involved in the administration of the pension fund. For example, appropriate benchmarks should be established for external asset managers. 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. The benchmarks should be reviewed regularly also to ensure their consistency with the pension fund objectives (e.g. the investment strategy).

Appropriate compensation can provide the right incentives for good performance. 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, such as asset managers, custodians, actuaries, as well as the members of the governing body.

The compensation policy of sales forces of pension plan providers 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.

Conflicts of interest situations should be identified and dealt with in a suitable manner. 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. In other cases, disclosure of the conflict of interest to the governing body may suffice, who should be required to monitor these cases closely.

Where the conflict involves a member of the governing body, the case should be reviewed and monitored by the 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 conflict of interest situation that may be judged by some of the members of the governing body as harmful to the interest of the plan members and beneficiaries, 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.

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.

An adequate risk measurement/management system and an effective internal audit should be also established. The risk management system should cover both investment and biometric risks. These control mechanisms form the basis of good business conduct, enhanced transparency, consistency as to management decisions, and for the protection of all stakeholders of the pension fund.

Finally, pension entities should have mechanisms to assess the compliance with the law. A compliance officer may be assigned to carry out this activity on a regular basis.

10. Reporting

Reporting channels between all the persons and entities involved in the administration of the pension fund should be established in order to ensure the effective and timely transmission of relevant and accurate information.

Processes need to be put in place to ensure that the members of the governing body receive appropriate, timely, accurate, complete, consistent, and easily comprehensible information so they may discharge their responsibilities effectively, in accordance with the code of conduct, and ensure that delegated responsibilities are fulfilled.

For its part, the governing body should ensure that actuaries, asset managers, consultants, custodians, and other professional service providers also receive relevant and accurate information in a timely manner in order to ensure they carry out their duties as established by the governing body.

11. Disclosure

The governing body should disclose relevant information to all parties involved (notably pension plan members, supervisory authorities, etc.) in a clear, accurate, and timely fashion.

All pension plan members should receive, on joining the plan, the plan details, which should include, at least, the following items:

- contribution rates payable by the plan sponsor and the plan member;
- investment guarantees and benefit promises, if any;
- fees to be paid by members;
- in defined contribution plans (i.e. where investment and biometric risks are borne by the plan member), a simplified, easy to understand description of the pension fund's investment policy.

Material changes in these plan details should be reported to pension plan members (or beneficiaries in the case of decease of the member) in a timely manner. On request, plan members should also be able to receive for free the fund by-laws, statutes, or rules and related documents. These documents should state clearly the objectives of the pension fund and the rights of plan members and beneficiaries.

Pension plan members should also have access to information about the operation of the pension fund. In defined benefit and hybrid plans, plan members should be able to obtain, upon request, information on the level of funding backing pension promises, the pension fund's asset allocation, and other relevant aspects of the operation of the pension fund. In defined contribution plans, members should receive statements, at least annually, showing their account balances, and the investment regime and performance of the pension fund in standardised format (e.g. net of fees performance should be comparable across funds). It may be appropriate to require that the governing body disclose information about the operation and performance of the pension fund on a more regular basis when plan members are able to exercise some investment choice. For example, information on investment performance and commissions may be disclosed publicly through the local financial press.

Disclosure to plan members and beneficiaries should also be required for decisions of the governing body that could have a material impact on future pension benefits, such as a change in the investment policy. In order to reduce the administrative burden on the governing body, disclosure could be made on a regular basis, for example, once a year, rather than after every meeting of the governing body.

12. Redress

Pension plan members and beneficiaries should be granted access to statutory redress mechanisms through at least the regulatory/supervisory authority or the courts that assure prompt redress.

Access to statutory redress channels grants members the opportunity to recover losses and can be most effective in sanctioning pension fund mismanagement. In addition, pension plan members and beneficiaries may have access to other, informal sanctioning and disciplining mechanisms to ensure that the governing body of a pension fund manages it in their best interest.

Informal redress channels, such as internal dispute procedures and independent arbitrators, offer many advantages, including the lower cost to consumers, and, potentially, quicker resolution of the matter. Independent arbitration may also provide 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 mismanagement, can be excessively costly for individual consumers, though it may be appropriate in the case where an entire group (e.g. and employment association) is affected.

Canadian Association of Pension Supervisory Authorities

Association canadienne des organismes de contrôle des régimes de retraite

CAPSA PENSION GOVERNANCE GUIDELINE AND IMPLEMENTATION TOOL

DRAFT FOR COMMENT

A Report prepared by the
Canadian Association of Pension Supervisory Authorities (CAPSA)
Pension Plan Governance Committee

May 25, 2001

CAPSA

May 25, 2001

Canadian
Association of
Pensions
Supervisory
Authorities

Association
canadienne
des organismes
de contrôle
des régimes
de retraite

Dear Pension Industry Stakeholder:

Re. CAPSA Pension Governance Guideline and Implementation Tool

On behalf of the Canadian Association of Pension Supervisory Authorities (CAPSA), we are pleased to enclose two documents in draft form for your review and comment:

- The *CAPSA Pension Governance Guideline,* which is a broad, flexible outline of key pension governance principles; and

- The *CAPSA Pension Governance Implementation Tool,* which is designed to help pension plans adopt the pension governance principles set out in the *CAPSA Pension Governance Guideline*.

CAPSA believes that good pension plan governance is essential if plan members are to receive the benefits they have been promised. Building on important work by labour organizations, industry associations and pension regulators, these documents have been prepared to provide guidance to pension plans of all types and sizes, in all jurisdictions of Canada.

