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On the Governance of Public Pension Fund Management

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Abstract

Impavido surveys the empirical literature on the relationship between governance of public pension fund management and investment performance. He makes a preliminary attempt to identify good governance practices and distill governance guidelines aimed at reducing the political risk that is associated with central, public pension fund management. The author highlights the need for further work to support the development of a satisfactory set of governance guidelines.

This paper—a product of the Financial Sector Operations and Policy Department—is part of a larger effort in the department to study the effects of contractual savings on financial markets. Copies of the paper are available free from the World Bank, 1818 H Street NW, Washington, DC 20433. Please contact Patricia Braxton, room MC9-704, telephone 202-473-2720, fax 202-522-7105, email address pbraxton@worldbank.org. Policy Research Working Papers are also posted on the Web at http://econ.worldbank.org. The author may be contacted at gimpavido@worldbank.org. August 2002. (36 pages)

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INTRODUCTION

World labor force coverage by publicly managed pension schemes is estimated at approximately 800m. This is roughly one third of total world labor force. Of this 800 million, about 49 and 32 percent is covered by mandatory, publicly managed defined benefit (DB) pay-as-you-go (PAYG) and partially funded schemes, respectively. The rest of the workforce is covered by a mix of public DB and private defined contribution (DC). Only 10-15% of it is covered by public and/or private DC schemes (Palacios and Pallares 2000). In mature economies with flat demographic pyramids like Poland, Italy and Slovenia, universal coverage is norm, public pension spending can reach 15% of GDP, and gross implicit pension debt can be as high as 400% of GDP. Ageing of population is bound to increase pressure on countries to reform their pension systems and so far, at least 25 countries have adopted reforms and many other are in the process of formulating serious reform proposals. Table 1 compares the ratio of reserves to GDP for publicly managed pension funds with that of privately managed funds.

Table 1. Pension fund reserves in select countries

Partially funded defined-benefit		Centrally managed defined-contribution (provident funds)		Privately managed defined-contribution	
Country	Percent of GDP	Country	Percent of GDP	Country	Percent of GDP
Egypt	33.1	Malaysia	55.7	Switzerland	117.0
Sweden	32.0	Singapore	55.6	Netherlands	87.3
Japan	25.0	Sri Lanka	15.2	UK	74.7
Jordan	16.9	Kenya	12.1	Australia	61.0
Mauritius	13.1	Tanzania	9.4	Chile	45.0
Philippines	11.2	Swaziland	6.6	Denmark	23.9
Gambia	11.1	India	4.5	Argentina	3.0
Canada	11.0	Nepal	4.0	Colombia	2.9
Belize	10.5	Indonesia	2.8	Peru	2.1
Ghana	9.4	Brunei	2.4	Poland	1.1
Morocco	8.7	Zambia	0.7	Uruguay	1.0
Switzerland	7.1	Uganda	0.6	Bolivia	1.0
Korea	7.0			Mexico	0.5
Tunisia	6.9			Kazakhstan	0.5
Swaziland	6.6			Hungary	0.4
Jamaica	5.7			El Salvador	0.3
Costa Rica	5.4			Croatia	0.0
United States	5.0			Sweden	0 0
Yemen	4.0			Hong Kong	0.0
Honduras	3.5				
Senegal	1.6				
Ethiopia	1.4				
Algeria	1.2				
Chad	0.5				
Namibia	0.4				
Paraguay	0.4				

Source: Palacios and Pallares (2000).

The issue of management is relevant to some sixty-two public pension schemes (Palacios 2001). The investment performance of these schemes has been mixed, to say the least, with many funds obtaining negative real rates of return over an extended period of time. Investment performance is obviously of central importance if accumulated assets

are used to meet pension obligations. This is especially true in developing countries, where these schemes represent a large share of retirement income for covered workers.[1]

The topic should also be of relevance to a wider and diversified audience:

- Pension fund managers, to the extent that their remuneration is linked to performance, are likely to be interested in understanding the variables that influence the return on their portfolios.
- Participants in public pension schemes are likely to be interested in knowing the risks to which they are exposed.
- Policymakers and pension reformers are likely to be interested in addressing the design of pension schemes, governance issues, and performance as well as in improving the performance of public pension funds as part of their effort to instill financial and fiscal discipline throughout the economy.
- Academicians are likely to be interested in analyzing the aspects of governance in the private sector that are transferable to public schemes.

The remainder of this paper is structured in the following way. Section I presents evidence from the literature linking the performance of public pension funds with their governance. Section II focuses on governance issues of the pension governing body, it indicates the need to distinguish between the governance of public and private pension funds, and it presents governance practices in select countries. Finally, conclusions follow in Section III, where lines for future research and work are highlighted.

I GOVERNANCE AND PERFORMANCE

A relatively large body of the literature underlines the importance of governance for the performance of public pension funds.[2] For instance, Iglesias and Palacios (2000: 35) observe, "The worst returns are produced by publicly managed pension funds in countries with poor governance records." Figure 1 summarizes this statement by plotting the average real return on public pension assets for twenty developing and developed countries against a governance index.[3] The relationship is highly nonlinear, with rapidly diminishing (but positive) marginal returns to governance levels. In other words, countries like Uganda could improve considerably the rate of return on public pension assets by making very limited improvements in governance practices.[4] For many of these countries, investment returns of public pension funds are often below bank deposit rates and almost always below the growth of per capita income.

[1] From a social policy point of view, one could argue that the issue of fund management is not a high priority in countries (African countries, for instance) where the covered labor force is, on average, only 10 percent of the total labor force. However, it could be also argued that, if existing governance structures are not improved, it will be difficult to address the more important problem of poverty during the retirement age.

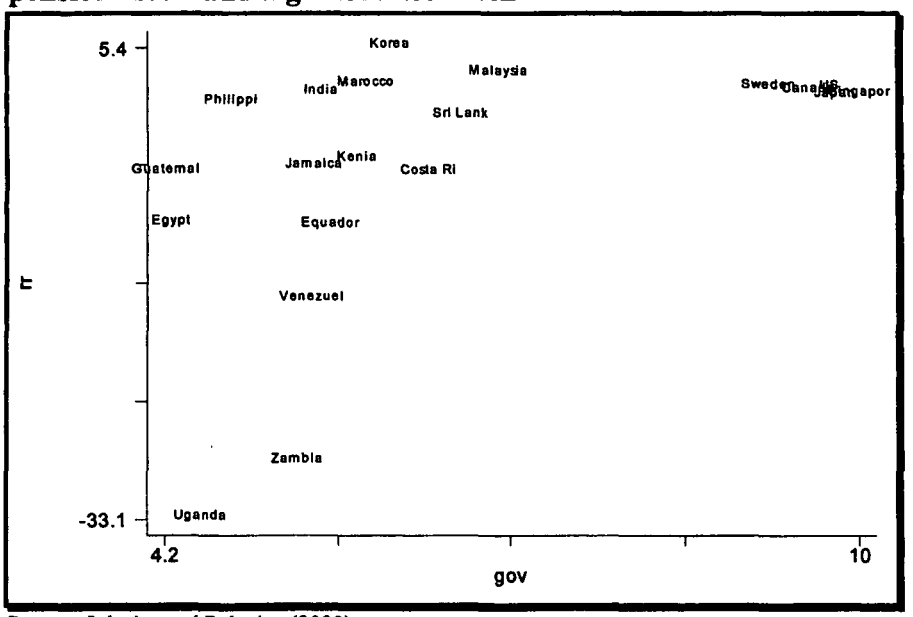
[2] The text refers to four main pieces of work: Ambachtseer (2001), Iglesias and Palacios (2000), Mitchell and Hsin (1997), and Useem and Mitchell (2000). Further references can be found at the end of this paper and in the references there listed.

[3] See Iglesias and Palacios (2000) for details.

[4] Notice, however, that the relationship presented does not imply causality, just correlation.

Factual evidence also links this poor performance to undue political interference in the investment decision of public funds. Governments have often imposed on financial intermediaries explicit social and developmental objectives that undermine their financial viability. When explicit mandates are absent, governments have often relied on their powers of coercion to ensure sufficient demand for their debt to finance public expenditure or demand for other securities to finance well-connected entrepreneurs and public enterprises. Sometimes regulations require commercial banks to meet reserve and liquidity requirements by holding government paper. Other times, and both in developing and in developed countries, commercial banks, insurance companies, pension funds, as well as social security funds are required to invest in government bonds, sometimes in specially issued nonmarketable instruments with substantially below-market yields.

Figure 1. Correlation between average real return on public pension assets and a governance index



Source: Iglesias and Palacios (2000).

