County Council of Howard County, Maryland

2015 Legislative Session

Legislative Day No. 10

Resolution No. 141 - 2015

Introduced by: The Chairperson

A RESOLUTION acknowledging receipt of the annual report of the Howard County Retirement Plan and the Police and Fire Employees' Retirement Plan submitted by the Pension Oversight Commission.

Introduced and read first time September 8, 2015.

By order Jessica Feldmark
Jessica Feldmark, Administrator

Read for a second time at a public hearing on September 21, 2015.

By order Jessica Feldmark
Jessica Feldmark, Administrator

This Resolution was read the third time and was Adopted ✓, Adopted with amendments ____, Failed ____, Withdrawn ____, by the County Council on October 5, 2015.

Certified By Jessica Feldmark
Jessica Feldmark, Administrator

NOTE: [[text in brackets]] indicates deletions from existing law; TEXT IN SMALL CAPITALS indicates additions to existing law; Strike-out indicates material deleted by amendment; Underlining indicates material added by amendment.

WHEREAS, Title 1 Human Resources, Subtitle 4 Retirement Plans, Article VIII Pension Oversight Commission establishes the Pension Oversight Commission and requires the Commission to submit an annual report of the status of the Howard County Retirement Plan and the Police and Fire Employees' Retirement Plan to the County Executive and the County Council; and

WHEREAS, Title 1 Human Resources, Subtitle 4 Retirement Plans, Article VIII Pension Oversight Commission further requires the Howard County Council to accept by the resolution the annual report of the Pension Oversight Commission; and

WHEREAS, On June 29, 2015 the Annual Report as of the Fiscal Year Ending June 30, 2014 of the Pension Oversight Commission was submitted to the County Council.

NOW, THEREFORE, BE IT RESOLVED by the County Council of Howard County, Maryland, this 5th day of October, 2015 acknowledges receipt of the Annual Report for Fiscal Year Ending June 30, 2014 submitted by the Pension Oversight Commission.

Habicht, Kelli

From: Feldmark, Jessica
Sent: Thursday, September 17, 2015 12:57 PM
To: Habicht, Kelli
Subject: CR141-201
Attachments: Pension Oversight Commission's Annual Report

Hi Kelli,

Please include the attached email (and its attachments) in the legislative file for CR141-2015.

Thanks,
Jess

Jessica Feldmark
Administrator
Howard County Council
410-313-3111
jfeldmark@howardcountymd.gov

Habicht, Kelli

From: Southern, Scott
Sent: Monday, June 29, 2015 1:55 PM
To: Feldmark, Jessica
Cc: Reider, Terry; Hutchinson, Wanda
Subject: Pension Oversight Commission's Annual Report
Attachments: 2014 Annual Report w Cover Letter.pdf; CFA_Code of Conduct for Members of a Pension Scheme Governing Body.pdf

Ms. Feldmark,

I have placed six copies of the Pension Oversight Commission's Annual Report in inter-office mail for you and the members of the County Council. I have also included the electronic copy in this email. Please let me know if you have any questions.

Thank you,

Scott

Scott Southern
Retirement Assistant
(410)313-2363
ssouthern@howardcountymd.gov

PENSION OVERSIGHT COMMISSION
JEFFREY M. HUBE, CFA, CAIA
TODD D. SNYDER, JD
MITCHELL W. STRINGER
TOSHIE KABUTO, CFA
VANANZO H. EATON

June 4, 2015

Mr. Allan Kittleman, County Executive
Howard County Government
3430 Court House Drive
Ellicott City MD 21043

Dr. Calvin Ball, Chairperson
Howard County Council
3430 Court House Drive
Ellicott City MD 21043

Dear Mr. Kittleman and Dr. Ball:

Enclosed is, for your review, the Annual Report of the Pension Oversight Commission for the Howard County Retirement Plan and the Howard County Police and Fire Employees' Retirement Plan. The Annual Report is presented as one document for both Plans and covers the fiscal year 2014, ending June 30, 2014.

Howard County Code Section 1.482(c)(1) requires the Pension Oversight Commission to submit an annual report of the status of the plans to the County Executive and the County Council, and the County Council to review and accept by resolution the annual report submitted by the Oversight Commission. Please kindly inform the Commission when this action will take place.

Should you have any questions, please feel free to contact us.

Sincerely,

Jeffrey M. Huber
Chairman

cc: Commission File
Toshie Kabuto
Todd Snyder
Mitchell Stringer
Vananzo Eaton
Teresa Reider
Scott Southern

Enclosure: Annual Report

Introduction
One of the Duties and Responsibilities of the Pension Oversight Commission (Commission) is to:

> ...submit an annual report of the status of the Howard County Retirement Plan and the Police and Fire Employees' Retirement Plan (Plans) to the County Executive and the County Council. The County Council shall review and accept by resolution the annual report submitted by the Oversight Commission. The report shall include:
>
> i. The Commission's assessment of the appropriateness of the actuarial assumptions used;
> ii. A statement of revenues, including contributions, investment earnings, and forfeitures;
> iii. The cost of the plans, including an analysis of fees, commissions and expenses;
> iv. An evaluation of the administration of the plans; and
> v. Any proposal or amendment of the plans that the Commission may wish to recommend.
>
> *(Howard County Code Section 1.482*

These five sections are addressed in the Commission's Annual Report. Please note that the Commission plans to organize annual meetings in fiscal year 2016 with the actuary and the investment consultant to improve the process and efficiency in preparing the annual report on the status of the plans.