In particular, CAPSA would appreciate your comments on the following questions:

- Does the Guideline effectively capture the most important aspects of pension governance?

- Does the Implementation Tool usefully complement the Guideline? Can it be effectively utilized by plans in different situations?

- How might the documents be modified to make them even more responsive to the needs of plans of different types and sizes?

- Once the Guideline and Implementation Tool are adopted, how might they be usefully implemented across the country?

…2

CAPSA Secretariat, 5160 Yonge Street, P.O. Box 85
Toronto, Ontario M2N 6L9 Tel: (416) 226-7773 Fax: (416) 226-7880

Please forward your written comments on the CAPSA Pension Governance Guideline and Implementation Tool to:

Carla Adams
Policy Manager (Acting)
CAPSA Secretariat
c/o Financial Services Commission of Ontario
5160 Yonge Street, Box 85
North York ON M2N 6L9

We look forward to receiving your comments by July 31, 2001. Questions arising from this consultation paper may be directed to any of the members of the CAPSA Pension Plan Governance Committee identified in Appendix B.

Please note that this Guideline and Implementation Tool have been prepared to contribute to the adoption of good pension plan governance in all Canadian jurisdictions. They do not reflect the official position of any provincial or federal government or agency.

Yours very truly,

Sherallyn Miller
Chair, CAPSA
Superintendent of Pensions
British Columbia Ministry of Labour

Nurez H. Jiwani
Chair, CAPSA Pension Governance Committee
Director, Policy & Communcations
Financial Services Commission of Ontario

CAPSA PENSION GOVERNANCE GUIDELINE AND IMPLEMENTATION TOOL

May 25, 2001

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CAPSA PENSION GOVERNANCE GUIDELINE

INTRODUCTION

Pension plan governance refers to the processes used in the management, oversight and administration of a pension plan. CAPSA believes that good pension plan governance is essential if plan members are to receive the benefits they have been promised.

Pension legislation regulates plan governance by identifying who may be a plan administrator and what the plan administrator's responsibilities are. The administrator is usually the employer who established the plan, but may also be a board, a pension committee, an insurance company, a bargaining agent or another body established by law. Pension legislation defines the pension plan administrator as the governing body that is ultimately responsible for oversight of the plan.

An effective governance system establishes a framework for the division of responsibility and the accountability of all participants in the pension process. It considers all facets of pension plan management, including funding, investment and benefit administration. Effective governance provides reasonable oversight and enhances benefit protection, but does not discourage the establishment of pension plans.

Good governance is important for pension plans as it is essential to the fulfilment of fiduciary obligations. A good governance structure serves to minimize risks and maximize efficiencies. Good governance promotes the timely and cost-effective delivery of pension benefits and promotes the administration of the plan in the best interests of plan members and beneficiaries. Good governance requires appropriate control mechanisms that encourage good decision making, proper and timely execution, clear accountability, and regular review and assessment. Good governance contributes to positive pension plan performance and demonstrates due diligence on the part of the governing body.

The *CAPSA Pension Governance Guideline* is a broad, flexible outline of key governance principles. Different types and sizes of plans, however, may require different governance practices. Although it is strongly recommended that all pension plans adopt governance processes consistent with the principles identified in the *CAPSA Pension Governance Guideline*, plans will need to adapt their governance practices to accommodate their specific circumstances and resources.

The *CAPSA Pension Governance Guideline* recommends principles for effective pension plan governance, but does not address operational roles and responsibilities. While employers or bargaining agents may establish a pension plan, determine and amend its provisions, and even terminate the plan subject to relevant legislative requirements, contractual agreements and plan provisions, these are operational activities rather than governance responsibilities.

Many smaller pension plans and multi-employer pension plans established pursuant to a collective agreement may have a single body with both operational and governance responsibilities. In these situations, dual roles should be clearly identified and decisions made in different capacities should be carefully documented.

The *CAPSA Pension Governance Guideline* builds on important work by labour organizations, industry associations such as the Pension Investment Association of Canada (PIAC) and the Association of Canadian Pension Management (ACPM), and pension regulators such as the Office of the Superintendent of Financial Institutions (OSFI).

All pension plans in Canada are encouraged to determine whether their current governance structures are effective and strive to achieve the best practices set out in the *CAPSA Pension Governance Guideline*.

The *CAPSA Pension Governance Implementation Tool* (see Appendix A) has been prepared to help pension plans adopt the pension governance principles set out in the *CAPSA Pension Governance Guideline*.

I. PENSION PLAN OBJECTIVES

PRINCIPLE 1: THE PENSION PLAN SHOULD HAVE CLEARLY STATED OBJECTIVES WHICH ARE DOCUMENTED AND MADE AVAILABLE TO PLAN MEMBERS AND BENEFICIARIES.

1.1 PENSION PLAN OBJECTIVES

Pension plans should have objectives that explain why the pension plan exists and affirm the plan's intent to achieve its goals.

The pension plan's objectives should be clearly documented and should be made available to all stakeholders. The plan's objectives provide guidance in setting funding and investment policies, and set goals for the administration of the pension plan.

Sample Plan Objectives:

The pension plan's mission is to advance the financial benefit security of all plan members and beneficiaries by providing fully funded pension benefits for reasonable and stable contribution rates. The plan will:

- *Provide efficient and effective investment management designed to achieve the highest possible return at an acceptable level of risk*
- *Create and maintain an environment that promotes the interests of plan members and beneficiaries*
- *Provide high quality, cost-effective service to plan members and beneficiaries*
- *Provide effective and efficient governance processes.*

II. GOVERNANCE STRUCTURE

PRINCIPLE 2: THERE SHOULD BE CLEAR DELINEATION AND DOCUMENTATION OF ROLES, RESPONSIBILITIES AND ACCOUNTABILITIES OF ALL PARTICIPANTS IN THE GOVERNANCE STRUCTURE.

