

Whitepaper on Plan Governance¹

By PricewaterhouseCoopers LLP



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Plan governance in the United States has recently become an increasingly important topic for plan administrators, plan sponsors, and plan fiduciaries. This heightened awareness and interest is attributable to a number of factors, including:

- The evidence that investments in well governed plans outperform investments in other plans,
- The focus that larger plans have placed on corporate governance when evaluating investments, and the lessons they have learned from studying corporate governance,
- The exercise undertaken by US public companies to comply with Section 404 of Sarbanes-Oxley, and how it has highlighted the lack of control and governance around benefit plans,
- A growing focus on plan governance internationally, such as in the United Kingdom, Canada, and the OECD,
- Lessons learned from recent corporate, governmental, and plan scandals that have increased attention on the need for improved governance, and
- The improved awareness that good plan governance is essentially a facet of overall enterprise risk management, and builds upon existing control and governance principles that lead to better overall performance and risk management.

This whitepaper provides an introduction to plan governance, and discusses:

- what is plan governance,
- why plan sponsors should consider improving governance, and
- general plan governance standards or principles.

WHAT IS PLAN GOVERNANCE?

Plan governance is the application of traditional corporate governance principles to retirement plans. A concise description of corporate governance is a system or a framework that directs and manages a company through clearly defined roles, responsibility, and accountability. It is sometimes described using military parlance as the “command and control” structure of an organization.

The “command and control” of a plan, however, can be more complicated than a typical corporate structure. The governance structure of a plan doesn't neatly fit into a conventional organizational chart structure, with a board, subcommittees, senior management, and lieutenants carrying out the corporate goals. Instead, there are often multiple dotted-lines reflecting relationships where there is indirect or partial responsibility, and “lieutenants” (who owe their allegiance to the company, not the plan), charged with carrying out the goals of the plan. These conflicts and ambiguous relationships create tensions when trying to develop a plan's governance structure. Indeed, because of these tensions many plan have limited, or ill-defined governance in place.

¹ The term “plan governance” is used in this Whitepaper to describe governance of qualified retirement plans, although the principles would generally be applicable to nonqualified plans. The whitepaper was prepared by Charles Yovino and Wendy Vitale in our Atlanta GHRS practice.



Good governance demands a clear accountability for every decision made with respect to a retirement plan. This accountability leads to better plan administration.

A successful plan governance structure will incorporate the principles of good corporate governance with a pragmatic approach that recognizes the unique complexities associated with trying to govern plans. It will include the oversight mechanisms, including the processes, structures and information used for directing and overseeing all persons who have any responsibilities with respect to a plan. Perhaps the most important facet is that it will recognize, reflect and facilitate the discharge of fiduciary duty.

Accordingly, governance is one of the key tools that can be used by a plan fiduciary to insure the fiduciary is fulfilling his or her fiduciary obligations. While good governance cannot, in and of itself, guarantee good performance of a plan, it is a contributing factor to its success.

WHY IMPROVE GOVERNANCE?

Effective plan governance is an essential element in the prudent and proper functioning of retirement plans. Generally, good governance promotes the timely and cost-effective delivery of benefits and promotes the administration of the plan in the best interests of the plan members and beneficiaries. Good governance requires the appropriate control mechanisms that encourage good decision making, proper and timely execution, and regular review and assessment. Additionally, strong governance reduces potential

liability for the plan sponsor, the administrator, and associated advisors. Good governance demands a clear accountability for every decision made with respect to a retirement plan. This accountability leads to better plan administration.

In addition, the recent wave of business scandals, ethical lapses, and the large number of under-funded plans being foisted on the government and taxpayers have heightened public, press, and investor scrutiny of companies, demanding a corporate culture of integrity-driven performance and greater corporate transparency. Management and Boards now feel compelled to ensure that proper governance processes are in place to protect corporate reputation, brand image and shareholder value. Important purposes for establishing a proper plan governance approach is to protect the corporate reputation and image, ensure the financial viability of the plan and enhance the value of plan assets, and thereby protect shareholder value.

