December 19, 2011

MEMORANDUM: International Benefits Developments

The Council would like to make its multinational employer members aware of two recent developments in the area of international benefits.

First is a set of new "best practices" issued by the Organisation for Economic Co-operation and Development (OECD, a coalition of 34 countries whose mission is to promote economic progress and world trade) in conjunction with the International Organisation of Pension Supervisors (IOPS, the umbrella group for global pension regulators) for pension funds that invest in alternative investments, including hedge funds and derivatives. We would expect plan governance to increasingly reflect these practices and plans may wish to compare them to their current investment policy and due-diligence procedures. In particular, we note the emphasis on proper valuation and the controversial call for more information regarding alternative investments to be provided to plan participants.

Another development is in the United Kingdom (UK), which has been implementing a requirement for all employers to automatically enroll every employee in a plan providing a minimum pension, to be phased in between 2012 to 2016, depending on the size of the employer. To simplify the process for some employers, a quasi-governmental group IRA-like trust with a selection of investment funds (called the "NEST") is also being rolled out to receive the employer and employee contributions if the employer does not want to establish or continue their own plan. Now, though, the government has indicated it intends to delay the "staging dates" for all but the largest employers to auto-enroll their employees for another year.

More information follows below.

OECD and IOPS Adopt 'Good' Practices on Pension Funds' Use of Alternative Investments and Derivatives

At the meeting of the Working Party on Private Pensions at OECD headquarters in Paris on November 28 and 29, the OECD finalized its "good practices" for pension funds' use of alternative investments including derivatives. While formulated as "good" rather than "mandated" practices, the practices have also been adopted by IOPS, the international organization of over 80 countries' pension regulators (though not including the United States), so they may start to become mandated practices by pension regulators in the future. For now, the expectation appears to be that they would inform the investment governance practices of pension funds through accountants and advisors to pension investment fiduciaries. The **final guidelines** are available online at: http://www.oecd.org/dataoecd/12/12/49192070.pdf.

The guidelines are structured in six sections, summarized as follows:

1. *Investment Policy and Risk Management.*

   The use of alternative investments is to be clearly explained in the investment policy and risk management strategy. All significant risks are to be measured and monitored and controlled. As a part of this, the governing body of the pension fund would establish a strong valuation process, including oversight of how values are determined and with the use of independent valuation advisors where necessary.

2. *Internal Governance.*

   The pension fund's governing board needs to have sufficient understanding of the strategies and risks of alternative investments. Compensation policies need to ensure that staff with responsibility for alternative investments do not have misaligned motives or conflicts of interest.

3. *Due Diligence of External Asset Managers.*

   Due diligence needs to be applied to the selection of external asset managers and people, processes (including valuation of assets) and performance, including costs, of the external managers. Alternative investment mandates to external managers are to be based on adequate contract terms monitored regularly.

4. *Communications to Participants*

Pension funds are to be transparent in their communications with stakeholders about their policies and objectives with respect to alternative investments. Pension funds would be expected to at least annually report to members their exposure to derivative positions and the actual and potential profits and losses related to these. Pension funds would be expected to disclose to the member the fees and charges in relation to their alternative investments, how these are being managed, and the actual and potential profits and losses related to these.

Important Observation: This practice exceeds common practice in the United States currently, and there was active discussion in the Working Party on Private Pensions meeting as to whether the terminology throughout the good practices was too strongly indicative in places of specific requirements rather than good practices. Members of the OECD/IOPS Secretariat, however, made it clear in remarks in the open meeting that the document was not intended to indicate required practices, but merely suggest the items as "good" practices, dependent on the facts and circumstances. The position in the US would be in this case, for illustration, that the standards for employee communications under these OECD good practices are adequately met by current ERISA employee communications requirements and annual public reporting requirements (such as the Form 5500) even if, for example, plan members are not receiving information on projected profits or losses from alternative investments.

5. ***Regulation of Pension Funds Alternative Investments and Use of Derivatives.***

   Pension regulators may impose maximum levels of alternative investments, prohibit derivatives that involve the possibility of unlimited commitments, limit maximum potential loss limits, limit funds' exposure to counter-party risk, and require external independent valuation for non-listed, illiquid investments.

6. ***Supervision of Pension Funds Alternative Investments and Derivatives.***

   Pension supervisory authorities should collect data on pension funds' use of alternative investment and derivatives, and provide guidance to the plans on how they expect risk to be managed. Supervisory oversight should be risk-based.

   Observation: Section 6 uses the term "should" consistently with respect to pension regulators, and the explanation by the OECD/IOPS Secretariat for this was that these conditions reflect the OECD's general requirements rather than merely being good practices.

In summary, the new IOPS/OECD guidelines for investment in alternatives and derivatives by pension funds are not requirements (though in some instances overlap with ERISA duties already), but employers with responsibilities for governance of investments of global pension funds – particularly those with plans in countries that are members of IOPS – should probably take note and consider their application. In addition, where a plan is faced with regulatory oversight of its alternative investments in IOPS countries, it may also consider whether the regulators can defend their standards as compliant with these good practices.

Mandatory Auto-Enrolment for Small and Mid-Sized Employers, Rise in Minimum Employer Contribution for Large and Mid-Sized Employers, to be Delayed in UK

In a controversial move on November 28, the UK government announced that it will delay pension auto-enrolment for firms employing 49 or fewer employees by a little over a year. (This is based on the number of UK employees subject to the Pay-As-You-Earn (PAYE) reporting system, so a small group of UK employees of a US company would still be a small employer under this rule.)

Under the revised timetable, those small employers would have to begin automatically enrolling their staff in May 2015 instead of April 2014. A week later, a government minister indicated that the staging date for mid-sized employers with between 50 and 2,999 employees would also likely be delayed to a date between August 2013 and March 2015, to be announced in 2012. Employers with more than 3,000 employees presumably must continue with their auto-enrolment preparations for an unchanged staging date on or before July 1, 2013. Final rules have not been announced, though, (they are currently expected in January 2012) so the staging dates remain in flux and general confusion.

In addition, the proposed minimum employer contribution for large and mid-sized companies will remain at 1 percent for an additional year. Instead of rising to 2 percent in 2016, it is now expected to rise to 2 percent in 2017 and 3 percent in 2018. (Additional information on the impact of UK auto-enrolment on US companies, including satisfying the UK auto-enrolment requirement with the US plan for mobile employees, in **Groom Law Group's April 4, 2011, Benefits Brief**.)