Among public pension funds, many countries impose a minimum quantitative floor for assets to be invested in government paper, and politicians are often allowed to have a say in the investment policy of social security funds.[5] Obviously, these policies can greatly

[5] In the Philippines, the Social Security System (SSS) and the Government Service Insurance System (GSIS) are "offered" tax-free government bonds that remain tax free to the extent that they are not subsequently traded, effectively forcing the two social security institutions to hold these assets until maturity. In Singapore, the Central Provident Fund is required to invest a large share of its assets in nonmarketable government securities; and only until recently this share was 100 percent. In the Philippines, SSS and GSIS were often instructed to provide direct lending to industries to which commercial banks refused to lend. In Mexico as well as in the Philippines, a large share of pension contributions have to be invested in housing, INFONAVIT and Pag-IBIG, respectively. The real returns on the assets of these "specialized" institutions have been rather disappointing (Impavido, Musalem, and Vittas 2001). Also, as discussed in Mitchell (2001), the Malaysian Employee Provident Fund was used to keep insurers solvent, and the Korean Pension Fund was forced to lend two-thirds of its assets to the Ministry of Finance for "social" purposes. The Korean investment companies (mutual funds) have received loans from the Central Bank with the mandate that they must support the stock market. African social security plans are required

reduce the credibility of the macroeconomic stance in countries with a poor record of economic discipline.

Even countries without explicit social mandates for pension funds often limit investment abroad, with the implicit rationale that local savings should be used to develop the local economy. Is localization of investments justified? Should exchange controls be applied to contractual savings? Fontaine (1997) surveys the Chilean experience with foreign investment by pension funds and concludes that there are no (good) macroeconomic reasons to treat international investment by pension funds differently than local investment.[6] In other words, foreign investment by pension funds should be subject to the same (*mutatis mutandis*) rules of diversification applied to domestic investments. Indeed, policymakers should allow foreign investment by public pension schemes in order to diversify away local risks. Countries that need to impose foreign investment restrictions on the stock of contractual savings assets (public or private) because of balance of payments concerns are countries that have an unstable macroeconomic environment. These countries need to stabilize their economies first.

Table 2. Drivers of organizational performance

Governance
My governing fiduciaries have good mechanisms to understand and communicate with plan stakeholders.[a]
My governing fiduciaries do a good job of balancing overcontrol and undercontrol.
Our fund has an effective process for selecting, developing, and terminating its governing fiduciaries.
My governing fiduciaries and related committees use their time efficiently (focused and do not waste time).
There is a high level of trust between my governing fiduciaries and the pension investment team.
There is a clear allocation of responsibilities and accountabilities for fund decisions between the governing fiduciaries and the pension investment team.
Planning and management
I can describe our vision of where we should be in the future.
I can describe our fund's strategic positioning (how we provide better value to stakeholders than alternatives).
I can describe our resource plan (obtaining and optimally utilizing the required human, financial, and information technology resources).
Developing our asset mix required considerable effort on the part of myself and the governing fiduciaries, and it reflects our best thinking.
Operations
My organization uses its time efficiently (well focused and does not waste time).

Notes: a. Governing fiduciaries are members of the governing body.
Source: Ambachtseer (2001).

In a work of a different flavor (and focusing on private pension funds), Ambachtseer (2001) also finds that organizational performance is strongly correlated with governance

to invest in mortgage loans and often asked to be direct developers. The Alaskan Retirement System lost around $80 million from its housing investments (mortgages and real estate) when the price of oil fell and with it the value of properties and the ability of borrowers to repay the loans. In the second half of the 1990s, the National Social Security Fund of Tanzania (NSSF) was investing in personal loans and in huge residential and commercial buildings despite financial guidelines from the Central Bank requiring that social security funds be used to purchase liquid assets.

[6] Only in March 1990 were pension funds allowed to invest abroad, almost ten years after the pension reform. At that time, regulation allowed foreign investment of up to 3 percent of the portfolio in fixed-income securities issued by low-risk countries and banks. In 1995 investment in foreign shares was allowed with a limit of 12 percent of the total portfolio.

indicators. Fifty private pension fund executives were asked to list the most important "drivers" of organizational performance (Table 2). Six out of the eleven performance drivers identified are statistically significant at the 5 percent level and belong to the category of good governance.

Useem and Mitchell (2000) use two surveys of U.S. state and local pension systems carried out in 1992 and 1993 to show that the way public pensions are governed has an impact on investment strategies and how assets are invested. This, in turn, directly affects fund performance. Governance variables comprise indicators that are related to the structure of public pension governing bodies as well as rules that guide its oversight of fund assets. These variables are regulatory restrictions on international investments, independent performance evaluation, board composition and size, and responsibility of the board for setting investment policies and for choosing investments. Variables related to the investment strategies used are step dummies for the use of tactical investment, external fund management and some internal fund management, and the share of equities in total asset portfolios.

Table 3. Impact of governance on public pension investment strategies

Explanatory variables: Governance policy	Tactical investment	Equities as percentage of total	All external management	Some international management
Investment restrictions	-1.44	-7.59	-0.41	-0.24
	(0.46)**	(2.34)**	(0.39)	(0.33)
Independent performance evaluation	-1.60	14.08	0.55	1.48
	(0.38)	(2.34)**	(0.41)	(0.38)**
Board purview				
Board sets asset allocation	1.88	3.97	0.75	-0.41
	(0.40)**	(2.64)	(0.42)	(0.37)
Board is responsible for investment	-0.12	1.59	-0.11	0.05
	(0.37)	(2.15)	(0.36)	(0.30)
Board composition and size				
Number of governors	-0.54	0.63	-0.11	0.09
	(0.57)	(0.31)*	(0.05)*	(0.04)*
Plan participants as a percentage of governors	0.14	-4.28	-1.23	0.67
	(0.66)	(3.97)	(0.70)	(0.58)
R^2 or log-likelihood/concordant pairs	209/82.2 percent**	0.226**	219/76.7 percent*	293/62.1**

Note: ** $p < 0.01$, * $p < 0.05$. Regressions are based on 254, 243, 215, and 235 retirement systems, respectively; linear regression for equities is as a percentage of total; logistic regression is for other variables. Standard errors are in parentheses.
Source: Useem and Mitchell (2000).

Table 3 shows that, in general, governance variables explain a large share of the variability of the investment strategy variables. However, not all governance indicators are always individually significant. International investment restrictions are highly significant in explaining whether funds adopt tactical investment strategies or whether funds invest a higher share of assets in stocks. Nevertheless, they are not significant in explaining the decision of pension funds to use internal, external, or a combination of internal and external asset managers. Independent performance evaluation is highly significant at explaining all of the investment strategy variables except the decision to outsource all asset management. Finally, the number of governors appears to be

associated with a larger share of asset portfolios in stocks, but the presence of plan members' representatives has little significant impact on any of the investment strategies.

Table 4. The most important single determinants of key investment strategies

Investment strategy	Most important governance determinant
Allocation of funds into equities	Independent performance evaluation
Placement of funds in equity indices	Board responsible for investments
Long-term investing	Board responsible for setting asset allocations
Tactical investing	Governors elected by plan participants and investment restrictions
External management portfolio	Number of governors
At least some international investing	Independent performance evaluation
Investor activism	Governors elected by plan participants
Social limiting	None
Economic targeting	None

Source: Useem and Hess (2001).

Useem and Hess (2001) obtain similar results using surveys of U.S. state and local retirement systems conducted during the 1990s. They identify seven determinants of governance that are consistently associated with seven key investment strategies, as shown in Table 4.

Table 5. Impact of governance on public pension fund performance

	Dependent variable: Rate of return on assets	
Explanatory variable	(1)	(2)
Governance Policies		
Investment restrictions	-0.23 (0.59)	-0.16 (0.59)
Independent performance evaluation	0.81 (0.67)	0.43 (0.72)
Board purview		
Board sets asset allocations	-0.72 (0.71)	-0.48 (0.76)
Board is responsible for investments	0.18 (0.51)	0.43 (0.55)
Board composition/size		
Number of governors	-0.08 (0.06)	-0.15 (0.07)*
Share of plan participants	-1.16 (10.6)	-1.16 (1.07)
Investment Strategies		
Tactical investing of assets	1.69 (0.65)*	1.25 (0.69)
Equities as a percentage of total assets	0.07 (0.02)**	0.07 (0.22)**
External management of all assets	0.58 (0.58)	0.71 (0.58)
International investment of some assets	2.17 (0.52)**	1.87 (0.56)**
Other Controls		
Investment risk [a]		0.05 (0.09)
System assets (ln)		0.41 (0.30)
Multiple R^2	0.38**	0.41**

Note: *$p < 0.05$, ** $p < 0.01$. Regression is based on 104 retirement systems; linear regression is for return on assets. Standard errors are in parentheses.
a. Standard deviation of annual return on assets for 1988–92.
Source: Useem and Mitchell (2000).

Although governance indicators have a direct impact on investment strategies, Useem and Mitchell (2000) do not find a direct impact on performance, measured as the annual rate of return on assets one year later and shown in Table 5. Only investment strategy variables are found to explain a relatively large variability of fund performance, and these

results do not change when controls for investment risk and portfolio size are taken into consideration (regression 2).

Indeed, two of the investment strategy variables—equity and international investing—are associated with higher fund performance the following year, with a coefficient that is significantly different from zero at less than 1 percent level of significance.[7] From this analysis, the authors conclude that governance of public pension funds affects performance only indirectly by determining key investment strategies; these strategies are associated, in turn, with higher performance.