A number of published studies have also established a correlation in defined benefit plans between better plan governance, and improved investment results. In the defined benefit plan context, this is important for employers since improved investment results will lead to reduced contributions and expense. If the premise that better governed plans have better investment

results can be extrapolated to defined contribution plans, then plan fiduciaries of poorly governed defined contribution plans may be at risk for the lost return. Similarly, if they are not exercising adequate oversight of services providers and plan expenses, they could be causing the plan to overpay for these services. Again, the result would be lost return for the plan participants and possible exposure to the plan fiduciaries. The proposed rules issued by the Internal Revenue Service and the Department of Labor in 2007 requiring greater transparency of plan fees and expenses will only heighten the focus on these issues.

BEST PRACTICES IN GOVERNANCE

Best practices are the means by which leading companies have achieved top performance. They serve as goals for other companies striving for excellence. Best practices are not the definitive answer to a business problem but should serve as a source of creative insight for business process improvement. Best practices for plan governance considers all facets of plans, such as funding, investment, benefits administration, and risk management.

Governance models vary from one company and one industry to another, though successful systems share a number of common characteristics.



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Included in the common characteristics are the following simple principles which are the foundation for good plan governance.

- Establishment of plan mission and objectives;
- Defining clear roles, responsibility and accountability;
- Risk management;
- Transparency and disclosure;
- Clear performance measures;
- Adequate knowledge and skill sets;
- Oversight and compliance;
- Establishment of a plan level code of conduct and a policy to address conflicts of interest;
- Succession planning;
- Fiduciary duty; and
- Periodic self assessment.

These principles, discussed in detail below, lead to the sound administration of plans, as well as the proper handling of funding and investments. These principles apply to all types and sizes of plans. While the application of these principles is essential to achieving effective governance, there can be many methods for implementing them.

1. Establishment of plan mission and objectives

The plan sponsor, administrator and fiduciaries should begin by establishing a plan mission that briefly describes the plan's overall goals and purpose. Although the plan's mission might initially seem obvious (e.g., to provide for retirement

benefits), the mission should provide insight into how the plan will provide retirement benefits. Where will the plan stand philosophically on the following questions:

- Will the emphasis be on providing participant education on investing and saving?
- Will there be a focus on managing cost? (This could require a simpler plan, more indexed funds, and a lower level of service from the administrator.)
- Is the plan a differentiator in the market? Is it intended to help attract and retain personnel?
- How important is risk management? This can impact both the investments in the plan, and the vendors selected.

The mission statement, if properly crafted, can provide guidance for all the decisions that are made relating to the plan. It provides the compass that keeps all the players facing in the same direction, with the same ultimate goals.

Equally important are the objectives the plan sponsor, administrator and fiduciaries are responsible for achieving. The objectives should be clear, documented and communicated to all the parties involved in plan administration (as well as to plan participants). The objectives provide the framework for the administration, management and overall oversight of the

plan. Objectives should be set for the plan as a whole as well as targeted to specific activities within the plan.

For the plan sponsor, administrator and fiduciaries, the objectives should be established strategically (e.g., identify the transactional risk associated with the plan, and establish a control framework to manage the risk). The "lieutenants" or managers responsible for execution should look to plan objectives for guidance in establishing priorities. These objectives should be reviewed when performing self-assessments to determine the effectiveness of the plan's governance and the success of its operations.

2. Defining clear roles, responsibility and accountability

The plan's administrators should define the roles and responsibilities of each person or entity involved in the management and operations of the plan. The governance structure should make it clear who is responsible for overseeing that certain task or functions are accomplished, and who is accountable for completing those functions or tasks. Effective supervision is possible only if management has clear instructions from the plan administrator or fiduciaries as to their specific responsibilities, and the responsibilities of their subordinates. Also, the managers must fully understand their roles in terms



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of expected results and policies to be followed. Roles should be defined in terms of both specific actions and expected outcomes so that the people in the roles can make adjustments to their actions if that is needed to achieve the desired outcome. These specified actions should be included in those individuals' performance measures so that they will be rewarded when desired outcomes are achieved. Additionally, the plan's administrators should clearly identify the stakeholders to whom each entity or individual are accountable. This way, everyone knows what is expected of them and who will be confirming that they meet these expectations.

Good governance demands a clear accountability for every decision made with respect to a plan. This accountability leads to better plan administration. While responsibilities can be delegated to committees and personnel both internal and external, accountability for direction setting and supervision cannot be delegated. The chain of delegation should be documented and performance objectives and reporting relationships established between the roles. Accountability for selecting delegates and for monitoring actions of delegates should be clear. Individuals who delegate tasks still maintain accountability for the role leading to the requirement for oversight of delegated duties.