The first section covered in the Annual Report is section v (Recommendations) given their importance as they relate to the governance and long term sustainability of the Plans.

Recommendations

1. The Commission recommends developing a formal policy to re-confirm the Plans' investment consultant and establish independent reviews at least once in every 5 years to ensure that the County would receive excellent package of the services available in the market at competitive fees.

   While the Commission is not in a position to opine on the quality of services provided by the current investment consultant, as the consultant plays a significant role in the plans management. It is prudent for the County to conduct an independent review periodically.

2. The Commission recommends the County assesses whether hiring an internal investment professional would be beneficial and cost effective in the oversight of the Plans. Given the significant asset level of the Plans ($750 million as of June 30, 2014), the reliance on a third party investment consultant and the Plans' increasing allocations to sophisticated alternative investments (e.g. hedge funds and private equity funds), an internal investment professional could enhance the Plans' investment capabilities in terms of investment due diligence and risk controls. The Commission believes an internal investment professional could work in conjunction with an investment consultant and not replace the consultant.

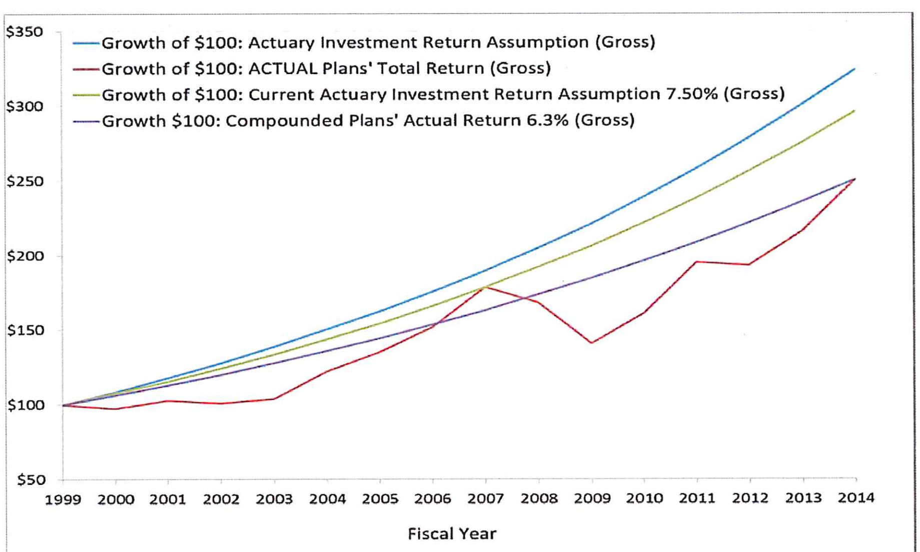
3. The Commission recommends the adoption of the Code of Conduct for Members of a Pension Scheme Governing Body issued by the CFA Institute which is attached in this report. The conduct of those who govern pension schemes significantly impacts the lives of a number of people, both as dependent on pensions or ultimate supporter of the pensions as tax payers. It is therefore critical that Plans are managed by a strong, well-functioning governing body in accordance with fundamental ethical principles of integrity, independence, fairness, and competence. This code of conduct is considered to be the best practice in the industry and adopting the code will demonstrate a commitment to serving the best interests of participants and beneficiaries.

4. The Commission recommends there be a requirement for "clear reporting to show how and when pension plans will be fully funded." (This is a policy recommendation from the Pension Funding Task Force which was established in 2012 by the National Governors Association, National Conference of State Legislatures, Council of State Governments, National Association of Counties, National League of Cities, U.S. Conference of Mayors, the International City/County Management Association and the Government Finance Officers Association.)

5. The Commission recommends that the County Executive and County Council would meet with the Commission within 45 days after their receipt of an annual report from the Commission to facilitate the review and acceptance process of the annual report according to *Howard County Code Section 1.482*.

6. A reoccurring recommendation by the Commission is to consider lowering the Plans' investment return assumption. The investment return assumption serves as the discount rate used to compute the present value of the Plans' future liabilities. (A decrease in this rate increases the Plans' net pension liabilities.) As of July 1, 2014, this rate was 7.50% net of fees and expenses. The Commission believes the Plans' investment return assumption continues to be too aggressive for the following the reasons:
    - The return assumption is higher than the long term return forecast presented by Summit. The Commission believes the Summit used reasonable and appropriate assumptions to produce its long term return forecast of 6.25%. Even though the discount rate was lowered to 7.50% from July 1, 2014, it is still 1.25% higher than the expected rate of return based on the existing asset allocations in the policy portfolio. Please see Actuarial Review Section (pages 4-6) for details on Summit's return forecast.

    - The historical disconnect between the return assumption and the actual investment returns of the Plans since fiscal year 2000. The chart below highlights this disconnect



Source for the Plans' actual performance (red line) is from Summit Strategies Group.