2.1 ROLES / RESPONSIBILITIES / ACCOUNTABILITIES

There should be clearly defined and documented roles, responsibilities and accountabilities for all participants in governance (oversight and policy-making), management and operation of the pension plan.

The pension governance structure, roles and responsibilities, accountabilities and reporting relationships (i.e. chain of delegation) should be clearly documented and communicated to all participants.

All roles and responsibilities should be identified and assigned in accordance with appropriate commitment, knowledge, experience and time availability.

The governing body is expected to oversee and assume responsibility for the plan, but is not expected to manage the plan on a day-to-day basis. The governing body can delegate management functions, but retains ultimate responsibility and accountability for supervision and ensuring that the promised benefits are provided.

The governance role consists of establishing the plan's objectives, policy, goals, strategy and governance structure as well as performing high-level monitoring. The management role consists of assisting and supporting the governing body, and translating their decisions into operational plans for execution by staff and others. The operating role consists of implementation of the objectives, policy and strategy by staff on a day-to-day basis.

2.1.1 "Smaller" Pension Plans

Where governance and management functions are performed by the same person(s) there must be a clear recognition and understanding of the different roles and responsibilities of each function. Decisions and actions taken under the separate roles shoud be clearly documented.

Clear separation of the governance and management functions in a "smaller" pension plan does not necessarily require separate persons to perform different functions.

PRINCIPLE 3: THE GOVERNING BODY MUST FULFIL ITS FIDUCIARY RESPONSIBILITIES TO PLAN MEMBERS AND BENEFICIARIES.

3.1 FIDUCIARY RESPONSIBILITIES OF THE GOVERNING BODY

The governing body has a duty to act in good faith and in the best interests of the plan members and beneficiaries of the pension plan.

The pension governance process should facilitate the discharge of the governing body's fiduciary duties. This may require judicious advice and impartial recommendations from appropriate professional advisers.

A fiduciary relationship exists when the fiduciary has scope for the exercise of discretion or power, and can exercise this power or discretion to affect a beneficiary's interests. Investment managers are fiduciaries; other professional advisors and service providers may also be fiduciaries depending on the circumstances. The greater the discretionary powers of the fiduciary, the greater the scope of their fiduciary duties.

The governing body has a duty to act in good faith in the best interests of the beneficiaries of the pension plan, to treat members impartially and with loyalty, to exercise the care, skill and diligence of a prudent person, to interpret the plan terms fairly, impartially and in good faith, and to prevent personal interests from conflicting with those of the plan.

Matters that fall within the fiduciary obligations of the governing body include ensuring prudent investing (including investment policy development and effective implementation), proper benefit payments, proper remittances of contributions, appropriate communications to plan members, and compliance with legislation and plan policies.

3.1.1 Member-directed Defined Contribution Plans

The governing body should take into account specific considerations about the selection of investment options offered to plan members.

The governing body should consider the following issues:

- who will make the investment decisions;
- whether members will invest the total account or just their contributions;
- the number and diversity of investment choices required to materially affect the potential returns and degree of risk;
- whether member representatives will participate in the selection of investment alternatives;
- how frequently the members can modify their investment choices;
- how performance and costs will be monitored; and
- what the default investment selections will be.

Member-directed defined contribution plans should provide enough investment options to satisfy the different risk tolerances and investment horizons of plan members. The governing body should provide members with appropriate tools to help them make informed investment choices.

3.1.2 Employers or Bargaining Agents Acting as the Governing Body

Where employers or bargaining agents also assume the role of the governing body, they must act in the best interests of plan members and beneficiaries.

When acting as the governing body, employers or bargaining agents must use discretion in a fair and impartial manner, and put the interests of plan members and beneficiaries above their own. Instances where conflicts may occur include the establishment of an investment policy, the payment by the sponsor of expenses directly out of the pension fund, ownership of surplus, plan mergers and conversions, and funding policy.

PRINCIPLE 4: THE GOVERNING BODY SHOULD HAVE THE RIGHT MIX OF SKILLS AND EXPERIENCE AND THE MEMBERS OF THE GOVERNING BODY SHOULD COLLECTIVELY DEMONSTRATE THE SKILLS, CAPABILITY AND DEDICATION REQUIRED TO FULFIL THEIR GOVERNING RESPONSIBILITIES.

4.1 GOVERNING BODY COMPETENCY AND COMPOSITION

The members of the governing body should collectively demonstrate the skills, capability and dedication necessary to fulfil their governing responsibilities. Where appropriate, the governing body should seek information and advice from qualified external advisors.

4.2 Sub-Committee Composition

Where the pension governance structure includes sub-committees, the sub-committee members should collectively demonstrate the skills, capability and dedication necessary to fulfil their governing responsibilities. The sub-committees should have the right mix of skills and experience.

The governing body should delegate responsibilities to sub-committees where appropriate. The role and functions of the sub-committees should be clearly set out.

Possible committees include an investment committee, a governance committee, an audit committee, and a benefit committee.

PRINCIPLE 5: MEMBERS OF THE GOVERNING BODY SHOULD BE PROVIDED WITH APPROPRIATE TRAINING AND UNDERTAKE ONGOING EDUCATION.

