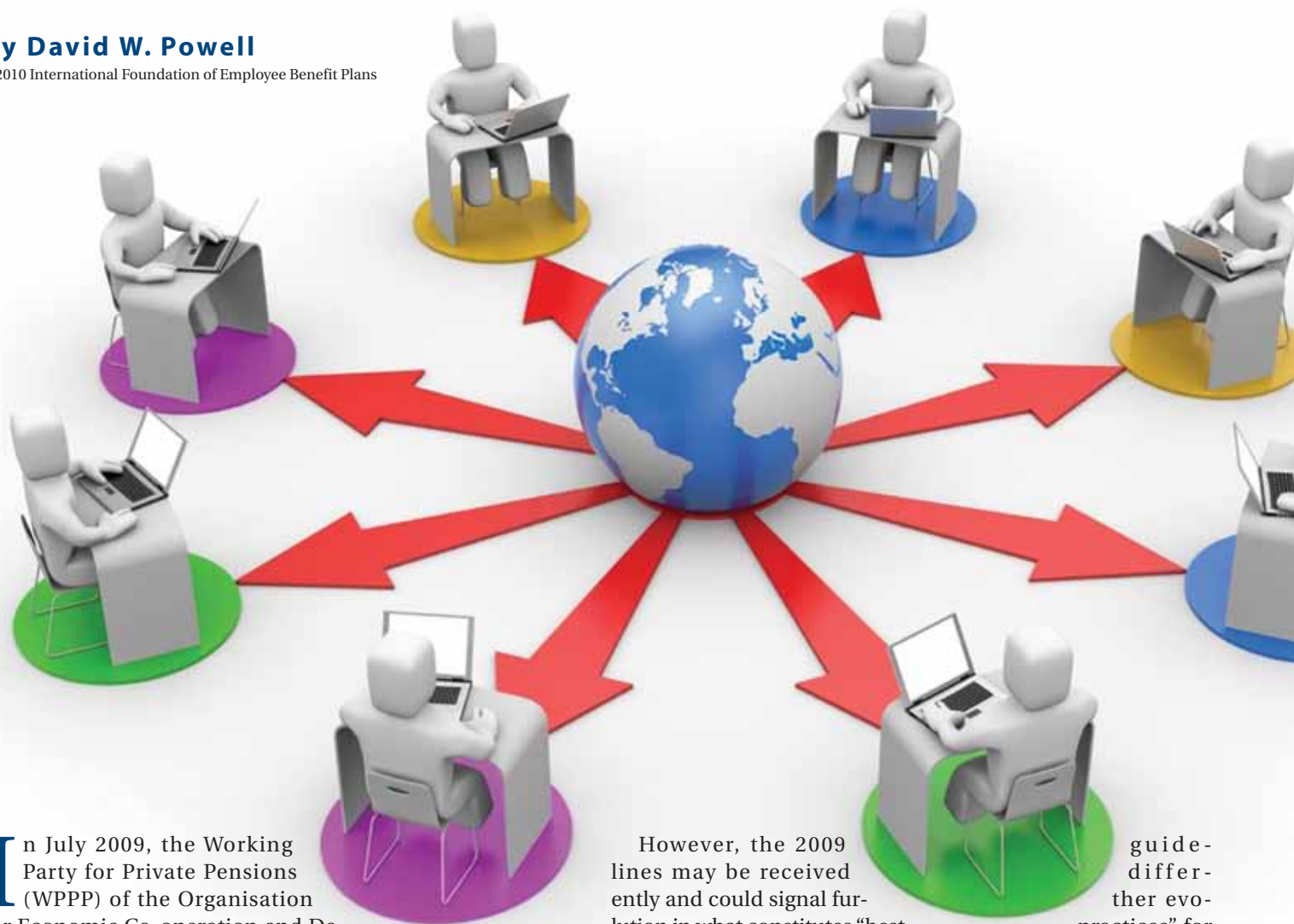


Updated Guidelines for Pension Fund Governance have been approved by the Organisation for Economic Co-operation and Development. Although pension plan governing bodies are not required to adopt these 2009 guidelines, they indicate world trends and may be useful to governing bodies overseeing pension plans across borders. The author suggests that where the 2009 guidelines vary from current U.S. pension plan governance practices, U.S. plan sponsors and fiduciaries—including public pension plan boards may wish to think ahead as to whether they should be moving toward adopting the recommendations as practices where appropriate.