Table 6. Determinants of public pension fund investment returns

	Dependent variable	
Explanatory variable	1990 return	Five-year average return
Pension board composition		
BDELAC	-0.01 (0.02)	-0.02 (0.01)
BDELRT	-0.17 (0.07)**	-0.002 (0.05)
Pension management practices		
ADINVST	-0.34 (0.89)	-1.24 (0.58)**
INVINHS	0.80 (1.36)	0.60 (0.92)
TOP10MG	-0.49 (1.32)	-0.32 (0.86)
TOP10*EXT	-0.08 (1.78)	1.03 (1.17)
Pension investment practices		
INSTATE	-0.08 (0.04)*	-0.02 (0.02)
PRUDMAN	0.83 (1.20)	0.33 (0.84)
STKMAX	-0.03 (1.18)	0.57 (0.86)
Pension reporting practices		
INDINVPF	-1.16 (1.00)	-0.57 (0.68)
FREQVAL	0.70 (0.54)	0.13 (0.56)
R^2	11.3	12.4
N	158	132

Note: ** pval > 0.01, * pval > 0.01.Both models also include a constant term as well as controls for plan type, plan size, and the fraction of the plan assets held in bonds and stock. Standard errors are in parentheses. Mitchell and Hsin (1997) give the following definitions of variables used: BDELAC, fraction of pension boards elected by active employees (percent); BDELRT, fraction of pension boards elected by retired employees (percent); ADIVNST, administrative costs charged to pension investment income; INVINHS, investment staff of pension portfolio partly (or fully) managed in-house; TOP10MG, some investments handled by top-ten money managers; TOP10*EXT, plan investments handled exclusively by top-ten money managers; INSTATE, fraction of pension investment that must be directed in-state; PRUDMAN, pension board required to act according to "prudent man" rule; STKMAX, maximum limitation on assets in the pension portfolio; INDINVPF, use of independent investment performance evaluations; and FREQVAL, frequency of independent investment performance evaluations.
Source. Mitchell and Hsin (1997).

Finally, Mitchell and Hsin (1997) use a survey of 201 U.S. pension systems conducted in 1991, covering 269 separate retirement plans, to link governance and information

[7] A non quantified selection bias may partly explain the results obtained. The authors note that data on all variables were available for only half of the plans surveyed. Plans providing full information were found to have the same average performance but higher shares of equities and foreign assets in their portfolios than plans providing only partial information.

disclosure variables with funding levels or with practices and performance. The governance and information disclosure indicators used are pension board composition, board management practices, and reporting requirements and assumptions.

As shown in Table 6, Mitchell and Hsin (1997) find that composition of public pension boards is significantly associated with performance.[8] They explain the negative association by the fact that these representatives make more conservative investment decisions than the representatives of other boards. However, they do not conclude that retiree participation on pension boards is to be avoided or discouraged. Finally, contrary to Useem and Mitchell (2000), they find that the presence of independent evaluation is not correlated with performance. This last result is probably due to the presence of the reporting frequency variable, which tends to offset the expected positive impact of independent performance evaluation.[9]

In summary, governance has a significant impact on public pension performance. The literature surveyed finds that inconsistent performance is associated with indicators of poor governance. However, a direct link between governance and investment performance cannot be established with U.S. data, although governance indirectly affects performance by determining key investment strategies. A few results are contradictory, like the impact of the size and composition of the board. Other results are more clear-cut, like the fact that independent performance evaluation is associated with better investment policies and that frequent performance evaluation is not significantly associated with performance. Evidence for developing countries—some empirical, most factual—clearly indicates that the poor governance (that is, the inability to isolate fund management from political risk) is an important determinant of poor performance. Further research is clearly needed, especially to identify in developing countries the governance elements or mechanisms that are necessary to improve public pension fund management and hence performance.

II TOWARDS A DEFINITION OF PUBLIC PENSION FUND GOVERNANCE STANDARDS

This section makes a preliminary attempt to define the elements of good governance necessary for public pension schemes. The discussion is based on the empirical and factual evidence presented earlier as well as on key concepts imported from the literature on governance of private pension funds. Limitations of this approach are also highlighted.

The term governance refers to the manner in which an institution is governed and regulated, its method of management, or its system of regulations. In the context of pension funds (public or private), this assumes a more specific connotation; it refers to the manner in which authority or power is exercised to fulfill duties and obligations to a constituency or stakeholders. With respect to a public pension fund, authority is vested in

[8] This is contrary to the findings of Useem and Mitchell (2000), who find that representation of plan participants is not significantly correlated with performance, while Mitchell and Hsin (1997) find that participation of retirees on public pension boards is negatively correlated with performance.

[9] The regulatory requirement to invest locally in-state (INSTATE) has a significantly negative impact on 1990 performance. Localization of investments is one of the practices often used in developing countries to "develop" the local economy; this is often thought to explain poor performance because it sacrifices appropriate diversification of the portfolio.

the administrator (for example, the governing body or the state), and the constituency consists of the beneficiaries. Duties and obligations should be specified by law or in the trust agreement, plan document, and other related documents (custodial, investment management, and insurance contracts). In summary, good governance is a function of the responsibilities and accountabilities of key groups in the organization, as well as of the presence of qualified and trustworthy staff to discharge those responsibilities.

This definition makes governance endogenous and raises several major issues: the definition of a public pension plan, the definition of stakeholders in public pension plans to which key groups are accountable, the definition of the manner in which the governing body is elected and exercises its power, the definition of responsibilities of the governing body, and the way in which the governing body is made accountable. These issues are addressed in the remainder of this section.[10]

II.A What is a public pension plan?

The issue of what makes a pension plan "public" is rather complicated. It is difficult to devise a unique metric that classifies all existing pension funds into public or private. This paper categorizes public pension funds as funds with publicly centralized management and, hence, with governments as important stakeholders.[11]

Despite the obvious difficulty of defining what is public in pension plans, their *raison d'être* is identical to that of private pension plans: that is, the provision of an affordable and sustainable retirement income.[12] In other words, and in order for this to be achieved, the plan should have no objectives other than the one just mentioned. The objective or mission should be clearly stated in order to facilitate the adoption of measurable goals against which the performance of the plan and of its governors and administrator can be measured. It should not include social and developmental objectives, as is often the case in developing countries.

The Canadian legislated requirements draw a sharp distinction between the investment mandate of the Canadian Pension Plan Investment Board (CPPIB) and that of public funds in many other nations. For example, unlike pension funds in Japan, Korea, and the United States, the CPPIB is only required to make funds available to government if it is decided that a bond portfolio is to be built and the CPPIB has not yet built one. Furthermore, it is not required to make loans to state-owned firms, it is not required to make social investments, and it is not used to implement economic development policy, as occurs in many other nations, including Sweden, Japan, and Iran (MacNaughton 2001).

[10] Table 7, Table 8, and Table 9 in Appendix A summarize governance practices in select countries.

[11] This issue warrants a more detailed analysis than is possible here.

[12] Holzmann and others (2002) advocate that retirement income should be adequate, affordable, sustainable, and diversified. Adequate refers to both the absolute level of income (preventing old-age poverty) as well as the relative level of income (replacing life-time earnings enough to smooth life-time consumption). Affordable refers to the financing capacity of individuals and the society. Sustainable refers to the current and future financial viability of different plans. Diversified refers to the source of financing of old-age income: unfunded through contributions of the working population and funded through the returns on assets and their divestment from a diversified financial portfolio. These characteristics apply to both the retirement income system as a whole and to individual plans or schemes. Indeed, affordability and sustainability should be attained at the level of individual plans, while adequacy and diversification should be attained at the level of the retirement income system as a whole.

The Norwegian Government Petroleum Fund, although strictly speaking not a public pension plan, also invests abroad because of diversification concerns.[13] The fund invests 100 percent of assets abroad in an attempt to diversify national wealth away from petroleum. Indeed, the rationale behind the diversification abroad lies in the consideration that (a) the fund should not constitute a second budget for the government; (b) petroleum activity already yields substantial foreign currency, forcing appreciation of the local currency; (c) if foreign reserves were not allowed to accumulate, a real appreciation of the currency would take place and production input would be encouraged to move away from less productive sectors of the economy; (d) eventual depreciation following real appreciation would result in misallocation of resources, as predicted in what is known as Dutch disease.

The Namibian Government Institution Pension Fund (GIPF) has no social mandate to invest in targeted industries, and investment regulation aims at achieving liquidity and diversification of risk. Foreign investment is allowed. However, at least 35 percent of pension fund assets must be invested within the borders of Namibia, while foreign investment is restricted to a maximum of 15 percent of total assets. This excludes South Africa, where, at present, the GIPF invests 55 percent of its assets.

In Ghana, the Social Security and National Insurance Trust (SSNIT) also aims to maintain the financial viability of the plan. Investment managers are required to invest in safe assets with adequate yield and liquidity. Rules for asset diversification are followed to ensure that an optimal funding ratio is maintained and that long-term rates of return are secured for the fund (Dei 2001). However, the fiduciary responsibility of governors toward beneficiaries is compromised because the SSNIT investment policy includes a social and developmental mandate in the following areas: housing finance, student loans, and industrial estates. Although returns on these assets were not reported, Dei (2001) comments that the student loan scheme has become a burden for the SSNIT. Loans are provided to poor students at a subsidized interest rate up to a university education. Loans are repaid through social security contributions, and repayment can take up to ten years. The number of students has increased considerably, but postgraduate unemployment has also increased. Since loans are indexed to inflation, their value also has increased considerably. Finally, the government delays the payment of interest subsidy to the SSNIT.