The blue line shows the growth of $100 using the Actual Investment Return Assumptions used by the Plans. Over time, the assumptions have been lowered from 8.50% in 2000 to the current

7.50%. The green line shows the growth of $100 if 7.50% had been applied since 2000. The purple line shows the growth of $100 compounding at the actual gross returns of the Plans. The red line shows the growth of $100 using the actual annual returns of the Plans. There has been an over estimation of the Investment Return Assumption over this 15 year period, and therefore an under estimation of the net pensions liabilities.

The Commission recommends that the Commission consider whether a 6.25% to 6.50% Investment Return Assumption would better reflect the future long-term returns and the Plans' net pension liabilities.

Evaluation of the administration of the plans

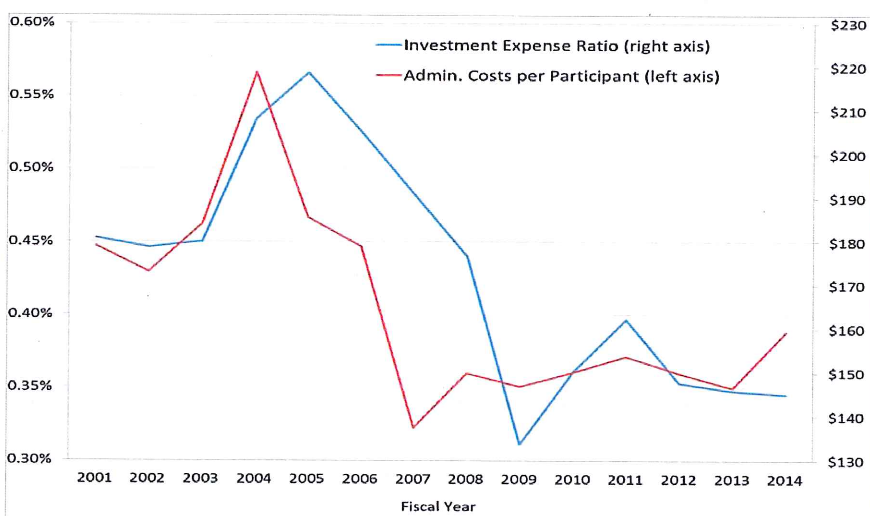
The Commission's evaluation of the administration of the plans is summarized in the first five recommendations in the above Recommendations section.

Statement of revenues, investment earnings, and forfeitures

The Plans' investment earnings were $103 million for fiscal 2014 which was a record for the Plans. The Plans' net appreciation from investments accounted for $84 million of the $103 million. The Plans' total contributions from employees were $43.1 million which was a $3.8 million increase from the previous year, 2013. The Plans' total payout to recipients was $26.8 million which was a $3.4 million increase from the previous year.

Analysis of fees, commissions and expenses

The Commission feels the Plans' fees and expenses appear to be reasonable and in line with the Plans' recent past.



The Commission does not have information that breaks out commissions paid, and believes commissions are included in investment expenses.

Actuarial Review

County's Pension Contributions

The Commission reviewed the Actuarial Valuation Reports dated July 1, 2014 submitted by Bolton Partners Inc. The principle objective of the reports is to determine the county's plan contributions for the fiscal year 2016 (starting July 1, 2015). According to the reports, there are no significant changes to the county's contribution amounts comparing to those recommended in the fiscal year 2015. The recommended contribution amounts for the fiscal year 2016 are $21,908,101 for the Howard County Police and Fire Employees' Plan (the "Police and Fire Plan") and $13,106,918 for the Howard County Retirement Plan (the "Employees Plan"), respectively. Last year's contributions were $21,934,844 for the Police and Fire Plan and $13,364,996 for the Employees Plan. The contribution ratios, as measures by the contribution amount relative to the payroll, are 30.0% for the Police and Fire Plan and 12.4% for the Employees Plan, respectively.

Funded Ratios

The funded ratios, as reported in the Auditor's Report for the fiscal year 2014, are 83% for the Police & Fire Employees' Retirement, and 92% for the County Employees' Retirement Plan, respectively. The ratios are calculated using the market value of the plan assets as of June 30, 2014 and the present value of the plan liabilities. A ratio of less than 100% indicates that plan assets are less than estimated plan liabilities.

For the funded ratio calculation, the value of pension assets is simply determined based on the market value of the assets on the valuation date. Determining the value of pension liabilities is, however, more difficult and would require the following two components of assumptions: (1) the expected future cash stream of pension benefit payments and (2) the discount rate used to determine the present value of the expected future cash stream.

The expected future cash stream of the benefit payments is determined by the actuary with a set of assumptions, such as future salary increases, future mortality rates and disablement rates to mention a few examples. The details of the assumptions that the actuary used to calculate the future cash stream of the pension benefit payments are listed in the experience reports, most recently issued on June 26, 2014.

Once the actuary determines the expected future cash stream of payments, a discount rate is applied to calculate the present value of all the future benefit payments to determine the pension liabilities on the valuation date. As the pension benefits are long-term in nature, the present value of the pension liabilities is extremely sensitive to the level of discount rate. The higher the discount rate is, the lower the present value of the pension liabilities would be. To determine the pension liabilities for the fiscal year 2014, the discount rate used is 7.75% although the rate was lowered to 7.50%, which became effective July 1, 2014. The discount rate is selected based on the expected long-term rate of investment return of the plans.