New Fiduciary Considerations for U.S. Public and Private Pension Plan Governance— *A Look at New OECD Guidelines*

by David W. Powell

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In July 2009, the Working Party for Private Pensions (WPPP) of the Organisation for Economic Co-operation and Development (OECD), of which the United States is a member, approved updated Guidelines for Pension Fund Governance.¹ In the past, developments in OECD have seemed to have little noticeable influence on ERISA-covered pension plans in the United States and perhaps even less on U.S. public pension plans (i.e., state and local government pension plans).

However, the 2009 guidelines may be received differently and could signal further evolution in what constitutes “best practices” for both ERISA-covered and public pension plans for a number of reasons. For example, when the prior governance guidelines were published in 2002, international guidance on pension plans received far less publicity because business and investments were less globalized. In addition, the 2002 guidelines were vaguer and were drafted to some degree to try to catch the

rest of the world up to existing standards under ERISA.

In contrast, the 2009 guidelines go further than the 2002 guidance in how pension plan fiduciaries should govern their pension plans. Though many of the updated provisions parallel advances in fiduciary best practices for ERISA plans, as discussed below, some introduce ideas that have been resisted in the United States.

Furthermore, as business and communications have become more globalized, there has been increased publicity and discussion of international trade-related guidance, such as this type of OECD guideline.

Not unrelated, the duties of pension plan fiduciaries, such as the traditional pension plan committee for large U.S. plans, have been expanded to include responsibilities for pension plans and investments in other countries. Similarly, duties for non-U.S. executives and committees of multinational corporations to oversee U.S. subsidiary pension plans have been expanded. Those changes and the rise of global pension investing all make the application of cross-border pension plan guidance a higher profile issue than it was only a few years ago.

What Are the 2009 Guidelines?

OECD as an organization dates back to 1961. The OECD's purpose is achieving the highest sustainable economic growth and employment and a rising standard of living in member countries, while maintaining financial stability, contributing to sound economic expansion and encouraging the expansion of world trade.

Though it is easy to see how pensions fit into those purposes, OECD's interest in pension funds is of a more recent vintage. The first Guidelines for Pension Fund Governance were only issued in 2002. Other relevant pension guidance from OECD includes Core Principles for Occupational Pension Fund Regulation dating to 2004, Guidelines on Funding and Benefit Security in Occupational Pension Plans issued in 2007, and OECD-IOPS Guidelines on the Licensing of Pension Entities adopted only recently in 2008. This last set of guidelines also illustrates growing cooperation with the International Organisation of Pension Supervi-

sors (IOPS), an association of governmental pension regulators that is not restricted to OECD members (though it does not include the United States), which may signal an acceleration of the impact of the 2009 guidelines on the actual laws of many IOPS and OECD member countries.

Background—What Is the Legal Status of the 2009 Guidelines?

Though the convention of OECD allows for decisions that are binding on member states, that authority is rarely used. Generally, OECD acts through recommendations, which include guidelines that may be adopted by committees or its senior body, the OECD Council.

Such guidelines, including the 2009 guidelines, are essentially strong recommendations that the member countries have a general commitment to implement, but that are not binding in a legal sense. These promulgations have in a number of areas been very influential and already representative of the intentions of many member states, as with tax policy, for example.

OECD recommendations are also typically influenced by, coordinated with or reflective of the views of other bodies such as IOPS and the International Accounting Standards Board (IASB), further heightening the importance of OECD recommendations. OECD also publishes a good deal of statistical analysis used by pension-related financial institutions and insurance companies in their businesses.

Who Will Enforce the 2009 Guidelines?

At present, at least in the United States, no one will enforce the 2009 guidelines. But plan fiduciaries might take note of a few converging trends. With the increased interest of IOPS in the OECD guidelines, pension plan governance and other OECD guidelines have a growing chance of moving from mere guidelines to law of the jurisdiction involved.