A similar judgment can be made for the National Pension Fund (NPF) of Korea and the Indian Employee Provident Fund (EPF). As discussed in Han (2001), the objectives of the Korean NPF are to (a) achieve long-term financial stability, (b) contribute to economic and social development, and (c) increase beneficiaries' welfare. Until recently, it implemented this policy by lending to the government at non market rates, purchasing non tradable government bonds, and imposing minimum deposit requirements. The EPF has no formal social mandate, but according to Rao (2001), the fund seeks to (a) ensure the complete safety of employees' funds and confidence in the system, (b) channel funds

[13] The fund was established by law in 1990. The inflow to the fund is represented by the annual surplus of the central government account. The fund is not formally a pension fund, but the government uses it to manage the budget surplus or deficit.

to the government sector, and (c) pay a reasonable return to the employee.[14] Since the EPF is a multipurpose fund, it also lends to plan participants for housing purposes.

Finally, the Singaporean Central Provident Fund (CPF) also has many objectives besides retirement. It administers schemes covering housing, medical savings accounts, and cursory education and permits extensive pre-retirement withdrawals for investment in real estate, financial assets, and even gold and commodities. Several accounts are set up for specific needs. The housing account, for example, can be used to purchase a house, which is the predominant expense for most members.[15] A medical account is used to pay for hospital services, certain outpatient services, and catastrophic health insurance premiums, which cover between 20 and 40 percent of the average hospital bill.

II.B Who are public pension stakeholders?

The understanding of who are public pension stakeholders allows us to identify to whom the authority charged with administering the system should be accountable. The key stakeholders in any pension system are the participants: that is, current contributors. In addition, other stakeholders can have vested interests in the design and operation of the system, such as retirees (especially when the system is unfunded and provides insurance for longevity risk) as well as other beneficiaries, such as survivors and dependents. Since participants are the central stakeholders of all pension systems, Western trust law holds that a pension plan must be managed solely in their best interests.[16]

The government is a legitimate stakeholder in any public pension system. Indeed, public pensions can be assimilated to other public goods, and the government, as plan sponsor, has a keen interest in how the plan works, how expensive it is to run, and how the pension assets perform (to the extent the plan is funded). Indeed, public pension obligations are contingent liabilities of the government. Other public agencies could have vested interests in the design and operation of the system, depending on the role that existing regulations give to these agencies. These could include, for instance, legislative bodies and regulators, tax authorities, investment managers, and other entities charged with budgeting in the public domain.[17]

Finally, taxpayers and general lenders to governments are natural stakeholders of any public pension system. Taxpayers and lenders are the ultimate source of financing used to make good on underfunded promises of a pension in publicly managed defined-benefit, pay-as-you-go plans.

[14] Despite the absence of an explicit social mandate, the allowance of drawdowns on assets makes it seem that providing adequate return to all employees is not an official objective. The EPF permits withdrawals for specific purposes, like housing, major medical expenses, children's education, and marriage. Many contributors make use of this ability. In fact, almost everyone who buys a house uses the provident fund to do so. The same is true in Singapore.

[15] Thirty percent of contributions go toward funding this account.

[16] This holds for private sector employees under U.S. ERISA law and also applies in the United Kingdom.

[17] In the United States, for instance, the Internal Revenue Service plays a key role in determining what pension contributions may be set aside on a pretax basis and in allowing the inside buildup to be similarly tax free until the payout phase (Mitchell 2001).

II.C Key groups: the governing body

Governance elements should apply to all key groups in a pension plan: the governing body, management, and junior staff.[18] This section focuses on the governing body, which is the entity with the highest level of governance authority as defined by the terms of the law or other regulations. In Western common law, it usually takes the name of board of directors or board of trustees, while in French-speaking countries, it takes the name of *conseil d'administration.* Its identification should be independent of any nominal label, but strictly related to its role and responsibilities.

The remainder of this section discusses issues related to structure and qualifications, roles and responsibilities, and accountability and information disclosure.

II.C.1 Structure and qualifications

In many countries, the governing bodies of public pension funds are populated with representatives of interested parties. This usually means the government, as plan sponsor or employer, some form of representation of private sector employers, and some form of representation (usually unions) of contributors. For instance, the governing body of the Korea National Pension Fund follows this model. The Fund Operating Committee—the governing body—is composed of twelve representatives of the insured and seven government representatives.[19] However, two specialists are also on the board: the presidents of the Korean Development Institute and the Korean Institute for Health and Social Affairs (Han 2001).

Another example of a public pension plan with a representative board is the Central Provident Fund (CPF) of Singapore. The CPF board is composed of twelve members with representation from the government, employers, employees, and professionals. A key challenge for the CPF is to ensure that competent and independent governors are appointed to the board (Asher 2001). As of today, no piece of legislation requires the appointment of qualified and independent governors who operate in a prudent manner in the sole interests of beneficiaries.

The Namibian governing body (GIPF) is composed of nine members, three appointed by the Office of the Prime Minister, three appointed by recognized labor unions, and three appointed by the Public Service Commission (Hango and Jensen 2001).

Finally, the governing body of the Indian Employee Provident Fund is composed of thirty-seven members: the minister of labor, the central provident fund commissioner, five federal government representatives, five state government representatives, ten employer representatives, and ten employee representatives (Rao 2001). The chief

[18] Indeed, the importance of these three groups is underlined in Ambachtseer and Ezra (1998), who define them as governing, management, and operational fiduciaries.

[19] The twelve representatives of the insured include three representatives of the employees, three representatives of the employers, and six representatives of farmers, fishermen, and other rural beneficiaries. The composition of the Committee for National Pension Fund Operation (NPFO) was changed in 1998 as part of a reform of the National Pension Fund. The minister of health replaced the minister of finance as chairman, and the number of members was increased from eleven to twenty. The members include the vice ministers of finance, agriculture, industry, and labor, the president of the National Pension Corporation (which administers the NPF), three representatives of employers and employees, respectively, six representatives of farmers, fishermen, and the self-employed, and two pension experts.

executive officer of the EPF is also on the board of governors, violating the principle of separation between governing and managing fiduciaries.

In general, due to the absence of proper incentive mechanisms in the appointment procedures of governors, these tripartite boards can be directed by fiduciaries not necessarily fit and proper for their role. Indeed, the main concern about tripartite boards is their lack of independence. In many developing countries, the politicization of representatives on the board often means that funds are invested imprudently and not necessarily in the interest of beneficiaries but rather in the interest of the sponsor's other public policies. Even in more developed countries, it is possible to link the difference in performance between private sector pension funds and public pension funds to the composition of their respective boards of governors. Mitchell and Hsin (1997) argue that a possible explanation for why the investment portfolios of U.S. public plans yield consistently lower rates of return than portfolios of private sector pension funds is that the two sets of funds operate under different rules. Private sector funds are managed by professional and qualified governors with a clear economic mandate, while public pension funds are managed by staff responding to economic as well as political pressures. The governing body of public funds typically is composed of eight members: three elected members (usually active employees), three appointees (often appointed by the state governor), and two ex officio members (such as the state treasurer or superintendent of schools).[20] Thus the better performance of private pension funds is hypothesized as being a result of the professional nature of their governing fiduciaries. Mitchell and Hsin then test this hypothesis on a sample of 168 public employee retirement systems using dummies for the presence of active employees and retired beneficiaries on the governing body. They find that the presence of retired beneficiaries on the governing body is associated with lower returns and conclude that either the type or the inappropriate selection of governors negatively affects performance.

Hence, two questions become relevant: (1) what are the appropriate qualifications for governors? and (2) how can independence of governors from political power be ensured?

Prudence (and logic) should demand the following from a governor of a pension plan:

- Governors should understand financial markets, risk management, and actuarial principles.
- Governors should be prepared to study and understand the promise and policies of the pension plan.
- Governors should clearly understand their conflicts of interest and commit to resolve them in favor of the plan's beneficiaries.
- Governors should enunciate and follow an appropriate code of conduct, behave only in an ethical fashion, and clearly understand their fiduciary duties.
- Finally, some basic criteria should be used in selecting governors so that persons without the morale status required by the position are excluded. Thus

[20] Mitchell and Hsin (1997) analyze the governance structure and performance of public employee retirement systems, which are established by state and local governments for individuals like teachers and other school employees, police and firefighters, judges, and other civil servants.

governors should not have been convicted of any criminal offence or have received significant civil penalties in relation to the administration of a pension plan or its governing body. They should not have been involved in insolvent or bankrupt companies.