To assess the appropriateness of the discount rate used for the pension liability calculations, the Commission reviewed (1) the long-term capital market assumptions by the Summit Strategies

Group provide in the presentation dated September 30, 2014 and (2) the plans' policy asset allocations set by the Retirement Plan Committee effective in June 30, 2012. Table below provides a summary of the review. In the table, the expected return for each asset class is based on the Summit Strategies Group's long-term expected return assumption listed in the presentation dated September 20, 2014—this is the latest such information received by the Commission—and the current policy asset allocations as well as the actual asset allocations as of December 31, 2014.

First, in the Commission's view, the Summit Strategies Group's long-term capital market assumptions as presented in September 2014 are reasonable given under the current low rate environments and low risk premiums offered in various asset classes. Secondly, the Commission assessed the expected rate of investment return based on the target weight of each asset under the policy asset allocation. The expected rate of return of the policy portfolio would be 6.25% using the Summit Strategies Group's long-term capital market assumptions, (see table below).

Table 1. Expected Long-Term Investment Return

	Asset Allocation		Long-Term Return Assumptions		Expected Rate of Return	
	Target Weight	**Actual Weight (12/31/14)**	**Expected Sector Return**	**Expected Alpha Return**	**Based on Target Weight**	**Based on Actual Weight**
Large Cap Composite	16.90%	20.65%	5.50%	0.50%	1.01%	1.24%
Non-Large Cap Composite	5.60%	6.97%	5.25%	0.75%	0.34%	0.42%
Intl. Developed Mrkts Composite	14.60%	13.01%	6.75%	0.75%	1.10%	0.98%
Emerging Markets Composite	7.90%	6.06%	8.50%	1.00%	0.75%	0.58%
Fixed Income Composite	32.50%	32.83%	3.75% 1/	0.25%	1.30%	1.31%
Real Estate Composite	5.00%	4.45%	8.5% 2/		0.43%	0.38%
Private Equity Composite	10.00%	6.00%	8.97% 3/		0.90%	0.54%
Hedge Fund Composite	7.50%	9.11%	5.75% 4/		0.43%	0.52%
Cash Composite	0.00%	0.92%	2.75%		0.00%	0.03%
Total	100.00%	100.00%			**6.25%**	**5.99%**

Source: Summit Strategies Group, Economic & Capital Market Review, 9/30/2014

Note: 1/ Core plus Fixed Income
2/ Non-Core Real Estate
3/ Weighted average of 14% Private Debt (expected return 7.25%) and 86% of Private Equity (expected return 9.25%) based on Summit Strategies Group's Private Equity presentation on 2/27/2014

Furthermore, according to the Summit Strategies Group's presentation dated December 31, 2014, the portfolio is overweight in the large and non-large cap equity, hedge funds and underweight in international developed and emerging markets equity, private equity and real estate sectors. Based on the current tactical allocations, which are different from the policy allocations, the expected rate of return of the actual portfolio would be 5.99%.

Based on the analysis above, the Commission notes that the 7.75% discount rate used to assess the present value of the pension liabilities for the fiscal year 2014 is higher than the long-term rate of investment returns presented by Summit to the plans. Even though the discount rate was lowered to 7.50% from July 1, 2014, it is still 1.25% higher than the expected rate of return based on [Summit's estimates applied to] the existing asset allocations in the policy portfolio.

Funded Ratio Sensitivity

The independent auditor provided the estimates of the net pension liability for the fiscal year 2014 if different discount rates were used. According to the estimates, if the discount rate is lowered to 6.75% from 7.75 %—this is closer to the policy portfolio's expected rate of return of 6.25%—the net pension liabilities for both plans would be substantially higher and the funded ratios would be 73% instead of 83% for the Police and Fire Plan and 81% instead of 92% for the Employees' Plan (Table 2). Applying a 5.99% discount rate (which is the expected rate of return for the actual portfolio) would result in a further reduction of funding ratios.

Table 2. Net Pension Liabilities Sensitivity to Changes in the Discount Rate

	1% Decrease (6.75%)	FY2014 Discount Rate (7.75%)	1% Increase (8.75%)
Net Pension Liability FY2014			
Police and Fire Plan	148,935,936	81,979,316	26,560,368
Employees Plan	77,422,576	29,255,083	(11,000,826)
Funded Ratio			
Police and Fire Plan	73%	83%	94%
Employees Plan	81%	92%	103%

Source: Financial Statements, June 30, 2014 and 2013

Code of Conduct for Members of a Pension Scheme Governing Body

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Centre for Financial Market Integrity

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The mission of the CFA Institute Centre for Financial Market Integrity is to be a leading voice on issues of fairness, efficiency, and investor protection in global capital markets and to promote high standards of ethics, integrity, and professional excellence within the investment community.

CFA Institute, with more than 94,000 members worldwide, is the not-for-profit organization that awards the Chartered Financial Analyst® designation.