5.1 Orientation / Ongoing Education

The governing body members should have or acquire the knowledge and skills required to make informed decisions.

Members of the governing body should have or obtain an understanding of financial markets, risk management, actuarial principles, pension finance, relevant investment principles, good governance, benefit entitlements and regulatory or other requirements respecting the pension plan.

Members of the governing body should be provided with appropriate training and ongoing education.
Special attention should be paid to educating board members at the onset of their roles. This can be accomplished through formal orientation programs, handbooks and information booklets.

PRINCIPLE 6: THERE SHOULD BE A PROCEDURE FOR THE SELECTION AND SUCCESSION PLANNING OF MEMBERS OF THE GOVERNING BODY AND SENIOR MANAGEMENT.

6.1 Selection and Succession planning: Governing Body and Senior Management

There should be a formal and transparent procedure for the selection of the governing body and senior management of the pension plan with appropriate selection criteria. A succession planning process should be established and reviewed periodically.

The selection and succession planning structure should deal with the term, selection, appointment/election and removal of members of the governing body and senior management of the pension plan. The term of the governing body members may vary depending on the type and context of particular plans.

III. COMMUNICATION

PRINCIPLE 7: THE GOVERNING BODY SHOULD RECEIVE APPROPRIATE, TIMELY AND ACCURATE INFORMATION.

7.1 DISTRIBUTION OF INFORMATION TO THE GOVERNING BODY

Processes should be put in place to ensure that governing body members receive appropriate, timely, accurate, complete, consistent and easily comprehensible information so they may discharge their responsibilities effectively, and ensure that delegated responsibilities are fulfilled.

Processes should ensure that information related to all aspects of a pension plan, including investment activities, funding activities, benefits and operating activities are adequately addressed.

Information related to investment activities includes:

(i) investment performance reports including
- performance of each manager
- effect of the plan's investment policy and strategy on returns
- effect of investment management structure on returns

(ii) reports on changes to any manager's ownership or investment philosophy

(iii) risk management and compliance reports

(iv) reports from management recommending changes related to investment activities

Information related to funding activities includes:

(i) actuarial reports

(ii) reports on funding status

(iii) financial statements, including a comparison of expenses to budgets and other financial data

Information relating to benefits and operating activities includes:

(i) reports on membership

(ii) detailed reports on benefit calculation and payment activities

(iii) reports detailing member complaints and action taken

(iv) reports detailing actual and proposed communications

(v) reports on internal control

(vi) certifications from senior management and all external service providers and advisors confirming compliance with legislative requirements and pension plan policies

PRINCIPLE 8: A COMMUNICATION POLICY SHOULD BE ESTABLISHED FOR PLAN MEMBERS AND BENEFICIARIES TO ENSURE TRANSPARENCY AND ACCOUNTABILITY.

8.1 COMMUNICATION POLICY: PLAN MEMBERS AND BENEFICIARIES

A communication policy should be established for the disclosure of plan governance information to members and beneficiaries. Communication should be appropriate, timely, accurate, complete, consistent, cost-effective, useful, comprehensible and accessible.

The governing body should consider its fiduciary duties and standard of care when deciding what to disclose, the manner and form of disclosure, and to whom the information will be disclosed. The operations, administration and investments of the pension plan should be as transparent as possible.

8.1.1 Plan Member and Beneficiary Concerns

Pension plan members and beneficiaries have a right to voice their concerns, and have them appropriately addressed in a timely fashion.

The names and responsibilities of the governing body members and information regarding key contacts should be disclosed to plan members and beneficiaries.

8.1.2 Defined Contribution Plans and Hybrid Plans

The governing bodies of defined contribution and hybrid plans should explain the inherent risks of such plans to plan members and indicate that investment risks are borne by plan members.

8.1.3 Member-directed Defined Contribution Plans

A communication and education plan for plan members should be designed to ensure that plan members understand the inherent risks of member-directed defined contribution plans, the effects of risk versus return, the investment choices, and basic investment strategies.

The governing body of a member-directed defined contribution pension plan should ensure there is an appropriate communication and education plan in place. When developing education and communication strategies and policies, the governing body/plan sponsor must determine:

- members' needs, investment knowledge and different learning styles;
- how to best communicate to plan members the risks of a member-directed defined contribution plan, in particular, during times of low investment returns and high annuity costs;
- what information or investment counselling will be provided to plan members;
- how to educate plan members to make good investment decisions; and
- how to measure the effectiveness of communication and education policies.

The governing body should provide plan members with adequate initial information about the pension plan and educational material related to investments. The governing body should also provide plan members with adequate ongoing information to ensure they are aware of the performance of their investment options and capable of making informed decisions about their investment options.

Plan members should be made aware of the broader implications of their investment decisions on asset accumulation and estate planning and advised that they should seek external assistance where necessary.

The governing body should be aware of the difference between communication and advice, and the increased liability of providing advice. (Advice is individualized information that serves directly as the primary basis for a plan member's investment decisions while communication is general financial and investment information about markets and risks.)

IV. INTERNAL CONTROLS

PRINCIPLE 9: A CODE OF CONDUCT AND CONTROL MECHANISM FOR CONFLICTS SHOULD BE ESTABLISHED.

9.1 CODE OF CONDUCT AND CONTROL MECHANISM FOR CONFLICTS

A code of conduct should be established for the governing body, senior management and plan advisors in their role as fiduciaries. The code of conduct should set out required behaviour and establish a control mechanism for conflicts with a due process, a conflict of interest policy, and a review mechanism to ensure compliance with the code of conduct.