The roles and responsibilities of each employee involved in

the oversight or administration process of the plan should be clearly defined in a written document. This will allow for the continuation of roles after the employees who are currently in these positions change employment. Without written documentation covering these roles, their continuation depends on word of mouth and may change depending on the interests of the new employees. Also, these documents should be distributed to each employee involved in the oversight or administration process of the plans so that they will be aware of them.

3. Risk Management

The plan administrator or plan fiduciaries should establish an internal control framework, appropriate for the plan's circumstances, that focuses on the plan's potential risks. Control activities should exist to ensure all plan activities receive proper review and that necessary actions are taken to address and mitigate any potential risks. Control activities have various objectives and are applied at different organizational levels. Separate control activities should be in place which relate to both plan policies and to plan financial information. Once the control activities are established, those individuals who will be accountable for the findings of the control procedures should be included in the monitoring of these activities.

The administrator, acting in its fiduciary capacity, should

understand and approve the framework as well as the written internal control procedures supporting the framework. Internal control procedures should identify responsibilities and accountabilities; set out the process for recommending, approving, and implementing decisions; prescribe the frequency and format of reporting; confirm that funds are managed prudently; verify that plan provisions are being interpreted consistently and benefits paid correctly; and address policies on funding, investing, expense management documentation, recordkeeping, benefit administration compliance, outsourcing and communication. Exceptions, such as those arising where plan provisions are not clear or where there is room for some discretion, should be reviewed and approved by the plan administrator.

4. Transparency and Full Disclosure

Transparency of information about existing conditions, decisions and actions is integrally related to accountability. Accountability is enhanced through disclosure and transparency. Accountability is the responsibility for specified activities after the action has occurred, while transparency relates to disclosing details of specified activities before or during the time in which they occur. These are similar though differ in the timing of the disclosure and therefore the ability to alter the future



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implications of the actions in question.

The plan administrator should provide for the communication of the governance process, the objectives, and other items to plan members, beneficiaries and other stakeholders to facilitate transparency and accountability. Responsibilities of each participant in the governance, management and operation of the plan should be clearly communicated to that party as well as to other parties involved in the process. Board and committee members should receive reports on the activities of those people to whom they delegate any responsibility.

There is no requirement to provide detailed information on the governance process to plan participants. Transparency can simply mean a high level overview of how your plan is managed. The intention is to provide a comfort level that the plan is being properly managed. This may require some high level, basic information about the governance process. Most members want to know about: (1) benefit entitlements, and (2) investment returns. Detailed governance information is not as important to the average member. Most members only want to know there is a good governance process in place, though they are not concerned with the details.

The plan administrator and fiduciaries should have responsible and capable parties

available to address member inquiries and able to handle any complaints through a conflict resolution process. The steps involved in this process should be clearly defined to participants so that if they should have a complaint, they will know the proper procedure to have it addressed. Generally, this process is included in the summary plan description sent to each participant.

5. Clear Performance Measures

The plan's administrator and fiduciaries should provide for the creation of performance measures for monitoring the performance of individuals and entities involved in the plan's administration and investments. Performance in all plan activities, including pension administration and funding status as well as investments, should be measured against pre-defined goals, adjusted for differing needs over time. Performance objectives and measures should be tailored to each plan's specific requirements. Results should be reported to the appropriate stakeholders. Measuring performance facilitates the separation of the supervision of operations from their execution.

These measures should be set for all parties with responsibilities related to the plans. This includes internal and external parties. The administrator and the plan sponsor should expect and look for an acceptable level of professional conduct and

advice from the plan trustees, managers and advisors and, if the conduct is not appropriate, the administrator should determine what follow-up action is necessary, including the use of professional disciplinary procedures and legal recourse, and proceed as the situation demands.

These measures should be established in advance of the measurement period and be communicated to all the parties being assessed. If everyone knows what is expected of them, they have a much better chance of meeting these expectations. Defining and communicating the performance objectives will substantially increase the likelihood of having these goals met.

It is important to make sure the performance measurements are understandable to each person involved in the process. Performance measures should be "SMART" goals. The characteristics of SMART performance measures are:

- Specific: clearly identifiable, should be obvious not just what actions are to be performed, but what results are to be achieved.
- Measurable: performance is quantifiable;
- Accountable: who specifically is accountable for what;
- Realistic: should focus on objectives of the plan and be of a scope and scale that could be achieved by the individual; and
- Timely: a specific target date for achieving each goal should be agreed upon.