Perhaps a greater pressure for adopting measures found in OECD guidelines will come from the accounting profession. As international accounting standards and U.S. financial accounting standards converge, the application of a uniform set of standards to be applied by a pension plan's auditor, regardless of where the

pension plan is located, seems increasingly likely. The 2009 guidelines themselves promote this approach by placing the auditor "in charge of" verifying the controls relating to risk management and conflicts of interest and boosting the actuary's "whistle-blowing function."

U.S. pension plan sponsors are becoming accustomed to having their auditors look at their pension plan arrangements more closely than ever before. If auditors start following international standards, the 2009 guidelines may very well influence what areas of pension plan governance auditors scrutinize, and influence fiduciary "best practices" of plans.

How Do the 2009 Guidelines Compare to Current U.S. Practices?

Some of the provisions of the 2009 guidelines suggest new or expanded areas for pension plan governing bodies in the United States to consider:

- *Pension plan policies regarding environmental, political and regulatory changes.* The 2009 guidelines provide for disclosure by pension plan governing bodies to all parties, including plan members and beneficiaries, of information regarding if and how environmental, social and governance considerations are taken into account in pension plan investment policies. Sponsors of U.S. pension plans are, of course, familiar with the general ERISA fiduciary duties concerning social investing, and U.S. public pension plans have often had to wrestle with these issues at a state or local level. However, it is probably not yet common, outside of multinational plan sponsors already addressing such concerns under the norms of other jurisdictions, for such policies to be reduced to writing and disclosed. The formalization of such policies may also offer greater opportunity for various stakeholders, including interest groups, to seek to become more involved in this subject.
- *Adoption of a formal code of conduct and conflict-of-interest policy.* In recent years, code of conduct and conflict-of-interest policies have become

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more common for nonprofit organizations and corporate employers. Some of these policies may have been extended to service on pension plan committees. The 2009 guidelines pick up on this trend and state that a pension plan's governing body should have a code of conduct and conflict-of-interest policy in place.

- *Changes to pension plan governing body's structure, activities and risk management.* One notable addition to the 2009 guidelines, not surprising given the events of the last year, is an emphasis on the pension plan governing body's risk manage-

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ment and oversight responsibilities. Clearly, the 2009 guidelines show increased concern for investment risk, and note that more sophisticated investments may require an equally sophisticated investment subcommittee. The 2009 guidelines also encourage separation of the responsibility for operations of the plan from the responsibility for more strategic and oversight functions such as the investment policy, strategic asset allocation, funding policy and risk management policy.

Consistent with this greater concern for risk management, WPPP has been paying increased attention to liability-driven investing (LDI) by pension plans, which is encouraged by some in response to the new international accounting standards and by regulators in some countries. Though not explicitly endorsed by the OECD guidelines (OECD has been

studying many different ways to lessen risks of pension underfunding), this trend appears to be emerging in the United States, aided by the convergence with international accounting standards, and in the case of multinational companies, by global pension committees in countries where it may be more common. Of course, many questions of how ERISA fiduciary duties apply to LDI and other investing methodologies remain.

- *Adding employee representatives to the pension plan's governing body.* The 2009 guidelines provide a new recommendation that pension accountability can be enhanced by requiring representation of plan members and beneficiaries on the pension plan's governing body. They also provide that appointment of independent professionals to the governing body may be an effective way to promote governance. As to the employee representatives on the pension plans' governing body, the 2009 guidelines state that, in some countries, labor laws may prescribe when employee representation on a pension fund is "necessary," as is the case under the Taft-Hartley Act in the United States.
- *Proper qualifications for becoming a member of a pension plan governing body.* The 2009 guidelines emphasize more specific pension plan expertise for members of a pension fund's governing body than the 2002 guidelines, as well as the need for members of the pension plan's governing body to collectively have competence and experience in the governance of pension funds and a high level of integrity and professionalism. The 2009 guidelines stress adequate training to enhance knowledge and ensure that the governing body have necessary "skill sets" to oversee the functions of the pension plan, as well that all professional staff have adequate qualifications and experience. In fact, the 2009 guidelines suggest that a pension plan's governing body undertake a skills inventory and prepare a training plan, with training of members on appointment and at least every two years thereafter. This recommendation is consistent with the trend in the United States to have

pension plan committee members undergo periodic training in their ERISA fiduciary duties and seek independent advisors where appropriate. It is also consistent with the recommendation of the recent OECD-IOPS pension licensing guidelines requiring pension plan committee members to be subject to "fit and proper" requirements, which may be subject to review by the country's pension regulatory authority. The 2009 guidelines also provide that the members of a pension plan's governing body should restate annually that they are aware of and in compliance with the governance obligations and key documents relating to the fund and have addressed any potential conflicts. This may also raise a question as to whether the auditors of the pension plan will seek to confirm such affirmations.