The governing body and senior management must always behave in a manner consistent with their fiduciary obligations. A process should be put in place to ensure that the code of conduct is effectively implemented and is also applied to plan advisors in their role as fiduciaries.

The conflict of interest policy should set out a procedure for the disclosure of conflicts of interest to identified decision makers in the governance process and to beneficiaries where appropriate. The policy should guard against both actual conflicts and the appearance of conflicts of interest.

There should be mechanisms in place to ensure that differences between the various interests represented on the governing body are appropriately resolved. A due process should allow governing body members unencumbered access to senior management and external advisors.

PRINCIPLE 10: PENSION PLANS SHOULD HAVE AN APPROPRIATE INTERNAL CONTROL FRAMEWORK.

10.1 INTERNAL CONTROL FRAMEWORK

Every pension plan should have an internal control framework to ensure that potential risks are addressed and appropriate controls are in place.

The governing body should understand and approve the framework and the written internal control policies supporting the internal control framework. There should be clear written rules and control processes regarding financial stability and plan funding, asset management, asset protection and expenses, outsourcing of functions and selection of service providers/professional advisers.

(i) Financial Stability and Plan Funding Control Framework

The governing body should monitor the financial stability of the pension plan and ensure the adequacy of plan funding. These steps include:

- assessing the adequacy of required contributions to meet current and future needs;
- investigating the sensitivity of the plan to economic and demographic conditions;
- determining the desired level of surplus needed as a cushion against potential downturns; and
- maintaining the desired level of benefit security (i.e. by recommending investment policy modifications, changes in contribution levels or benefit adjustments).

(ii) Asset Management Control Framework

An asset management control framework necessitates the establishment of investment policies and procedures in accordance with pension legislation, regulations and guidelines issued by pension regulators. The framework should facilitate the prudent management of pension assets and the detection of changes in policies or procedures of service providers/professional advisers. The asset management control framework should ensure that:

- assets are managed in compliance with applicable policies and procedures, pension legislation and regulations and guidelines issued by pension regulators;
- investment policies and procedures are documented and address permitted asset classes, policy asset-mix and permitted ranges, permitted investment instruments, and minimum diversification criteria;
- collateral margins on loaned securities are maintained;
- proxy voting procedures are followed;
- investment managers are in compliance with their mandates;
- appropriate performance benchmarks are developed and monitored; and
- assets are cost-effectively managed.

(iii) Asset Protection and Expense Control Framework

A policy and process for asset protection and expense control should be established. The framework should set out clear written rules and guidelines regarding permissible disbursements, the separation of plan assets from other assets, and the use of the plan assets for purposes other than benefit payments which are consistent with pension legislation, regulations and the terms of the plan.

(iv) Outsourcing of Functions and Selection of Service Providers/Professional Advisers

Procedures should be in place that address the decision to outsource functions. The governing body should establish criteria and a process for deciding what functions will be outsourced to service providers/professional advisers.

An impartial selection process with clearly stated selection criteria should be established for service providers/professional advisers. The governing body should ensure that appropriate written contracts are entered into and periodically reassess arrangements with service providers/professional advisers.

10.1.1 Asset-related Fees

> If asset-related fees are charged to the plan or paid by members, the governing body should ensure the fees are reasonable and competitive.

10.1.2 Multi-employer Pension Plans

> The governing body shoud ensure there is a delinquency control program with procedures for the collection of unremitted contributions and data, and remedies for non-compliance.

PRINCIPLE 11: THE GOVERNING BODY SHOULD HAVE APPROPRIATE MECHANISMS IN PLACE TO OVERSEE THE ADMINISTRATION OF THE PENSION PLAN AND ENSURE COMPLIANCE WITH LEGISLATIVE REQUIREMENTS.

11.1 Oversight of Plan Administration and Compliance with Legislative Requirements

> Every pension plan should have processes and standards in place to ensure that the pension plan complies with legislative requirements and pension benefits are paid to plan members and beneficiaries in accordance with the terms of the plan and legislative requirements.

11.1.1 Pension Benefit Administration

Processes and standards should be established to ensure administration of pension benefits in accordance with the terms of the pension plan and legislative requirements. The processes and standards should ensure that:

- the governing body implements and interprets plan provisions consistently with

plan objectives;
- the governing body uses discretionary powers in a fair, transparent and objective manner;
- the governing body seeks clarification for unclear plan provisions;
- pension benefits are paid correctly;
- information transmitted to plan members and related calculations are accurate and subject to periodic audits; and
- complete and accurate records are maintained.

11.1.2 Compliance with Legislative Requirements

The governing body should have an internal control framework in place to ensure compliance with minimum legislative requirements, including filing requirements, and policies established by the governing body. The governing body should have skilled personnel to meet compliance obligations and seek professional assistance when necessary.

V. PERFORMANCE MEASURES AND ASSESSMENT

PRINCIPLE 12: OBJECTIVE PERFORMANCE MEASURES FOR DECISION MAKERS AND PENSION PLAN PERFORMANCE SHOULD BE ESTABLISHED.

12.1 PERFORMANCE MEASURES – DECISION MAKERS

Objective performance measures should be established for all key decision makers including the governing body, senior management, staff, custodians, investment managers, third-party benefit administrators and professional service providers/professional advisers. Performance should be regularly evaluated against the performance measures and results should be reported to appropriate stakeholders. Performance measures should be reviewed regularly.