Plan administrators may delegate some or all of their responsibility. Accountability is not transferred by this delegation, and thus there should be a supervisory process in place.

Finally, the issue of goal setting must be addressed at different levels within a retirement plan. Each manager must be given objectives specific to their role.

6. Adequate Knowledge and Skill Sets

The plan administrator and fiduciaries should establish an ongoing process to identify the knowledge and skills needed for the effective governance of the plan. Each person involved in plan administration should have, or be expected to acquire the knowledge and skills that are current and appropriate for the responsibilities and accountabilities they carry. The plan administrator should develop a process to address any gaps in knowledge and skills through training or ongoing education.

Administrators who accept the oversight role must have the experience and qualities necessary to oversee a complex financial endeavor. In many instances, the plan administrators and fiduciaries may find their plan duties require skills or knowledge that are broader in scope than their normal duties. While there is no explicit curriculum that needs to be studied as a steward of retirement plans, prudence demands that an administrator or fiduciary should have a minimum level of understanding in areas where they will be making decisions, such as financial markets, risk management and vendor management. Plan administrators and fiduciaries

must also be prepared to study and understand the terms and policies of the plans.

The challenges facing the administrator of a plan require the use of a broad range of skills and knowledge. The administrator may acquire skills and knowledge by employing qualified staff (plan managers) or through outsourcing. Selection of staff and/or agents and monitoring of the delegated work are the responsibility of the party who commissions the tasks. In addition, the administrator must assess the quality of the services or advice and decide whether to accept the services or follow the advice. The administrator and the fiduciaries need to have sufficient knowledge and skill to assess the quality of services and advice provided by professional advisors. The administrator and the fiduciaries must have a reasonable understanding of the issues to assess the credibility of the advisors and the rationale behind their recommendations.

7. Oversight and Compliance

Plan administrators are not required to devote their full time and attention to the plan's affairs. They may delegate some or all of their responsibility for plan administration to a committee, who in turn may assign this authority to senior officer(s), who in turn may assign it to a more junior officer or to an external agent. Accountability is not transferred by this delegation, and thus there should be a supervisory process in place.

The plan administrator is expected to oversee the business and affairs of the plan but is not expected to manage the plan on a day to day basis. Delegation should be made to a group of managers who are responsible to and report to (whether directly or indirectly) the plan administrator or committee on a regular basis.

The work being delegated should be performed conscientiously and with a focus on quality by those people to whom the work is being delegated. Several of the above principles help to ensure quality and diligence in performance of assigned duties. Clear performance objectives and clearly defined roles will help in the understanding of job duties. Accountability and strong internal controls will help to ensure no one in the plan administration is working contrary to the plan objectives. These principles in action along with knowledgeable and skilled employees should ensure work related to the plan is being performed with due diligence and at acceptable quality levels.

To oversee the operation of the plan, the plan administrator and fiduciaries needs sufficient and timely information about financial and administrative performance. In its supervisory role, the administrator and fiduciaries should perform the following tasks to properly supervise plan operations: assess periodically if objectives of the plan are being met; ensure absence of (potential) conflicts of interest; ensure controls are in



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place and that they are audited regularly; set expectations with management and evaluate performance through effective delegation where required; consider the necessary resources required to pursue the objectives and strategies; review correspondence relating to the plan to assess specific administration matters; maintain appropriate records of key meetings and decisions affecting the plan, and confirm follow-up action.

The plan administrator should establish appropriate mechanisms to facilitate oversight and ensure compliance with the legislative and regulatory requirements, and the plan documents and policies. The plan administrator should identify the legislative and regulatory requirements and the documents and policies that apply to the plan. The plan administrator should put in place a mechanism to ensure compliance with the legislative and regulatory requirements and the plan documents and policies. Often this task is delegated to a member of the legal department though ultimate accountability rests with the plan administrator or fiduciaries.