MacNaughton (2001) discusses how this is achieved in Canada. The twelve members of the board of the Canada Pension Plan Investment Board are selected for their investment and business expertise in areas such as economics, accounting, actuarial science, finance, investing, banking, and business in general. The requirement for relevant expertise and experience is set out in legislation. This is quite different from most of the public pension funds around the world, which typically are governed by nominees or representatives from government, unions, and employers.

In order to ensure that the appointed governors are both qualified and independent from management and the sponsor of the plan (the government in case of publicly managed pension plans), a transparent and credible mechanism is needed for appointing and electing them. This should be an open and transparent process in which the sponsor consults independent bodies, such as Parliament or other expert committees.

The process for nominating the directors of the CPPIB provides a good example of how to de-politicize the nomination of governors of public pension plans (MacNaughton 2001).[21] In Canada the federal finance minister and the finance ministers for the nine participating provinces appoint a nominating committee. Each government nominates one committee member. The federal finance minister chooses the committee chair among chief executive officers of private sector companies. The committee identifies a set of qualified (as previously defined) prospective candidates from across Canada. The committee must agree on the list of qualified candidates, which is referred to the federal finance minister. The federal finance minister then consults with his provincial counterparts on the proposed names and appoints directors from the list of nominees recommended by the arm's-length committee. The federal finance minister also appoints the chair of the CPPIB, but again, in consultation with his provincial finance minister counterparts and also in consultation with the directors already appointed. Once appointed, the directors serve a three-year term, renewable three times. The CPPIB chair can serve a fourth term, for a total, potentially, of twelve years. No director may be removed from the board during his or her term of office other than for cause. This means that, during any three-year period, nobody can be removed from the board for any reason other than illegal or immoral conduct.

Finally, an appropriate balance should be sought on the number of governing fiduciaries. A large number of governors could ensure independence from government if

[21] Independence from political interference is also achieved by having two separate juridical persons for the Canada Pension Plan (CPP) and the CPP Investment Board (CPPIB). The CPP is the exclusive responsibility of the federal and provincial governments. Through the CPP, these governments are responsible for the design, administration, and funding policy of the plan. For example, they set contribution rates, and they determine the benefits, with the federal government actually collecting contributions and paying benefits. The CPPIB is a separate Crown corporation with the only mandate being to invest funds transferred from the plan. The CPPIB has no policy or administrative responsibility for the plan itself. Not only is it governed and managed independently of the CPP, but it also is governed and managed independently of governments.

they are appointed outside the ranks of civil servants. However, a small number of governors usually ensures that the work is done because it reduces the incentive of individual free riding on the contributions of others. The number of governors should be limited to maximize effectiveness of the board.

II.C.2 Role and responsibilities of the governing body

A pension business should be governed and monitored by individuals who have accepted the responsibility to keep the stakeholders' objective for the business clearly in mind. Hence, pension governors should be responsible for the performance of the fund. They may not necessarily be required to devote their full time and attention to the pension plan's affairs, and they are not expected to manage the plan on a daily basis. However, they are expected to oversee the business and affairs of the plan. Ongoing management of large plans should be delegated to a senior manager or group of managers who are responsible to and report to the board on a regular basis. In other words, "governing" functions and responsibilities should be clearly separated from "managing" functions and responsibilities. Different individuals should belong to each of these groups.

The law of fiduciary duty should define the responsibilities of governors. Legally, governors should act as owners of the assets (to ensure accountability) and on behalf of the beneficiaries and must exercise the care, skill, and diligence of a prudent person in carrying out their duties. Fiduciary obligations normally extend to and include the following:

- Complying with legislative requirements,
- Communicating to members their rights and entitlements,
- Ensuring that actuarial valuations are performed for defined-benefit plans,
- Ensuring that required contributions are remitted to the plan in a timely manner,
- Ensuring that funds are prudently invested,
- Ensuring that the payment of benefits is correct, timely, and in accordance with terms of the plan and the law, and
- Ensuring that the level of funding is appropriate; this is likely to be different from private sector pension funds because taxpayers (and other lenders) are the ultimate source of public pension funs.

The objectives of governors should be clearly included in the relevant sets of regulations. For instance, the Canadian legislation sets two main objectives for the governors of the Canada Pension Plan. First, governors are to manage the cash transferred to them in the best interests of the contributors and beneficiaries. That means that monies must be invested in the best interests of, currently, about 16 million people. Second, governors are expected to maximize investment returns without incurring undue risk of loss. Furthermore, they are not to conduct any business that is inconsistent with these two objectives (MacNaughton 2001).

In meeting their fiduciary obligations, pension governors should decide the main goals and policies for the fund. These could include and exceed the following:

- Governors should decide how much balance sheet risk is acceptable and what returns are targeted for given levels of risk.
- Governors should hire or fire the organization's chief executive officer.
- Governors should approve the business plan.
- Governors should monitor outcomes versus target expectations and establish a system of compensation linking the economic objectives of the plan to the remuneration of management.

The governing body can be divided into separate committees with separate responsibilities, such as for investment, auditing, human resources and compensation, and governance. Government bodies should have a process for evaluating their own performance and that of their committees. In particular, the investment committee should establish both an investment policy and an implementation policy covering issues such as asset allocation and active versus passive management.

Management fiduciaries should be responsible for the day-to-day operations and execution of the policies established by the board, and they are bound by their fiduciary responsibility. They should be constituted as independent from the board but still report to the governing body through a chief executive officer. This is typical of large funds. However, smaller funds might decide to outsource specific functions, such as asset management, to external providers in an effort to reduce the large sunk costs of many aspects of pension fund management. Notwithstanding the outsourcing arrangements, integrated management is essential. Even though oversight is separated from management, the presence of a CEO ensures that the pension fund is managed as an integrated business entity.

In meeting its fiduciary obligations, the operational management should assemble the necessary human and operational resources. It should define a strategy for meeting the investment targets and identify tactics for implementing that strategy. It should develop systems to measure the success of the strategy and tactics. It should advise the governing fiduciaries on balance sheet risk policy. It should analyze and report outcome versus target policy and investment performance to the governing body.

In summary, the governing body should represent the best interests of the stakeholders. For public pension plans, these stakeholders include, among others, the government, plan participants, beneficiaries, taxpayers, and eventually other government agencies. The responsibility of the board should be to review and approve the policies and strategies, provide oversight of management, and compensate management according to its performance. Management should be responsible for all aspects of the ongoing operation of the organization within the approved policies, strategies, plans, and budgets. It should implement policies, strategies, annual business plans, and budgets and present them to the board for approval.

II.C.3 Accountability and information disclosure

Without a system of accountability, governance cannot be improved. In general separation between ownership and management dictates that the governing body should report to the plan stakeholders, and management should report to the board. This principle should be supported by a strict system of internal controls that regulates the activities of fiduciaries and by commitment to public transparency and reporting.

For private sector pension funds, accountability over governance functions is particularly important in order to allow the supervisory authority and members and beneficiaries of the plan to sanction or discipline the governing body in case of bad management. The legal basis for accountability is personal liability. Insurance for personal liability can further ensure the ability of the pension fund to recover losses in case of mismanagement. Compulsory insurance of this liability, however, is rare among industrial countries, the United States being a special case. Most industrial countries, however, hold members of the governing body accountable under the law for their actions and decisions with regard to operation of the pension fund.

Accountability is more difficult to establish for public pension funds than for private ones, largely due to differences between the two types of plans. For instance, public pension plans do not have a supervisory authority, Costa Rica being a special case.[22] They also have a very large number of stakeholders. One of these stakeholders is the government, which sets financial and fiscal policies directly affecting the extent to which governors and the fund can perform. Accountability of public pension governors is limited by the fact that many of the parameters against which their performance could be measured are outside their control. Investment regulation, contribution rates, and funding policies are often established by law and may be inconsistent with the fiduciary responsibilities usually attributed to governors of private pension funds. Personal liability of truly independent governors should be established. However, the local legislative framework may inhibit the development of such a concept for public figures. Also, it may be difficult, if not impossible to insure the personal responsibility of governors of large public pension funds.[23]

If personal liability cannot be established, governors should be made accountable to an independent body representing all stakeholders. Should this representative body be the same governing body or should it be an external one? Stakeholder representation is guaranteed in tripartite governing bodies, but experience has shown that this type of representation is often highly politicized, which undermines accountability. Does a tripartite governing body meet all the standards of governing bodies in private plans that are needed to establish proper accountability? These include independence, absence of politicization, fit and proper tests, transparent and monitored standards and process for nomination, fixed period of appointment, removal with due cause, and so forth. The

[22] The Namibian GIPF can be considered another special case as it is currently supervised. However, in Namibia there is no public pension plan per se. Around 400 pension plans are registered under the 1956 Pensions Funds Act. These cover around 120,000 members of the 500,000 economically active population. The GIPF covers about 70,000 of these 120,000 members.

[23] In the United States, governors of the Thrift Savings Plan are exempted from personal liability because during the legislative process it was established that personal liability could not have been insured in the private sector.

literature has not yet provided a definite answer. Before more information is made available on the strengths and weaknesses of tripartite governing bodies, experience suggests that representation should be sought elsewhere. The local legislature seems to be the strongest candidate for this role.