Performance evaluations should be based on impartial assessment, which may require independent professional advice. Recommendations for change should be directed to the group to which decision makers are accountable. Mechanisms and follow-up actions should be established to rectify inadequate performance.

12.2 PERFORMANCE MEASURES – PENSION PLAN PERFORMANCE

Objective comprehensible performance measures should be used to measure the performance of the pension plan.

Performance measures used by pension plans should be quantified wherever possible and reviewed over appropriate time periods. Performance measures may be modified to reflect changing needs.

Performance objectives and measures should be tailored to each plan's specific requirements and should include measures for plan funding, asset management and benefit administration. Annual objectives for the management of the plan should be set and progress should be reviewed. Results should be reported to appropriate stakeholders.

PRINCIPLE 13: A GOVERNANCE SELF-ASSESSMENT SHOULD BE CONDUCTED AND REPORTED TO PENSION PLAN MEMBERS, BENEFICIARIES, EMPLOYER(S) AND BARGAINING AGENT(S).

13.1 GOVERNANCE SELF-ASSESSMENT AND REPORTING

> The governing body should periodically review governance procedures to ensure the objectives of the pension plan are effectively pursued. Best practice for self-assessment reporting would require the governing body to periodically report to pension plan members, beneficiaries, employer(s) and bargaining agent(s).

Every pension plan should have a mechanism in place to assess the performance of the governing body and the governance structure of the pension plan on a regular basis. Ongoing review of the governance procedures will allow for the determination of the effectiveness of a pension plan's governance structure and operations in meeting the pension plan objectives and discharging the governing body's fiduciary responsibilities. The governance structure should be modified as required to ensure its effectiveness.

Self-assessment should be based on impartial assessment, which may require independent professional advice. Self-assessment can be tailored to the circumstances of the pension plan. Pension plans can utilize the *CAPSA Pension Governance Implementation Tool* as a self-assessment tool.

Best practice for self-assessment reporting would require the governing body to periodically report to pension plan members, beneficiaries, employer(s) and bargaining agent(s), setting out how they complied with or exceeded the pension governance guideline, and explaining any non-compliance. Best practice should be followed once the pension plan has the appropriate governance structures in place. Progress in developing and complying with an appropriate governance structure should be assessed over time and reported to plan members.

GLOSSARY OF TERMS

Administrator:
The administrator is responsible for running the pension plan. The administrator is usually the employer who established the plan, but may also be a board, a pension committee, an insurance company, a bargaining agent or another body established by law.

Beneficiary:
A beneficiary is an individual, other than a plan member, entitled to a benefit.

Defined Benefit Plan:
A defined benefit plan is a pension plan where the pension benefit to be provided is based on criteria such as number of years of plan membership and career or final earnings. Employees may or may not contribute to the pension plan.

Defined Contribution Plan:
A defined contribution plan (also known as a money purchase plan) is a pension plan with a specified contribution formula. Employees may or may not contribute to the pension plan. Contributions are recorded on an individual account basis. The benefit a member will receive on retirement is calculated at the date of retirement based on accumulated contributions and investment returns.

Governing Body:
The governing body is the individual(s) or entity that is ultimately responsible for pension plan oversight. Pension legislation defines the pension plan "administrator" as the governing body.

Jointly-trusteed:
A jointly-trusteed pension plan is a plan that is governed by a board comprised equally of employee and employer representatives.

Multi-employer Pension Plan:
A multi-employer pension plan (MEPP) is a pension plan that allows two or more unrelated employers to contribute to a single pension fund. Some MEPPs are sponsored and/or administered by a bargaining agent.

The fund is established by an agreement, statute or municipal bylaw. MEPPs are subject to special rules since they differ significantly from single-employer pension plans.

Negotiated Pension Plan:
A negotiated pension plan is a plan where the terms are negotiated by a bargaining agent and employers and contained in a collective agreement.

Pension Fund:
The pension fund refers to the assets of the pension plan, which are held separately and apart from other assets.

Plan Member:
Plan members include both active and non-active plan members.

Senior Management:
Senior management of a pension plan refers to the group of individuals, aside from the governing body, that is in a position to influence decisions made on behalf of the pension plan.

Stakeholders:
Stakeholders include plan members, beneficiaries, administrators, employers and bargaining agents.

CAPSA
PENSION GOVERNANCE IMPLEMENTATION TOOL

DRAFT FOR COMMENT
May 25, 2001

Appendix A

INTRODUCTION

The *CAPSA Pension Governance Implementation Tool* (the "Tool") has been prepared to help pension plans adopt the best practices found in the *CAPSA Pension Governance Guideline*. The Tool addresses the implementation of good governance principles for all types and sizes of pension plans, and contains particular recommendations for defined contribution plans, member-directed defined contribution plans, negotiated pension plans, jointly-trusteed plans, multi-employer plans and "smaller" plans.

The Tool can be used by pension plans to determine which principles of good governance have been instituted and determine what action steps should be taken to improve governance of their pension plans.

The Tool can be adapted by pension plans to suit their particular needs. For instance, timelines, priorities, and the names of designated individuals with implementation responsibilities can be added to the Tool.

To be fully effective, the Tool should be completed honestly, objectively and realistically by the individual(s) with the best knowledge of each issue and approved by the highest level of pension governance authority.