- *More formal delegation of duties and oversight by pension plan governing bodies.* While probably not surprising to U.S. plans, the 2009 guidelines encourage more formal delegation of duties to executives, staff and, where appropriate, external service providers. Because such delegations may have grown in a less formal manner over time in some pension plans, this recommendation may encourage pension plan governing bodies to review their duties and memorialize delegations of these duties and how oversight of the delegates will be performed.

What Do the 2009 Guidelines Mean for Global Pension Plan Committees?

It is increasingly common for multinational corporations, whether based inside or outside the United States, to centralize at least some pension-related functions—particularly concerning investments—in a committee operating at a fairly senior level in the corporation's home country. Whether the home office or the local committee is the actual decision maker for a particular plan has sometimes been unclear, though increasing attention to the extraterritorial reach of ERISA fiduciary duties has added some impetus to obtaining clarification of that.

While the laws of each country must be followed with respect to each plan, it may be advisable for global pension plan committees to consider the 2009 guidelines as an overarching set of considerations that meet some convergence of all of the rules, either now or in the future, of OECD countries. This approach may result, for example, in some more formal procedures relating to decision making, delegation of duties and the fiduciary standards involved.

Even (or perhaps especially) for countries that are not members of OECD, the 2009 guidelines are important for their aspirational aspect, for those countries that aspire to be part of OECD are judged on how seriously they take OECD's guidance. (For example, countries currently in various forms of observer status or in discussion for accession to possible OECD membership include Israel, Russia, Brazil, China, India, Indonesia and South Africa.) In other words, making global pension plan decisions and acting in accordance with OECD guidelines is most likely to satisfy the rules of OECD member countries while also holding to a standard that may become the standard in other countries. It is reasonably certain that acting in accordance with the 2009 guidelines will not violate the rules of any OECD member country, though some countries may impose additional legal requirements. Acting in accordance with the 2009 guidelines for pension plans located in non-OECD countries may have the benefit of providing a defense to actions by local regulators that are not consistent with OECD guide-

lines, at least where the country has some aspirations to an OECD-level of participation in global economic affairs.

Impact of the 2009 Guidelines on Public Pension Plans

International bodies such as OECD rarely draw a distinction between public sector and private sector pension plans, or between ERISA and non-ERISA plans. Generally, OECD tends to view a pension plan as a pension plan, in whatever form it may take in whatever country. Indeed, in light of the publicity given to the possible impact of underfunded U.S. public pension plan obligations on the economy, a major focus of OECD, it is unlikely that public pension plans would escape attention. Accordingly, public pension plans may also look to the 2009 guidelines as a harbinger of things to come.

Conclusion

In one sense, the 2009 guidelines



David W. Powell is a principal in the Groom Law Group in Washington, D.C. He has worked on tax and ERISA issues relating to all types of employee pension and welfare benefit plans for more than 26 years. He is the U.S. editor of the *International Pension Lawyer* and a member of the editorial advisory board of the *Journal of Deferred Compensation*. Powell earned his J.D. degree from the University of Texas and his B.B.A. degree from Southern Methodist University. He is also a certified public accountant.

serve as an indicator of world trends in pension plan governance, as opposed to requirements that a pension plan's governing committee should proceed to adopt immediately. However, the 2009 guidelines may in fact be immediately useful to pension plan governing bodies overseeing plans across borders. And where the 2009 guidelines vary from current U.S. pension plan governance practices, U.S. plan sponsors and fiduciaries, including public pension plan boards, may wish to think ahead as to whether they should be moving toward adopting the recommendations of the 2009 guidelines as practices where appropriate.

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Endnote

1. The 2009 guidelines are available at www.oecd.org/dataoecd/18/52/34799965.pdf.

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