8. Establishment of a Plan level Code of Conduct and a Policy to Address Conflicts of Interest

A code of conduct that applies to corporations or boards of directors should be different than a code of conduct designed

for plan administrators and fiduciaries due to different roles and responsibilities. A plan level code of conduct, including conflict of interest policies and procedures that set out the required behavior for the plan administrator, fiduciaries and their delegates should be clearly articulated and monitored. This code should cover benefits administration and funding, as well as investments. Potential conflicts between plan roles and corporate roles should be recognized. Examples of such conflicts should be spelled out so there is no confusion by those acting on behalf of the plans. If there is any question about whether a conflict exists, the individual with the conflict should have access to an independent advisor. The code should address actual and perceived conflicts of interest of the plan administrator, fiduciaries and their delegates and provide a dispute resolution mechanism when conflicts arise.

To meet the fiduciary duties required of plan administrators and fiduciaries, employees are sometimes forced to place the interests of the participants above the interests of the company. Administrators and fiduciaries must understand what conflicts of interest they may face and commit to resolve them in favor of the plan's beneficiaries. It is important for those employees to have a special code of conduct to follow in these circumstances. An appropriate code of conduct specific to the governance

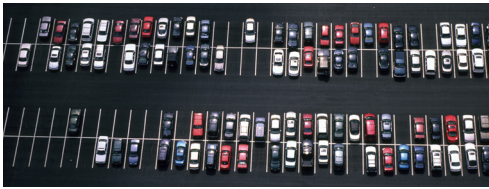
objectives adopted by the plan administrators should be published and made available to those acting on behalf of the plan.

9. Succession Planning

Succession planning is important whenever continuity is critical. Just as it is important in maintaining corporate governance, it is important for plan governance. A procedure or process should exist for selecting members of the governing body, for setting their term and for their removal. It is knowledgeable and competent employees with a clear understanding of their roles and a strong commitment to carrying out these roles that make the governance structures and policies as well as overall plan operations work in practice. Succession planning for these individuals is vital to the long-term success of the plan. Without this, good governance may be only temporary. Consequently, succession planning should be established and reviewed regularly and it should be part of the long term governance objectives of the plan.

10. Fiduciary Duty

One of the most basic foundations of a plan governance process is that the process must recognize fiduciary duties and make it as easy as possible for employees to fulfill their fiduciary duties. A fiduciary has the power and discretion to unilaterally affect the plan beneficiaries' interests. The plan administrators



Governance should be reviewed continuously to meet emerging challenges.

have a duty to interpret the plan terms fairly and pay the benefits promised. Clearly the plan member is vulnerable to the fiduciaries' decisions and actions, giving rise to the need for duty, care and prudence. The greater the discretionary powers of the administrator and fiduciary, the greater is the scope of fiduciary duties. The terms of the plan design are frequently set unilaterally by the plan sponsor, but they must be interpreted impartially, fairly, and in good faith when paying the benefit promised. Plan fiduciaries must always act in the best interests of the beneficiary, impartially treating members with loyalty and without personal profit.

Fiduciary obligations normally extend to and include ensuring the completeness of plan terms, complying with legislative requirements, communicating to members their rights and entitlements, ensuring actuarial valuations are performed for defined benefit plans, ensuring required contributions are remitted to the plan at the correct times, ensuring funds are prudently invested, and ensuring payment of benefits is correct, timely and in accordance with plan terms and the law. The plan administrator and fiduciaries must make sure that their fiduciary responsibilities have been fulfilled through judicious advice and recommendations. In these actions, the plan administrator and fiduciaries should be extremely conscientious in considering the interests of the plan beneficiaries.

They should also be aware of their fiduciary responsibilities and the standard of care required when considering what to disclose, the manner and form of disclosure, and whom to inform.

11. Periodic Self Assessment.

Governance should be reviewed continuously to meet emerging challenges. Some form of governance evaluation is essential for plan administrators in understanding the governance risks they and their plans face, and where improvements are required. The plan administrator should establish a process for the regular review of the plan's governance. This may be accomplished through a self-assessment process, which can involve the assistance of third-parties (e.g., internal audit, outside advisors, etc.). Self-assessment offers an opportunity for plan sponsors to share responsibility for the benefit delivery with the other stakeholders. The governance process should be reviewed and modified periodically to ensure its effectiveness. The plan administrator should put in place an effective process to address any problems or inconsistencies found with the plan's governance process. The objective of the assessment should be to determine the effectiveness of the plan's governance structure and operations.

With the increasing scrutiny on plan operations and performance, plan governance is becoming increasingly important. The principles outlined in the whitepaper provide a good basis for plans to begin developing a strong plan governance structure.