Completed By:

______________________	______________________	______________________	__________
Name	Title	Principles completed	Date
______________________	______________________	______________________	__________
Name	Title	Principles completed	Date

Approved By:

______________________	______________________	__________
Signature	Title	Date

I. PENSION PLAN OBJECTIVES				
PRINCIPLE 1:	THE PENSION PLAN SHOULD HAVE CLEARLY STATED OBJECTIVES WHICH ARE DOCUMENTED AND MADE AVAILABLE TO PLAN MEMBERS AND BENEFICIARIES.			
1.1	PENSION PLAN OBJECTIVES	Yes/No/Partial	Explanation	Action Plan
	Pension plan objectives are clearly documented and made available to all stakeholders.			

II. GOVERNANCE STRUCTURE				
PRINCIPLE 2:	THERE SHOULD BE CLEAR DELINEATION AND DOCUMENTATION OF ROLES, RESPONSIBILITIES AND ACCOUNTABILITIES OF ALL PARTICIPANTS IN THE GOVERNANCE STRUCTURE.			
2.1	ROLES / RESPONSIBILITIES / ACCOUNTABILITIES	Yes/No/Partial	Explanation	Action Plan
	There are clearly defined and documented roles, responsibilities and accountabilities for all participants in the governance, management and operation of the pension plan. These roles, responsibilities and accountabilities are clearly communicated to all participants.			
2.1.1	"Smaller" Pension Plans	Yes/No/Partial	Explanation	Action Plan
	Where governance and management functions are performed by the same person(s), there is a clear recognition and understanding of the different roles and responsibilities.			

PRINCIPLE 3:	THE GOVERNING BODY MUST FULFIL ITS FIDUCIARY RESPONSIBILITIES TO PLAN MEMBERS AND BENEFICIARIES.			
3.1	**FIDUCIARY RESPONSIBILITIES OF THE GOVERNING BODY**	**Yes/No/Partial**	**Explanation**	**Action Plan**
	All fiduciaries have a clear understanding of their fiduciary duties and fulfil their fiduciary duties to the plan members and beneficiaries of the pension plan.			
3.1.1	**Member-directed Defined Contribution Plans**	**Yes/No/Partial**	**Explanation**	**Action Plan**
	The governing body considers all issues concerning the selection of investment options offered to members. Plan members are provided with tools that help them make informed investment decisions.			
3.1.2	**Employer(s) or Bargaining Agent(s) Acting as the Governing Body**	**Yes/No/Partial**	**Explanation**	**Action Plan**
	The employer(s) or bargaining agent(s) acts in the best interests of plan members and beneficiaries.			
PRINCIPLE 4:	**THE GOVERNING BODY SHOULD HAVE THE RIGHT MIX OF SKILLS AND EXPERIENCE AND THE MEMBERS OF THE GOVERNING BODY SHOULD COLLECTIVELY DEMONSTRATE THE SKILLS, CAPABILITY AND DEDICATION REQUIRED TO FULFIL THEIR GOVERNING RESPONSIBILITIES.**			
4.1	**GOVERNING BODY COMPETENCY AND COMPOSITION**	**Yes/No/Partial**	**Explanation**	**Action Plan**
	The governing body effectively oversees the pension plan and makes informed decisions. The selection process ensures that the governing body collectively demonstrates the skills, capability and dedication to fulfil its governing responsibilities.			
4.2	**SUB-COMMITTEE COMPOSITION**	**Yes/No/Partial**	**Explanation**	**Action Plan**
	The roles and functions of sub-committees are clearly set out. Sub-committee members collectively demonstrate the skills, capability and dedication necessary to fulfil their responsibilities. Sub-committees have the right mix of skills and experience.			

PRINCIPLE 5:	**MEMBERS OF THE GOVERNING BODY SHOULD BE PROVIDED WITH APPROPRIATE TRAINING AND UNDERTAKE ONGOING EDUCATION.**			
5.1	**ORIENTATION / ONGOING EDUCATION**	**Yes/No/Partial**	**Explanation**	**Action Plan**
	Members of the governing body are provided with appropriate training and ongoing education. Members of the governing body have, or are acquiring, the knowledge and skills required to make informed decisions.			
PRINCIPLE 6:	**THERE SHOULD BE A PROCEDURE FOR THE SELECTION AND SUCCESSION PLANNING OF MEMBERS OF THE GOVERNING BODY AND SENIOR MANAGEMENT.**			
6.1	**SELECTION AND SUCCESSION PLANNING: GOVERNING BODY AND SENIOR MANAGEMENT**	**Yes/No/Partial**	**Explanation**	**Action Plan**
	There is a formal and transparent procedure for the selection of the governing body members and senior management of the pension plan, which deals with the term, selection, appointment/election, and removal of members and managers.			

III. COMMUNICATION				
PRINCIPLE 7:	**THE GOVERNING BODY SHOULD RECEIVE APPROPRIATE, TIMELY AND ACCURATE INFORMATION.**			
7.1	**DISTRIBUTION OF INFORMATION TO THE GOVERNING BODY**	**Yes/No/Partial**	**Explanation**	**Action Plan**
	Processes have been established to ensure that governing body members receive appropriate, timely, accurate, complete, consistent and easily comprehensible information. These processes ensure that governing body members receive information related to all aspects of the pension plan (e.g. investments, funding, benefits and operating activities).			
PRINCIPLE 8:	**A COMMUNICATION POLICY SHOULD BE ESTABLISHED FOR PLAN MEMBERS AND BENEFICIARIES TO ENSURE TRANSPARENCY AND ACCOUNTABILITY .**			
8.1	**COMMUNICATION POLICY: PLAN MEMBERS AND BENEFICIARIES**	**Yes/No/Partial**	**Explanation**	**Action Plan**
	A communication policy has been established for disclosure of plan information to members and beneficiaries which ensures appropriate communication (i.e. timely, accurate, complete, consistent, cost-effective, useful, comprehensible and accessible).			
8.1.1	**Plan Member and Beneficiary Concerns**	**Yes/No/Partial**	**Explanation**	**Action Plan**
	Pension plan members and beneficiaries have a right to voice concerns and have them appropriately addressed in a timely fashion.			
8.1.2	**Defined Contribution Plans and Hybrid Plans**	**Yes/No/Partial**	**Explanation**	**Action Plan**
	Plan members understand the inherent risks of plans with DC attributes and know that investment risk is borne by plan members.			