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Code of Conduct for Members of a Pension Scheme Governing Body

CFA Institute Centre for Financial Market Integrity

Contents

Preamble

The conduct of those who govern **pension schemes**[1] significantly impacts the lives of millions of people around the world who are dependent on pensions for their retirement income. Consequently, it is critical that **pension plans**, also known as systems, schemes, or funds, are overseen by a strong, well-functioning **governing body** in accordance with fundamental ethical principles of honesty, integrity, independence, fairness, openness, and competence.

Codes of conduct addressing professional activities are standard practice for many successful investment firms and have become increasingly common among public and private pension schemes. Such codes are established to improve the performance of schemes sponsored by private enterprise and public pension schemes alike. Just as there is no one-size-fits-all governance structure for investment firms, there is no single governance structure that can be universally applied to pension schemes. Varying goals, restrictions, political environments, market conditions, manager/**trustee** competencies, regulatory schemes, and many other factors will affect the appropriate governance structure for any pension scheme.

This *Code of Conduct for Members of a Pension Scheme Governing Body* (the code) represents best practice for members of the pension governing body when complying with their duties to the pension scheme. Whether public or private, each pension scheme board that adopts the code will demonstrate its commitment to serving the best interests of **participants** and **beneficiaries**.

The code provides guidance to those *individuals* overseeing the management of the scheme regarding their individual duties and responsibilities and is not meant to replace the overall policies and procedures established for the governance of the pension scheme. However, to reflect best ethical practice, incorporating the fundamental ethical principles embodied in this code will enhance those policies and procedures.

Depending on the nature and type of pension scheme, members of the governing body may have responsibility for overseeing the administration of benefits as well as the scheme's investment decision-making process. All of the principles outlined in this code apply equally to the officials' duties in each of these roles.

For the purposes of this document, pension plans, systems, and funds are referred to collectively as "plans" or "schemes" and the individuals who serve on the governing body of the plans, schemes, or funds are referred to as "trustees."

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[1]Bold indicates terms defined in Appendix A.

Code of Conduct

Pension trustees

1. Act in good faith and in the best interest of the scheme participants and beneficiaries.
2. Act with prudence and reasonable care.
3. Act with skill, competence, and diligence.
4. Maintain independence and objectivity by, among other actions, avoiding conflicts of interest, refraining from self-dealing, and refusing any gift that could reasonably be expected to affect their loyalty.
5. Abide by all applicable laws, rules, and regulations, including the terms of the scheme documents.
6. Deal fairly, objectively, and impartially with all participants and beneficiaries.
7. Take actions that are consistent with the established mission of the scheme and the policies that support that mission.
8. Review on a regular basis the efficiency and effectiveness of the scheme's success in meeting its goals, including assessing the performance and actions of scheme service providers, such as investment managers, consultants, and actuaries.
9. Maintain confidentiality of scheme, participant, and beneficiary information.
10. Communicate with participants, beneficiaries, and supervisory authorities in a timely, accurate, and transparent manner.

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Code of Conduct Guidance

1. Act in good faith and in the best interest of the scheme participants and beneficiaries.

The overriding objective of the pension scheme is to serve as a secure source of retirement income. Pension scheme trustees have a primary duty to act for the benefit of the scheme participants and beneficiaries. Trustees comply with this duty by striving to safeguard and grow the assets of the pension scheme to provide maximum benefit to the scheme participants and beneficiaries.

To act in the participants' and beneficiaries' best interest, an effective trustee will

- Consider the different types of beneficiaries relevant to each pension scheme, including **deferred beneficiaries** and pensioners. Trustees often engage in a delicate balancing act of taking sufficient risk to generate long-term returns high enough to support real benefit increases for active participants who will become future beneficiaries while avoiding a level of risk that jeopardizes the safety of the payments to existing pensioners.

- Place the benefit of the scheme participants and beneficiaries above that of the **sponsor** of the pension scheme even if the trustee is employed by or appointed to the board of the pension scheme by the scheme's sponsor.

- Consider whether the position of the scheme is enhanced by any investment or action and will not be swayed by other considerations, such as the interests of the employer sponsor of the pension or other external institutions (e.g., trade unions or political parties).

However, trustees who exclusively seek to enhance the position of participants and beneficiaries cannot discount additional considerations, such as the effect of the trustees' decisions on the financial health and viability of the scheme sponsor or their impact on scheme investments.

In carrying out their responsibilities, effective trustees will

- Consider the additional objectives of ensuring an adequate match between plan assets and liabilities, maintaining stable funding costs over time, keeping management costs down, and paying benefits upon the death, disability, retirement, or other special circumstances of plan members.

- Carry out the scheme activities in a way that does not impose an unnecessary financial burden on the plan sponsor and serves the interests of plan members well but without excessive burden to the plan sponsor.

- Consider the position of other stakeholders when carrying out their duties to the fund. If appropriate under applicable law, it is acceptable for a trustee to consider the impact that the investment of scheme assets may have—for example, creating jobs or stimulating industry in the local area—so long as the interests of the participants and beneficiaries remain paramount.

- Consider all relevant risk and value factors deemed appropriate when designing the scheme's investment strategy. In addition to typical financial measures, these factors may include environmental, social, and corporate governance issues.

2. Act with prudence and reasonable care.

Effective trustees will exhibit the care and prudence necessary to meet their obligations to pension scheme participants and beneficiaries. The exercise of prudence requires acting with the appropriate levels of care, skill, and diligence that a person acting in a like capacity and familiar with such matters would use under the same circumstances.