In fact, the need to promote disclosure seems to support the choice of Parliament as the external and independent entity to which the governing body of the public pension fund should be accountable. Indeed, since accountability is limited in public pension funds, transparency and information disclosure become even more important than for private pension funds. But information disclosure should not be limited to the Parliament alone. All members of the pension plan should receive information on the objectives of the fund, its agenda to achieve the stated objectives, and the rights of plan members. This information should be stated in a simple and easy to understand format. Eventual changes in these objectives or rights should be reported to members and beneficiaries in a timely manner. Relevant aspects regarding the means of achieving the objectives should include the composition of the governing body, its committees, their mandates and objectives, contribution rates and benefit schedules, investment strategy of the pension fund, level of funding, and other relevant aspects of the financial accounts. Plan participants should receive, when appropriate, periodic statements reporting accrued benefits and performance of the pension fund. They should also receive information regarding conflicts of interest and remuneration of key fiduciaries.

Two other functions should be instituted to ensure accountability: auditing and custody. Although auditing can be provided internally, it should be provided externally as well. The financial activities of the fund should be audited on a regular basis. The auditor should be required to verify that the fund activity complies with all relevant regulations. The auditor also should conduct a periodic actuarial evaluation of liabilities and provide an analysis of funding levels. Obviously, custody should be provided externally only by an independent financial institution. The main function of the custodian is to carry out securities movement and control. The assignment of custody responsibility to an entity other than the asset manager is an efficient way to ensure the physical and legal integrity of the assets and to oversee the transactions of the asset manager. For public pension plans, an ideal custodian would be a truly independent central bank.

These internal controls and disclosure rules are commonly in place in plans with a good system of governance. The Canadian CPPIB, for instance, imposes tight controls on the personal investing of directors and employees. Directors and employees are required to clear trades before executing them for their personal accounts and to report on their investment activity on a regular basis. Also directors and employees are required to disclose in writing any real or potential conflicts of interest and to take appropriate steps to ensure that the interests of the CPPIB and of its contributors and beneficiaries cannot be deliberately or inadvertently compromised. In assessing these matters, both real and perceived conflicts are taken into account. The idea is to avoid the possibility that CPPIB employees will use confidential information for their personal financial benefit or for any other inappropriate purpose. This is important in order to build and maintain public confidence in the integrity of the CPPIB staff and the CPPIB itself.

Additional checks and balances are also in place for the same purpose. They include (a) the appointment of an independent, outside accounting firm to review the CPPIB

operations and record and to report directly to the audit committee, (b) a procurement policy covering the selection of outside organizations and suppliers, (c) an external custodian selected through a rigorous process of due diligence, and (d) the determination of signing authorities and limits to protect cash and portfolio assets. These illustrate the range of policies that the CPPIB has adopted in an effort to earn and nurture the public trust.

The CPPIB also has a strong commitment to public transparency and reporting. A report is published annually and is distributed to the federal and provincial finance ministers. The report includes audited financial statements, a statement of corporate governance practices that sets out the duties, objectives, and mandate of the board of directors, the board's committees and their composition, mandates, and activities, the decisions of management requiring the board's prior approval, the procedures in place for the board to assess its own performance, and the director's expectations with respect to management.

The CPPIB has a legislative requirement to include in the annual report a discussion of the objectives for the past year and how these have been met as well as objectives for the coming year. Annual returns for the Canadian, international, and total portfolios are calculated and disclosed. This information is also provided in an annualized format so that Canadians can compare recent performance with long-term performance. The fund is required to disclose the total compensation of the top five officers, as well as the total compensation of the directors and executive officers. All of this is presented and discussed in the federal Parliament and the provincial legislatures, and it is made available to all interested Canadians.[24]

The Namibian GIPF also generally complies with these principles of accountability and disclosure. The pension act requires the use of external auditors. An investment consultant, who advises the board and the investment committee on the selection of asset managers and also the investment strategies and policies, is also used. The board has an audit committee. However, actuarial evaluation of liabilities and analysis of funding levels are not done externally. Even if external procurement were made, the Namibian regulation would prevent the GIPF from using the services of firms not incorporated in Namibia.

Finally, the Irish National Pension Reserve Fund has included in its statute all regulation on disclosure applying to Irish private pension plans. These include a requirement for a detailed annual report with information focusing on expenses and charges, investment performance, and clear statements on how investment performance compares with the investment strategy and objectives. There have to be valuations of the fund at regular intervals and both independent evaluations and independent assessments of the investment performance. Finally, there are requirements for an annual audit of the accounts by the comptroller and auditor general (the senior auditor in the state).

[24] In fact, the annual report is sent to all members of the parliaments and legislatures, to stakeholder groups, such as trade unions, pensioner associations, business associations, economic and social policy research groups, universities, and every public library in Canada.

III CONCLUSIONS

This paper has sought to provide initial consideration on the importance of governance in public pension fund management, advocate the development of governance guidelines tailored to the public nature of these funds, underline the necessity of implementing these guidelines in developing countries where the largest share of retirement income is provided by public pension funds, and identify lines of future work and research to support the development of such guidelines.

The empirical literature on the relationship between governance and public pension fund performance, based largely on U.S. data, indicates that governance determines key investment strategies that, in turn, affect performance. These results are also supported by evidence in developing countries—some empirical, most factual—clearly indicating how the absence of good governance (that is, the inability to isolate fund management from political intervention) is an important determinant of poor performance. Few detailed results are so clear. For instance, independent performance evaluation is clearly associated with better investment policies, while frequent performance evaluation is not significantly associated with performance. However, other detailed results are not so clear. For instance, it is not clear what impact the size and composition of the board have on performance, although consensus is building that governors should be fit and proper and not too numerous. Further research clearly is needed, especially to identify the governance elements or mechanisms that are necessary to improve public pension fund management and hence performance in developing countries.

Governance clearly matters. On the one hand, the importance of governance for private pension funds has been stressed for quite a long time now. In Canada, the Pension Investment Association of Canada (PIAC), the Association of Canadian Pension Management (ACPM), and the Office of the Superintendent for Financial Institutions (OSFI) have all developed independent guidelines for governance. The Canadian Standing Senate Committee on Banking, Trade, and Commerce issued a report on the governance practices of institutional investors in November 1998, which included a recommendation that pension plans in Canada adopt industry best practices with respect to plan governance. Specifically, the committee recommended that plan administrators adopt one of the PIAC, ACPM, or OSFI guidelines and report annually to pension plan members, setting out how they comply with, or exceed, the adopted guidelines and explaining why they do not comply if they choose not to do so.[25] On the other hand, the development of governance guidelines for public pension funds has lagged behind, probably because of the cross-national nature of the debate. Only a handful of countries are active in this area.

Nevertheless, consensus is building on the following statements:

- The sole objective of public pension funds should be to provide affordable and sustainable retirement income.

[25] Since the three guidelines issued by PIAC, ACPM, and OSFI in the past few years contain many common principles, these organizations have formed a Joint Task Force on Pension Plan Governance. Its purpose is to develop a common set of principles for pension plan governance and a guide for plan administrators to conduct an assessment of their governance practices.

- Governors should be independent from political power and fit and proper for their role.
- The law of fiduciary duty should define the responsibilities of governors.
- Governors should be made accountable for the performance of the fund.
- Independent performance (investment, audit, actuarial, and other) evaluations should be conducted by external and independent entities on a regular basis.
- Outside experts should be used regularly in the definition and implementation of fund policies.
- Finally, internal controls should be established to avoid conflicts of interest.

Beyond this, proper guidelines are needed to implement these concepts and to develop a satisfactory list of governance elements for public pension fund management. In order to attain this objective, an exhaustive survey of governance practices in both developed and developing countries should be carried out. This should well exceed the preliminary information reported in the second part of appendix A. It is possible that the design of this exercise will be modified with time, given the endogenous nature of the guidelines one would like to develop. The starting point could be the list of governance elements reported in the first part of appendix A, which is the result of considerations made in this paper.

Research is clearly needed on several topics. There is a need to identify what governance elements are relevant for, and specific to, public pension plans that are not relevant for private pension funds. There is a need to identify what governance elements are linked with performance specifically in developing countries. There is a need to identify what good practices of governance can be used to improve the performance of public pension fund management in developing countries and how these can be implemented.

Finally, there is a need to establish a network of public pension fund managers responsible for the development of these guidelines.