8.1.3	Member-directed Defined Contribution Plans	Yes/No/Partial	Explanation	Action Plan
	A communication and education plan is in place which ensures that plan members understand the inherent risks of member-directed defined contribution plans, the effect of risk versus return, basic investment strategies, investment choices, and pension plan and investment information. Plan members are provided with adequate initial and ongoing information so they can make informed decisions about their investment options. The governing body has considered all relevant issues when developing the education and communication plan.			

IV. INTERNAL CONTROLS				
PRINCIPLE 9:	**A CODE OF CONDUCT AND CONTROL MECHANISM FOR CONFLICTS SHOULD BE ESTABLISHED.**			
9.1	**CODE OF CONDUCT AND CONTROL MECHANISM FOR CONFLICTS**	**Yes/No/Partial**	**Explanation**	**Action Plan**
	A code of conduct has been established which sets out the required behaviour of the governing body, senior management and plan advisors in their role as fiduciaries. The code of conduct also establishes a control mechanism for conflicts, a conflict of interest policy and a review mechanism.			
PRINCIPLE 10:	**PENSION PLANS SHOULD HAVE AN APPROPRIATE INTERNAL CONTROL FRAMEWORK.**			
10.1	**INTERNAL CONTROL FRAMEWORK**	**Yes/No/Partial**	**Explanation**	**Action Plan**
	The pension plan has an internal control framework that ensures all potential risks for the plan are addressed. There are clear written policies and control processes regarding financial stability and plan funding, asset management, asset protection and expenses, the outsourcing of functions and the selection of service providers/professional advisers.			
10.1.1	**Asset-related Fees**	**Yes/No/ Partial**	**Explanation**	**Action Plan**
	If asset-related fees are charged to the plan or paid by members, steps have been taken to ensure they are reasonable and competitive.			

10.1.2	Multi-employer Pension Plans	Yes/No/ Partial	Explanation	Action Plan
	There is a delinquency control program with procedures for the collection of unremitted contributions and data, and remedies for non-compliance.			
PRINCIPLE 11:	**THE GOVERNING BODY SHOULD HAVE APPROPRIATE MECHANISMS IN PLACE TO OVERSEE THE ADMINISTRATION OF THE PENSION PLAN AND ENSURE COMPLIANCE WITH LEGISLATIVE REQUIREMENTS**			
11.1	**OVERSIGHT OF PLAN ADMINISTRATION AND COMPLIANCE WITH LEGISLATIVE REQUIREMENTS**	**Yes/No/Partial**	**Explanation**	**Action Plan**
	There are processes and standards in place to ensure the pension plan complies with legislative requirements and pension benefits are paid to plan members and beneficiaries in accordance with the terms of the plan and legislative requirements.			
11.1.1	**Pension Benefit Administration**	**Yes/No/ Partial**	**Explanation**	**Action Plan**
	Processes and standards have been established to ensure administration of pension benefits in accordance with the terms of the pension plan and legislative requirements.			
11.1.2	**Compliance with Legislative Requirements**	**Yes/No/Partial**	**Explanation**	**Action Plan**
	An internal control framework is in place to ensure compliance with minimum legislative requirements.			

V. PERFORMANCE MEASURES AND ASSESSMENT				
PRINCIPLE 12:	**OBJECTIVE PERFORMANCE MEASURES FOR DECISION MAKERS AND PENSION PLAN PERFORMANCE SHOULD BE ESTABLISHED.**			
12.1	**PERFORMANCE MEASURES – DECISION MAKERS**	**Yes/No/Partial**	**Explanation**	**Action Plan**
	Objective performance measures have been established for all key decision makers (including the governing body, pension committee members, senior management, staff, custodians, investment managers, third-party benefit administrators and professional advisors) and a process for regular evaluation against the performance standards has been established. Mechanisms and follow-up actions have been established to rectify inadequate performance.			
12.2	**PERFORMANCE MEASURES – PENSION PLAN PERFORMANCE**	**Yes/No/Partial**	**Explanation**	**Action Plan**
	Objective comprehensible performance measures are utilized to measure pension plan performance and performance measures are reviewed over appropriate time periods. Results are reported to appropriate stakeholders.			
PRINCIPLE 13:	**A GOVERNANCE SELF-ASSESSMENT SHOULD BE CONDUCTED AND REPORTED TO PENSION PLAN MEMBERS, BENEFICIARIES, EMPLOYER(S) AND BARGAINING AGENT(S).**			
13.1	**GOVERNANCE SELF-ASSESSMENT AND REPORTING**	**Yes/No/Partial**	**Explanation**	**Action Plan**
	The governing body periodically reviews the governance procedures. Self-assessment reporting to plan members, beneficiaries, employers and bargaining agents is done on a periodic basis and sets out how the pension governance guideline was complied with, exceeded or not complied with.			

APPENDIX B: CAPSA PENSION PLAN GOVERNANCE COMMITTEE MEMBERS

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