HR Focuses on Retirement-Plan Governance

The number of lawsuits, combined with regulatory complexity, the growing cost of benefits and the volatility of investments, has motivated some U.S. companies to beef up the governance of their retirement plans, say experts. But relatively few are proactively addressing governance risks.

By Marlene Prost

Wary of lawsuits and complex federal regulations, more and more HR leaders are improving the governance of their retirement plans, according to Towers Watson. But many are still not taking proactive steps to manage their risks.

Forty percent of 245 U.S. employers surveyed by the New York-based consulting firm say they expect to spend more time governing their employer-sponsored retirement plans over the next two years; only 2 percent expect to spend less time.

The bulk of respondents, 86 percent, say they are most concerned about existing and pending complex federal government regulations by the U.S. Department of Labor and the Internal Revenue Service, including new rules intended to increase transparency of fees and possible conflicts of interest.

"There is an economic cost to poor pension governance," says Susan Mangiero, an independent fiduciary consultant in Trumbull, Conn. "In addition to plan participants, shareholders and creditors can end up paying for bad retirement-plan decisions.

"Litigation, regulation and diminished productivity from unhappy employees have the potential to depress share price, bond ratings and cash flow," she says.

However, the Towers Watson survey, entitled *U.S. Retirement Plan Governance Risks and Responses*, which was released in June, finds that relatively few companies are proactively addressing governance concerns.

While most of the respondents have an investment committee in place, as well as a charter and policy statement, only about half have adopted specific metrics to measure the effectiveness of their plans and only 26 percent schedule regular compliance reviews.

Many of the companies do not keep records of decisions regarding plan interpretations and a majority don't regularly educate committee members on plan matters or have an expert on the Employee Retirement Income Security Act regularly attend meetings.

"Unfortunately," says Robyn Credico, a senior consultant with Towers Watson in Arlington, Va., "it appears that most plan sponsors generally wait until compliance issues emerge rather than take action to avert them."

Even so, U.S. companies have made great strides in retirement-plan governance in the past five to 10 years, primarily in reaction to "the wave of litigation," says Howard Pianko, an employment benefits attorney with Seyfarth Shaw in New York.

"Within the U.S., there has been a dramatic change in the number of companies that have developed [governance plans]," including creating investment committees, charters and written guidelines, says Pianko.

In contrast, global companies still have a long way to go in monitoring retirement plans in other countries in which plan members are located, he says.

The catalyst for increased governance, says Credico, was the collapse of Enron in 2001, after which plan participants began filing "hundreds" of lawsuits regarding the use of company stock in defined-contribution plans. In most cases, the companies settled.

Then, in the past five or so years, litigation took the form of class-action lawsuits challenging the practice of revenue-sharing payments to 401(k) plan providers.

"There have been some rulings, but they're not consistent," says Credico."If the company was governing their plan well, the [suit was] far more likely to be dismissed. If you are trying to do the right thing and follow the rules, the courts are far more lenient on you.

"That's your best defense," she says. "You can't stop anyone from suing, but you can defend yourself."

Good governance starts with the creation and appointment of the investment committee. "[Select] the right people, the right policies and the right benchmarks," Credico says.

Once that is in place, employers should conduct "more regular compliance reviews ... [so they] can get ahead of concerns over regulatory complexity and vendor quality."

In the past, retirement-plan compliance was often solely managed by HR, but committees today often include representatives from finance and legal.

"It is important to have competent people who ... can represent the multi-faceted aspect of employee-benefit-plan management," says Mangiero."This is a direct recognition that the offering of employee benefits has both strategic and financial impact for the [plan] sponsor."

There is debate, however, says Pianko, about whether the CFO should sit on the investment committee because of potential conflicts of interest, since the fiduciary committee has a legal responsibility under ERISA to act exclusively on behalf of the participants. If senior management does sit on the governance committee, it has to be clear when they're acting in a fiduciary capacity,

"It is an important issue," Mangiero says, "inasmuch as some ERISA lawsuits precede securities fraud allegations, each of which may cite a CFO, treasurer and/or board member as defendant(s) if they serve as a plan fiduciary."

Once a committee has been established, Credico says, it needs to create policies and procedures, including a mission statement, documentation on how to manage the plan, an investment policy that instructs the committee on how to keep an eye on their investments and benchmarks to monitor third-party and investment performance.

Then, Mangiero says, it's time to talk about risk and how much a company is willing to take on.

"Have a regular, vigorous discussion to identify important risks and to decide what should be done to manage them. Ask, 'What should be keeping members of the investment committee up at night? What are the worst things that can go wrong?' " she says.

Create a "comprehensive risk management policy statement" that goes further than the investment policy statement "in terms of action steps and internal controls related to a wide array of relevant risks," she says.

In addition, Credico says, an independent third-party can be hired to review the plan's progress and make sure it is consistent with the plan document, which record-keepers must file with the federal government.

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