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# Pension Fund Governance: Knowledge is power

*The quest to raise standards in governance places strenuous demands on pension funds, requiring the right organisational model, the right people, and – last but not least – access to the right data. On 19 November 2013, some 70 Dutch pension managers, trustees, other asset owners and representatives from the Dutch regulator gathered at an event hosted by Northern Trust to discuss key elements and dilemmas of pension fund governance.*

Achieving good governance is a multi-faceted challenge for Dutch pension schemes. Good governance is viewed as a matter of priority in the Dutch pension industry, both in terms of structure and quality of pension scheme governance as a whole, and more specifically with regards to governance of the investment chain. At the Northern Trust conference on 19 November these two sides of the governance coin were represented by Iris Sluiter, department head of the Pension Fund Governance Centre of Expertise at pension regulator De Nederlandsche Bank, and Rob Oosterhout, vice-chairman of the board of trustees at ING Pension Fund.

On one hand pension funds are taking steps to comply with the new Pension Fund Governance Act (PFG Act), which takes full effect in July 2014, with some provisions already in effect today. The new governance legislation will require pension schemes to adopt one of five governance models: a board model based on 'parity' or equal representation of stakeholders, a board consisting of independent trustees, and three different varieties of a one-tier board.

Depending on the model selected, an accountability or stakeholder council will be installed to ensure co-determination and stakeholder participation, while pensioner representation will be mandatory on all parity-based board models. With the exception of the one-tier models, internal supervision will be provided by either a visitation committee or permanent supervisory board – the latter being mandatory for industry-wide pension funds.

By last September, some 30 percent of pension funds had selected the governance model of their choice, with the majority opting for a parity-based board, reported Sluiter. Most of the remaining schemes are expected to choose a model before the end of the year. Sluiter stressed that pension funds should not wait until the last minute. "Deciding after January 2014 is simply too late," she said, adding: "DNB will get in touch with the approximately 16 percent who will not have made their choice by then."

Sluiter conceded that the legislative process leaves precious little time between finalisation and implementation of the governance legislation. "We are taking account of the fact that this may impact pension funds' decision making process. But we would urge pension schemes to prepare for the new legislation regardless, and while we cannot speed up the legislative process, we can provide schemes with sufficient information to be prepared," she said.

Likewise, while she conceded that new, more strenuous qualification and availability requirements will make it more difficult for pension schemes to find suitable candidates for trustee positions, she emphasized that this dilemma is simply not to be avoided: "As suitability requirements are tightened, the number of fish in the pond will decline. But this cannot be helped, as society demands this of the industry."

With regard to the issue of remuneration, another hot topic when it comes to governance, she reiterated that society demands accountability – but stressed that high fees are not necessarily frowned upon by DNB, "just so long as schemes are well aware of the interests and risks involved, have decided what level of remuneration they find acceptable ahead of time, and are prepared to be held accountable."

## Governance of the investment chain: knowledge is power

Even as pension schemes are gearing up to meet requirements of the new PFG Act, at the same time many have focused on improving governance of the investment chain. Following the 2008 crisis DNB redoubled its supervisory efforts to ensure that trustee boards are in control of their asset management at all times, as required by law. The supervisor looked especially hard at pension funds that experienced significant funding rate losses, demanding that pension funds bolster their countervailing power vis-à-vis their asset managers and improve transparency and risk management capabilities in order to enhance the governance of the investment process.

In response, Stichting Pensioenfonds ING embarked on a mission to radically improve its asset management governance structure by implementing a new governance model, an undertaking the pension fund took on in collaboration with, among others, its asset servicer, Northern Trust.

"Our scheme is based on nominal liabilities only and strives to maintain adequate capital buffers at all times. With those prerequisites in mind our starting point is a strategic risk standard based on two elements: the risk of our funding rate dipping below 105 percent over a fifteen year period must not exceed 1 percent, and the risk of our funding rate dipping below 99 percent cannot exceed 1 percent in any one-year period," explained Rob Oosterhout *. As a result of this approach the Asset Liability Management study – which traditionally focuses on the long term – is now taking into account both long-term and short-term perspectives, and is used not to yield a specific asset allocation but to yield a funding rate dependent risk budget. "We no longer navigate on the basis of a fixed asset mix and varying risk level, but instead we plot our course on the basis of a limited risk level depending on the funding rate and varying asset mix," he said.

This new risk-based approach to asset management governance required detailed, tailored portfolio transparency, which was easier said than done. "We needed to gain access to a tremendous amount of data from a large number of different asset managers all over the word, and we needed this data to be delivered in a more or less universal format. We employed Northern Trust as our asset servicer to get the job done," explains Oosterhout.

Getting the required data delivered on time and in the required format was no small feat, acknowledged Frans Hofkens, senior vice president, Institutional Investor Group at Northern Trust. "However, the increasing need for more transparency is universally understood. Also, the fact that Northern Trust has a well-established working relationship with a wide range of asset managers across the world has really helped."

ING Pension Fund's new approach has considerable implications in terms of governance. Different governance levels are engaged depending on the actual risk budget bandwidth involved. Mid-range decision making is limited to the 70-90 percent swath of the risk budget which falls within the trustee support board's remit. The Balance Management Board is responsible for any decisions in the realms of 50-70 percent and 90 – 95 percent of the risk budget. Anything under 50 percent or over 95 percent of the risk budget requires a decision by the board.

"However, adopting a risk based governance model with regards to the investment chain does not in any way limit or impact a pension scheme's options in terms of the overall governance model. In other words: each of the five governance models provided for in the PFG Act can accommodate our risk based investment governance approach," says Oosterhout.

Whichever governance model pension funds adopt, the need for greater transparency and look-through information is increasingly becoming an integral part of good governance. "We find that the demand for accurate, comprehensive data provision is clearly on the rise as asset owners are focusing more on governance-related issues," says Hofkens of Northern Trust.

Perhaps not surprisingly: "When it comes to pension fund governance, knowledge is power. After all, this is the information that is essential for trustee boards to be 'in control'," Oosterhout points out. "And ultimately that is our objective."

**This was the case at the time of the presentation / panel interview. On 9 January 2014, the parties involved have announced that negotiations have yielded an agreement to modify this nominal-only approach.*