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APPENDIX A

Table 6. Preliminary guidelines for governance of public pension fund management

Governance structure	Governance element
Plan objectives	The mission statement should indicate the sole objective of providing a safe and adequate retirement income to its beneficiaries by maximizing investment returns without incurring undue risk of loss. Any other objective (social, developmental, welfare of participants, and so forth) should not be considered.
Governing body	
Structure and qualifications	Governors should be fit and proper for their role and should be independent. Appointments should be for a fixed period, and removal should be allowed only with due cause. The process of nomination should be transparent and public. An independent body should establish the criteria and process. The governing body should not be too large or too small.
Role and responsibilities	The governing body should be, by law, the ultimate body responsible for the performance of the fund. Governors' responsibilities should be defined by the law of fiduciary duty. Fiduciary duties include (1) complying with legislative requirements; (2) communicating to members their rights and entitlements; and ensuring that (3) actuarial valuations are performed (for defined-benefit plans); (4) contributions are remitted in a timely manner; (5) funds are invested prudently; (6) payment of benefits is correct and timely; and (7) an appropriate level of funding is maintained. Governors should set relevant policies to meet their fiduciary obligations and relevant performance benchmarks.
Accountability	If personal liability cannot be implemented, accountability to an independent body representing stakeholders (Parliament) should be established. Tripartite governing bodies have yielded mixed results. They are probably an alternative means for ensuring accountability if governors are fit and proper for their role, their election is transparent, and their affiliation is not with politicized groups.
Essential facilitating mechanisms	These include (a) independent evaluations of performance (investment, audit, actuarial, and so forth) by external and independent entities, (b) periodic self-assessment of governance, (c) external and independent custody of assets, perhaps by the Central Bank, (d) external as well as internal asset management for benchmarking purposes, (e) use of outside experts in the definition and implementation of policies, and (f) internal controls to avoid conflicts of interest.

Governance structure	Governance element
Information disclosure	Information disclosure is more important for public pension than for private fund management due to the limits in establishing accountability of public pension governors. The following at least should be frequently disclosed to the public: (a) the plan mission, (b) investment, governance, conflict of interest, and code of conduct policies, (c) investment process, (d) administrative cost structure, (e) investment returns of internal and external asset managers, (f) criteria for selection of key groups like governors, asset managers, auditors, custodians, and so forth, (g) results of the self-assessment of governance, (h) remuneration of key individuals and groups, and (i) all other elements that would limit accountability as relevant parameters are defined outside the governing body (investment regulation, actuarial assumptions, contribution rates, funding policies, and so forth). Disclosure to Parliament would enhance accountability.

Governance practices in selected countries

Blank cells indicate that information is not available.

Table 7. Governance practices in select countries (Europe and North America)

Governance elements	Canada	Ireland
Scheme name	Canadian Pension Plan Investment Board (CPPIB)	National Pension Reserve Fund (NPRF)
Governing body characteristics		
Independent governing body	Yes	Yes
Transparent process of governing trustee nomination	Yes. The Ministry of Finance establishes a selecting committee at the federal level This receives suggestions from state governments and prepares a short list from which the Ministry of Finance has to appoint twelve trustees	Yes The minister for finance appoints the commission, consisting of a chairperson and six other commissioners.
Legal requirements for fit-and-proper test for governing trustees	Yes. Directors need expertise to support objectives of the fund, no director may be an officer, and directors must be independent to make objective investment decisions.	Yes This requirement is in the Pension Fund Act 2000. Trustees are subject to a statutory requirement for substantive expertise and experience at a senior level in specified areas.
Tripartite boards	No	No
Governing body size	Twelve	Seven
Governing body representation	Not applicable due to its independence Government is represented in the Canadian Pension Plan and not in CPPIB.	Not applicable due to its independence.
Fixed-period appointment of governing trustees	Yes	Yes
Removal with due cause	Yes	Yes Commissioners cannot be fired without due cause
Accountability	A culture of transparency characterizes the CPPIB policies.	The commission is accountable to Parliament. The Pension Fund Act provides for accountability, annual reports, and an annual audit.
Governing body functions (as related to investment)		
Investment committee, other specialized committees, and other governance mechanisms	The CPPIB has an audit committee, a human resource and compensation committee, and a governance committee.	Yes. Investment committee
Investment policy and strategy	Yes	Yes
Performance evaluation of asset managers	Yes	Yes
Performance evaluation of governance process	Yes	Yes [CHECK]
Separation of governing and managing functions in the area of investment	Yes. Directors establish investment policies, standards, and procedures, codes of conduct and conflict of interest policies, risk management policies, and management performance policies Management develops policies, strategies, business plans, and budgets for board approval and is responsible for all aspects of operations	Yes The Pension Fund Commission is the governing body, while the NTMA is the manager.
Use of external specialists	Yes, as required Also used are external auditors, actuarial evaluations, and asset managers.	Yes. Especially in the appointment of asset managers

Governance elements	Canada	Ireland
Governing trustees subject to fiduciary obligations		
The fund has no social mandate	True. Canadian legislation sets two main objectives for the trustees of the CPPIB First, trustees are to manage the cash transferred to them in the best interests of the Canadian Pension Plan's contributors and beneficiaries Second, legislation directs trustees to maximize investment returns without incurring undue risk of loss Furthermore, any business that is inconsistent with these two objectives cannot be conducted	True No mixing of financial and social objectives The fund has only a commercial investment mandate There is a prohibition on drawdowns until 2025
Complying with regulatory requirements	Yes	Yes
Communicating members' rights	Commitment to transparency	
Ensuring remittance of contributions in a timely manner		
Ensuring actuarial evaluation of reserves	Yes, through an independent external audit firm	Yes, through an independent external audit firm
Ensuring timely and correct payment of benefits		
Investing reserves to maximize return without incurring undue risk	Yes	The investment mandate (policy) is very clear to obtain the optimal financial return, subject to prudent risk management
Diversification abroad	Allowed	Only type of investment allowed
Reporting to Parliament or other independent body	Yes The CPPIB reports annually on its activities and performance to local and federal governments as well as to Parliament	Yes

Table 8. Governance practices in select countries (Africa and Latin America)

Governance elements	Costa Rica	Ghana	Morocco	Namibia
Scheme name	Caja Costarricense de Seguros Social (CCSS)	Social Security and National Insurance Trust (SSNIT)	Caisse Nationale de Sécunté Sociale (CNSS)	Government Insurance Pension Fund
Governing body characteristics				
Independent governing body		No	No The CNSS has permanent directors from various ministries.	No
Transparent process of governing trustee nomination		No	No. Government representatives are trustees ex officio, while representatives of employers and members (unions) are elected through a random nomination process.	No
Legal requirements for fit-and-proper test for governing trustees		No	No	No
Tripartite boards		Yes	Yes	Yes. GIPF is the only pension fund in Namibia with a tripartite board
Governing body size			Twenty-four	Nine
Governing body representation			Eight representatives each for the government, the labor unions, and the employers.	Nine members, three appointed by the Office of the Prime Minister, three appointed by recognized labor unions, and three appointed by the Public Service Commission
Fixed-period appointment of governing trustees			No. Only for randomly elected trustees	
Removal with due cause			No. Many directors are ex officio	
Accountability			No, but the CNSS publishes annual reports	
Governing body functions (as related to investment)				
Investment committee, other specialized committees, and other governance mechanisms	Yes The Investment Commission is composed of six members: two of them are outsiders and appointed by the board of directors; three are the managers of the financial, modernization and development, and pension divisions, respectively; and one is the treasurer of the CCSS, who has a voice but does not vote.		No	Yes. Plus quantitative limits in law All Namibian funds must appoint a compliance officer with reporting duties to the supervisory authority Namibia Financial Institutions Supervisory Authority (NAMFISA)
Investment policy and strategy	Yes. The annual investment policy and strategy are defined by the board of directors	The investment policy of the SSNIT aims to (1) maintain the financial viability of the scheme through safety, liquidity, diversification, and adequate yield and to (2) provide investments that are oriented toward development and contribute to the national good.	No. Reserves are managed by CDG and CNSS receives a rate of return aligned with the five-year government bond instrument.	Board establishes policy, but legislation does not yet require funds to define, maintain, and monitor investment policies. These requirements are planned for a new bill.

Governance elements	Costa Rica	Ghana	Morocco	Namibia
Performance evaluation of asset managers			No	Yes, but in a legislative vacuum and largely through the appointment of independent money managers and regular monitoring of the adherence to the mandate and performance benchmarks.
Performance evaluation of governance process		No	No	No
Separation of governing and managing functions in the area of investment		No. Internal management establishes the guidelines for regular actuarial reviews, formulates investment policy, investment models, and analysis, and monitors investments.	Yes	
Use of external specialists	Yes, in the Investment Commission		No	Yes. Annual external audits and annual and triannual actuarial evaluation of reserves Appointment of independent asset managers Use of investment consultants
Governing trustees subject to fiduciary obligations				
The fund has no social mandate	False. The law requires that funds be invested for the benefit of plan members, striking a balance between yield, safety, and liquidity; however, preference should be given to those investments that would improve services of the CCSS and contribute to the benefit of the insured, to housing development projects, to the prevention of illness, and to the general social welfare.	False. The SSNIT has a social investment mandate in three social/developmental areas: housing finance, student loans, and industrial estates	No	True
Complying with regulatory requirements	Yes SUPEN supervises the compliance with regulation	Yes	Yes	Yes
Communicating members' rights				
Ensuring remittance of contributions in a timely manner			No. The responsibility belongs to the employers	
Ensuring actuarial evaluation of reserves			No	Yes, through an independent external audit firm
Ensuring timely and correct payment of benefits			Yes	
Investing reserves to maximize return without incurring undue risk		Governing trustees are indirectly responsible for maximizing returns.	No	Yes
Diversification abroad		Not allowed	Not allowed	Allowed
Reporting to Parliament or other independent body			No	