In the context of serving as a trustee, prudence requires

- Acting in a judicious manner to avoid harming scheme participants and beneficiaries.
- Acting in good faith, without improper motive or purpose.
- Exercising power and discretion consistently.
- Following the investment parameters set forth by the scheme documents and applicable regulation.
- Having appropriate knowledge of and skill in balancing risk and return by seeking appropriate levels of diversification.

Pension schemes typically employ experts to advise, direct, and implement the decisions of their trustees. Both internal staff and **external consultants** are retained for this purpose. These "designees" thereby partner with the trustees in carrying out the responsibilities set forth in this code. However, external third-party service providers and professional consultants may have less accountability or vested interest in the outcome of actions resulting from their advice.

Trustees can rely on external third-party service providers and professional consultants provided that the trustees have made reasonable and diligent effort to

- Determine that the service providers act with appropriate skill, competence, and diligence.
- Determine that third-party experts are independent and free of conflicts of interest and have the proper incentives to act in the best interests of the fund participants.
- Ensure that the designees' decisions have a reasonable and adequate basis and that the decision process is adequately documented.

Trustees may also consider

- Appointing expert trustees.
- Hiring internal staff with investment expertise who may act as an internal consultant.
- Developing an internal investment team to manage the fund directly.

However, although the delegation of certain trustee responsibilities to experts is a prudent option, the trustees retain the ultimate fiduciary duty and responsibility to monitor the experts and to ensure that the delegated responsibilities are carried out appropriately.

3. Act with skill, competence, and diligence.

Skill and diligence require trustees to be knowledgeable about the matters and duties with which they have been entrusted. Ignorance of a situation or an improper course of action on matters for which the trustee is responsible or should at least be aware is a violation of this code. Improper or ill-advised decisions can be costly to the pension scheme and detrimental to the scheme's participants and beneficiaries. Prior to taking action on behalf of the scheme, effective trustees and/or their designees analyze the potential investment opportunities and act only after undertaking due diligence to ensure they have sufficient knowledge about specific investments or strategies.

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Effective trustees will have knowledge and understanding of

- Trust and pension laws.
- Pension scheme funding and liabilities.
- The policies of the scheme.
- The strategies in which the scheme is investing.
- Investment research and will consider the assumptions used—such as risks, inflation, and rates of return—as well as the thoroughness of the analysis performed, the timeliness and completeness of the information, and the objectivity and independence of the source.
- The basic structure and function of the selected investments and securities in which the scheme invests.
- How investments and securities are traded, their liquidity, and any other risks (including counterparty risk).

The level of such analysis will depend on the investment style and strategy employed by the scheme. Certain types of investments, such as hedge funds, private equity, or more sophisticated derivative instruments, necessitate more thorough investigation and understanding than do fundamental investments, such as straightforward and transparent equity, fixed-income, or mutual fund products. Trustees may seek appropriate expert or professional guidance if they believe themselves lacking the expertise necessary to make an informed decision.

Trustees should not act—or fail to act—for the beneficiaries if lacking appropriate understanding or knowledge.

- Trustees are expected to take any training or educational opportunities necessary to ensure that their level of knowledge and understanding about pensions and investments remains current.
- Incumbent trustees and the pension scheme sponsor have a responsibility to ensure that new trustees receive proper training and education to fulfill their duties.

4. Maintain independence and objectivity by, among other actions, avoiding conflicts of interest, refraining from self-dealing, and refusing any gift that could reasonably be expected to affect their loyalty.

Effective trustees endeavor to avoid actual and potential conflicts of interest between their work with the pension scheme and other personal or outside interests. Conflicts of interest are many and varied, but the interests of pension scheme participants and beneficiaries are paramount.

Effective trustees

- Strive to avoid even the appearance of impropriety. Outside duties or responsibilities should not influence decisions because the trustee acts primarily for the beneficiaries and participants of the scheme.
- Take great care to put their duties to the pension scheme before their loyalty to the sponsoring entity that appointed them (such as a company plan sponsor or labor union).
- Do not solicit political contributions from service providers to the fund, either personally or on behalf of another.

- Do not allow political interests, philosophy, or political party loyalty to influence decisions made on behalf of the scheme.

- Do not put themselves in a position where their interests and the interests of the pension scheme conflict. Trustees who also are pension scheme participants or beneficiaries should take precautions to avoid any personal profit at the expense of the scheme.

- Do not use the prestige or influence of their position for private gain or advantage.

- Avoid any employment or contractual relationship with, or any interest in, firms that provide services to the pension scheme.

- Are not involved in any retention or termination decisions of such firms or otherwise vote on matters related to the trustees' firms.

- Refuse any gift or benefit that could reasonably be expected to affect their independence, objectivity, or loyalty.

- Do not receive or accept, directly or indirectly, any gift, service, favor, entertainment, or any other thing of value from anyone currently engaged by or seeking business from the pension scheme if it could reasonably be expected to influence a decision or be considered a reward. The governing body should establish a written policy limiting the acceptance of gifts and entertainment in a variety of contexts.