Table 9. Governance practices in select countries (Asia and the Middle East)

Governance elements	India	Japan	Korea	Malaysia	Philippines	Singapore	Thailand
Scheme name	Employee Provident Fund (EPF)	Government Pension Investment Fund (GPIF)	National Pension Fund (NPF)	Employer Provident Fund (EPF)	Social Security System (SSS)	Central Provident Fund (CPF)	Government Pension Fund (GPF)
Governing body characteristics							
Independent governing body	No	No The governing body in practice is fully appointed by the Ministry of Health, Labor, and Welfare	No The NPF is under the Ministry of Health	No The EPF is under the Ministry of Finance.	No. The Social Security Commission is directed by the secretary of labor and employment All eight members are appointed by the president of the Philippines.	No The Central Provident Fund is under the Ministry of Manpower	No The committee of the Government Pension Fund is partly composed of politicians or civil servants
Transparent process of governing trustee nomination	No	No Institutions external to the Ministry of Health, Labor, and Welfare do not seem to have access to the nomination process.			No.		No. The minister of finance establishes the criteria and procedures to elect representative members. The experts are appointed by the nine ex officio directors and twelve elected directors.
Legal requirements for fit-and-proper test for governing trustees	No				No. Only mention in the SSS Law that trustees need to have "adequate knowledge and experience regarding social security."	No	No
Tripartite boards	Yes		Yes		Yes	Yes	Yes
Governing body size	Thirty-seven	Three	Twenty		Eight	Twelve	Twenty-four Decisions are made if at least half of trustees are present.
Governing body representation	The EPF has a central board of trustees, a tripartite body whose chairman is the minister of labor and vice chairman is the labor union	Three board members; only the chairman is appointed by the minister. Other two members are selected by the chairperson with	The composition of the Committee for National Pension Fund Operation (NPFO) was changed in 1998 as part of a reform of the National Pension	EPF board has representation from the government, employers, employees, and professionals	Three workers' groups, three employers' groups, and one general public representative	CPF board has representation from the government, employers, employees, and professionals	Ex officio are the permanent secretary for finance as chairman, the budget director, secretary general of the Office of the Council of State,

Governance elements	India	Japan	Korea	Malaysia	Philippines	Singapore	Thailand
	secretary It is composed of five representatives from the central government, fifteen representatives from state governments, ten representatives of workers, and ten representatives of employers The rationale for the massive representation of employers and state government is not clear because the savings and the risks of the EPF scheme belong to workers	approval of the minister of health, labor, and welfare	Fund (NPF). The minister of health replaced the minister of finance as chairman, and the number of members was increased from eleven to twenty The members include the vice ministers of finance, agriculture, industry, and labor, the president of the National Pension Corporation (which administers the NPF), three employer and employee representatives, respectively, six representatives of farmers, fishermen, and the self-employed and two pension experts.				secretary general of the Office of the Civil Service Commission, secretary general of the National Economic and Social Development Board, the deputy governor and vice chairman of the court of director of the Bank of Thailand, the deputy secretary general of the Office of the Securities and Exchange Commission of Thailand, the position director of the General Fiscal Policy Office in the Ministry of Finance, the comptroller general of the Comptroller General's Department, the secretary general of the Government Pension Fund, twelve representatives of members, and three appointed experts.
Fixed-period appointment of governing trustees					Yes, for the seven appointed members. Plus all vacancies that occur prior to the expiration of the term shall be filled for the unexpired term only.		Yes
Removal with due cause							Removal is linked to the loss of status.
Accountability		Yes, through the Ministry of Finance			Yes	None There is no statutory obligation on holding companies to reveal	

Governance elements	India	Japan	Korea	Malaysia	Philippines	Singapore	Thailand
						investment portfolio and performance of CPF balances.	
Governing body functions (as related to investment)							
Investment committee, other specialized committees, and other governance mechanisms		No		The investment panel is separate from the board It has six members. the executive chairman of the EPF, representatives from the Finance Ministry, and private sector experts	Audit commission. The investment committee is not mentioned in the law.	The investment function is performed outside the CPF board's jurisdiction by the Government of Singapore – Investment Corporation (GSIC) and other government investment holding companies.	The Investment Subcommittee is not independent. It is constituted by the director of the Fiscal Policy Office as chairman, a representative of the Bank of Thailand, and four experts appointed by the committee. The secretary general of GPF is a member and secretary of the subcommittee. The function of the subcommittee is to advise the committee on investment and report on investment operations.
Investment policy and strategy	No. Provident fund members are credited with an interest rate determined administratively without much consideration to market conditions	Yes The board establishes investment policy and strategy.			Yes		Yes
Performance evaluation of asset managers		Yes			No. However, reserves cannot earn less than the average rates of treasury bills.	No	No
Performance evaluation of governance process	No	Not formally			No	No	
Separation of governing and managing functions in the area of investment	No The CEO of the EPF is also on the board	Yes. The board sets objectives constraints, and investment policy; monitors fund	No The president of the National Pension Corporation (which administers the NPS) is on the NPS		Yes		No The secretary general of GPF is also the director.

Governance elements	India	Japan	Korea	Malaysia	Philippines	Singapore	Thailand
		managers, custodians, and trustees; sets evaluation and selection criteria of fund managers and administrators, and establishes guidelines of in-house investment management.	board of directors.				
Use of external specialists	The EPS is required to be evaluated through a qualified actuary on an annual basis.	The board appoints a committee of outside investment experts. External asset managers are also selected following established procedure. An external audit firm is also used	No, but two specialists are represented on the Fund Operating Committee.	No, but specialists are on the board and on the Investment Panel.	No, but external asset managers can be appointed.	No	Yes. Three are appointed as trustees.
Governing trustees subject to fiduciary obligations							
The fund has no social mandate	True The Indian EPF has no formal social mandate, but according to Rao (2001) the objectives of the fund appear to be (1) ensuring the complete safety of employees' funds and confidence in the system; (2) channeling funds to the government sector; and (3) paying a reasonable return to the employee. Furthermore, in addition to retirement income, the fund also provides loans for housing		False. The objectives of the Korean NPF are to (1) achieve long-term financial stability, (2) contribute to economic and social development, and (3) increase beneficiaries' welfare.	Contributions to the EPF are channeled into three accounts 60 percent to a retirement account, 30 percent to a housing account, and 10 percent to a health care account.	True. The SSS mandate does not contain any reference to social objectives However, political influence requires SSS to invest in targeted industries on an ad hoc basis.	False. The CPF has many objectives besides retirement. It administers schemes covering housing, medical savings accounts, and cursory education and permits extensive preretirement withdrawals for investment in real estate, financial assets, and even gold and commodities.	No The GPF mission is to be a provider of good services for members, be a solid, dynamic, and modern entity; conduct the affairs with honesty and integrity; promote the development of employees' potentials; promote long-term/contractual savings; and encourage good corporate governance among financial institutions. However, the presence of the secretary general of the National Economic and Social Development Board among

Governance elements	India	Japan	Korea	Malaysia	Philippines	Singapore	Thailand
							governing trustees raises concerns of independence from political influence
Complying with regulatory requirements		Yes	Yes		Yes	Yes	Yes
Communicating members' rights	Delays of more than one year are frequent regarding the dissemination of annual account statements						
Ensuring remittance of contributions in a timely manner							
Ensuring actuarial evaluation of reserves	The EPF audit and actuarial reports are neither timely nor published. The annual audits are conducted under Section 19(2) of the Comptroller and Auditor General's Act, 1971 The EPS is required to be evaluated through a qualified actuary on an annual basis.				Only internal actuary and every four years		No
Ensuring timely and correct payment of benefits	The accumulated amount of non-credited interest reached 26 percent of total financial assets in 1998						
Investing reserves to maximize return without incurring undue risk	No. Funds must be invested primarily in public sector instruments However, participation of market-based against nontraded investments has been increasing. Fund management has no role to play: the EPF is essentially authorized to hold	The minister has political rather than economic responsibility. Most key players are public employees and managers, and their compensation is regulated and constrained by the budget			The commission manages and invests with the skill, care, prudence, and diligence necessary under the circumstances then prevailing that a prudent man acting in like capacity and familiar with such matters would exercise in the conduct of an enterprise of a like	No	The Pension Fund Act establishes the objectives and investment policies. The board of directors supervises the operations of investments. The Investment Subcommittee reviews investment proposals makes recommendations. The secretary general and the

Governance elements	India	Japan	Korea	Malaysia	Philippines	Singapore	Thailand
	securities, not trade them				character and with similar aims. Also in line with the basic principles of safety, good yield, and liquidity.		director of the investment Committee establish the tactical asset allocation Operating offices execute the investment policy
Diversification abroad	Not allowed						Not allowed
Reporting to Parliament or other independent body		GPIF must report to the minister about annual business plans and its achievements, including investment results (audited by an outside accounting firm). The minister must disclose that report as well as its supervision policy of GPIF and investment policy Disclosure must be made to the Social Security Council, the Diet, and the general public (insured).			Annual report is submitted to the president of the Philippines and to Congress.		The minister receives monthly reports on fund management.

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