- Refuse to accept gifts or entertainment of more than a minimal value from service providers, consultants, potential investment targets, or other business partners. Pension scheme governing bodies should define what the minimum value is and should consult applicable regulations, which may help establish limits as well. The governing body should also create a reporting mechanism for disclosure of gifts and consider creating limits (e.g., amount per time period, per vendor) for accepting gifts and prohibit the acceptance of any cash gifts.

To the extent conflicts may not be avoided, effective trustees recognize and take appropriate measures to deal with and manage the conflict, such as

- Disclosing all real or perceived conflicts of interests.

- Abstaining from a vote or excluding themselves from any deliberations in which they are in direct conflict.

- Ensuring that the pension scheme has procedures in place to manage and disclose any such conflicts. Policies should be appropriate to the circumstances and level of control that the trustees have over trading decisions of the fund.

- Documenting and disclosing to the pension scheme the acceptance of any gift or entertainment.

The overriding principle is that trustees should act in the best interests of the participants of the pension scheme and disclose any conflicts of interest.

The personal and business relationships that are built among the trustees or between trustees and outside experts, such as **investment managers**, are an intangible asset to be leveraged for the benefit of the scheme. The scheme should adopt policies to prohibit former trustees from using information gained about the scheme or relationships with incumbent trustees, investment managers, or other experts for personal benefit.

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5. Abide by all applicable laws, rules, and regulations, including the terms of the scheme documents.

The pension scheme governing body, having been vested with the power to manage and administer the pension scheme, is responsible for ensuring adherence to the terms of the arrangement, statutes, bylaws, contract, trust instrument, or other associated governing documents. As a general matter, pension schemes operate in a complex, varied, and rapidly changing regulatory environment. Generally, trustees are not expected to master the nuances of technical, complex law or become experts in compliance with pension regulation.

Effective trustees

- Consult with professional advisers retained by the scheme to provide technical expertise on applicable law and regulation.
- Regularly investigate and ensure that the pension scheme has adopted and updated compliance policies and procedures designed to maintain compliance with laws and regulations that govern the pension scheme.
- Report any suspected illegal, unethical, or financial irregularities to the appropriate parties, including the scheme's internal auditor.

Policies and procedures are critical tools to ensure that pension schemes meet their legal and ethical requirements. Specific policies and procedures of the pension scheme supplement the fundamental principle-based ethical concepts embodied in this code. Documented compliance procedures will assist trustees in fulfilling the responsibilities enumerated in this code.

6. Deal fairly, objectively, and impartially with all participants and beneficiaries.

To maintain the trust that beneficiaries of the pension scheme place in them, trustees deal with all scheme participants and beneficiaries in a fair and objective manner. Effective trustees do not give preferential treatment to beneficiaries within a particular class of members or otherwise favor one class over the others. Many schemes have different types of participants: **active members** who are making contributions and accruing benefits, deferred members who have left employment but have not transferred their assets and will draw future benefits when reaching retirement age, and **retirees**, including spouses of deceased members, who are currently drawing retirement benefits. Effective trustees balance the interests of all types of members, treating each category of member fairly.

7. Take actions that are consistent with the established mission of the scheme and the policies that support that mission.

Effective trustees develop and implement comprehensive written investment policies that set forth the mission, beliefs, and strategic investment plans that guide the investment decisions of the scheme (the "policies").

Trustees

- Draft written policies that include a discussion of risk tolerances, return objectives, liquidity requirements, liabilities, tax considerations, and any legal, regulatory, or other unique circumstances.
- Review and approve the scheme's investment policies as necessary, but at least annually, to ensure that the policies remain current.

- Only take investment actions that are consistent with the stated objectives and constraints of these established scheme policies.

- Consider the suitability of investments given the needs of the pension scheme, its future (or projected) liabilities, risk tolerance, and diversification goals.

- Select investment options within the context of the stated mandates or strategies and appropriate asset allocation.

- Establish policy frameworks within which to allocate risk for both asset mix policy risk and active risk as well as frameworks within which to monitor performance of the asset mix policies and the risk of the overall pension fund.

- Work to achieve the proper investment blend to reflect the sometimes competing interests among the different classes of scheme members while focusing on long-term stability and growth.

- Carry out the terms of the scheme while abiding by any supplemental legal or regulatory requirements.

8. Review on a regular basis the efficiency and effectiveness of the scheme's success in meeting its goals, including assessing the performance and actions of scheme service providers, such as investment managers, consultants, and actuaries.

Effective trustees have the knowledge and understanding to critically review and verify the performance of the scheme's investment managers.

Trustees

- Develop disciplined decision rules for hiring, firing, and retaining investment managers that foster a long-term investment focus and are consistent with the scheme's investment policy statement. Hiring and firing decisions should be made by considering well-reasoned criteria that may include performance, organizational or operational strength, personnel quality, and other considerations.

- Ensure that the investment entity managing scheme assets employs qualified staff and sufficient human and technological resources to thoroughly investigate, analyze, implement, and monitor investment decisions and actions.

- Ensure that investment managers and consultants retained by the scheme adopt and comply with adequate compliance and professional standards.

- Ensure that the pension scheme has in place proper monitoring and control procedures for investment managers.

- Review investment manager performance assessments relative to the scheme's investment policy statement on a regular basis, generally quarterly but at least annually.

Trustees may delegate the selection and monitoring of investment managers to an investment committee or professional staff as long as the trustees maintain essential oversight and policy-setting responsibilities.

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9. Maintain confidentiality of scheme, participant, and beneficiary information.

Effective trustees hold strictly confidential all information communicated to them in the context of their duty to the scheme, and they take all reasonable measures to preserve this confidentiality. This discretion applies to information related to individual scheme participants and beneficiaries as well as any information that may affect the scheme's competitive ability (e.g., detailed security transactions, investment holdings, private equity transactions, and merger and acquisition information). Effective trustees ensure that the scheme has in place a privacy policy that addresses how confidential pension scheme information will be collected, used, stored, and protected and should ensure that this policy extends to external agents and delegates.

10. Communicate with participants, beneficiaries, and supervisory authorities in a timely, accurate, and transparent manner.

Full and fair disclosure of relevant information is a fundamental ethical principle of capital markets and the investment services industry. Developing and maintaining clear, timely, and thorough communication practices is critical to providing high-quality financial services to scheme participants and beneficiaries.

Trustees have a responsibility to

- Ensure that the information they provide to scheme participants and beneficiaries is accurate, pertinent, and complete.

- Not misrepresent any aspect of their services or activities in any communications, including oral representations, electronic communications, or written materials (whether publicly disseminated or not).

Communication with participants and beneficiaries is generally provided on a regular timetable and by the pension scheme, not by individual trustees. Nevertheless, effective trustees work to ensure that all communications with scheme participants and beneficiaries are timely, relevant, complete, and accurate. If the pension scheme is considering significant changes, such as mandating a later retirement age, lowering the percentage of future benefits, or closing the scheme to new members, trustees will communicate this information well in advance to allow affected parties the opportunity to provide input. Among other disclosures, trustees have a duty to present performance information that is a fair representation of the scheme's investment record and that includes all relevant factors. Trustees have a responsibility to comply with the scheme's disclosure policies by submitting any requested information in a timely manner. To be effective, disclosures of information must be made in plain language and in a manner designed to effectively communicate the information.

Appendix A
Definitions

Active member. See **Participants.**

Beneficiaries. Those persons who are no longer making contributions to the pension scheme but who are receiving benefits.

Deferred member or **Beneficiary.** Those persons who are eligible for benefits in the future but who are no longer making contributions.

External consultant. An individual or entity outside the pension plan retained to provide professional services to the plan, including assisting the plan in selecting investment managers.

Governing body. The group of persons or legal entity responsible for managing and safeguarding the assets of the pension scheme.

Investment manager. An individual or entity retained by the pension scheme to invest the assets of the plan.

Participants. Those persons who are participating in the pension scheme by making contributions but who are not yet receiving benefits.

Pension plan or **Pension scheme.** An arrangement whereby a public or private employer, such as a corporation, labor union, or government agency, provides income through deferred compensation to its employees after retirement.

Plan sponsor. The entity that establishes the pension scheme and employs the members of the scheme.

Retirees. Those persons who are receiving pension benefits from the scheme.

Trustee. An individual who serves on the governing body of a pension plan, scheme, or fund.

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CFA Institute Centre for Financial Market Integrity

The *Code of Conduct for Members of a Pension Scheme Governing Body* (the code) is a joint effort to develop and promote a code of professional conduct for individuals who sit on the governing bodies of pension funds. The CFA Institute Centre for Financial Market Integrity invited representatives from a number of industry organizations to participate in a working group that guided the creation of the initial draft of the code. We are grateful to the following groups who contributed to the working group's efforts: the Council of Institutional Investors (United States), the National Association of Pension Funds (United Kingdom), the Dutch Association of Industry-wide Pension Funds, the Swiss Pension Funds Association, the Hong Kong Retirement Schemes Association, and the Organisation for Economic Co-operation and Development. We are also thankful for the efforts of individuals and organizations who reviewed the document and sent in their contributions during the public comment period.

Standards of Practice Staff

Kurt Schacht, CFA
Executive Director

Jonathan Stokes, JD
Director
Standards of Practice Policy Group

www.cfainstitute.org/centre

THE AMERICAS

560 Ray C. Hunt Drive
P.O. Box 3668
Charlottesville, VA 22903-0668
USA

(800) 247-8132 **PHONE (USA and Canada)**
+1 (434) 951-5499 **PHONE**
+1 (434) 951-5262 **FAX**
info@cfainstitute.org **E-MAIL**

477 Madison Avenue
Suite 220
New York, NY 10022-5802
USA

ASIA-PACIFIC

Suite 3407, Two Exchange Square
8 Connaught Place, Central
Hong Kong SAR

+852 2868-2700 **PHONE**
+852 8228-8820 **INFO HOTLINE**
+852 2868-9912 **FAX**
info@cfainstitute.org **E-MAIL**

EUROPE

10th Floor
One Canada Square
Canary Wharf
London E14 5AB
United Kingdom

+44 (0) 20-7531-0751 **PHONE**
+44 (0) 20-7531-0767 **FAX**
info@cfainstitute.org **E-MAIL**

www.cfainstitute.org/centre

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90000
9 781932 495867